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*REPORT TO THE COMMITTEE ON INTERNATIONAL RELATIONS HOUSE OF REPRESENTATIVES*

*BY THE COMPTROLLER GENERAL OF THE UNITED STATES*

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# Coproduction Programs And Licensing Arrangements In Foreign Countries

## Departments of Defense and State

Coproduction and licensing arrangements cover a diversity of defense items manufactured in other countries. Although these arrangements contain clauses which restrict transfers to a third country of U.S. defense items, no formal procedures or mechanisms exist to insure that such transfers are not made without prior approval of the President. There is a lack of statutory coverage on sales of defense services, which include the sale of defense information. The United States has no statutory control over third-country transfers of defense articles produced by the purchasing country using such defense information. There is no restraint on granting U.S. approval to third-country transfers under Mutual Security Act regulations.



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DEC. 2, 1975

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-163582

The Honorable Thomas E. Morgan, Chairman
Committee on International Relations
House of Representatives

Dear Mr. Chairman:

This report is in response to section VII of your letter of February 5, 1975, asking us to study military and military-related assistance programs abroad.

As you requested in subsequent discussions, we also reviewed the legality of certain transfers of F-104S aircraft from Italy to Turkey in view of the congressionally imposed cutoffs of military assistance to Turkey. This information is contained in appendix I.

From the inception of the program in 1960, 33 coproduction agreements have been signed valued at $9.8 billion and agreements valued at $2.1 billion are under consideration. These agreements involve the production of such diversified defense items as armored personnel carriers, howitzers, tanks, rifles, machineguns, ammunition, helicopters, anti-tank rockets, aircraft, and vessels.

We also identified 387 industry-to-industry licensing arrangements, 71 percent of which cover the production of aircraft parts. Other military items being produced in foreign countries under licensing arrangements with U.S. firms include aircraft, missiles, ammunition, armor, radar, sonar, gyroscopes, and electrical parts.

Formal procedures or mechanisms do not exist for detecting whether defense articles sold to foreign countries are transferred to third countries without the prior approval of the President.

Coproduction and licensing arrangements contain clauses which restrict third-country transfer of U.S. defense items. However, as in the case of defense

articles which are sold, there are no formal procedures or mechanisms to insure that transfers to third countries are not made without the prior approval of the President. Controls over the disposition of military items produced under license in foreign countries is one of the concerns in this type of arrangement. In addition, changing political conditions sometimes make it necessary to amend license provisions.

Our review of the legality of certain transfers of F-104S aircraft from Italy to Turkey revealed that neither of the two sales of 18 F-104S aircraft was illegal despite the congressionally imposed cutoff of arms to Turkey.

The first cutoff prohibited the use of appropriated funds by the U.S. Government for military assistance or for sales of defense articles and services to Turkey. The second cutoff prohibited all military assistance, sales of defense articles and services, and licenses for transportation of arms, ammunition, and implements of war to the Government of Turkey, as well as the use of appropriated funds therefor. Since none of the parts of the Memorandum of Understanding reflect any United States-Turkey transaction, none of its provisions are directly affected by either cutoff.

Restriction on third-country transfers in subsection 3(a) of the Foreign Military Sales Act are not applicable to sales of defense services, which includes the sale of defense information. Consequently, the United States has no statutory control over third-country transfers of defense articles produced by the purchasing country using such defense information.

There is a significant difference between the restrictions on third-country transfers contained in subsection 3(a) of the Foreign Military Sales Act and those included in the International Traffic in Arms Regulations (22 CFR 124.10(m)). Under the provisions of the Foreign Military Sales Act, the President cannot give his consent to the transfer unless the United States itself would transfer the defense article to the country. No such restraint exists on the granting of U.S. approval to a transfer under the Arms Regulation.

Several studies have been made which address the impact of arms sales on U.S. employment. However, these studies focus on reduced defense expenditures, not specifically on the employment impact of coproduction and licensing arrangements.

If the assumption were made that foreign countries would buy directly from the United States were no coproduction alternative available, coproduction and licensing arrangements could result in a loss to U.S. labor. Conversely if no sales of an item would be made were it not to be coproduced, coproduction would have a positive effect because part of the item would be produced in the United States.

If licensing agreements are considered as an extension of U.S. production capabilities, they could also be considered to have a beneficial effect on the U.S. economy since the U.S. firm would be realizing license and royalty fees which contribute to the profit margin of the firm and the U.S. tax base, as well as to the balance of payments.

As requested by your office, we have not obtained written comments from the Departments of Defense and State on matters included in this report.

Sincerely yours,

Comptroller General
of the United States

# Contents

# COPRODUCTION PROGRAMS AND LICENSING ARRANGEMENTS IN FOREIGN COUNTRIES

## INTRODUCTION

The term "coproduction" refers to the program by which the United States and an eligible country join together in producing a U.S. military system or item in the foreign country. The combined effort may be government-to-government, industry-to-industry, or a mix of government and private resources. Coproduction projects may be implemented either directly through the Foreign Military Sales program or indirectly by designated commercial firms through specific licensing arrangements. The arrangements enable an eligible foreign government, international organization, or designated commercial producer to acquire substantial know-how to manufacture or assemble, repair, maintain, and operate in whole or in part a specific weapon, communication, or support system for an individual military item. The know-how furnished by the United States may include research, development production data and/or manufacturing machinery or tools, raw or finished material, components or major subassemblies, managerial skills, procurement assistance, or quality control procedures.

Coproduction may be limited to the assembly of a few end items with a small input of parts produced incountry or it may extend to a major manufacturing effort requiring the buildup of capital industries.

Major objectives of coproduction projects, as defined by Department of Defense directives, are to (1) enable eligible countries to improve military readiness through expansion of their technical and military support capability and (2) promote U.S. allies' standardization of military material and equipment, which in turn would generate the establishment of uniform procedures and logistics support and would expand multinational operational capabilities.

Scope of coproduction agreements

Coproduction programs currently involve the production of such diverse defense items as armored personnel carriers, howitzers, tanks, rifles, machineguns, ammunition, helicopters, anti-tank rockets, aircraft, and vessels. (See app. III for examples of projects.) From the inception of the program in 1960, 33 coproduction agreements have been signed valued at $9.8 billion. (See app. II.)

Five coproduction agreements valued at $2.1 billion are under consideration for projects in Iran and Korea. The matter of coproduction in Iran has been the subject of an interagency study and we were informed that a classified report has been prepared, with an executive summary for the President's consideration.

Scope of licensing arrangements

Presently there are 387 industry-to-industry licensing arrangements with 15 countries and NATO. More than 90 percent of all these arrangements are with 6 countries, and 71 percent of the arrangements cover the production of aircraft parts. Other military items include aircraft, missiles, ammunition, armor, radar, sonar, gyroscopes, and electrical parts. (See app. II.)

LEGISLATION

U.S. coproduction and licensing arrangements in foreign countries are currently authorized by the Foreign Military Sales Act of 1968, as amended, and the International Traffic in Arms Regulations (22 CFR 121-128) which were issued under the Mutual Security Act of 1954. In addition, the Foreign Assistance Act of 1961 authorizes grant assistance for use in coproduction projects.

Foreign Military Sales Act

Public Law 90-629, the Foreign Military Sales Act of 1968, as amended, states that the United States will enter into agreements to facilitate the common defense of friendly foreign countries. It provides

that special emphasis be placed on procurement of military articles in the United States but that consideration of defense articles of U.S. origin be given to coproduction or licensed production outside the United States when such production best serves U.S. foreign policy, national security, and economy. To this end, the Departments of State and Defense and the military services have issued directives and regulations implementing the coproduction and licensing program.

Mutual Security Act of 1954

The Mutual Security Act of 1954 requires the President to control the export and import of arms, ammunition, and implements of war, including technical data, by other than a U.S. Government agency. These articles, as designated by the President are included in Title 22, subchapter M of the Code of Federal Regulations. The regulations also include registration provisions; information on licenses for unclassified arms, ammunition, and implements of war; manufacturing licenses and technical assistance agreements; unclassified technical data and classified information; and prohibit shipments to or from certain countries.

The act also currently provides the statutory basis for U.S. support of NATO. In accordance with this act, the United States has furthered the development of coordinated production and procurement programs within the NATO Alliance.

BACKGROUND

Program funding

Funds needed to coproduce an item may take the form of Foreign Military Sales credits, grant aid, cash reserves of a foreign country, or any combination of each. Each year Congress has authorized limits on the extension of Foreign Military Sales credit. This credit may, upon approval of the President, be used for financing coproduction projects within foreign countries. The funds are repayable with interest within 10 years after delivery of the defense articles or the rendering of the defense services.

For example, in May 1974 the United States signed a Memorandum of Understanding with the Republic of the Philippines to establish an M-16 rifle assembly and manufacturing capability there. Under this agreement, the United States would provide a maximum of $15.6 million in Foreign Military Sales credits or in loan guarantees from private lending institutions at interest rates equal to the cost of money to the U.S. Government during the month in which the credit agreement was signed.

Grant aid funds may be used alone or in conjunction with Foreign Military Sales funds to finance a coproduction project. This method of funding was used for the Korean ammunition coproduction program. In other cases, coproduction programs may be funded without any form of U.S. assistance.

Approval responsibilities

Before a potential coproduction agreement can be consummated it must be sanctioned by a number of organizations. The Office of the Assistant Secretary of Defense (Installation and Logistics), the Defense Security Assistance Agency, the military services, the White House and the State Department must all concur in government-to-government agreements.

--The Defense Security Assistance Agency acts as the negotiator with the foreign country and arranges for the contract terms, i.e. amount to be produced, payment, delivery dates, etc.

--The military services assist the Agency during contract negotiations and may supply technical assistance once an agreement has been reached. During the negotiations, a feasibility study may be conducted in-country to determine whether the country has the capability required to carry out a coproduction agreement. After production has commenced, the Army will send a

project official to monitor major coproduction projects. The Navy and Air Force do not follow this procedure. The services also evaluate the impact of procurement and delivery of the necessary items under the proposed coproduction agreement.

--The White House approves or disapproves the agreement after considering its political implications.

--The State Department's Office of Munitions Control exercises its influence by approving coproduction licenses and issuing export licenses. Before U.S. firms can ship articles agreed to under the terms of a Memorandum of Understanding, they must obtain export licenses. The State Department thus gives its approval by issuing the licenses.

--The Office of the Assistant Secretary of Defense (Installations and Logistics) evaluates the logistical aspects of the proposed agreement and the affects the project will have on the U.S. military system and industry. The Office also considers the affects of potential future competition from the foreign country due to the technology gained.

The Arms Control and Disarmament Agency also acts in an advisory role in coproduction and licensing arrangements. Its main areas of interest are to determine whether decisions to furnish military assistance contribute to an arms race, increase the possibility of outbreak or escalation of conflict, or prejudice the development of bilateral or multilateral arms control arrangements. The Agency also has an interest in preventing third-world countries from diverting funds needed for humanitarian and economic uses to military uses.

Project initiation

A coproduction project may be initiated by the (1) Assistant Secretary of Defense (International Security Affairs), (2) the Defense Security Assistance Agency with prior Assistant Secretary of Defense (Installations and Logistics) coordination, (3) the military departments subject to prior Assistant Secretary of Defense (International Security Affairs), Defense Security Assistance Agency, and Assistant Secretary of Defense (Installations and Logistics) approval, (4) Military Assistance Advisory Groups, and (5) authorized representatives of foreign governments and/or international organizations. The agreements may be on a government-to-government, industry-to-industry, and/or government-industry basis. If the agreement is government-to-government, a Memorandum of Understanding or "umbrella" agreement is signed by the participating governments. Elements covered in such agreements include security, documentation, standardization, identification, information flow back, reporting, source inspection, proprietary rights, qualified products, use of government equipment, sharing of research and development costs, expenditures in the United States, technical assistance, supply components, and resale or transfer to third countries.

Coproduction programs may also be carried out on an industry-to-industry or industry-to-government basis and are performed under licensing arrangements entered into by U.S. companies and foreign companies and/or governments. The license arrangements must be approved by the Office of Munitions Control, and, before any military item can be exported, an export license must be obtained from that Office. In granting these licenses that Office may solicit the concurrence of responsible Departments of Defense and State components or other interested agencies, such as the Nuclear Regulatory Commission, National Aeronautical and Space Administration, and Arms Control and Disarmament Agency.

## ADVANTAGES AND DISADVANTAGES OF COPRODUCTION AND LICENSING PROGRAM

Whether coproduction and licensing arrangements are the most desirable means of achieving stated program objectives is largely a matter of value judgement. Because of the lack of uniformity in coproduction agreements, it is almost necessary to evaluate each agreement individually. Licensing arrangements better lend themselves to evaluation since they have more uniformity--U.S. manufacturers grant foreign governments or industries the authority to produce U.S. items.

Below are the principal advantages and disadvantages of coproduction and licensing arrangements. No attempt has been made to rank them in order of priority or importance.

### Advantages

--Create incountry compatibility with U.S. standardized equipment, thereby creating allied compatibility for supporting deployed U.S. Forces.

--Promote standardization of materiel or equipment to integrate and strengthen international military operations.

--Encourage multinational acceptance of strategic and tactical concepts through use of common materiel equipment.

--Establish or broaden base for common and interchangeable logistics.

--Improve procurement, production, contract administration, and mutual support capability of friendly nations.

--Permit entry into foreign markets at minimum investment cost and into markets that, due to import restrictions, might otherwise be closed to direct sales.

--Avoid expense of having to adjust home-based production and personnel to sometimes unstable demands.

--Obtain additional revenue from company-owned patents, trademarks, and accumulated know-how.

--Gain some tactical or strategic advantage in marketing U.S. manufacturers' products overseas.

--Develop market outlets for raw materials or components made by the domestic company.

Disadvantages

--Create the potential for foreign competition.

--Unit cost may be higher to foreign country.

--Loss of technology by the United States.

--U.S. labor employment loss if straight sales of U.S. manufacture would have been an alternative.

CONTROL OVER THIRD-COUNTRY TRANSFERS

The government-to-government agreements as well as the industry-to-industry and industry-to-government licensing arrangements contain clauses which restrict third-country transfer of U.S. defense items, but there are no formal procedures or mechanisms to insure that U.S.-furnished defense articles are not transferred to third countries without prior approval of the President.

There is a significant difference between the restrictions on third-country transfers contained in subsection 3(a) of the Foreign Military Sales Act and those included in the International Traffic in Arms Regulations (22 CFR 124.10(m)). Under the provisions of the Foreign Military Sales Act, the President cannot give his consent to the transfer unless the United States itself would transfer the defense article to the country. No such restraint exists on the granting of U.S. approval to a transfer under the Arms Regulation.

No substantial transfers to third countries have been reported by Departments of State and Defense personnel. The consensus is that, although there are no formal procedures or mechanisms to insure that U.S. defense items furnished, coproduced, or manufactured under license agreements have been transferred to third countries without the prior approval of the President, no transfers of consequence have occurred or could occur without coming to the attention of U.S. officials. U.S. Defense Attaches in countries around the world are always alert to this type of situation. Military Assistance Advisory Group personnel also report third-country transfers through the Departments of Defense and State if and when they become aware that such transfers are being made.

The following cases illustrate problem areas in licensing arrangements.

Anti-submarine/assault-type helicopters

In July 1959, the Office of Munitions Control approved a 5-year licensing arrangement for the manufacture of an anti-submarine/assault-type helicopter. On March 4, 1964, the licensee exercised its option to extend the terms of the agreement for 5 additional years. The agreement was again amended on November 15, 1967, to extend the terms for a further period of 10 years ending July 27, 1979. This agreement contained a worldwide sales territory provision which excluded United States, Canada, and Sino-Soviet bloc destinations. However, during 1966-69 the U.S. Government found it necessary--in response to changing political conditions, particularly in the Middle East, and to

related congressional pressures--to revise and update third-country controls, particularly as they applied to foreign licensing of U.S.-origin hardware.

For 3 years the licensee refused to change the worldwide sales territory. In 1966, the Office of Munitions Control requested the U.S. licensor to revise the sales territory to specific countries. The licensor, after 3 years of trying to accomplish this, notified the Department of State in 1969 that the licensee remained adamant and that the matter should be handled government to government.

As reports of pending sales of this helicopter to India and Egypt were received during 1971 through 1973, the situation evolved into a drawn out awkward affair for the companies and the governments concerned. In November 1973 representatives of both governments met to attempt to resolve the problem. The licensee was not in legal violation of terms of U.S. Government approval of the original agreement but was acting contrary to the intent and spirit of U.S. export policies and regulations. Modifying the sales territory provisions would prevent U.S.-identified equipment from going to prohibited or restricted areas and would avoid direct conflict with U.S. export control policies. In June 1974, the U.S. Government received assurance from the foreign government that helicopters manufactured under the licensing agreement would not be transferred except to NATO countries, Sweden, Switzerland, Spain, Japan, Australia, and New Zealand without prior consultations with the U.S. Government. After such consultations the final decision in each case will rest with the foreign government.

F-104S Aircraft

The F-104S aircraft is coproduced in Italy under a license from the Lockheed Aircraft Corporation and pursuant to a Memorandum of Understanding between the ministry of defense of Italy and the U.S. Department of Defense.

At the time cutoff of military assistance to Turkey was being considered, enacted, and reconsidered --October 1974 to February 5, 1975--permission was obtained by Italy from the United States to transfer

F-104S aircraft to Turkey. In view of the congressionally imposed cutoff of military assistance to Turkey, we were requested to review the legality of certain of these transfers.

The embargo on transfer of military arms to Turkey began on October 17, 1974, and has been in effect continuously thereafter except from October 29 to December 10, 1974 and December 31, 1974, to February 5, 1975. The issue presented is whether either or both cutoffs affected the legality of two sales of F-104S aircraft, each consisting of 18 planes. The most important considerations in such a determination are the form of the transaction, the fact that the contemplated sales were from Italy to Turkey rather than from the United States, and the dates on which the events occurred. A detailed description of these considerations is included in appendix IV.

The first cutoff prohibited the use of appropriated funds by the U.S. Government for military assistance or for sales of defense articles and services to Turkey. The second cutoff prohibited all military assistance, all sales of defense articles and services, and all licenses for the transportation of arms, ammunition, and implements of war (including technical data related thereto) to the Government of Turkey as well as the use of appropriated funds therefor. The United States-Italian Memorandum of Understanding contained no reference to United States-Turkey transactions. Therefore, none of its provisions are directly affected by either cutoff.

In addition, restrictions on third-country transfers in subsection 3(a) of the Foreign Military Sales Act are not applicable to sales of defense services, which includes the sale of defense information. Consequently, the United States has no statutory control over third-country transfers of defense articles produced by the purchasing country using such defense information. For example, had the U.S. Government sold defense information --any document, sketch, photograph, plan, model, specification, design, prototype or other recorded or oral information relating to any defense article or defense service --covering the F-104S to Italy, it would have no statutory control of transfers by Italy of the F-104S produced in

Italy to any recipient third country, including Turkey. Equally important are the facts that we know of no U.S. Government-furnished defense articles in the transferred aircraft and the arms regulations (22 CFR 124.10(m)) does not prohibit granting third-country transfer approval where the United States could not make a direct defense article transfer. Thus, neither of the two sales were illegal despite the congressionally imposed cutoff of arms to Turkey.

IMPACT ON U.S. EMPLOYMENT

Studies have been made which address the impact of arms sales on U.S. employment. However, these studies focus on the impact of reduced defense expenditures and not specifically on the employment impact of coproduction and licensing arrangements. Some of the studies we identified are:

--Survey of Economic Models for Analysis of Disarmament Impacts. University of Michigan, July 1965

--The Timing of the Impact of Government Expenditures. University of Pittsburgh, November 1970

--Adjustments of the U.S. Economy to Reduction of Military Spending. University of Colorado, December 1970

--Post-Vietnam Economy. U.S. Department of Labor, November 1971

One available study of the economic effects of a coproduction project is a recent section of a classified GAO staff study of the Multinational F-16 Agreement, dated September 2, 1975, made at the request of the Chairman, Senate Committee on Appropriations. Included in this study as attachment C is an economic analysis of the F-16 agreement. The study analyzes the agreement's primary effects on U.S. production and estimates the economic impact on the overall economy, balance-of-payments, and regional economics.

If the assumption were made that foreign countries would buy directly from the United States if no coproduction alternative was available, then coproduction and licensing arrangements would result in a loss to U.S.

labor. On one coproduction project for the assembly of 10,000 radios, it was estimated that 60 man-years of U.S. employment would be lost because of the assembly of these radios abroad. However, coproduction agreements are generally only considered as the last alternative in providing military assistance.

If the assumption were made that no sales of the item would be made were it not to be coproduced, it can be said that coproduction has a positive effect on the U.S. employment situation. Since, in most cases, approximately 50 percent of the value of the coproduction agreement is provided from U.S. sources, some employment opportunities would be created in the United States. One U.S. firm estimated that, as a result of an estimated $29.4 million coproduction project, it would be able to retain approximately 450 employees for a period of 6 months to 1 year longer than they would have been retained without the coproduction contract.

Licensing agreements, if considered as an extension of U.S. production capabilities, could also be considered to have a beneficial effect on the U.S. economy since the U.S. firm would be realizing license and royalty fees which contribute to the profit margin of the corporation and the U.S. tax base as well as to the balance of payments.

## FUTURE COPRODUCTION EFFORT: THE F-16 AIRCRAFT PROGRAM

When Secretary of Defense James R. Schlesinger signed a five-nation Memorandum of Understanding on June 10, 1975, the United States and a European Consortium (Belgium, Denmark, Norway, and the Netherlands) entered into what was described as "the arms deal of the century." The program is a cooperative effort to design, develop, produce, and deploy F-16 air combat fighters in the United States and Europe. As planned, the initial Consortium purchase of 348 F-16 aircraft will amount to more than $2 billion, and purchases by third countries will add to the program as subsequent F-16 sales are made.

Planned purchases of the F-16 by the United States and the European Consortium are as follows.

| Country | Number of aircraft |
|---|---|
| United States | 650 |
| Belgium | 116 |
| Denmark | 58 |
| The Netherlands | 102 |
| Norway | 72 |
| Total | 998 |

Initial U.S. proposal

The Consortium's ministers of defense met in the fall of 1974 with Secretary of Defense Schlesinger to discuss U.S. proposals for coproducing an advanced lightweight fighter aircraft. The proposals were intended to help European NATO members to modernize their air forces and reduce dependency on the United States. Secretary Schlesinger offered the Consortium the opportunity to coproduce the winner of the U.S. air combat fighter competition, to participate in the development program, and to offset a large share of balance-of-payment costs through production within their own countries.

On January 13, 1975, the U.S. Air Force selected the General Dynamics F-16 as the winner in the U.S. air combat fighter competition. However, before deciding to participate in the F-16 program, the Consortium had considered various foreign aircraft. A Consortium steering committee conducted various technical and cost evaluations of the F-16, the French Dassault Mirage F1/M53, and the Swedish SAAB-Scania Viggen 37.

The agreements

The Memorandum of Understanding and the four Preliminary Contracts delineate the agreement by the five countries to enter into a cooperative program for procuring and producing F-16 aircraft. The Memorandum is a multilateral document and contains production, assembly, and offset commitments which can be classified under the term coproduction. The four Preliminary Contracts are bilateral documents signed by the U.S. Secretary of Defense and the minister of defense for each Consortium country.

How agreements will work

General Dynamics, as prime contractor, has management responsibilities for the design, development, and production of all F-16 aircraft. It will deliver the completed aircraft to the U.S. Government which, in turn, will deliver them to the Consortium. This dual delivery might occur simultaneously as a result of the procedural arrangements; however, the Consortium governments will be customers of the U.S. Government, not of General Dynamics.

The relationship between General Dynamics and its Consortium cocontractors and suppliers will be a direct relationship, based on contracts between the three parties.

U.S. avionics and subsystem suppliers will establish coproduction participation relationships with avionics and subsystem equipment industries in the Consortium countries. General Dynamics will select and contract with U.S. suppliers who will, in turn, establish coproduction programs with Consortium suppliers for parts and components to be supplied for U.S. Air Force, Consortium, and third-country F-16 aircraft. U.S. suppliers will be responsible for supplier coproduction, but General Dynamics will monitor this activity with and through them. This monitoring will be necessary to establish confidence that the Consortium industry will support program requirements.

Coproduction offsets

The Memorandum of Understanding stipulates that, in U.S. Air Force contracts for production of F-16s, the prime contractor will place with Consortium industries

--10 percent of the procurement value of U.S. Air Force purchases,

--40 percent of the procurement value of all Consortium purchases, and

--15 percent of the procurement value of all third-country purchases.

The remaining procurement value of all F-16s will be produced in the United States. Although certain components will be produced within the Consortium, the United States will maintain an autonomous capability in this regard. Components produced within the Consortium will also be produced in the United States, eliminating U.S. dependence on Consortium contractors.

European production and assembly

Under the program, F-16s for Belgium and Denmark will be assembled in Belgium by a joint Fairey/SABCA effort and for the Netherlands and Norway by Fokker in the Netherlands. General Dynamics officials stated that these European assembly plants are necessary so that Consortium production offsets can be achieved by each country. Engine modules for the Consortium aircraft will be assembled in Belgium by Fabrique Nationale. Denmark and Norway will have primary responsibility for producing electronics systems and other highly technical systems and subsystems. All four Consortium nations will produce some parts for the U.S. Air Force F-16s--which will be assembled at the General Dynamics plants in Fort Worth, Texas--as well as for Consortium aircraft.

Financial commitments

The United States quoted the Consortium a unit cost of between $5.69 million (the most probable price) and $6.09 million (the not-to-exceed price), computed in January 1975 dollars. Because of higher European production costs, the Consortium will end up paying more per aircraft than will the U.S. Air Force. The United States has estimated that the Consortium will incur a "most probable" flyaway unit cost for its 348 aircraft of $5.69 million. On the other hand, as a result of agreements with the Consortium, the Air Force expects to achieve an estimated flyaway unit cost of $4.6 million for its initial buy of 650 aircraft. These "most probable" cost estimates are broken down as follows.

| | Consortium | U.S. Air Force |
|---|---|---|
| | (millions) | |
| Basic unit flyaway | $5.02 | $4.6 |
| Research and development recoupment | .47 | N/A |
| Industrial management fee (estimated) | .005 | N/A |
| Cost of duplicate tooling | .196 | N/A |
| Most probable flyaway cost | $5.69 | $4.6 |

The contract is a fixed-price, incentive-fee contract, insuring the manufacturer's interest in the lowest possible cost.

Not-to-exceed price--This price resulted from the Consortium's desire to know the outer limits of its liability. Defense officials have informed us that the not-to-exceed price is an estimate and is not contractually binding on the United States. The United States was able to provide the Consortium with a not-to-exceed price because approximately 90 percent of the price is covered contractually by airframe and propulsion commitments. The cost for radar and U.S. Government-furnished equipment are unknown factors; therefore, Defense informed the Consortium that the remaining 10 percent could not be guaranteed.

General Dynamics believes the not-to-exceed price provides a sufficient cushion against loss because:

--The YF-16 prototype gave it a firm fix on production, labor, and resource requirements. The F-111 program, which was subject to numerous cost overruns, had no working prototype at inception.

--The target price of the U.S. Air Force and Consortium aircraft includes an inflation index which can be increased over time. If extraordinary inflation

is experienced, the contract between the Air Force and General Dynamics will be adjusted.

--A cost contingency factor was added to the target price to arrive at the General Dynamics not-to-exceed price for the Consortium.

--Any change in orders or requirements to stretch production will require a new contract.

The United States will share all costs exceeding the stated target price on a predetermined basis with the prime contractors, up to the not-to-exceed price. The agreement contemplates that any costs in excess of the not-to-exceed price will be borne by the contractors.

SCHEDULE OF COPRODUCTION AGREEMENTS
March 1960 through July 1975

| Service administering agreements and countries involved | Item | Total agreement value (millions) | Expected U.S. value (millions) | Date of agreement |
|---|---|---|---|---|
| ARMY: | | | | |
| Germany | UH-ID helicopters | $ 228.4 | $ 96.6 | May 30, 1965 |
| Italy | M113APC family | 157.0 | 48.5 | Feb. 12, 1963 |
| | M60A1 Tanks | 67.0 | 42.0 | Oct. 3, 1964 |
| | M109 SP howitzer | 30.2 | 23.2 | Feb. 1, 1968 |
| | ARGUS 10 radar system | 23.0 | 6.0 | May 13, 1974 |
| Japan | HAWK missile system | 230.1 | 96.8 | Oct. 13, 1967 |
| | NIKE HERCULES missile system | 189.4 | 74.7 | Oct. 13, 1967 |
| | ADCCS | 33.1 | 12.7 | Oct. 13, 1967 |
| The Netherlands | M109 SP howitzer | 18.1 | 14.7 | May 3, 1966 |
| Norway | M109 SP howitzer | 16.3 | 12.2 | Dec. 30, 1966 |
| Republic of China | General purpose vehicles | 122.2 | 80.4 | July [illegible], 1966 |
| | UH IH helicopter | 43.8 | 39.4 | Aug. 13, 1969 |
| | M14 Rifle M60 Gun 7.62 Ammo | 12.3 | 10.1 | June 23, 1967 |

APPENDIX II

| Service administering agreements and countries involved | Item | Total agreement value | Expected U.S. value | Date of agreement |
|---|---|---|---|---|
| | | (millions) | | |
| Korea | M16 Rifle | $ 72.6 | $ 42.0 | Apr. 22, 1971 |
| | Ammunition | 80.4 | 43.9 | Jan. 6, 1972 |
| | AN/PRC-77 radio | 21.2 | 16.0 | Aug. 14, 1973 |
| NATO | HAWK missile system | 658.0 | 140.8 | Mar. 1960 |
| | HELIP | 1,049.0 | 734.0 | July 11, 1968 |
| | M-72-LAW | 31.4 | 10.9 | Jan. 20, 1964 |
| The Philippines | M-16 Rifle | 29.4 | 21.8 | May 17, 1974 |
| Turkey | 2.75 Rocket | 1.5 | 1.5 | May 29, 1972 |
| Iran | M-47 Retro | 53.0 | 48.0 | June 16, 1970 |
| | | 3,167.4 | 1,616.2 | |
| AIR FORCE: | | | | |
| Italy | F-104S aircraft | 641.0 | 115.0 | Dec. 10, 1965 |
| Japan | F-4 aircraft | 700.0 | 345.0 | Apr. 4, 1969 |
| Republic of China | F-5E aircraft | 229.6 | 219.6 | Feb. 9, 1973 |
| NATO | F-104G aircraft | 1,500.0 | 145.0 | Dec. 17, 1960 |
| | | 3,070.5 | 824.6 | |

APPENDIX II

| Service administering agreements and countries involved | Item | Total agreement value | Expected U.S. value | Date of agreement |
|---|---|---|---|---|
| | | (millions) | | |
| NAVY: | | | | |
| Germany | CH-53G helicopters | $ 312.3 | $ 176.6 | June 27, 1968 |
| England | F-4 aircraft | 700.0 | 610.0 | Feb. 9, 1965 |
| Italy | SIDEWINDER missile system | 20.0 | 10.0 | Apr. 1, 1974 |
| NATO | SEASPARROW missile system | 39.7 | 34.0 | June 1968 |
| | SIDEWINDER missile system | 36.0 | 10.0 | |
| Spain | DEG Ships | 300.0 | 125.0 | Nov. 1964 |
| | | 1,408.0 | 965.6 | |
| F-16 Program (note a) | | 2,116.0 | | |
| Total | | $9,762.0 | $3,406.4 | |

a/ The F-16 coproduction program had not, as of August 15, 1975, been assigned to a specific service.

COPRODUCTION AGREEMENTS
MARCH 1960 THROUGH JULY 1975
(dollar amounts in millions)

| Country | Aircraft No. | Aircraft Cost | Missile No. | Missile Cost | Vehicles/ armor No. | Vehicles/ armor Cost | Ships No. | Ships Cost | Arms No. | Arms Cost | Artillery No. | Artillery Cost | Radar/ radio No. | Radar/ radio Cost | Missile control No. | Missile control Cost | Total No. | Total Cost |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| NATO | 2 | $3,616.0 | 4 | $1,782.7 | | $ | | $ | 1 | $ 31.4 | | $ | | $ | | $ | 7 | $5,430.1 |
| Japan | 1 | 700.0 | 2 | 419.5 | | | | | | | | | | | 1 | 33.1 | 4 | 1,152.6 |
| Italy | 1 | 641.0 | 1 | 20.0 | 2 | 224.0 | | | | | 1 | 30.2 | 1 | 23.0 | | | 6 | 938.2 |
| England | 1 | 730.0 | | | | | | | | | | | | | | | 1 | 700.0 |
| Germany | 2 | 540.7 | | | | | | | | | | | | | | | 2 | 540.7 |
| China | 2 | 272.4 | — | — | 1 | 122.2 | — | — | 1 | 12.3 | — | — | — | — | — | — | 4 | 407.9 |
| | 9 | 6,471.1 | 7 | 2,222.2 | 3 | 346.2 | | | 2 | 43.7 | 1 | 30.2 | 1 | 23.0 | 1 | 33.1 | 24 | 9,169.5 |
| Other eight nations | — | — | — | — | 1 | 53.0 | 1 | 300.0 | 4 | 183.9 | 2 | 34.4 | 1 | 21.2 | — | — | 9 | 592.5 |
| Total | 9 | $6,471.1 | 7 | $2,222.2 | 4 | $399.2 | 1 | $300.0 | 6 | $227.6 | 3 | $64.6 | 2 | $44.2 | 1 | $33.1 | 33 | $9,762.0 |



APPENDIX II

ACTIVE LICENSE AGREEMENTS
AS OF MARCH 1975

| Country | Aircraft | | Missiles | | Ammunition | Artillery | Armor | Ships | | Radio/radio parts | Support equipment | | | Misc. Support | Total | Percent |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Parts | End product | Parts | End product | | | | Parts | End product | | Radar/sonar | Electronic parts | Gyroscopes | | | |
| Japan | 79 | 3 | 4 | 1 | | 1 | 3 | 3 | | | 4 | | 3 | | 101 | 26.1 |
| Italy | 58 | 4 | 3 | 2 | | | 2 | 2 | 1 | | | 1 | 2 | | 75 | 19.4 |
| England | 55 | 3 | | 1 | | 1 | 1 | 3 | | 1 | | | 3 | | 68 | 17.6 |
| Germany | 28 | | 5 | | | | 2 | | | 1 | 2 | 2 | | 5 | 45 | 11.6 |
| France | 23 | | 3 | | 1 | | | | | 2 | 6 | 3 | 1 | 2 | 41 | 10.6 |
| Israel | 22 | — | — | — | 1 | — | 2 | — | — | — | 2 | — | 2 | 4 | 33 | 8.5 |
| | 265 | 10 | 15 | 4 | 2 | 2 | 10 | 8 | 1 | 4 | 14 | 6 | 11 | 11 | 363 | 93.8 |
| Nations and NATO | 10 | 1 | 3 | — | 2 | 2 | — | 1 | — | 1 | 1 | — | 3 | — | 24 | 6.2 |
| Total | 275 | 11 | 18 | 4 | 4 | 4 | 10 | 9 | 1 | 5 | 15 | 6 | 14 | 11 | 387 | |
| Percent | 71.1 | 2.8 | 4.7 | 1.0 | 1.0 | 1.0 | 2.6 | 2.3 | 0.3 | 1.3 | 3.9 | 1.6 | 3.6 | 2.8 | | 100.0 |





APPENDIX II

## EXAMPLES OF LICENSING AND COPRODUCTION PROJECTS

### M-113 VEHICLE PROJECT

In December 1962, the U.S. Army Materiel Command began negotiating a Memorandum of Understanding with the Italian Government for 4,000 armored personnel carriers. The Memorandum was signed on February 12, 1963, and served as an umbrella agreement for the follow-on industry-to-industry agreements between the U.S. company--Food Machinery Corporation--and the Italian coproducers--OTO-Melara, Fiat, and Lancia.

The Italian Government was interested in coproduction to improve its economy and technology, reduce unemployment, and gain a competitive advantage in the manufacturing of tracked vehicles. The U.S. Department of Defense was interested in promoting foreign military sales, achieving maximum standardization of NATO equipment, and reducing the U.S. balance-of-payment deficit.

Implementation of the terms of the Memorandum of Understanding and the supporting technical agreements consisted of a two-part, three-phase program. Italy purchased the first 1,000 vehicles through the Foreign Military Sales program and the remaining 3,000 vehicles were to be coproduced in Italy.

The first phase of the coproduction endeavor provided that, beginning in December 1963, 200 vehicles were to be assembled in Italy, with the United States furnishing all the components. Under phase two, which was to begin in July 1964, 300 vehicles were to be assembled using Italian-produced hulls and some parts, with the balance being furnished by the United States. Phase three, which was to begin in February 1965, provided that the remaining 2,500 vehicles would be produced in Italy by the most economical combination of Italian and American manufactured components. This phase involved the production in Italy of the maximum number of components of the M-113, although certain components were uneconomical to produce in Italy because of the limited quantity required compared to the high cost of manufacture.

F-104G AIRCRAFT PROJECT

In 1956 the German ministry of defense began looking for a new fighter aircraft to fulfill Germany's role in the defense efforts of Western nations. In December 1958, after tentative selection was made of the F-104, Lockheed and Germany began discussing configurations and contracts for follow-on production arrangements, which resulted in a two-part agreement. In February 1959 the German Government and the Lockheed Corporation signed a contract for the initial delivery of 96 U.S.-manufactured aircraft, to be shipped assembled to Germany. In March 1959 the German Government purchased the licensing rights to build the aircraft in Germany. However, the licensing arrangement did not allow the German Government to buy manufacturing data or information outright from Lockheed. Upon completion of the license terms, the German Government agreed to return to Lockheed all data and information it provided.

By the end of 1959, Belgium and the Netherlands decided that the aircraft being developed for Germany also met their requirements. In 1960 Italy came to a similar conclusion, and a European Consortium including Germany, Belgium, the Netherlands, and Italy was formed for the F-104G aircraft coproduction venture. The technical and financial details were included in a Memorandum of Agreement entered into by the Consortium countries and the United States in December 1960.

To coordinate the coproduction effort, the Consortium countries established the "Organisme de Direction et de Controle." In 1961 this organization was superseded by the NATO F-104G Starfighter Production Organization, which become responsible for coordinating and supervising the cooperative production of the F-104G aircraft. In this role, the Organization reviewed all design changes and insured that the weapon system being manufactured in Europe met the defense criteria required for each specific country and for NATO as a whole.

The European assembly and production of the F-104G aircraft totaled 949 aircraft--604 of which were required by Germany, 125 by Italy, 120 by the Netherlands, and 100 by Belgium.

F-104J AIRCRAFT PROJECT

In November 1959 the Governments of the United States and Japan began negotiating the type of arrangement under which Japan would coproduce the F-104J aircraft. The Japanese Government selected Mitsubishi Heavy Industries as the prime contractor, the Fawasaki Aircraft Company as the airframe subcontractor, and Ishikawajima-Harima Heavy Industries as the major engine manufacturer. The primary U.S. company was the Lockheed Corporation.

Other U.S. companies involved in manufacturing components for the F-104G also negotiated arrangements with Japanese companies which would be responsible for producing the items in Japan. In total, more than 500 licensees and licensors were involved in this coproduction program.

By 1961 the government-to-government and industry-to-industry agreements were finalized and an order was placed for 200 F-104 aircraft. The second portion of the production arrangement called for an additional 30 F-104J aircraft.

The extent of production in Japan varied for the aircraft produced. Of the first 200 F-104 aircraft ordered, 20 were to be of the trainer type. These aircraft were totally manufactured in the United States, disassembled, shipped to Japan, and reassembled by Mitsubishi. The first 80 F-104Js were assembled in Japan from components and parts manufactured in the United States and shipped to Japan in the form of knock-down kits.

The remaining 100 aircraft and the 30 second-phase aircraft were primarily manufactured in Japan by local industries. Only 181 items of the thousands of parts and components comprising the F-104J could not be locally manufactured in Japan by the middle of 1965. By 1966 nearly all of the J-79 engine was being manufactured there.

## LEGAL REVIEW OF F-104S AIRCRAFT TRANSFER FROM ITALY TO TURKEY

We have reviewed the legality of certain transfers or proposed transfers of two sets of 18 F-104S aircraft from Italy to Turkey in view of the congressionally imposed cutoffs of military assistance to Turkey. We believe that these actions or proposed actions were not illegal. The following is an in depth analysis of this matter as requested. (It should be noted that agency comments were not received in the preparation of this memorandum as is our normal procedure.)

Two separate so-called cutoffs or terminations of military assistance to Turkey were enacted in response to Turkish involvement in developments in Cyprus stemming from the commencement of the Cyprus conflict on July 20, 1974. The first enactment, section 6 of the joint resolution, approved October 17, 1974, Pub. L. No. 93-448, 88 Stat. 1363, making continuing appropriations for the fiscal year 1975, provided:

> "None of the funds herein made available shall be obligated or expended for military assistance, or for sales of defense articles and services (whether for cash or by credit, guaranty, or any other means) or for the transportation of any military equipment or supplies to Turkey until and unless the President certifies to the Congress that the Government of Turkey is in compliance with the Foreign Assistance Act of 1961, the Foreign Military Sales Act, and any agreement entered into under such Acts, and that substantial progress toward agreement has been made regarding military forces in Cyprus: Provided, That the President is authorized to suspend the provisions of this section and said Acts if he determines that such suspension will further negotiations for a peaceful solution of the Cyprus conflict. Any such suspension shall be effective only until December 10, 1974 and only if, during that time, Turkey shall observe the cease-fire and shall neither increase its forces on Cyprus nor transfer to Cyprus any U.S. supplied implements of war." (Emphasis added.)

The President exercised this suspension authority under the proviso in section 6 on October 29, 1974. (Presidential Determination No. 75-3, 39 F.R. 39865 (November 12, 1974)). In the absence of his making the required certification, however, upon the mandatory expiration of the suspension, the cutoff again went into effect.

The second cutoff was imposed by section 22 of the Foreign Assistance Act of 1974, approved December 30, 1974, Pub. L. No. 93-559, 88 Stat. 1795, 1801, which added subsection x to section 620 of the Foreign Assistance Act of 1961, as amended, 22 U.S.C.A. § 2370 (x) (Pam. No.1, February 1975) as follows:

> "All military assistance, all sales of defense articles and services (whether for cash or by credit, guaranty, or any other means), and all licenses with respect to the transportation of arms, ammunitions, and implements of war (including technical data relating thereto) to the Government of Turkey, shall be suspended on the date of enactment of this subsection unless and until the President determines and certifies to the Congress that the Government of Turkey is in compliance with the Foreign Assistance Act of 1961, the Foreign Military Sales Act, and any agreement entered into under such Acts, and that substantial progress toward agreement has been made regarding military forces in Cyprus: Provided, That the President is authorized to suspend the provisions of this section and such Acts if he determines that such suspension will further negotiations for peaceful solution of the Cyprus conflict. Any such suspension shall be effective only until February 5, 1975, and only if, during that time, Turkey shall observe the ceasefire and shall neither increase its forces on Cyprus nor transfer to Cyprus any United States supplied implements of war." (Emphasis added.)

Section 5 of the joint resolution approved December 31, 1974, Pub. L. No. 93-570, 88 Stat. 1867, 1868, making further continuing appropriations for fiscal year 1975, contained a corresponding restriction on the use of appropriated funds. The President exercised the suspension authority of the second cutoff on December 31, 1974. (Presidential Determination No. 75-8, 40 F.R. 4257 (January 29, 1974)). In the absence of the required Presidential certification and the mandatory expiration of the Presidential suspension authority, the cutoff has again become effective. Accordingly, the embargo on military arms to Turkey, which began on October 17, 1974, has been in effect continuously thereafter except for the period October 29, 1974, until December 10, 1974 and the period December 31, 1974 until February 5, 1975.

The issue presented is whether either or both of the foregoing cutoffs affect the legality of the sales by Italy to Turkey of the two sets of F-104S aircraft, each consisting of 18 planes. The most important factors relevant in such determinations are the forms of the transactions, the fact that the contemplated sales were from Italy to Turkey rather than from the United States, and the dates upon which the events occurred.

The F-104S aircraft is manufactured in Italy under a co-production license. The plane is a derivative model of the F-104G aircraft. The F-104G was originally licensed by Lockheed Aircraft Corporation (Lockheed) for manufacture in Italy pursuant to a "Limited License for Joint Manufacture of Lockheed Model F-104G Aircraft" (License Agreement or co-production license) between the Republic of Italy and Lockheed dated March 2, 1961. Pursuant to a "Memorandum of Understanding Between the Ministry of Defense of the Government of Italy and the Department of Defense of the United States of America Relating to the F-104S All-Weather Interceptor" (Memorandum of Understanding), dated December 10, 1965, the two Governments agreed to cooperate in further development of the F-104G aircraft to give it an all-weather interceptor capability, the improved aircraft being designated the F-104S. One result was that the License Agreement was amended on April 22, 1967 to cover the manufacture of the F-104S aircraft in accordance with a "Development Contract" entered into effective April 20, 1967, as well as the manufacture of the F-104G.

Although neither of the cutoff statutes is explicitly addressed to co-production, it does not necessarily follow that co-production, or at least aspects thereof, may not be affected by the language of the cutoffs. Accordingly, it is necessary to analyze the law relating to co-production and the specifics of the foregoing documents to determine if the transactions at issue were prohibited. Co-production or licensed production outside the United States of defense articles of United States origin is currently specifically authorized by section 42 of the Foreign Military Sales Act, as amended, 22 U.S.C. § 2791 (Supp. III, 1973). It was apparently first authorized by subsection 201 (0)(5) of the Foreign Assistance Act of 1967, approved November 14, 1967, Pub. L. No. 90-137, 81 Stat. 445, 457, although apparently not prohibited prior to that time. While the term "co-production" is not statutorily defined, Paragraph III of DOD Directive No. 2000.9, "International Co-Production Projects and Agreements Between the United States And Other Countries or International Organizations," January 23, 1974, provides as follows:

> "A. The term ' co-production' as used herein encompasses any program wherein the U.S. Government, under the aegis of an international diplomatic level or Ministry of Defense-to-Department of Defense agreement, either directly through the FMS program, or indirectly through specific licensing arrangements by designated commercial firms, enables an eligible foreign government, international organization or designated commercial producer to acquire the 'know-how' to manufacture or assemble, repair, maintain and operate, in whole or in part, a specific weapon, communication or support system, or an individual military item.

" 1. The 'know-how' furnished may include research, development production data and/or manufacturing machinery or tools, raw or finished material, components or major sub-assemblies, managerial skills, procurement assistance or quality-control procedures.

"2. Third country sales limitations and licensing agreements are also included as required.

" B. Co-production may be limited to the assembly of a few end-items with a small input of local country parts, or it may extend to a major manufacturing effort requiring the buildup of capital industries."

As is indicated, co-production arrangements may sometimes require the supplying of component defense articles and/or defense services to the producing country. These may take the form of grants or sales by the United States Government or sales by U.S. commercial firms. Since each of these forms of supply is currently substantially governed by a separate statute, one co-production arrangement may be subject to restrictions contained in several statutes. The Foreign Assistance Act of 1961, as amended, 22 U.S.C. §§ 2301 et seq., currently regulates U.S. Government military grants, while the Foreign Military Sales Act, as amended, 22 U.S.C. § 2751 et seq., governs U.S. Government military sales. In addition, the Government exercises certain control over commercial sales to foreign purchasers of items on the Munitions List under section 414 of the Mutual Security Act of 1954, as amended, 22 U.S.C. § 1934, (1970 and Supp. III, 1973), principally by the issuance or denial of export licenses. There are certain provisions in these acts whose application or nonapplication to the transactions at issue may be affected by the cutoffs.

The Memorandum of Understanding in this case, supra, contemplated both governmental and private commercial participation, although the degree of governmental participation which actually occurred is not clear. The substance of the Memorandum which is relevant here may, for purposes of convenience, be divided into parts. A major part of the agreement, Article III(A), provided that the United States would permit the release to Italy of all information and technical data on a certain engine and missile necessary for their further adaptation, testing and production for F-104S application. In return, under Article III(C), Italy agreed, inter alia, to furnish the United States all technical data and information resulting from the development, testing and production of the F-104S weapon system, including the right to use and authorize others to use it royalty-free, although not for production purposes. Since the two governments also agreed to exercise their best efforts to protect proprietary rights owned by third parties required for the production of the

F-104S weapon system (Article IV), presumably it was contemplated that Lockheed would be involved in the release of the information and technical data and would be appropriately compensated.

As a second part of the agreement, the United States agreed to provide technical assistance on a reimbursable basis, including (1) source inspection for those items procured from United States sources; (2) United States tooling and facilities; (3) United States bases and test facilities; (4) services of United States specialists in development, procurement, and production, including pricing assistance; and (5) United States Government material and munitions required and utilized for prototype testing of the F-104S in the United States and for completion of the program in Italy. Article VIII(B).

As a third part of the agreement, the United States in Article II agreed to

> "examine all available banking and Government financial resources and provide to Italy a guaranty of availability of up to $85 million in credit assistance, as required for financing the articles and services to be procured from United States sources. Such credit assistance would be repayable over five years at an interest rate not to exceed five per cent per annum on the unpaid balance."

Article I(B) provided that of the estimated $410 million cost to be borne by Italy, approximately $165 million worth of the articles and services was expected to be procured by Italy and Italian industry from United States sources.

It should be noted that the language of neither cutoff appears to directly cover any of the foregoing parts of the Memorandum of Understanding. More particularly, the first cutoff proscribes the use of appropriated funds by the United States Government "for military assistance, or for sales of defense articles and services * * * or for the transportation of any military equipment or supplies to Turkey * * *." (Emphasis added.) The second cutoff proscribes "all military assistance, all sales of defense articles and services * * * and all licenses with respect to the transportation of arms, ammunitions, and implements of war (including technical data related thereto) to the Government of Turkey, * * * " (Emphasis added.) None of the provisions of the Memorandum of Understanding refers to any United States Turkey transactions. Therefore, none of its provisions are directly affected by either cutoff.

Nevertheless, the foregoing does not insure that the two sets of sales of planes by Italy to Turkey are legal without regard at all to the cutoffs, for the cutoffs may indirectly impact on the transactions

so as to render them illegal. Such indirect consequences may result from the triggering by the cutoffs of specific statutory provisons of or regulations under the Foreign Assistance Act of 1961, the Foreign Military Sales Act, or the Mutual Security Act of 1954, which would proscribe the transactions at issue. Specifically, the concern is with potential application of statutory provisions or regulations relating to third country transfers. It is therefore necessary to categorize the parts of the Memorandum of Understanding to determine the primary statute under which each is governed so that the appropriate restriction on third country transfers may be examined for potential application. Accordingly, we must consider the legal significance and ramifications of each of the parts of the Memorandum of Understanding seriatim.

The third part of the Memorandum of Understanding, as described above, dealing with the financing of articles and services to be procured from United States sources, may create the most legal difficulty although it is apparently not the major part of the agreement. Under the language of part three, a number of differing factual situations could have occurred. We do not presently have knowledge of what actually occurred. For example, adequate private financial resources may have been available to enable Italy to make the necessary procurements from the United States sources without any Governmental financial assistance of any form. Perhaps although private financial resources were available, a Governmental guarantee was required to consummate the transactions. On the other hand, the Government itself may have made a credit sale to Italy of the necessary articles and services.

Since no Government grants are involved under any of the factual examples, it is clear that the Foreign Assistance Act of 1961, supra, is not applicable to any portion of the third part of the Memorandum of Understanding. In the first factual example, since there would be no Governmental financial involvement, the Foreign Military Sales Act, supra, also would not be applicable. In the second factual situation, even though there would be a financial commitment of the Government in the form of a guarantee, which is authorized by section 24 of the Foreign Military Sales Act, as amended. 22 U.S.C. § 2764, (Pam. No. 1, February 1975), since no sale was involved, the restrictions on third country transfer contained in subsection 3(a) of that act, as amended, 22 U.S.C. § 2753(a) (1970 & Supp. III, 1973) quoted below, would not be applicable. In the last factual situation, a sale would be involved and, in the absence of an amendment to the Memorandum of Understanding extending the repayment terms for credit assistance, most probably any direct credit assistance will have been repaid to the United States plus interest. The critical factor, however, is not repayment but whether any defense articles

procured with the use of United States Government credit assistance became components in any of the planes transferred or to be transferred to Turkey, since subsection 3(a) of the Foreign Military Sales Act, supra, provides in part:

> "No defense article or defense service shall be sold by the United States Government under this chapter to any country or international organization unless--
>
> * * * * *
>
> (2) the country or international organization shall have agreed not to transfer title to, or possession of, any defense article so furnished to it to anyone not an officer, employee, or agent of that country or international organization and not to use or permit the use of such article for purposes other than those for which furnished unless the consent of the President has first been obtained;
>
> * * * * *
>
> In considering a request for approval of any transfer of any weapon, weapons system, munitions, aircraft, military boat, military vessel, or other implement of war to another country, the President shall not give his consent under paragraph (2) to the transfer unless the United States itself would transfer the defense article under consideration to that country, and prior to the date he intends to give his consent to the transfer, the President notifies the Speaker of the House of Representatives and the Committee on Foreign Relations of the Senate in writing of each such intended consent, the justification for giving such consent, the defense article for which he intends to give his consent to be so transferred, and the foreign country to which that defense article is to be transferred. In addition, the President shall not give his consent under paragraph (2) to the transfer of any significant defense articles on the United States Munitions List unless the foreign country requesting consent to transfer agrees to demilitarize such defense articles prior to transfer, or the proposed recipient foreign country provides a

> commitment in writing to the United States Government that it will not transfer such defense articles, if not demilitarized, to any other foreign country or person without first obtaining the consent of the President. The President shall promptly submit a report to the Speaker of the House of Representatives and to the Committee on Foreign Relations of the Senate on the implementation of each agreement entered into pursuant to clause (2) of this subsection." (Emphasis added.)

The evidence we have available to us from the Department of Defense is that no components of the 36 F-104S aircraft involved were provided to Italy under the Foreign Assistance Act of 1961 or the Foreign Military Sales Act. Assuming that information is accurate, the requirements of subsection 3(a) would not apply before the transfers from Italy to Turkey could be authorized.

The second part of the agreement, covering the provision of incidental technical assistance on a reimbursable basis, does come within the Foreign Military Sales Act, as a sale of defense services, since a "defense service" is defined as including "any service, test, inspection, repair, training, publication, or technical or other assistance, or defense information used for the purpose of furnishing military assistance." 22 U.S.C. § 2403(f) (1970). See subsection 45(c) of the Foreign Military Sales Act, 82 Stat. 1320, 1327, 22 U.S.C. § 2751 note (1970). However, the restrictions on third country transfers in subsection 3(a) of such act, supra, are not applicable to sales of defense services. This is understandable for most items of defense service except perhaps for sales of defense information. "Defense Information" includes any document, writing, sketch, photograph, plan, model, specification, design, prototype, or other recorded or oral information relating to any defense article or defense service * * *." 22 U.S.C. § 2403(e)(1970). One consequence of the lack of statutory coverage of sales of defense information in the third country transfer restrictions of subsection 3(a) is that the United States has no statutory control over third country transfers of the defense articles produced by the purchasing country using such defense information. For example, had the United States Government sold defense information covering the F-104S to Italy, it would have no statutory control of transfers by Italy of F-104S aircraft produced in Italy to any recipient third country, including Turkey.

With respect to the first part of the agreement, transactions between a commerical U.S. corporation and a foreign government were contemplated. Lockheed, as owner of the overall design rights

in the F-104G, had furnished to Italy "the information, data, drawings, plans, specifications and other material and matter" pertaining to that aircraft (Article 5(a) of the co-production license) in conjunction with its granting to Italy the exclusive right and license to manufacture or have manufactured within Italy the F-104G. Article 1(a)(i) of the co-production license. After the signing of the Memorandum of Understanding between the United States and Italy with respect to the development of the derivative model F-104S, Italy executed the "Development Contract" with Lockheed, whereby, for a consideration, Lockheed agreed to reconfigure the F-104G airplane design to the F-104S design, to produce and deliver a model specification for the F-104S to be manufactured in Italy, to furnish the necessary technical data and to furnish the services of technical specialists. Article 1 of the Development Contract. In conjunction therewith Lockheed granted Italy the exclusive right and license to manufacture or have manufactured within Italy the Lockheed Model F-104S aircraft. Article 1(b)(i) of the co-production license, as amended April 22, 1967.

As indicated previously, such private commercial sales of defense articles and defense services, including technical data related thereto, to a foreign government are statutorily governed by section 414 of the Mutual Security Act of 1954, 22 U.S.C. § 1934, supra, and regulations promulgated thereunder. Subsection 414(a), of most significance here, provides:

> "The President is authorized to control, in furtherance of world peace and the security and foreign policy of the United States, the export and import of arms, ammunition, and implements of war, including technical data relating thereto, other than by a United States Government agency. The President is authorized to designate those articles which shall be considered as arms, ammunition, and implements of war, including technical data relating thereto, for the purposes of this section."

Regulations entitled "International Traffic in Arms" (ITAR) have been promulgated thereunder in subchapter M of title 22, Code of Federal Regulations, Parts 121 through 128. Such regulations currently require, and have required at least since 1960, that proposed agreements between persons or companies residing in the United States and foreign persons or entities, private or governmental, for the manufacture abroad of or furnishing abroad of technical assistance concerning, arms, ammunition, and implements of war on the U.S. Munitions List are required to be submitted to the Department of State before the effective date of the

agreement for review from the standpoint of United States foreign policy and military security. 22 C.F.R. § 124.01 (April 1, 1975 and January 1, 1958, cumulative pocket supplement January 1, 1964, respectively). That was clearly done with the co-production license and amendments thereto in this case.

However, the primary concern here, as with the second and third parts of the agreement, are the conditions under which Italy could make third country transfers of the aircraft produced under the co-production license and the impact, if any, of the arms embargoes to Turkey. At neither the time of issuance of the original co-production license relating to the F-104G alone on March 2, 1961, or the time of approval of the amended license on April 22, 1967 which expanded its coverage to the F-104S, did the ITAR regulations require the inclusion of third country transfer restrictions in co-production agreements. Such restrictions are, however, now contained in 22 C.F.R. § 124.10 (April 1, 1975), which provides in pertinent part:

> "Proposed manufacturing license and technical assistance agreements (and amendments thereto) shall be submitted in five copies to the Department of State for approval. (Such agreements shall not become effective until the Department's approval has been obtained.) The proposed agreements shall contain, inter alia, all of the following information and statements in terms as precise as possible, or the transmittal letter * * * shall state the reasons for their omission or variation:
>
> * * * * *
>
> "(k) Specific identification of the countries or areas in which manufacturing, production, processing, sale, or other form of transfer is to be licensed.
>
> * * * * *
>
> "(m) (1) With respect to all manufacturing license agreements, a statement that reads as follows: 'No export, sale, transfer, or other disposition of the licensed article is authorized to any country outside the territory wherein manufacture or sale is herein licensed without the prior written approval of the U.S. Government.'

"(2) With respect to manufacturing license agreements for significant combat equipment, the Department may require that the prospective foreign licensee furnish an 'Nth Country Control Statement' (Form DSP-83) to the Office of Munitions Control. The Nth Country Control Statement shall provide that the licensee agrees to ensure that any contract or other transfer arrangement with a recipient of the licensed article in any country within the licensed sales territory will include the following provision:

"The recipient shall obtain the approval of the U.S. Government prior to entering into a commitment for the transfer of the licensed article by sale or otherwise to another recipient in the same or any other country in the world."

However, Article 14 of the instant co-production license stated:

"(a) This agreement is subject to such laws and regulations of the United States of America as may be in effect from time to time with respect to the exportation or disclosure of data or material or with respect to any other provision of this agreement.

"(b) Licensor shall be excused from any failure to perform or delay in performing this agreement caused by such laws or regulations or by any cause which results without the fault or negligence of licensor, provided prompt notice of the cause of such delay shall have been given to the Licensee."

In addition, Article 16 of the Development Contract provided in part:

"(1) This contract is subject to such laws and regulations of the United States of America and the State of New York as may be in effect from time to time.

* * * * *

> "(3) Contractor [Lockheed] shall not be liable for any delay in its performance under this contract due to causes beyond its control and not occasioned by its negligence or fault, or by reason of force majeure. * * *"

Moreover, the market area was in fact specifically delineated in Article 1(b)(iv) of the co-production license, as amended, where Lockheed granted Italy:

> "The non-exclusive right to sell or have sold:
>
> A. Complete F-104S airplanes and F-104S peculiar spare parts, special tools and ground service equipment to the Federal Republic of Germany, The Netherlands, and Belgium.
>
> B. Modification kits for converting the F-104G airplanes to the F-104S configuration, along with F-104S peculiar spare parts to any European NATO Country (including Turkey) and Spain."

In addition, since Article 1(d) of the co-production license, as amended, provides that "the exercise of any rights granted by Licensor [Lockheed] under the terms of this Article 1 shall be subject to * * * any then effective agreement or understanding between the Government of the United States and Licensee [Italy]," permission of the United States Government would be required for sales of F-104S aircraft, components or spare parts produced in Italy to third parties under Article V(B) of the Memorandum of Understanding. Therefore, the total effect of these provisions is the same as if the current regulation on third country transfer had been in effect at the time of the issuance of the co-production license and the amendment thereto.

In terms of the specific transfers of concern in this case, the following factual background is necessary. As stated previously, the Cyprus outbreak commenced on July 20, 1974. On August 2, Lockheed requested Department of State approval that Article 1(b)(iv) of the co-production license, quoted above, be amended so as to delete Germany, The Netherlands and Belgium from the market area and replace them solely with Turkey. The State Department reponded on August 16, 1974 by retaining Germany, The Netherlands and Belgium in the market area and merely adding Turkey thereto, with the following proviso:

"This approval does not authorize the retransfer of any F-104S aircraft from Italy to Turkey. Such authorization must be obtained through Government-to-Government channels and is subject to an appropriate undertaking by the receiving Government concerning further retransfer."

In the meantime, on August 7, the Government of Italy had requested permission in accordance with Article V(B) of the Memorandum of Understanding to sell 18 F-104S aircraft to Turkey with an option for Turkey to purchase 18 more. It was then anticipated that 6 planes would be sent to Turkey within 15 days after a final agreement was signed, the balance to be delivered within 6 months. On September 20, the State Department advised that they were prepared to approve the transfer upon receipt from Turkey of assurances that Turkey would not retransfer the aircraft without U.S. consent, as authorized and illustrated by 22 C.F.R. § 124.10(m)(2), supra. On October 8, Turkey signed the required third country transfer assurances, which were received by the United States on October 9. Also on October 9, the Senate passed H.J.Res. 1131, 93d Cong., making further continuing appropriations for fiscal year 1975, clearing it for Presidential signature. Section ^ thereof prohibited the use of any such appropriated funds for arms to Turkey. The State Department gave its approval for the transfer of the first 18 aircraft from Italy to Turkey on October 11. On October 14, the President vetoed H.J.Res. 1131. H.R. Doc. No. 93-369, 93d Cong., 2d Sess. His veto was sustained by the House of Representatives on October 15. Cong. Rec. H10542-45 (Daily ed.)

Although the foregoing evidences a difference in policy between the legislative and executive branches of the Government, there was clearly no violation of law of which we are aware with respect to the approval of the transfer of the first 18 F-104S aircraft by Italy to Turkey, for no cutoff had as yet been enacted.

Continuing with events, on October 17, 1974, the President signed H.J.Res. 1167, 93d Cong., into law, Public L. No. 93-448, which contained the first cutoff which is quoted above. He then exercised his suspension authority thereunder on October 29, 1974, which was valid until December 10, 1974. The request for the transfer of the second 18 aircraft had been received on December 9, 1974. On December 10 the State Department approved the second set of proposed F-104S transfers by Italy to Turkey, subject to receipt from Turkey in writing of standard assurances regarding third party transfers. With the passage of the Foreign Assistance Act of 1974, supra, on December 30, 1974 and the continuing appropriations resolution, Public L. No. 93-570, supra, on December 31,

1974, the President was authorized again to suspend the embargo on arms to Turkey. He exercised that authority on December 31, 1974, and the suspension continued until February 5, 1975 when the statutes mandated that it expire. In that interval , specifically February 4, the United States received the written standard assurances from Turkey on third country transfers of F-104S aircraft should Turkey exercise its option to purchase the additional set of 18 planes. Thereafter, on February 5, the State Department gave approval of the transfer of the second set of 18 aircraft. We do not know whether Turkey in fact exercised its option.

Reviewing these facts for legal significance, we note initially that the contingent approval of the second set of transfers occurred on December 10 and the final approval on February 5. The language of the respective cutoff statutes was that the respective presidential suspensions of the cutoffs "shall be effective only until December 10, 1974" and "until February 5, 1975." The legislative history does not specifically address whether the respective suspensions were to persist through December 10, 1974 and February 5. 1975 or whether the cutoffs were to resume on December 10, 1974 and February 5, 1975. For the sharply divergent meanings given by the case law to the word "until" in this context, see 43A Words and Phrases, "Until" p. 162 (1969 ed.). Accordingly, we cannot conclude that the actions of the State Department were unreasonable or invalid under the cutoff statutes.

Once one accepts the construction of the State Department with respect to the time limitations, it is evident that on the basis of the information available to us and disclosed herein, the approval of the State Department of the transfer from Italy to Turkey of the second set of 18 F-104S aircraft was not illegal, although perhaps not in accordance with the spirit of the statutes, since all of the critical events took place during the presidential suspensions of the cutoffs.

Of perhaps more concern is the fact that had Congress clearly intended the cutoffs to resume on December 10, 1974 and February 5, 1975, so that both critical events would have occurred on dates when the embargo on arms to Turkey was in effect, the approval of the State Department of the transfer from Italy to Turkey of the second set of 18 F-104S aircraft would still not be illegal. This results from a significant difference between the restrictions on third country transfers contained in subsection 3(a) of the Foreign Military Sales Act, quoted earlier, and those contained in 22 C.F.R. § 124.10(m) (April 1, 1975) under the Mutual Security Act of 1954, also quoted earlier, or their equivalent as developed from the documents in this case. That is, under the former "the President shall not give his consent * * * to the transfer unless

the United States itself would transfer the defense article under consideration to that country." No such restraint exists on the granting of United States approval to a transfer under the latter. Consequently, in this case, since the cutoffs only applied prohibitions on direct United States Government Turkey transactions, there was no requirement that the United States heed the Congressional embargo on arms to Turkey for indirect United States Government involvement such as prevails under the facts of this case.

In conclusion, therefore, we believe that neither of the transfers or proposed transfers of two sets of 18 F-104S aircraft from Italy to Turkey was illegal despite the congressionally imposed cutoffs of arms to Turkey.

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