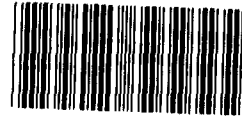


GAO

Testimony



143777

For Release
on Delivery
Expected at
2:00 p.m. EDT
Tuesday
April 30, 1991

European Initiatives and Reciprocal
Procurement MOUS

Statement of
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Before the
Subcommittee on Investigations
Committee on Armed Services
House of Representatives



Mr. Chairman, Members of the Subcommittee:

I am pleased to be here today to discuss the results of our work on reciprocal defense procurement Memorandums of Understanding (MOU) and some U.S. government and industry perceptions on European defense procurements and contract awards. I will also discuss the recommendations we made in our report¹ and offer limited comments on H.R. 1238 concerning Defense Department waivers of the Buy American Act². As you know, our work in this area was part of an effort to examine European initiatives and their implications for U.S. defense trade and cooperation--work we performed at the Subcommittee's request. I will focus most of my remarks on the reciprocal procurement MOUs the United States has entered into with the European members of the North Atlantic Treaty Organization (NATO), as opposed to those with other countries. It is under these agreements that the Department of Defense (DOD) currently waives requirements of the Buy American Act as well as applicable customs duties for procurements from Europe.

First, I'd like to place the MOUs in a broad, historical context. When the United States entered into these agreements in the 1970s, it was enjoying a significant defense trade advantage with the European allies, and political pressure was building to make

¹European Initiatives: Implications for U.S. Defense Trade and Cooperation (GAO/NSIAD-91-167, Apr. 1991).

²Title 41 U.S.C. Section 10a-10d.

defense trade more of a two-way street. This pressure, along with the promotion of rationalization, standardization, and interoperability of equipment within NATO, was one of the motivations behind the agreements. At the same time, the United States was encouraging the allies to become more self-sufficient and to strengthen the European pillar of the NATO alliance. Since then, there have been many changes: the U.S. defense trade advantage has substantially declined, the U.S. and European defense budgets are beginning to shrink, and concerns and interests in maintaining defense industrial bases, partially through foreign sales, are increasing on both sides of the Atlantic. In addition, several initiatives are underway in Europe to consolidate the European defense industry and make it more competitive with that of the United States. Our report points out that efforts of the European Community and the Independent European Program Group (comprised of the European members of NATO, except Iceland) have serious implications for future U.S. defense trade in Europe. Both the reciprocal defense procurement MOUs and H.R. 1238 should be considered in this context.

Before commenting on the bill, I would like to address three key matters related to the reciprocal defense procurement MOUs and European defense procurement and development practices and trends: First, what do the MOUs obligate the signatories to do, and what don't they cover? Second, what has the practice been on both sides of the Atlantic? And third, what are some of the U.S. government

and industry perceptions about trends in European defense contract awards and new development programs?

MOUs DO NOT SPECIFICALLY OBLIGATE
RECIPROCITY IN WAIVERS OF TARIFFS AND
BUY NATIONAL LAWS

Although some believe the MOUs ensure reciprocal waivers of duties or tariffs and buy national restrictions and access to signatories' defense markets, the agreements themselves do not specifically obligate the signatories to reciprocity in these areas. The MOUs generally call for the signatories--including the United States--to waive buy national restrictions and duties or tariffs and, if duties are not waived, to evaluate bids without considering the duties. However, the countries are obligated to do so only to the extent that it is consistent with their national laws and regulations. Because of this escape clause, we and DOD's General Counsel concluded that the signatories are not specifically obligated to waive duties and buy national laws if the waiver conflicts with their national laws and regulations. As you know, U.S. law currently allows the Secretary of Defense to waive requirements of the Buy American Act and any applicable customs duties for procurements from MOU countries under certain conditions.

U.S. AND EUROPEAN PRACTICES

In practice, DOD generally waives Buy American Act restrictions and applicable customs duties for its procurements of products originating from the MOU signatory countries. However, until 1989, DOD had not been fully aware of how the European NATO allies interpreted their MOU commitments regarding waivers of duties on defense procurements from the United States. DOD became aware of European signatories' practices when the European Community was considering a proposal to harmonize member states' practices in collecting duties on defense items.

Practice varies among the European signatories regarding the levy of tariffs on defense procurements from U.S. firms. Some signatories waive tariffs on all defense procurements from the United States. Other signatories' defense ministries pay tariffs on their procurements from the United States from their budgets to their national treasuries or the European Community. The Federal Republic of Germany, the Netherlands, and Belgium currently impose tariffs on U.S. defense goods they import, and on the basis of information available to us, France's defense ministry paid tariffs up until February 1988. While the United Kingdom's defense ministry does not pay duties on lethal items it imports from the United States, it does pay them on dual-use and nonlethal defense items.

Moreover, as a practical matter, some European officials consider tariffs when evaluating U.S. contractors' bids. We questioned whether a country could evaluate a U.S. bid without considering tariffs or duties because the tariffs could place a U.S. bid out of the competitive range or beyond the procurement budget. Indeed, certain countries--at least the Netherlands and Belgium--do consider the tariffs when weighing U.S. bids because of practical budget constraints. German defense ministry officials told us that their contracting officials are directed not to consider tariffs when evaluating bids; if tariffs cause a U.S. bid to exceed the budget allocation for a program, they would request additional funds from their Parliament.

The fact that certain countries impose tariffs and consider them when evaluating U.S. contractors' bids takes on additional importance when considered in the context of EC 92. Because national customs duties have been eliminated among the European Community members in favor of common external tariffs, U.S. firms could be placed at a competitive disadvantage with bidders from within the European Community.

DEBATE OVER CONTINUED UTILITY OF MOUs

Officials from DOD's Office of Foreign Contracting maintained that the MOUs have provided U.S. producers a degree of access to the European market they otherwise would not have had under other

trade agreements. But some DOD and U.S. defense industry officials did not agree with this assessment and felt that the MOUs have worked more to the advantage of European defense companies. There has been debate over the continued utility of the MOUs, especially since the U.S. defense trade advantage has declined. One study noted that the MOUs lack meaningful reciprocity and may be inappropriate, given the changes in worldwide defense trade patterns.

Features of Recently Renewed MOUs

The MOUs with France, Italy, and the Netherlands were renewed between June and November 1990. When the agreements were renewed, they incorporated some new provisions. These agreements now address publication of bids and require the signatories to have procedures for redressing grievances. They also provide that, upon request, suppliers will be promptly provided pertinent information as to why they were not allowed to participate in a procurement or were not awarded a contract. We consider these to be improvements in the MOUs, but they do not address the need for reciprocal treatment in waivers of buy national laws and customs duties or tariffs.

U.S. GOVERNMENT AND INDUSTRY PERCEIVE
GROWING INTRA-EUROPEAN PREFERENCE IN DEFENSE
PURCHASES AND NEW PROGRAMS

While many U.S. government and industry officials perceive that the Europeans increasingly prefer to buy European rather than U.S. military equipment, this perception is difficult to confirm or prove. We have reported in the past that the lack of information about foreign procurement practices makes it difficult to determine whether European countries discriminate in defense procurement and to assess the degree of discrimination.³ DOD officials have also noted that European defense procurement policies are lacking in transparency, or openness. Nevertheless, it is generally acknowledged that since at least the early 1980s, the European allies have preferred to buy nationally first, then buy European, and buy U.S. equipment as a last resort. We also obtained, and our report on European initiatives and defense trade discusses a number of anecdotal and testimonial accounts indicating Europeans' growing preference for European firms in contract awards and new programs.

We identified three major factors contributing to this perception. First, European defense representatives told us that the European nations find it more natural and easier to cooperate among themselves on defense projects and programs than they do with the United States, partly because of differences in U.S. and European

³International Procurement: Problems in Identifying Foreign Discrimination Against U.S. Companies (NSIAD-90-127, Apr. 1990).

views of military missions and requirements. Second, the single market process and other European defense-related initiatives promote a more unified West European defense industrial base and market and therefore a preference for European firms in defense contracts. Third, the politics of cooperation among the European governments contributes to a preference for European firms in defense purchases and development projects.

In our 1991 report, we made a recommendation intended to improve DOD's awareness of how the allies fulfill their commitments under these agreements and surface problems that may need to be addressed at higher levels. We recommended that the Secretary of Defense task U.S. embassies' offices of defense cooperation in European nations to (1) track military procurements and evaluate the effect of certain European initiatives on host governments' procurement practices; (2) determine whether price, capability, or buy national (or European) criteria were critical factors in awarding contracts; (3) discuss contested contracts with U.S. industry representatives; and (4) determine if trans-Atlantic defense trade is subject to discriminatory practices or invisible barriers. If properly implemented, this recommendation should provide DOD better insight into problematic contract awards and should prompt DOD and the State Department to raise these matters with the signatory governments, if necessary.

But a wide range of other issues and activities affecting U.S. defense trade with Europe need to be addressed at high policy levels. From what we learned, the relevant offices within the Departments of State and Defense have not been tasked or organized to effectively monitor, assess, and coordinate and formulate U.S. government positions on a number of European initiatives that could have serious implications for U.S. defense trade. To improve interagency coordination and needed policy formulation, we recommended that the Secretary of State form a sub-group under a relevant Policy Coordinating Committee to address European initiatives affecting U.S. defense trade interests within the National Security Council. To support the deliberations of the Policy Coordinating Committee, we made other recommendations to improve internal monitoring and assessments within the Departments of State and Defense and between those agencies and relevant U.S. missions abroad. At the Subcommittee's request, we did not obtain written agency comments from DOD and State on the report we just issued this month, and at this time we are uncertain about their formal positions on the recommendations. We will, however, be following up on the recommendations in the future.

H.R. 1238

As my statement indicates, we identified a number of problems and issues--in addition to the reciprocal treatment under the MOUs--that need to be addressed by the executive branch at the national

policy level. It appears that, with or without this type of legislation, the Europeans will likely be buying less U.S. equipment in the future.

Generally, H.R. 1238 embodies some positive principles, such as considering the impact of foreign procurements on the U.S. industrial base and maintaining better insight and information on the extent of the use of waivers, but we believe the bill could have some unanticipated negative effects. It appears that the bill requires each Secretary of Defense waiver of the Buy American Act to be authorized by the Congress and to meet a number of other criteria. If passed, the bill could severely hamper DOD's ability to procure competitively from European sources on a timely basis--even when it is in the interest of U.S. national security. While we do not agree with all of DOD's comments on the bill, we think that the legislation may not be appropriate at this time.

We think the first step is to get the executive branch organized, get a better handle on the problems and issues, assess their implications for the United States, and proactively formulate and convey U.S. positions on them to the appropriate institutions and countries. The executive branch will also have to consider U.S. defense procurement policies and industrial base requirements in its deliberations.

The European signatories of the MOUs both need and want to continue to sell to the U.S. defense market. Consequently, DOD's ability to waive Buy American Act restrictions to permit European access to the U.S. market is a substantial lever for negotiation. In our view, the proposed legislation could diminish that leverage while adding to protectionist pressures in Europe. In addition, enactment of the proposed legislation would still leave unresolved many of the issues that our recommendations were intended to address. If the administration fails to use the leverage it currently has or to implement our recommendations, then legislation may be needed.

Mr. Chairman, Members of the Subcommittee, this concludes my prepared remarks. I would be happy to answer any questions you have at this time.

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