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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

U.S. Participation In The NATO Infrastructure Program

U.S. participation in NATO's infrastructure program is a frequently used method of meeting some of the U.S. military construction requirements in Europe. However, unique programing policies and procedures, a large NATO civilian and military bureaucracy, and numerous U.S. organizations responsible for carrying out U.S. participation in the program, all combine to make programing, construction, and funding of infrastructure projects a lengthy, complicated process.

GAO's report answers some of the most frequently asked questions about how NATO carries out the program, how projects are funded and costs shared among the alliance members, and what benefits the United States obtains through its participation.

GAO also identifies how savings could be achieved by changing the current schedule of U.S. payments to the infrastructure program, and recommends that the Department of Defense develop and propose to the Congress a separate funding mechanism for paying for U.S. projects built prior to formal NATO approval and recovering the funds from NATO.

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WASHINGTON D C 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report provides answers to some frequently asked questions about the workings of NATO infrastructure--the alliance's commonly funded military construction program. It also contains several recommendations to improve the management of U.S. participation in the program.

Copies of this report are being sent to the Director, Office of Management and Budget, and to the Secretaries of State, Defense, and Treasury. We are also providing copies of this report to appropriate congressional committees.

Charles A. Bowsher
Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

U.S. PARTICIPATION IN THE
NATO INFRASTRUCTURE PROGRAM

D I G E S T

The North Atlantic Treaty Organization (NATO) infrastructure program is the alliance's commonly funded military construction program. It provides funds for building essential operational facilities in support of NATO's military forces.

The infrastructure program has given NATO a network of airfields, shelters, common communications, a fuel distribution and storage system, air defense installations, and air and naval navigational aids. Since 1971, the program has constructed facilities predominately used by U.S. forces valued at about $1.5 billion. (See p. 13.)

Projects are paid for by the participating NATO member nations according to agreed-upon cost-sharing arrangements and within a total program funding ceiling. For the current 5-year cost-sharing period, 1980 to 1984, the United States is committed to contributing about 27 percent of the agreed-upon funding ceiling of close to $4 billion. (See p. 4.)

Since the program's inception in 1951, NATO nations have provided over $12 billion for these military facilities. The U.S. share has been over $3.8 billion.

CONGRESSIONAL INTEREST IN THE NATO INFRASTRUCTURE PROGRAM CONTINUES

The Congress has had a longstanding interest in the workings of the NATO infrastructure program and U.S. participation in it. In recent years, the Congress has sought information on how NATO carries out the program, the benefits obtained by the United States through its participation, the U.S. record on recovering funds from NATO (recoupments) for projects built by the United States prior to receiving NATO approval and funding (prefinancing), and ways to reduce U.S. program costs.

To assist the Congress in carrying out its oversight responsibilities over U.S. participation in the program, GAO performed a review to (1) answer some frequently asked questions about how the program works, (2) identify actions to improve the future recovery from NATO of funds spent by the United States on prefinanced projects, and (3) suggest how savings could be achieved by the Department of Defense (DOD) through better cash management over U.S. payments made to the infrastructure program.

DOD TRACK RECORD ON RECOUPMENTS, THOUGH IMPROVING, COULD BE BETTER

The United States has used military construction appropriations to prefinance projects for reimbursement by NATO since about 1959. As of June 30, 1982, the U.S. military services had used military construction appropriations totaling about $832.6 million. To date, the services have recouped only $313.7 million, or about 38 percent of the total amount prefinanced. However, the military services have made progress in the past few years in recovering these funds for projects which NATO has already approved. In fiscal years 1980 and 1981, they recovered over $100 million to reduce the backlog of projects approved by NATO for recoupment.

About $250 million or 30 percent of the total amount prefinanced by the U.S. military services is currently categorized as non-recoupable (i.e., the United States does not expect NATO to repay). For the most part, projects included in this category are considered ineligible for recoupment by DOD because (1) U.S. construction exceeds NATO's standards, or (2) the project does not fall into one of NATO's 13 approved eligible categories. (See pp. 19 through 21.)

The Congress has been critical of DOD's record on recoupments and, since 1979, congressional restrictions have resulted in a substantial reduction in prefinancing by the United States, both in absolute terms, as well as relative to other NATO member countries. (See p. 22.)

The NATO infrastructure program is also experiencing funding shortfalls and does not have enough funds to finance many of NATO's already approved projects. U.S. military commanders find themselves in a dilemma. Charged with responsibility to increase conventional warfare capability, they are often unable to obtain funding for their NATO-eligible projects through the infrastructure program. With the Congress reluctant to advance funds to prefinance these projects, construction does not take place. (See p. 22.)

ACTIONS TO IMPROVE FUTURE RECOVERY OF FUNDS

The United States is faced with a difficult decision. If critical construction projects are vital to U.S. security interests, but the infrastructure program is unable to accommodate them in a timely fashion, then prefinancing could be a solution. However, if the military services seek to make greater use of the prefinancing mechanism, GAO believes DOD and the Congress may need to take actions to improve the U.S. prefinancing and recoupment record. (See p. 23.)

GAO identified two possible actions.

- --Creation of a separate funding mechanism for prefinancing, known as a "rolling fund."
- --Expansion of the U.S. European Command's role in the selection of projects to be prefinanced.

At present, prefinanced projects are identified and funded through U.S. military service department channels and the U.S. European Command's participation in project selection is only advisory.

GAO believes consideration of these two actions could provide additional assurances that only the most needed U.S. service projects likely to be approved by NATO would be proposed for prefinancing. Additionally, a rolling fund could provide the needed incentive to the military services to recover funds more quickly and completely because:

- --Funds would be returned to the rolling account for DOD use rather than to the infrastructure account. Funds put into the infrastructure account are used to pay for part of the U.S. contribution to this program. This system does not provide direct benefits to DOD because recoveries are used to support total NATO infrastructure requirements rather than being targeted to DOD's most urgent construction needs.

--The ability to prefinance future projects would be contingent on service recoupment performance. (See pp. 23 through 25.)

MODIFYING THE SCHEDULE OF PAYMENTS COULD SAVE MONEY

GAO's work revealed that savings could be realized by changing the timing of the U.S. payments to the infrastructure program. U.S. contributions to the NATO infrastructure program are paid directly to NATO member nations in response to a quarterly request for payments known as a NATO call. The United States currently pays in one installment within 30 days of the NATO call. (See pp. 28 and 29.)

Using interest rates supplied by the Department of the Treasury, GAO's analysis of U.S. payments to the infrastructure program from 1979 to 1981 revealed that by using a monthly rather than a quarterly payment schedule, the United States could have saved over $3.9 million. Because the U.S. payments are for estimated obligations to be incurred by NATO nations during the quarter, spreading U.S. payments over the quarter in three monthly increments could save money by minimizing the premature disbursement of funds. As U.S. infrastructure program expenditures are expected to increase in the next few years, adopting a monthly payment schedule could result in considerable savings to the Treasury. (See pp. 30 and 31.)

RECOMMENDATIONS TO THE SECRETARIES OF STATE AND DEFENSE

GAO recommends that the Secretary of State, in conjunction with the Secretary of Defense, task the U.S. Mission to NATO to pursue with NATO authorities the feasibility of changing the current schedule of U.S. payments and report on its findings. Until NATO adopts more precise payment criteria and unless it can be demonstrated that a monthly schedule of U.S. payments will have an adverse impact on NATO program implementation, GAO believes a monthly payment schedule should be used. (See p. 31.)

GAO also recommends that the Secretary of Defense, before requesting any additional prefinancing for NATO-eligible construction projects, develop and propose a system like the rolling fund to provide a greater incentive to the military services to recover maximum funding from NATO. Such a system should also provide for a greater U.S. European Command participation in the selection of candidate projects by the military services for prefinancing. (See p. 26.)

MATTER FOR CONSIDERATION BY THE CONGRESS

In debating prefinancing decisions, the Congress should consider whether a system like the rolling fund would meet congressional mandates for improving DOD's performance in recovering funds from NATO for prefinanced projects. Specific authorizing legislation would be needed to implement such a system. (See p. 26.)

AGENCY COMMENTS AND GAO'S EVALUATION

The Departments of State, Defense, and Treasury reviewed a draft of this report and generally agreed with the facts presented. DOD expressed some concerns on its implementation of GAO's recommendation to develop a separate funding mechanism for prefinancing. DOD agreed, however, that it would (1) improve the U.S. prefinancing and recoupment record, (2) respond to congressional concerns over prefinancing, and (3) provide additional assurance that the Congress has been seeking for improved DOD performance.

The Department of the Treasury strongly supported changing the timing of payments in response to NATO calls from quarterly to monthly increments. Treasury advised that such a schedule of payments would avoid premature drawdowns of funds from the Treasury and support its efforts in improving Federal cash management.

DOD and the Department of State were reluctant to change the timing of U.S. payments. Both suggested that no change should take place because of the potential political and programmatic disruptions which might result. DOD did acknowledge, however, it would be useful for the U.S. Mission to NATO to explore the possibility.

GAO recognizes that there are legitimate political and program concerns over changing the existing U.S. schedule of payments. However, given the potential savings involved, GAO believes the U.S. Mission to NATO should pursue the possibility, evaluate the anticipated political and program impacts, and report on the feasibility of such a recommendation.

Contents

ABBREVIATIONS

CBO	Congressional Budget Office
DOD	Department of Defense
GAO	General Accounting Office
GNP	gross national product
IAU	Infrastructure Accounting Unit
ILD	Infrastructure and Logistics Division
NATO	North Atlantic Treaty Organization
OMB	Office of Management and Budget
SHAPE	Supreme Headquarters Allied Powers, Europe
USEUCOM	U.S. European Command

CHAPTER 1

INTRODUCTION

To provide for its military construction requirements in Europe, the United States uses three methods: (1) the North Atlantic Treaty Organization's (NATO) commonly funded infrastructure program, (2) host nation support, and (3) U.S.-funded military construction programs. In recent years, the size of the U.S.-funded programs has increased, and the Congress has urged the Department of Defense (DOD) to seek more host nation support and infrastructure funding to reduce the U.S. defense burden. In particular, the Congress has directed DOD to use the NATO infrastructure program to the maximum extent possible to fund U.S. construction in Europe.

NATO's unique policies and procedures, developed to guide program implementation in a multinational setting, often contrast with those used in national programs and are viewed as complicated. Each year the Congress raises questions concerning the workings of the infrastructure program and U.S. involvement in it. Our discussions with congressional staff during the 1983 appropriations hearings cycle revealed continuing interest on the part of congressional committees for information on the status and implementation of the program, the record on recovery (recoupments) of funds from NATO for U.S. prefinanced projects, 1/ and ways to reduce U.S. program costs.

This report provides some answers to frequently asked questions about NATO infrastructure and discusses several alternatives to improve current management of U.S. participation in the program.

NATO INFRASTRUCTURE PROGRAM--OVERVIEW AND STATUS

The NATO infrastructure program is the alliance's commonly funded military construction program designed to provide essential operational facilities and equipment in support of its military forces. The program has given NATO a network of airfields, shelters, common communications, a fuel and lubricants distribution and storage system, air defense warning installations, and air and naval navigational aids. Since 1951, NATO has programed approximately $12 billion for military facilities of which the United States has contributed or agreed to contribute approximately $3.8 billion.

1/These are projects which are normally constructed and paid for by the United States prior to receiving NATO programing approval and funding.

Administration of the program

Infrastructure projects are paid for by NATO member nations according to an agreed-upon cost-sharing arrangement and within a total program fund ceiling. Cost-sharing percentages and the funding ceiling are negotiated periodically, currently every 5 years. The chart below shows the cost-sharing percentages for the 1980 to 1984 period.

COST SHARE (PERCENTAGES)

Member nation	"At 14" a/ (Without France)	"At 15" a/ (With France)
United States	27.4200	23.7583
Federal Republic of Germany	26.5446	22.9996
United Kingdom	12.0797	10.4665
Italy	7.9873	6.9206
Canada	6.3578	5.5087
Belgium	5.5912	4.8446
Netherlands	5.5912	4.4524
Denmark	3.7273	3.2296
Norway	3.1417	2.7222
Turkey	.8045	.8021
Greece	.7932	.6888
Luxembourg	.2130	.1846
Portugal	.2011	.2011
Iceland	0	0
France	0	13.2209

a/France participates in only a limited number of projects since its withdrawal from the allied military structure in 1967. Most of the program is shared using the percentages termed "At 14" by NATO.

Increments of the total program, known as slices, are proposed on a calendar year basis by NATO military commanders and approved by NATO's ambassadors. Program decisions--such as the funding ceiling, the cost-sharing percentages, and the projects to be constructed--require the unanimous consent of the participating nations.

The U.S. Mission to NATO in Brussels, Belgium, acts on behalf of the United States in the infrastructure program. The Mission provides a representative to NATO's Infrastructure Committee, which makes policy and procedural decisions, and to the Payments and Progress Committee, which approves individual projects and authorizes funding. The Director of the Infrastructure and Logistics Division (ILD) within the U.S. Mission commits the United

States to participation in any given NATO project and obligates the U.S. share of required funding. The Department of the Army, as executive agent, performs financial administration over funds which make up the U.S. share of the program.

Infrastructure programing and funding have increased significantly

Since it began in 1951, the infrastructure program has grown dramatically, both in the number and types of projects programed and funding levels. In the early years, NATO financed mostly airfields and communications systems. By 1982, the program had expanded to encompass the 13 eligible categories shown below and case-by-case agreements.

ELIGIBLE CATEGORIES

Airfields	Essential operational facilities and shelters for tactical aircraft.
Communications	Military communications connections with government satellite communications.
Petroleum, oil, lubricants	Pipelines and 30-day storage for jet fuel.
Naval bases	Petroleum, oil and lubricants, ammo and other storage, repair facilities, piers.
Warning installations	Air and sea early warning.
Training	Tank, air, and missile ranges.
War headquarters	Static and mobile for international headquarters.
Surface-to-air missiles	NIKE and HAWK sites.
Forward storage sites	Storage in forward areas.
Ammunition storage	Storage sites for U.S. special weapons.
Surface-to-surface missiles	PERSHING and ground-launched cruise missile sites.
NATO Air Defense Ground Environment	Integrated early warning, command, and control.
Reinforcement support	Storage for prepositioned supplies, equipment, ammo and reception and onward movement.

During the 1960s, the NATO members approved funding ceilings for two cost-sharing periods at about $749 and $634 million, respectively. For the most recent 5-year cost sharing period (1980 to 1984) the NATO members agreed to a funding ceiling of 1.074 billion IAUs 1/ (approximately $3.8 billion).

The amount of funds appropriated by the United States for the program has also increased substantially, as shown below.

Fiscal year	Congressional appropriations (millions)
1968	$ 37.5
1971	33.5
1975	69
1979	173
1981	250
1982	345
1983	375 (estimate)

Over the life of the program, however, the U.S. contribution as a percentage of the total program has decreased. In the early years, the United States contributed almost 44 percent of the total program cost. For the 1980 to 1984 period, the U.S. share is 27 percent.

Limitations exist to program accomplishments

Within the framework of the approved categories, NATO has established policies and guidelines over funding and programing of its construction projects. To qualify for NATO funding, projects must

--support NATO operational plans and NATO-assigned forces,

--possess a high degree of common interest and be available for use by all NATO forces during wartime, and

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1/An Infrastructure Accounting Unit (IAU) is an artificial unit of exchange which forms the basis for estimates and funding of projects. The value of one unit is established semi-annually by NATO.

--conform to NATO-approved construction standards and not exceed established minimum requirements for wartime.

Member nations have agreed that NATO funds cannot be used for construction of barracks, hospitals, quality of life improvements, and other essentially peacetime requirements. Such projects must be funded nationally.

OBJECTIVES, SCOPE, AND METHODOLOGY

Because of current funding shortages in the infrastructure program, over the next several years the Congress may be asked to consider requests by the military services for funds to prefinance construction projects in Europe.

Our report is intended to assist the Senate and House Appropriations and Armed Services Committees in evaluating the need to resort to this action, rather than funding such projects strictly through NATO channels. Our report also addresses how savings could be achieved by the United States through modifying the schedule of its infrastructure payments to NATO.

The objective of our review was to provide the Congress with an overall assessment of U.S. participation in the infrastructure program. More specifically, we sought to

--answer some of the most frequently asked questions about how the program works,

--analyze U.S. experience with funding projects prior to formal NATO approval and subsequently seeking recoupment of these costs, and

--explore ways of improving U.S. participation in the NATO infrastructure program.

In performing our review, we focused our attention on the specific tasks that must be carried out to plan, budget, implement, fund, and report on U.S. participation in the program. We reviewed pertinent U.S. and NATO reports and solicited views from U.S. program officials on ways to improve U.S. management and participation in the program. We also examined financial procedures governing payments to NATO, analyzed U.S. payments made to the infrastructure program for a 3-year period, and explored the feasibility of modifying the quarterly U.S. payment schedule to achieve savings.

We performed work in Washington, D.C., and at selected locations in Europe from January through June 1982. We met with officials from the Departments of Defense, State, Treasury, and the Army in Washington, D.C., and with U.S. officials at the U.S. Mission to NATO, Brussels, Belgium, U.S. European Command, Stuttgart, Germany, U.S. Army, Europe and Seventh Army, Heidelberg, Germany, U.S. Army Engineer Division, Europe, Frankfurt, Germany, 21st Support Command, Kaiserslautern, Germany, and NATO/SHAPE Support Group, Mons, Belgium. We also reviewed a Congressional Budget Office report on the infrastructure program and discussed our work with Budget Office staff. Our review of the program was performed in accordance with generally accepted government audit standards.

CHAPTER 2

ANSWERS TO SOME FREQUENTLY ASKED QUESTIONS

ABOUT THE NATO INFRASTRUCTURE PROGRAM

U.S. participation in NATO's infrastructure program, although a well-known method of meeting some of the U.S. construction requirements in Europe, is frequently misunderstood. Because there are numerous layers of review and screening by many different parties--the NATO committees and international staff, the NATO military commands, host and user nations--few individuals are fully acquainted with the workings of the entire program.

Policies and procedures governing NATO program implementation have developed over time through negotiations. Because all the member nations must agree on any proposed action, the proceedings tend to be lengthy and decisions are reached only after much negotiation and compromise.

The following questions and answers seek to generally describe the workings of the NATO infrastructure program and U.S. participation in it. We are providing this information in order to place U.S. actions into perspective within the context of NATO programing, planning, implementation, and financial management.

PROGRAM LEVELS, COST-SHARING ARRANGEMENTS, AND ANNUAL SLICES

How does NATO determine the amount of funding to be made available for the program?

NATO member nations decide through negotiations how much money will be made available to fund the infrastructure program. To preclude the need for yearly negotiations, the NATO members establish a funding ceiling to cover the estimated costs of the program over a several year period. These cost-sharing periods, known as slice groups, currently are for 5 years. NATO has programed four such 5-year cost-sharing periods since 1965

Slice group	Cost-sharing period (years)	Funding ceiling IAUs	Funding ceiling Approx. U.S. equivalent
		----------(millions)---------	
16 - 20	1965-69	198	$ 634
21 - 25	1970-74	305	1,215
26 - 30	1975-79	540	2,866
31 - 35	1980-84	1,074	3 794

Military requirements form the basis for the fund ceiling that the NATO members establish, but other factors also play an important role in determining this amount. For example, negotiations for the current slice group started with NATO military commanders' expressed requirements for the 5-year cost-sharing period totaling 1.9 million IAUs. Yielding to practical and political considerations, the NATO nations lowered this figure to, in their view, a militarily minimally acceptable level of 1.5 billion IAUs. Responding to the belief by some nations that projects could not be implemented at this rate, NATO, in May 1979, agreed to a ceiling of about a billion IAUs for the program. The United States reluctantly agreed to this lower amount, but with the provision that member nations would evaluate the need for a higher program ceiling midway through the cost-sharing period in 1982-1983.

How are the cost-sharing percentages determined for participating member countries?

The cost-sharing percentages are also arrived at through negotiations among the NATO members, and represent each country's ability and willingness to contribute to the program.

According to NATO documents, the infrastructure percentage contributions are based on three criteria: (1) each member country's capacity to contribute, (2) the advantage accruing to the user country, and (3) the economic benefit to the host country. Although these and other factors have been referred to in negotiations, no exact formula has ever been devised to consider these criteria.

Over time, there has been a decrease in the U.S. share (in percentage terms) of total contributions to the infrastructure program. During the period 1951 to 1956, for example, the United States contributed nearly 44 percent; for the 1980 to 1984 period, the U.S. share is 27 percent. The next largest contributer to the infrastructure program in the current cost-sharing period is the Federal Republic of Germany with 26 percent, followed by the United Kingdom with 12 percent.

How are NATO's annual infrastructure programs (slices) formulated?

The preparation of an annual slice can take as long as 30 months before a final approved program slice is agreed to by NATO.

The programing cycle begins with a user nation submitting to a host nation a list of desired construction projects. The host nation, which provides the land, access roads, and utility connections at its own expense, must be included early in the programing cycle. After reviewing the proposed projects, the host nation submits to the appropriate NATO subordinate command a list of projects it is willing to support. The NATO subordinate command reviews this list and forwards its recommendations for projects to be included in the slice to the major NATO commanders--the Supreme Allied Commander, Europe, and Supreme Allied Commander, Atlantic.

After further review by the major NATO commanders, a working paper is prepared and forwarded to the Ministry of Defense of each nation. Following Ministry of Defense review, the NATO commanders hold a conference with Ministry of Defense officials to discuss the working paper. After considering the comments of these officials, a recommended slice is prepared. It is then sent to NATO's Military and Infrastructure committees for review. The Infrastructure Committee, with the assistance of the International staff, examines the financial and technical aspects of the slice. At the same time, the Military Committee, with assistance from its international military staff, examines the slice from a military point of view.

When these reviews are completed, the recommended slice is sent to the Defense Planning Committee, where NATO ambassadors grant final approval. With that approval, the listing of projects is known as a NATO approved slice.

PROJECT EXECUTION AND FUNDING

How do NATO infrastructure projects get constructed?

Once an infrastructure slice has been approved, the construction execution phase begins. The entire responsibility for implementation is assumed by the host nation--generally the country on whose soil the project will be built.

The host nation must acquire the necessary land at its own expense (where not already owned), design the project, prepare detailed cost estimates for planned construction, and obtain NATO approval for funding. The host nation then invites bids for the contract from firms of participating member countries using NATO's International Competitive Bidding procedures.

With very few exceptions, the United States does not act as a host nation for infrastructure projects in the European theater. However, as a user nation for many of these projects, the United States must work closely with NATO and host nation officials on the design and construction of infrastructure projects.

How are NATO infrastructure projects paid for?

To obtain NATO funding, the host country submits a request to the Payments and Progress Committee for authorization to commit funds. This request includes technical plans, specifications, and construction cost estimates. Technical experts on the NATO international staff screen the requests, which are the bases for NATO budgetary control, before the Committee approves them. Payments and Progress Committee approval of funds commits NATO member nations to share project costs at their agreed percentage, and authorizes the host country to proceed with construction.

Host countries are advanced funds on the basis of their forecasts of construction expenditures for a 6-month period. After the forecasts are screened by the NATO international staff, a clearinghouse system is used to compute the amounts member countries must pay to each constructing host nation. These amounts are identified by the NATO international staff in what is known as a NATO quarterly paysheet, and funds are advanced for a 3-month period. In response to NATO's request for payments, the NATO members make payments directly to the host countries. Thus, NATO does not physically hold infrastructure monies. Once a project is completed, final cost adjustments are made on the basis of an audit performed by the NATO Board of Auditors. (See ch. 4 for a discussion of U.S. payment practices and our suggestion for change.)

<u>How are the costs of a normal infrastructure project divided?</u>

NATO pays for civil works, i.e., fixed buildings or installations, and wartime required communications and utilities.

Host nations pay for land, access roads, rail links where required, and the provision of utilities connections. These costs are estimated to be about 13 percent of the costs paid by NATO.

User nations pay for barracks, mess halls, schools, recreational facilities, family housing and other quality-of-life features. For the United States, these costs must be included in military construction programing concurrent with programing of the infrastructure project.

<u>How long does it take to complete a NATO infrastructure project?</u>

As noted above, it can take as long as 2-1/2 years just to get a project included in a programed slice. After approval, another 3 to 5 years can elapse before the project is completed. According to the U.S. Army Engineer Division, Europe--DOD's designated construction agency for Europe--there are several reasons for these long completion times:

--Some projects are included in an approved slice but specific sites have not been determined by a host nation. Real estate acquisition can take months or even years to be completed, particularly when there is local community opposition.

--In some cases, projects are included in an approved slice with no established construction standards. These standards have to be developed and screened by the host nation, the NATO military commands, and the NATO international staff.

--Most host nations and the NATO international staff lack sufficient personnel to expedite necessary design and construction work.

NATO committees and a number of host nations share the U.S. concern over the length of time it takes to program and complete a NATO infrastructure project. Considerable attention has focused on ways to shorten the overall cycle.

NATO has established a working group to examine both NATO and host nation procedures to determine new methods for accelerating program implementation. One recent change provides for NATO authorization of planning and design funds for projects included in a recommended slice; no longer will host nations have to wait until a project is approved by NATO before design work can commence.

Can a nation begin construction before a project is approved by NATO?

Another way that member nations seek to expedite NATO infrastructure project construction is through prefinancing. Prefinancing is action taken by a nation, using its own funds, to meet a requirement which cannot await normal NATO programing due to military urgency, or for which infrastructure funding eligibility is still pending. Once the project has been authorized by NATO, the member nation seeks to recover (recoup) these national funds. (See ch. 3 for a discussion of the current status of U.S. prefinancing and suggestions for improving recoupment performance.)

OBJECTIVES, LIMITATIONS, AND BENEFITS

What are the U.S. policy objectives with regard to its participation in the NATO infrastructure program?

During the 1950s, the U.S. objective was to provide through common financing, the installations required to support the military end items being furnished to U.S. European allies under the Military Defense Assistance Program. Infrastructure was also viewed as a mechanism for integrating facilities planning and providing common projects.

As the economic recovery of Europe became a reality, the United States pressed for inclusion of a maximum number of U.S. projects in the program. Current U.S. objectives seek to

--maximize NATO funding of facilities required by U.S. forces in NATO,

--promote the construction of essential facilities to meet NATO's military requirements at the least cost to the United States, and

--protect the interests of U.S. industry in its participation in the NATO program.

Why does NATO not pay for all U.S. military construction in Europe?

As shown on page 3, only certain categories of facilities are eligible for common funding. In addition, the NATO member nations have agreed to construct these facilities only to specific standards--normally austere and the minimum essential for effective wartime operations. NATO approves construction standards for most categories which specify, for example, the length of runways and amount of storage and office space, etc. Projects such as barracks, quality-of-life improvements, and other essential peacetime requirements do not qualify for common funding. The user nation generally finances these projects unless it has concluded a bilateral agreement with the host nation to provide this type of support. The United States and the Federal Republic of Germany reached such an agreement with respect to housing for a U.S. brigade that moved to northern Germany to bolster alliance defenses in that region.

Why not expand the eligibility criteria so that more U.S. projects could be funded?

U.S. officials believe that there is currently a serious funding shortfall in the infrastructure program which is affecting project implementation. According to U.S. Mission to NATO officials, there exists an estimated 140 million IAU backlog of projects from slices 21 to 30 (1970 to 1979) which were not funded, although included in approved NATO slices. Officials told us that inflation and cost overruns largely contributed to actual project costs exceeding anticipated costs during this time.

Sizable reductions have also taken place in slices 32 and 33 with respect to the amounts recommended by NATO's military authorities versus the funding levels approved by NATO. In addition, the funds remaining for slices 34 and 35--not more than 200 million IAUs--are small in comparison to projected requirements, which for the United States alone, total almost 500 million IAUs.

Since NATO cannot fund all its already eligible projects included in both recommended and approved slices, U.S. officials indicated that they are not considering attempting to expand existing project eligibility criteria. Additionally, these officials told us it would be unwise for the United States to expand the existing scope of the program. If, for example, quality-of-life improvements, such as personnel support facilities were included, the United States (with 10 percent of NATO's peacetime troops and paying 27 percent of infrastructure costs) might not be in a position to gain as much as some other member nations, whose present standards might not be as high as ours. Expansion of eligibility criteria could end up costing the United States more than it would reap in benefits.

Does the United States benefit from the program?

An April 1981 report by the Congressional Budget Office (CBO) examined the cost and benefits to the United States of the NATO infrastructure program.1/ The report focused on the equitability of the cost-sharing arrangement and the distribution of benefits among the member nations. The analysis suggested that in both areas the United States is doing well.

Some have argued that the U.S. contribution should be lower, for example, in 1973 the House and Senate Appropriations Committees directed that the United States negotiate its share down to 20 percent. However, U.S. Mission officials said that it is probably as low as it may reasonably be expected to get.

The CBO report on costs and benefits of the U.S. participation noted that the U.S. share is considerably lower than it would be under certain other possible allocation arrangements. For instance, if contributions were determined by population, the United States would contribute almost 43 percent; basing the contributions on gross national product (GNP) levels would result in the United States paying about 56 percent.

CBO also pointed out that the infrastructure program from 1971 through 1981 provided an estimated $1.5 billion for construction of facilities used predominantly by U.S. forces. This amount, plus the U.S. share of common-user facilities such as the fuel pipeline, exceeds the amount of the U.S. contribution to the infrastructure fund during that period.

Testifying before the House Appropriations Committee, a U.S. Mission to NATO official said that in comparing U.S. contributions with benefits, there are two factors which should be considered: (1) agreements on special projects which favor U.S. interests and (2) the costs that host nations assume. Both of these factors serve to reduce the U.S. effective share of infrastructure costs.

In 1970 some of the NATO nations augmented the program by 50 percent--around $500 million--without U.S. contribution, in order to expedite construction of aircraft shelters and communications projects. In 1975, the NATO members agreed to include within infrastructure a U.S. Special Program to provide facilities which would not normally be eligible for infrastructure funding. Again, in 1979, NATO agreed to establish a Reinforcement Support Category to permit NATO funding of previously ineligible facilities. This category favors U.S. projects for storage of prepositioned equipment, ammunition, and war reserve material.

1/Costs and benefits to the United States of the NATO Infrastructure Program, April 1981.

In addition, some of the costs of infrastructure projects--land acquisition, access roads utility connections, and administrative expenses beyond the 5 percent allowed by NATO--are borne by the host nation. Because the United States acts as a host nation for very few projects, it does not bear much in the way of these costs.

MANAGEMENT OF U.S. PARTICIPATION IN THE PROGRAM

Who is responsible for U.S. participation in the infrastructure program?

The Secretary of Defense has directed that the Deputy Assistant Secretary of Defense for Manpower, Reserve Affairs, and Logistics--specifically, the Office for Installations--plan and program U.S. military construction efforts worldwide, including U.S. participation in the NATO infrastructure program.

Day-to-day responsibilities in the program are shared by a DOD element within the U.S. Mission to NATO (a Department of State embassy equivalent) and the Department of the Army. While the Army administers the funds which make up the U.S. contribution to the program, the U.S. Mission has overall program, budget, obligation, and expenditure authority.

How is the annual budget request for our contribution to the NATO infrastructure program arrived at?

The Director, ILD, at the U.S. Mission to NATO prepares the budget estimate for the U.S. contribution. Since U.S. concurrence in a Payments and Progress Committee fund authorization is simultaneously an obligation for the United States, the Director, ILD, must forecast Committee authorizations for the fiscal year in question. Using as a base all projects included or expected to be included in approved annual slices, but not yet authorized, the Director must also consider the rate at which nations may actually be able to implement the authorized projects. On the basis of this estimate of total NATO authorizations, the Director, ILD, calculates the U.S. percentage share, to determine the amount of U.S. funds required for the coming year. The estimates are then reviewed by DOD and Office of Management and Budget (OMB) officials prior to their submission to the Congress.

How does the U.S. appropriations process tie into the infrastructure program?

Appropriations to cover the U.S. contribution to the infrastructure program are made by the Congress through DOD's Military Construction Appropriation. This fulfills the current agreement that the United States contribute 27 percent toward the cost of all projects that NATO approves. The individual NATO projects, however, do not come before the Congress for approval. No one knows ahead of time which projects NATO will decide to fund. That is why the appropriations request from DOD is an estimate of the U.S. share of authorizations to be made by NATO in any given year.

<u>Who accounts for the U.S. funds which are contributed to the infrastructure fund?</u>

The Department of the Army, as executive agent, is responsible for the financial administration of the U.S. contribution. The NATO/SHAPE 1/ Support Group, a subordinate Army element, records all obligations made by the U.S. representative to the Payments and Progress Committee, and makes disbursements as requested by the U.S. Mission to NATO to the host countries responsible for constructing infrastructure projects.

Because of the collective nature of the infrastructure program, and the clearinghouse system that is used for determining payments due to host nations, the United States does not do a project-by-project accounting of funds. However, when construction is completed, each project is inspected by a team consisting of representatives from the NATO international staff, the appropriate NATO military command, the host country, and the user country. The purpose of this inspection is to ensure that the project is complete, and militarily and technically acceptable. The team notes deficiencies that must be corrected, as well as work in excess of the austere NATO criteria, and reports to the Payments and Progress Committee recommending that the project be accepted by NATO.

Both throughout execution and upon completion of a project, NATO's Board of Auditors examines financial costs filed by the host country, and certifies costs charged to the infrastructure fund. The Board of Auditors issues "certificates of final financial acceptance" on each project when an audit examination has been completed and all financial adjustments requested by the Board have been made.

1/Supreme Headquarters Allied Powers, Europe.

CHAPTER 3

ACTIONS FOR IMPROVING FUTURE RECOVERY OF FUNDS FROM NATO FOR U.S. PREFINANCED PROJECTS

Although NATO-approved projects may be financed under the normal infrastructure process, member nations may initiate projects, using their own funds, before NATO has approved them. Nations may be reimbursed from infrastructure funds if (1) prescribed NATO prefinancing procedures are followed, (2) a project meets established NATO construction standards, and (3) a project is subsequently included in an approved NATO slice. The United States has prefinanced projects since about 1959. As of June 30, 1982, the U.S. military services (Army, Air Force, and Navy) had used military construction appropriations to prefinance projects for reimbursement by NATO, totaling about $832.6 million. During this same period, the services had recouped only about 38 percent of that total, and about $250 million will probably never be recouped.

The Congress has been critical of DOD's record of recoupment and, in recent years, has not approved many requests for military construction funds to prefinance projects. This comes at a time when the infrastructure program does not have enough funds to finance many of NATO's already programed projects. In light of these funding shortfalls, U.S. military services may see the need for--and the Congress may want to consider--approving prefinancing requests for some urgently needed projects. If the Congress should decide to approve future prefinancing requests, we believe there are actions available to improve future U.S. recoupment efforts.

WHAT IS PREFINANCING?

As we stated in chapter 2, prefinancing a NATO infrastructure project is an action taken by a host or user nation to finance a project which is not already included in an approved NATO slice. There are a number of benefits and drawbacks to its use, however.

The pros and cons

There are several reasons why a nation may decide to prefinance a project--the main one being expediency. Because initiating and completing a project through the infrastructure program can be quite lengthy, nations often seek to prefinance a project to meet an urgent national requirement, rather than waiting until NATO can program and fund the project. Some nations also use prefinancing to expedite their construction requirements toward the end of a cost-sharing period when NATO funding is often limited. They generally use this technique in hopes that funds will be available at the beginning of the next cost-sharing period.

Nations also seek to prefinance projects even when the projects are not currently eligible for infrastructure funding. In some cases, a nation will construct a project hoping that subsequent negotiations with NATO authorities will result in the project being eligible for recoupments. The United States did this in its construction of projects under the Long-Range Security Program, which subsequently became eligible for NATO funding and recoupment.

There are also a number of disadvantages to prefinancing. In some cases, as NATO's construction standards are austere, and completed national projects often exceed the established NATO standards, only a part of a project is authorized for funding by the Payments and Progress Committee. Excess costs resulting from differences in the standards must be funded nationally. In addition, obtaining NATO approval for funding a prefinanced project can take years. Because eligible prefinanced projects must compete against hundreds of other construction requirements, they often lack sufficient priority to be included in an approved slice. Until a project is included in an approved NATO slice, funding and recoupment cannot take place.

For the United States, prefinancing also increases the administrative requirements. A prefinanced project must be programed twice--once for military construction appropriations from the Congress, and once for infrastructure funds from NATO. Another disadvantage to current U.S. prefinancing practices is that when funds are recouped, they do not revert to the services who are responsible for recovery, but to the U.S. infrastructure account where they are used to pay part of the U.S. share of the total NATO programs. Many officials with whom we spoke suggested this often served as a disincentive to the U.S. military services to identify the best candidate projects for prefinancing, build the projects in accordance with NATO construction standards, and actively seek and fully recover U.S. funds used to prefinance these projects.

NATO prefinancing procedures must be followed

For a project to qualify for recoupment, the NATO Payments and Progress Committee must be advised of a nation's intent to prefinance. This is accomplished by either the host nation or the user nation submitting a prefinancing statement or a precautionary prefinancing statement. A precautionary prefinancing statement is used when a project is not considered eligible for infrastructure funding. Filing of these statements protects the possibility of recoupment. If this is not done, NATO will not fund any portion of the project. After the prefinancing statement has been submitted, the project can be contracted and constructed.

The next step--getting the project included in a NATO-approved slice--can begin even before the Payments and Progress Committee is notified. Obtaining NATO approval, however, is difficult. A project must survive several levels of screening by military authorities. No special consideration is given a project because it was prefinanced. In recent years, only a small percentage of projects submitted for possible programing are included in a recommended slice. Once a project is placed in an approved slice, the project--or some part of it--must be authorized by the Payments and Progress Committee before any funds are released. After authorization by the Payments and Progress Committee, the host nation must bill NATO for the cost of the project. In turn, the prefinancing nation must bill the host nation to recover its funds.

<u>The role of the U.S. military commands</u>

The three U.S. military service components in Europe 1/ and the U.S. European Command (USEUCOM) are primarily responsible for U.S. prefinancing and recoupment actions. Each component must ensure that NATO procedures are followed, so that full and timely recovery of U.S. funds is facilitated.

The identification of candidate projects for future prefinancing is also a responsibility of the components. Each year components develop a 5-year construction plan by service for both the U.S. military construction and NATO infrastructure programs. During this process, projects are identified as appropriate for prefinancing and included in the military construction program plan. These plans are forwarded to the respective service departments and DOD where final decisions are made on whether to seek congressional approval for prefinancing selected service projects.

Component commands must actively seek support of the NATO military commands to get prefinanced projects included in an approved slice. Once this has been accomplished they must assist host nations in completing and submitting the fund authorization request to NATO. Finally, once NATO makes funds available to the host nation, the components must obtain reimbursement for the amount of U.S. funds expended for prefinancing.

USEUCOM's role in both prefinancing and recoupment is largely one of managing and coordinating U.S. component command participation in the NATO infrastructure program. USEUCOM provides program guidance and sets recoupment goals for the components, and coordinates U.S. participation in the infrastructure program with NATO and U.S. Mission officials. USEUCOM also prepares a quarterly summary report on the status of prefinanced infrastructure projects and U.S. recoupments efforts for DOD.

1/U.S. Army, Europe and Seventh Army, U.S. Air Forces in Europe, U.S. Naval Forces, Europe.

With respect to selecting candidate projects for prefinancing, USEUCOM's participation in the process is largely advisory. The command reviews prefinancing statements for projects the component commands wish to prefinance. This is done to confirm that the time required to construct the project through the infrastructure program is militarily unacceptable. Existing U.S. infrastructure policy specifies that prefinancing of construction projects will be initiated only after thorough screening establishes that NATO funding is not currently appropriate or will not be timely enough to meet an urgent military requirement.

According to USEUCOM officials, they play no role in selecting projects for prefinancing since the component commands have already included the projects in their plans to service headquarters. As a unified command, USECOM does have the responsibility for preparing a theater-wide construction priority listing, based on the component plans, for both the U.S. program and the NATO infrastructure program. This is known as the Construction Annex to the USEUCOM Master Priority List. Although tasked to develop these theater-wide priority listings, USEUCOM has little impact on project selection for prefinancing because proposals for prefinancing are already included in the individual components' programs. Thus, an opportunity to look at project selection from both a theater and NATO perspective is lost.

U.S. RECORD TO DATE

To achieve maximum recovery of funds on prefinanced projects from the infrastructure program, a nation must assure that projects are included in an approved NATO slice, are built to NATO construction standards, and are authorized for funding. Once this is accomplished, a nation must then take steps to recover funds from the host nation.

The chart below shows the status of the U.S. record on prefinancing and recoupments.

Status of U.S. Prefinancing and Recoupments as of June 30, 1982

		(millions)
Amount recouped		$313.7
Amount potentially recoupable included in approved slice	$ 59.4	
Eligible, not included in approved slice	209.8	269.2
Amount currently considered non-recoupable		249.7
Total amount prefinanced		$832.6

Source. USEUCOM Quarterly Report on Status of Prefinancing and Recoupments.

As of June 30, 1982, the U.S. military services had prefinanced projects, for possible reimbursement by NATO totaling about $832.6 million. About $313.7 million worth of these projects have been programed into approved slices and the money recouped. Another $269.2 million is considered potentially recoupable. Of this amount, $209.8 million worth of projects is considered eligible for recoupment but has not yet been included in an approved NATO slice. The remaining $59.4 million represents projects already included in an approved NATO slice, and is the amount the services consider currently recoupable. The balance, about $249.7 million in the non-recoupable category, represents projects, or parts thereof, which are currently ineligible for NATO funding under existing NATO rules.

Potentially recoupable amounts

The components, with encouragement from USEUCOM, have made fairly good progress in the past several years in recovering funds for projects which NATO has already approved. In fiscal years 1980 and 1981, the components recouped over $100 million to reduce the backlog of projects approved by NATO. USEUCOM's goal is to eliminate the $59.4 million backlog by the end of fiscal year 1983.

The United States has also prefinanced about $209.8 million in projects which are considered eligible but are not yet included in an approved NATO slice. Because of the low NATO priorities for these projects and the limited amount of infrastructure funds available, we were told there is little likelihood that any of these projects will be programed by NATO until 1985, the beginning of the next cost-sharing period. Until these projects are included in an approved NATO slice and authorized by the Payment and Progress Committee, the United States cannot recover monies spent on these projects. Air Force projects--mostly aircraft shelters and fuel and ammunition facilities--account for about 80 percent of the total dollar amount in this category.

Non-recoupable amounts

About $249.7 million or about 30 percent of the total amount prefinanced by the U.S. military services is currently categorized as non-recoupable. For the most part, projects included in this category are considered ineligible for recoupments because (1) U.S. construction exceeds NATO's construction standards or (2) the projects do not fall into one of NATO's 13 approved eligible categories.

Although DOD guidance directs that U.S. prefinanced projects be built in accordance with NATO construction standards recoupment statistics indicate that this is not always done. Officials with whom we spoke conceded that in the past not enough attention has been devoted by the component commands to adhering to the NATO standards. We were told that the push to complete a project quickly to meet an urgent military requirement often took precedence over the construction of the project using NATO standards.

For example, a program undertaken by the United States to increase security measures at special weapon sites actually began before NATO had established its standards. USEUCOM officials expect that the United States would recover only about 75 percent of the total expended for the program. Changes to NATO's already established standards can also have an impact on the amount the United States can hope to recoup. USEUCOM officials indicated that, as an example, changes to NATO's authorized levels of ammunition igloos for a squadron of aircraft reduced the amounts the United States was able to recover on already constructed igloos.

There are also examples where NATO and the United States disagree on whether a project is NATO eligible and should be funded by the NATO infrastructure program. A recent example of this is U.S. prefinancing about $21 million for improvements to training range facilities for the new M-1 tank in Germany. In authorizing funds for this purpose, the Congress served notice to DOD that it should seek changes to NATO's eligibility criteria so that future improvements on these ranges would be paid for from NATO infrastructure funding. U.S. officials indicated that these facilities are not expected to be considered eligible by NATO but they issued a precautionary prefinancing statement to ensure recoupment if criteria were expanded to make these facilities eligible.

CONGRESSIONAL CONCERNS REGARDING PREFINANCING

For years, the Congress has been concerned about the amount of prefinancing done by the United States, primarily because of the large amount of money outstanding in the form of potential recoupments. Congressional dissatisfaction with the military services' recoupment record finally led to limitations being imposed. The Conference Report on Military Construction Appropriations for fiscal year 1979 in effect placed the following three restrictions on prefinancing:

--NATO must agree in advance that the projects are eligible for infrastructure funding.

--NATO must agree to a repayment schedule specifying in which slices the projects are to be programed.

--Prefinanced projects must be based on military urgency as defined in DOD directives.

The result of these restrictions has been a reduction in the amount of prefinancing done by the United States, both in absolute terms, as well as relative to other NATO member countries. According to DOD officials, strict adherence to the restrictions requiring a repayment schedule would virtually eliminate most, if not all, prefinancing initiatives in the future. Although detailed statistics on actual prefinancing by other countries are not available, the following figures on the intentions to prefinance show the U.S. share dropping sharply over the past 4 years.

PREFINANCING INTENTIONS

Program year	Total by all NATO countries	U.S. share	U.S. percent of total
	-----millions of	IAUs-----a/	
1978	70.9	30.3	43
1979	162.7	24.6	15
1980	89.1	4.7	5
1981	136.7	2.9	2

a/Infrastructure Accounting Units

Source. USEUCOM

For the past few years, the only request for prefinancing that has come before the Congress has been for the Air Force's collocated operating bases program. Funds for minimum essential facilities for selected airbases in Europe were sought for fiscal years 1982 and 1983, but they were not approved.

OUTLOOK FOR THE FUTURE

U.S. officials believe that there is currently a genuine crisis in the infrastructure program as a result of funding shortfalls. DOD concerns about this financial difficulty have been expressed often in recent times. High-ranking Pentagon officials have briefed the NATO Military Committee and the Defense Planning Committee on the impact of the shortfall in infrastructure funding on U.S. Long-Term Defense Program measures, force goal planning, and the reinforcement of NATO.

Although the United States lobbied for a higher ceiling for the current slice group, and continues to seek to raise the established ceiling at a mid-term review of the program, not much progress has been made. Even though the United States wishes to increase the size of the program, the capacity of the program is limited by the actions of all the member nations acting in concert.

U.S. military commanders in Europe find themselves in a dilemma. Charged with responsibilities to increase conventional warfare capability, they develop requirements which must be met in order to accomplish their missions. However, they are not always able to get infrastructure funding for their NATO-eligible projects, furthermore, the Congress is reluctant to advance funds to prefinance these projects.

SOME ACTIONS ARE POSSIBLE TO IMPROVE FUTURE RECOUPMENTS

The United States is faced with a difficult decision. If critical construction projects are vital to U.S. interests but the infrastrucuture program is unable to accommodate them in a timely fashion, then prefinancing could be a solution. If the military services seek to make use of the prefinancing mechanism, DOD and the Congress may need to take other actions to improve the U.S. prefinancing and recoupment record. Two possible actions are the

- --creation of a separate funding mechanism for prefinancing and
- --expansion of USEUCOM's role in the selection of projects to be prefinanced.

"Rolling Fund" could provide incentive for better U.S. recoupments

During the budget hearings for the fiscal year 1981 military construction program, a DOD official suggested that the Congress may want to reconsider the use of prefinancing by instituting a recoupments rolling fund of some kind. We followed up on this with DOD officials to examine the proposal more fully, but found that it had not been pursued with the Congress nor had it ever been developed by DOD or the services.

The concept of a recoupments rolling fund, more commonly known as a revolving fund, calls for the creation of a separate funding account by the Congress--outside of the current service military construction appropriation--to make funds available to the services to meet service requests for prefinancing projects. The use of a revolving fund is designed to finance a cycle of operations through amounts received by the fund. Expenditures from the revolving account generate receipts, which in turn, are earmarked for new expenditures. Most revolving funds are intended to become self-sufficient and not in need of annual appropriations from the Congress to operate. In practice, a DOD recoupments rolling fund could be established and included as part of the Title V Authorization of the Military Construction Authorization bill. The most recent recoupments, at a level to be prescribed by the Congress, could be used to provide the initial working capital for the fund, with money recovered by the services from anticipated future recoupments used to replenish the account.

A rolling fund is intended to address what many officials believe is a disincentive in the present prefinancing and recoupment process--funds are returned to the U.S. infrastructure account rather than to the services. These funds are then available to the Director, ILD to contribute to the U.S. share of the total NATO infrastructure program. Because funds recovered are not available to the services for their use, many officials suggested that adequate incentives do not exist to propose the best candidate projects for prefinancing, or to construct these projects in accordance with NATO standards. Some officials suggested a rolling fund would provide an incentive to recover funds more quickly and more completely because funds would be returned to a rolling fund for service use and the ability to prefinance future projects would be contingent on service recoupment performance. We believe this may have merit. However, in our view, the establishment of a rolling fund would also have to be accompanied by greater assurances that only the most needed projects and the projects most likely to be approved by NATO would be identified and proposed. In addition, specific provisions would have to be included in legislation on DOD's use of a rolling fund to preclude the possibility of any weakening of congressional review and oversight.

<u>USEUCOM could play a larger role in selecting projects for prefinancing</u>

To assure that maximum fund recovery for prefinanced projects takes place, the selection of the candidate project for prefinancing is critical. Full recovery of funds will not take place from NATO unless the

--entire scope of the project meets NATO construction standards,

--project has sufficient priority to be included in an approved NATO slice

--Payments and Progress Committee authorizes funding, and

--prefinancing nation bills the host nation to recover its funds.

USEUCOM provides theater-wide management over all U.S. prefinancing and recoupment efforts, coordinates the component commmands' participation in the infrastructure program with NATO authorities and U.S. Mission to NATO officials, and prepares theater-wide construction priority listings for use by DOD, the components, and the NATO military commanders. It appears to us, therefore, that USEUCOM is in a good position to offer its views on the likelihood of NATO programing and funding of U.S. prefinanced projects. USEUCOM would also be in an excellent position to assist DOD in managing a rolling fund should one be established.

USEUCOM's present involvement in the prefinancing process could be expanded to provide, at DOD's request, a theater-wide prioritized listing of candidate projects for prefinancing. Currently prefinanced projects are identified and funded through service department channels and USEUCOM's participation in project selection is only advisory. The preparation of this listing would be based on a review by USEUCOM of all projects identified by the components in their respective construction plans, including those identified as suitable for prefinancing. The listing could also contain for each project USEUCOM's views on the likelihood of NATO funding from an approved slice, as well as the extent to which the project would be constructed in accordance with NATO standards. Although final approval for selecting prefinanced projects for consideration by the Congress would remain with DOD and the Defense Review Board, the preparation by USEUCOM of a prefinancing priority listing could provide some additional assurances the Congress has been seeking to improve U.S. recoupment efforts.

NEED FOR CONGRESSIONAL CONTROLS OVER PROPOSED ROLLING FUND

Over the years, we have expressed some concerns on the use of revolving funds. It is generally viewed that the use of a revolving fund results in a lessening of congressional control over program activities because annual appropriations are not needed from the Congress. We have consistently applied the standard in our reporting that the public interest is best served when congressional control is exercised through the annual appropriations process.

We believe a rolling fund for prefinancing could be used by DOD without weakening congressional oversight and control over U.S. prefinancing and recoupment activities. The proposed rolling fund, if established, could contain legislative provisions to assure congressional control over DOD's use of prefinancing and the fund. To enable the Congress to maintain its longstanding review of DOD's prefinancing and recoupment performance and to exercise sufficient oversight, specific controlling language could be included in authorization legislation. Such restrictions could include

--placing a funding limit on prefinancing,

--requiring justification by DOD of its intention to prefinance (similar to current military construction project-submissions), and

--providing for DOD reporting on the status of the fund.

Because recoupments are currently used to reduce appropriations to the NATO infrastructure account, adoption of the rolling fund could increase the total military construction appropriation. However, the amount of increases would be under congressional oversight and could be offset by reductions in other parts of the military construction appropriation.

CONCLUSIONS

The use of prefinancing is not inconsistent with congressional direction that DOD use the NATO infrastructure program to the maximum extent possible to fund U.S. construction in Europe. If judiciously applied and properly executed, prefinancing is a tool which can be used by DOD to overcome periodic funding shortfalls in the NATO infrastructure program. It can also be used to meet urgent military construction requirements that cannot await the normal infrastructure programing and funding cycle. Prefinancing is available to and used by U.S. allies.

We recognize that the Congress has been reluctant in the last several years to approve service requests for prefinancing, principally because of past DOD recoupment performance. Should the Congress consider approving requests for prefinancing of selected military construction projects, we believe DOD's future recoupment performance could be improved through the use of a separate prefinancing funding mechanism like the rolling fund, and an expansion of USEUCOM's role in the prefinancing selection process. A larger USEUCOM role would provide some additional assurances that the best candidates for prefinancing are proposed, while the use of a rolling fund would provide DOD and the services with some additional incentive to recoup funds from NATO because future prefinancing would directly depend on it.

RECOMMENDATION

We recommend that the Secretary of Defense, before requesting any additional prefinancing for NATO-eligible construction projects, develop and propose a system like the "rolling fund" discussed in this report. Such a system should be designed to provide greater incentive to the military services to recoup funds from NATO. The system should also include greater participation by USEUCOM in the selection of projects for prefinancing.

MATTER FOR CONSIDERATION BY THE CONGRESS

In debating prefinancing decisions, the Congress should consider whether a system like the rolling fund would meet congressional mandates for improving DOD's performance in recovering funds from NATO for prefinancing projects. Specific authorizing legislation would be needed to implement such a system.

AGENCY COMMENTS AND OUR EVALUATION

DOD endorsed our view that selected prefinancing can be used to overcome funding shortfalls in the NATO infrastructure program and to provide for construction of urgent military requirements that cannot await the normal infrastructure programing and funding cycle. DOD also agreed that the two actions discussed in our report--a larger USEUCOM role and the use of a separate funding mechanism for prefinancing--would result in improved rates of recoupment. In addition, DOD generally agreed with our recommendation, but suggested that approaching the Congress with urgent prefinancing proposals should not be deferred pending the development of a new system. DOD pointed out that the initiation of a prefinancing proposal is properly dictated by military need.

We agree with the DOD point that prefinancing proposals should be presented to the Congress based on military need. However, the Congress has been very reluctant in the past few years to approve any prefinancing. Our recommendation that DOD develop and propose a system like the rolling fund before requesting additional prefinancing for NATO-eligible construction projects is intended to assist DOD in responding to congressional concerns in this area. The development of a separate funding mechanism could provide the Congress with many of the additional assurances it has been seeking to improve DOD's recoupment performance.

CHAPTER 4

CHANGES IN THE TIMING OF PAYMENTS FOR NATO INFRASTRUCTURE COULD SAVE THE UNITED STATES MILLIONS OF DOLLARS

Cost savings could be realized by changing the timing of U.S. payments to the NATO infrastructure program. Our analysis of U.S. payments to the infrastructure program from 1979 to 1981 revealed that by using a monthly rather than a quarterly payment schedule, the United States could have saved about $3.9 million. Because the timing of payments can have a direct impact on interest costs on Treasury borrowings, consideration should be given to establishing a payment schedule that minimizes interest expense, while providing for prompt and timely payment of U.S. obligations to NATO.

U.S. PAYMENTS TO NATO--THE PROCESS, PRACTICE, AND POTENTIAL FOR SAVINGS

U.S. contributions to the NATO infrastructure program are paid directly to host nations in response to a quarterly request for payments known as a NATO call. Amounts to be paid by the United States are determined by NATO's international staff based on expenditure forecasts submitted by host nations in semi-annual financial reports. The reports, due each February and August, provide estimates for construction expenses to be incurred by a host nation for a 6-month period. After adjustments by the international staff, the amounts to be paid to each host nation for the quarters are calculated and included in the NATO call. Payments are then made in the currency of the host nation.

Based on information supplied by the NATO/SHAPE Support Group, in calendar years 1979, 1980, and 1981, actual U.S. expenditures to the program were about $87, $149, and $149 million, respectively. For calendar years 1982 and 1983, U.S. Mission to NATO officials projected that the United States could spend about $192 and $230 million.

The NATO/SHAPE Support Group makes the payments to host nations or NATO agencies as specified in the NATO call. The Support Group receives the NATO call from the U.S. Mission to NATO, records the amounts owed by the United States, and makes payments. Current Treasury requirements provide for U.S. payments to be made in response to the NATO call within 30 days.

Timing of U.S. payments--why 30 days?

NATO has not issued instructions specifying when payments should be made to host countries or to NATO agencies which use infrastructure program contributions. Attempts to obtain agreement from all NATO members on when payments should be made to the program have not been successful. While nations are urged by NATO authorities to pay "as quickly as possible" in response to a NATO call, we found that payments by NATO member nations vary widely. Information we obtained on the payment schedules of eight NATO members showed that while some nations pay promptly, many others do not.

For the United States, existing Treasury regulations for cash management require that, where no due date is specified, the due date will be considered to be on the 30th day from the receipt of the invoice. In addition, regulations on the use of Government funds to meet obligations with foreign countries and international organizations provide that

--U.S. dollars will be retained in the account of the U.S. Treasury as long as possible to minimize interest costs on the public debt, and

--arrangements requiring U.S. funding will be negotiated to provide for dollar outlays as close to the need for current programs expenditures as possible.

Treasury regulations also prohibit currency speculation because financial risk should not be a part of meeting foreign currency needs for Government overseas operations.

Our recent reports 1/ focused on the need to develop well-defined operating procedures to govern U.S. management of payments to NATO's international programs. We noted that some currency speculation in the acquisition of foreign currencies had taken place and that the timing of the payments to NATO had not followed any consistent pattern. As a result of our reporting, agreements were reached among U.S. Mission to NATO, Support Group, and Treasury officials that foreign currency payments would be made for contract and delivery 30 days from the date of the approval of the NATO call, or on a due date specified in writing by the U.S. Mission to NATO. Some allowances were made for payments to be accelerated or delayed for political reasons by the U.S. Mission to NATO. Procedures have since been implemented to eliminate the possibility of currency speculation and to require that the payments be made in 30 days.

1/"Government Purchases of Foreign Currencies for Contributing to NATO" (ID-79-51, Sept. 26, 1979) and "Problems with the U.S. Management of Foreign Currency Transactions for NATO Programs" (ID-82-10, Dec. 16, 1981).

Further refinements in current payment procedures could save money

Effective cash management principles require that disbursements of U.S. funds be made as close to the actual due date as possible. Doing this minimizes the amount of interest the United States pays on its borrowings while still meeting its obligation to promptly pay its bills. The timing of U.S. payments to NATO has a direct effect on the amount of interest expense.

The United States is the largest net contributor to the NATO infrastructure program. For example, the United States pays out more than it receives because it does not often act as a host nation for constructing projects. Since the U.S. payments are for estimated obligations to be incurred by host nations during the quarter, spreading its payments out over the quarter can save money by minimizing the premature disbursement of funds. Although delaying U.S. payments too long into a quarter could have an adverse impact on project implementation, we believe consideration should be given to using a monthly schedule for U.S. payments in response to NATO s quarterly calls. As our analysis on the next page shows, such a schedule of monthly payments would be a more efficient use of U.S. cash resources. It would also provide a regular flow of funds to host nations so that project implementation would not be impaired.

Officials we talked to at the U.S. Mission to NATO and USEUCOM expressed concern that any change in the U.S. payment procedures would be watched closely by other member nations. U.S. officials did not know what the overall impact of such change would be, but they believed some of the financially troubled NATO members could be adversely affected by a change to monthly U.S. payments.

The ultimate benefit of the changed payment schedule is that government public debt borrowings will be delayed, resulting in reduced interest expenses being incurred. At Treasury's suggestion, however, instead of focusing on the reduced borrowings and hence the reduced interest expense, we treated those delayed payments as being retained as part of the Treasury's excess operating cash balances in the Tax and Loan Investment Program, which generate interest earnings. We were told by Treasury officials that this program provides the Treasury with a more definitive basis for determining the short-term value of money to the U.S. and costs associated with cash management practices.

Using applicable interest rates supplied by the Treasury Department for the U.S. payment period 1979 to 1981, we calculated the interest that the United States would have earned by comparing our proposed monthly payment system to actual payments made each quarter during that period. Based on our calculations, the payment of quarterly calls cost the United States about $3.9 million in lost income.

Calendar year	Amount of U.S. payments	Amount of lost income
1979	$ 86,802,251	$ 571,963
1980	149,038,600	1,386,345
1981	149,106,114	1,956,718
	$384,946,965	$3,915,026

In commenting on our draft report, Treasury advised that the measurement technique we used is an acceptable indicator of the anticipated savings to be achieved through a revised payment schedule.

The table at appendix I shows the results of our calculations for one payment. It illustrates the methodology we used to compute the interest income which would have been earned by making our payments in three monthly installments--at 30, 60, and 90 days--rather than at 30 days as is the current requirement.

CONCLUSIONS

The ability to increase the availability and utilization of the Government's cash resources is a major objective of better cash management in Government operations. Our analysis of recent U.S. payments to the infrastructure program revealed that by modifying current payment procedures, larger cash resources would be made available to the U.S. Treasury. As U.S. infrastructure program expenditures are expected to increase in the next few years, adopting a monthly payment schedule, particularly if interest rates remain relatively high, could result in considerable savings to the Treasury.

We were unable to assess the impact of our proposed payment change on NATO's host nations and U.S. officials did not know what reaction other NATO members would have. However, we believe employing a monthly schedule of payments is worthy of consideration because of the potential savings involved for the United States.

RECOMMENDATION

We recommend that the Secretary of State, in conjunction with the Secretary of Defense, task the U.S. Mission to NATO to pursue the feasibility with NATO authorities of changing the current schedule of U.S. payments and to prepare a report on its findings. Until NATO adopts more precise payment criteria and unless it can be demonstrated that a monthly schedule of U.S. payments will have an adverse impact on NATO program implementation, we believe a monthly payment schedule should be used. Existing payment procedures should be modified to reflect this change.

AGENCY COMMENTS AND OUR EVALUATION

In responding to our draft, both DOD and the Department of State did not fully agree with our recommendation. DOD agreed that it would be useful for the U.S. Mission to NATO to explore the possibility of changing the U.S. payment schedule to realize the savings in interest. However, both DOD and State suggested that the United States should maintain its present schedule of payments so that no disruption to the present NATO system would occur. State commented that the proposed change would result in political problems as it would require U.S. NATO allies to advance funds due by the United States. DOD noted that while there might be some cash savings by modifying current procedures, it would be likely that this would be done at the expense of disrupting the administration of an already complex system. It could also prompt the allies to modify their procedures, which, in the long run, could run counter to U.S. interests. DOD and State also stated that current U.S. Mission payments in response to NATO calls, on the average, protect U.S. Treasury interests.

The Department of Treasury concurred with our recommendation that the timing of payments should be changed from every quarter to 30-day increments. Treasury advised that such a schedule of payments would, by avoiding premature drawdowns of funds from the Treasury, support the Department's goals and responsibilities for improved Federal cash management.

We recognize that legitimate concerns exist over our recommendation to change the U.S. schedule of payments to the NATO infrastructure program and that is why we have called for a U.S. Mission to NATO report on its findings so that the political and program impacts can be identified, evaluated, and weighed against the potential dollar savings to be achieved by such a change. We continue to support a change to the payment system, however, because

--At present, no agreements have been reached among the NATO members specifying when payments should be made to host countries or to NATO agencies which use infrastructure program contributions.

--The payment schedules used by NATO members in responding to NATO calls vary widely.

--Payments made to the infrastructure program are advances based on projections of anticipated contruction expenses to be incurred for a 6 month period. Some officials have suggested that many of the projections may be overestimated.

--Modification of the existing payment schedule would benefit the U.S. Government by resulting in savings to the Treasury.

We believe that it would be useful for the U.S. Mission to pursue and report on the feasibility of the U.S. modifying its schedule of payments. Unless the NATO members adopt specific payment criteria or the U.S. Mission can demonstrate that such a unilateral change would adversely impact on program implementation and on host nations, we believe a monthly payment schedule should be used.

EXAMPLE OF U.S. CALL PAYMENT VS. ALTERNATE METHOD

	Date of call	Total amount to be paid	Required date of payment	Amount of payment	Balance due	Potential interest income earnings on Treasury cash holdings
Currently required	January 3, 1980	$27,006,144	February 2, 1980	$27,006,144 a/	0	0
Proposed	January 3, 1980	$27,006,144	1/3 February 2, 1980	$ 9,002,048	$18,004,096	$225,051 b/
			1/3 March 4, 1980	$ 9,002,048	9,002,048	$112,525
			1/3 April 3, 1980	$ 9,002,048	0	0
						$337,576

a/For this example, we assume that all payments in the call were made by the United States at 30 days in accordance with current requirements. However, as noted on page 32 of this report, our calculations were made by comparing our proposed monthly system with actual payments during the quarter. Since most of the payments for this call were made after 30 days, the potential interest earnings calculated by GAO were just over $300,000.

b/To compute the potential interest earnings we used the following formula supplied by the Department of Treasury.

$$\frac{\text{Balance Due x Applicable Weekly Interest Rate}}{\text{360 Days}} = \text{Daily Interest Earnings}$$

$$\frac{\text{18,004,096 x 15 percent}}{360} = \$7,501$$

$7,501 x 30 days = $225,051

APPENDIX I

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 20301

MANPOWER
RESERVE AFFAIRS
AND LOGISTICS

8 NOV 1982

Mr Frank C Conahan
Director, International Division
United States General Accounting Office
Washington, D C 20548

Dear Mr Conahan

This is in response to your letter of September 21, 1982, which transmitted to the Secretary of Defense GAO Draft Report No ID-83-3", GAO Code No 463667 (OSD Case No 6097)

The Department strongly endorses the report's conclusion that U S prefinancing of urgent military construction in the NATO Theater is an essential requirement in those instances when the Infrastructure Program cannot respond quickly enough

Detailed comments are enclosed

Sincerely,

James N Juliana

James N Juliana
Acting Assistant Secretary of Defense
(Manpower, Reserve Affairs & Logistics)

Enclosure a/s

GAO DRAFT REPORT NO ID-83-3
"UNITED STATES PARTICIPATION IN THE NATO
INFRASTRUCTURE PROGRAM - WHERE WE STAND
IN 1982" (OSD CASE NO 6097)

DEPARTMENT OF DEFENSE RESPONSE

FINDING A Current Level of United States Prefinanced Projects GAO found that as of June 30, 1982, (1) the U S Military Services (Army, Navy, and Air Force) had used military construction appropriations to prefinance projects for reimbursement by NATO, totalling about $832 6 million, (2) during this same period the Services had recouped only about 48 percent of the total, and (3) about $250 million will probably never be recouped (approximately 30 percent) (p. 16)
[See GAO NOTE on this page.]

DOD RESPONSE DOD agrees with the finding however, the following is provided for clarification The $250 million discussed above represents projects or parts of projects which are not currently eligible for NATO funding and should not be considered in the same light as the prefinancing of eligible projects Normally, the prefinancing of non-eligible projects is accompanied by a "precautionary" prefinancing statement This recognizes the fact that the projects are not eligible but are of such a nature that they could become eligible at some future time By submitting a prefinancing statement and adhering to prescribed NATO procedures the U S reserves the right to recoup funds in the future should the projects become eligible DOD takes the position that our record of recoupment should be measured only against the total of eligible projects prefinanced Using the statistics on page 30, this totals $582 9 million of which 53 8% or $313 7 million has already been recouped An additional $59 4 million is included in approved slices and should be recouped by the end of FY83 which will increase the percentage of recoupment to some 64% of the total of eligible projects prefinanced

FINDING B Congress Critical of DOD's Record of Recoupment GAO found that the Congress has been critical of DOD's record of recoupment and as a result, in recent years, has not approved many requests for military construction funds to prefinance projects, creating funding shortfalls (In connection with this finding, GAO noted that Congressional unwillingness to approve funds for prefinancing comes at a time when the infrastructure program does not have enough funds to finance many of NATO's already programmed projects) (pp. 21-22)

DOD Response DOD agrees with the above finding while noting that current Congressional criticism is directed primarily at the recoupment backlog While the Department's recoupment

GAO NOTE: Page numbers have been changed to reflect location in this report.

record has measurably improved over the past few years, there is still some $210 million which requires programming Of this total about 50 percent is for aircraft shelters prefinanced during the mid-seventies when airfield physical protection enjoyed a high NATO priority and near term recoupment was probable Unfortunately, NATO funds became scarce and other operational requirements took priority over sheltering As a consequence, recoupment of these projects will be delayed at least into the late 1980's In spite of this backlog there still exists a need for occasional prefinancing in those instances where urgent military needs cannot be funded by NATO

FINDING C Benefits of Prefinancing - GAO found there are several reasons why a nation may decide to prefinance a project--the primary one being expediency (because of the lengthy time it takes for NATO to program and fund a project), but also some nations use the prefinancing technique (1) to expedite construction toward the end of cost-sharing period when NATO funding is often limited in hopes that funds will be available at the beginning of the next cost-sharing period or (2) to construct a project that is not currently eligible for infrastructure funding hoping that subsequent negotiations with NATO authorities will result in the project becoming eligible for recoupments (pp.16-17)

DOD RESPONSE DOD agrees with the finding but with the following caveat The distinction between the prefinancing of eligible and ineligible projects should not become blurred As mentioned previously, when NATO procedures can be followed, a precautionary prefinancing statement is often submitted for non-eligible projects as a way of protecting U S investments in the event the project becomes eligible in the future The prefinancing of eligible projects is primarily initiated when the timing of urgently-needed construction cannot be satisfied by the more involved NATO process As noted in the report, prefinancing also becomes required toward the latter years of the five year infrastructure cycle when funds normally become scarce

FINDING D Drawbacks of Prefinancing GAO found there are a number of disadvantages to prefinancing--i e , because (1) getting a project included in an approved NATO slice and recovering NATO funds can take years, (2) there is always the risk to a nation of non-reimbursement, (3) NATO's construction standards are austere, and completed prefinanced national projects often exceed the established NATO standards (only a part of a project will be authorized for funding), leaving the excess costs to be funded nationally, (4) for the United States prefinancing increases administrative requirements in that a prefinance project must be programmed twice, once for military construction from the Congress and once for infrastructure funds from NATO, and (5) when funds are recouped, they do not revert to the Services responsible for recovery, but rather to the U S infrastructure account for reprogramming, creating a disincentive to the Services (pp. 16-17)

DOD RESPONSE DOD agrees in part with some of the report statements but takes exception with subsections (2), (3) Comments follow which address the other areas as well (1) In the past, much of the delay experienced in obtaining recoupments could be attributed to project selection and their relative priorities Prefinancing proposals are more selective now and take account of the probability of near term recoupment Some of the delays are also the result of host nation administration Some progress is being made here as well (2) The risk of non-reimbursement occurs only when prefinancing ineligible or parts of ineligible projects Additionally, this risk can occur when projects are prefinanced before criteria and standards are fully developed and approved Normally, the U S will construct to the draft criteria under review, however, final screening could delete some items already constructed and then only partial recoupment is possible 1/(3) NATO standards have been established as the minimum required for wartime operations Most infrastructure facilities are also used in peacetime and often the austere wartime standards are not suitable for continuous day-to-day operations Almost all NATO nations provide additional national funds (conjunctive funding) to augment the NATO criteria This is normally required to meet specific nationally-mandated health and safety standards which may not be eligible for NATO funds (e g , increased levels of heat and lighting, fire alarm and sprinkler systems) Oftentimes, U S prefinancing statements will be submitted to NATO with requests to consider deviations from NATO criteria There have been a number of instances where, as an exception, NATO funds have been authorized for what would normally have been a national responsibility (4) Although recouped funds do not revert to the Services, this is not reviewed as a serious disincentive The Services are keenly aware that Congress monitors recoupment and currently measures prefinancing proposals against satisfactory rates of reimbursement

FINDING E NATO Prefinancing Procedures Must be followed GAO found that in order for a prefinanced project to qualify for recoupment, NATO procedures must be specifically adhered to including the submission of a prefinancing statement or a precautionary prefinancing statement (used when a project is not considered eligible for infrastructure funding) and if this is not done, NATO will not fund any part of the project (p. 17)

DOD RESPONSE DoD agrees with the finding These procedures ensure that all prefinancing nations will construct to at

1/GAO NOTE: Discussion on point two was dropped from the final report.

least minimum NATO standards if they expect eventual reimbursement It also provides protection for maintaining the integrity of construction and protects the prefinancing nations by guaranteeing eventual full payment (once in an approved program) if all procedures have been followed

FINDING F No Special Consideration for Prefinanced Projects GAO found that obtaining NATO approval for any project is very difficult, it must survive several levels of screening by military authorities and no special consideration is given a project just because it was prefinanced (p. 18)

DOD RESPONSE DoD agrees with the finding All projects--whether prefinanced or not--are subject to the same operational and technical screening by the NATO Military Commanders This policy preserves the prerogative of the NATO Military to establish priorities and program projects without being influenced by the prefinancing actions of individual nations It also works to ensure that prefinanced projects will be included in an approved program based solely on their operational priority

FINDING G Role of U S Military Command GAO found that the three U S Military Commands are primarily responsible for (1) U S prefinancing and recoupment actions with each component ensuring that NATO procedures are followed so that full and timely recovery of U S funds is facilitated and (2) identification of candidate projects by development (for each Service) an annual 5-year construction plan for both the U S military construction and NATO infrastructure programs (p 28, Draft Report)

DOD RESPONSE DoD agrees with the finding The three U S component commands in Europe are best qualified to determine individual service priorities in theater However, HQ USEUCOM does prepare an integrated priority list which, in turn, is used by the various regional NATO military commands in determining overall U S construction priorities This has a decided influence on the selection of projects for NATO infrastructure programming--including those which have already been prefinanced

FINDING H Ability to Look At Project Selection From Both A Theater and NATO Perspective is Lost Although tasked to develop theater-wide priority listings (i e , development of Construction Annex), GAO found the U S European Command (USEUCOM) has little impact on project selection for prefinancing because proposals are already included in the individual service component's program and thus an opportunity to look at project selection from both a theater and NATO perspective is lost (p. 19)

DOD RESPONSE DoD does not agree with the finding The Department agrees that USEUCOM is not involved in the initial selection of projects proposed for prefinancing These are, generally, first reflected in the Service POMS, however, one would expect that the Services have taken account of EUCOM's overall construction priorities, the known priorities of the major NATO Military Commands, and OSD Defense Guidance The sum of all these influence inclusion of the project in a MILCON budget, ensure support during Congressional hearings and command a high enough priority to be eventually included in a NATO program (recoupment) In the past, loss of a theater perspective may have been true, however, in recent years with MRA&L assuming overall program management, all prefinancing proposals are reviewed very carefully in OSD during the PPBS cycle Review is conducted against published EUCOM priorities and the known priorities of the NATO Military Commanders Annual OSD-conducted POM reviews include EUCOM representation

FINDING I Potentially Recoupable Prefinanced Amount GAO found that the Military Components, with encouragement from USEUCOM, have made fairly good progress in the past several years in recovering funds for projects which NATO has already approved and that USEUCOM has established a goal to eliminate the $59 4 million backlog by the end of fiscal year 1983 (In connection with this finding, GAO noted that because of the low priorities of the prefinanced projects that have not yet been included in an approved NATO slice and the limited infrastructure funds available, it is very unlikely that any of these projects will be programmed by NATO until 1985, the beginning of the next cost-sharing period) (p. 20)

DOD RESPONSE DoD concurs with the Report finding and considers current recoupment progress extremely good particularly in view of many new and competing priorities and the current scarcity of NATO infrastructure funds DoD agrees that NATO programming will probably not include any prefinanced projects until FY 85 although, there remains a possibility that some supplemental NATO funding may be made available for the FY 84 period

FINDING J Non-Recoupable Amounts of U S Prefinancing GAO found that about $249 7 million, or about 30 percent of the total amount prefinanced by the U S Military Services is categorized as non-recoupable primarily because (1) U S construction exceeded NATO's construction standards (indicating that although DoD guidance directs U S prefinanced projects be built in accordance with NATO construction standards, this is not always done) or (2) the project does not fall into one of NATO's 13 approved eligible categories, but also because (3) there is a push to complete a project quickly to meet an urgent military requirement given precedence over NATO standards, (4) changes to NATO's already established standards (ammunition igloos was given as an example), and (5) differences between NATO and the United States on whether a project is NATO-eligible (pp.20-21)

DOD RESPONSE DoD agrees in general with the findings, however, some amplification is required In the absence of specific information regarding the type of projects which make up this $249 million, only some general remarks can be made

1 The difference between the prefinancing of NATO eligible projects and the precautionary prefinancing of non-eligible projects must remain clear In some instances, the U S will submit a (precautionary) prefinancing statement for projects or portions of projects which exceed NATO criteria but which are operationally required NATO builds only to minimum wartime standards which often is not adequate for continuous peacetime operations

2 Precautionary prefinancing statements are submitted for those projects currently ineligible for NATO funding but which could become eligible at some future time This is viewed as a way of preserving the U S right to recoup funds in the future, however, this is not considered routine prefinancing

> The total of precautionary prefinancing should not be a part of overall recoupment targets DoD has pursued a long standing policy of making maximum use of the NATO Infrastructure Program to satisfy our European construction requirements, and, as part of this policy, the Department seeks to expand eligibility where it is beneficial to the U S In many instances, it is more economically beneficial to nationally fund specific requirements rather than pay the U S 27 percent share of the total for all similar projects throughout NATO This is particularly true of personnel support facilities

(3) Pages 20/21 discuss how urgent military requirements sometimes take precedence over NATO standards and lead to less than full recoupment Historically, the U S, as well as the other NATO nations have prefinanced against partially developed and unapproved criteria without significant loss of recoupment The security program noted was, in fact, strongly supported by Congress, however, NATO construction was delayed due to various problems The U S prefinanced in the absence of fully developed criteria, which subsequently did not include many of the constructed items DoD views this instance as the exception rather than the norm (4) When prefinancing statements are submitted to the NATO payments and Progress Committee, the NATO major Commander representative is required to make a statement regarding eligibility, deviations from criteria and standards, and the probability of programming in any future slice The example on page 33 concerns facilities at a U S controlled training range in Europe It is not available to other NATO nations and therefore not eligible for common funding

FINDING K Congressional Concerns Regarding Prefinancing GAO found that for years the Congress has been concerned about the amount of prefinancing done by the United States, resulting in the imposition of strict limitations on prefinancing in the fiscal year 1979 military construction appropriation resulting in the U S share of prefinancing dropping sharply over the last 4 years (p. 21)

DOD RESPONSE DoD agrees with the finding Of the three restrictions listed on page 34, it is the requirement for a repayment schedule that serves to virtually eliminate prefinancing for the future

FINDING L Outlook For Future NATO Funding GAO found that responsible U S officials believe there is currently a genuine crisis in the infrastructure program as a result of funding shortfalls, adversely impacting (1) U S Long-Term Defense Program measures, (2) force planning, and (3) the reinforcement of NATO and although the United States has lobbied for a higher ceiling on the current slice group and continues this effort, not much progress has been made or is likely, (implied) because the capacity of the program is limited by the actions of all member nations acting in concert (p. 22)

DOD RESPONSE DoD agrees For the current NATO five year funding period, nations could reach agreement on a fund ceiling which met only 50 percent of the military commanders' identified requirement Inflation has also take its toll leaving little or no funding for the latter part of the period Past efforts to increase the infrastructure fund ceiling have not been successful due to the short term inability of a few nations (Germany in particular) to obligate additional monies Additional initiatives are now underway to surface this issue during the December 1982 NATO Ministerial meetings and to reach a positive decision Most NATO nations favor an increase but Germany has been delaying consideration citing national economic problems

FINDING M U S Military Commanders in Europe In a Dilemma GAO found that U S military commanders in Europe find themselves in a dilemma--on one hand charges with responsibilities to increase conventional warfare capability and on the other hand, they are not always able to get infrastructure funding for their NATO-eligible projects required to accomplish their missions, nor is the Congress willing to prefinance those projects (p. 22)

DOD RESPONSE DoD agrees Military requirements in the NATO Theater historically exceed the level of available funding Consequently, the major NATO military commanders are forced to establish a system of priorities which will produce the best mix of infrastructure and equipment procurement within a finite fund ceiling Oftentimes, many U S projects, even those in direct support of assigned forces, do not generate the priority (relative to all other requirements) needed for inclusion in an annual program During periods of scarce funds, even higher priority projects cannot be programmed and it is at precisely these times that prefinancing is essential if U S urgent operational requirements are to be met

FINDING N Instituting Recoupments "Rolling Fund " Although in the fiscal year 1981 budget hearing it was suggested to Congress that they might want to reconsider use of prefinancing by instituting a recoupments "rolling fund" which would require the creation of a separate funding account (outside the current Services military construction appropriation) GAO found DoD had not pursued this suggestion (p. 23)

DOD RESPONSE DoD concurs In view of Congressional opposition to prefinancing in general, and, more specifically their concerns regarding the large recoupment backlog, it did not appear to be a propitious time to initiate a request for a separate fund solely for prefinancing

FINDING O "Rolling Fund" Would Address Disincentive in Present Prefinancing and Recoupment Process GAO found that the establishment of a "rolling fund" (where the recouped amounts would be returned to the account for Service use and the ability to prefinance future projects would be contingent on Service recoupment performance) would address what many officials believe is a disincentive in the present prefinancing and recoupment process--i e , that the funds are returned to the infrastructure account rather than to the Services (p. 23)

DOD RESPONSE DoD concurs in part with the finding In the formulation of annual budgets(MILCON) the Services are constrained by fiscal limits established by the Department Any prefinancing proposal provide the Service with the required facility, however, it represents construction which should have been funded by NATO (if adequate funds had existed) Funds eventually recouped should, in theory be returned to the Services for the programming of national MILCON which was deferred in favor of prefinancing The policy of using recoupments for the U S NATO contribution coupled with recent Congressional restrictions has effectively stopped almost all prefinancing proposals The creation of a "rolling fund" would provide a source of funds quite apart from Service MILCON budgets but its existence would be dependent on recoupment rates Under these circumstances, the plan might be an incentive to better recoupment performance, although the recoupment rate has significantly improved Based on recent performance, Dod is not convinced that the Services require an incentive to recoup, rather, what is required is the capability to prefinance urgent military requirements in a timely fashion under those circumstances where the NATO program is not sufficiently responsive or short of funds A "rolling fund" cound provide a continuous source of funds for that purpose

<u>Conclusion 1</u> In light of the severe NATO infrastructure funding shortfalls, the U S Military Services may see the need for--and the Congress may want to consider--approving prefinancing requests for some urgently needed projects (p. 16)

<u>DOD RESPONSE</u> DoD concurs This is considered the most significant conclusion of the report - the recognition that selective prefinancing is required to meet urgent U S military construction requirements under certain conditions - when timing is critical and or the NATO program is critically short of funds

<u>Conclusion 2</u> Recoupment statistics indicate that in the past not enough attention has been devoted by the component commands to adhering to the NATO standards (p. 20)

<u>DOD RESPONSE</u> DoD does not agree The statistics provided on page 32 do not support this conclusion As stated earlier in this response, the $247 7 million of 'non-recoupable" prefinancing represents the prefinancing (assumed most precautionary) of construction which was not eligible for NATO funds The report does not clarify the fact that this is required construction which is to be funded nationally However, under certain circumstances the Services submit prefinancing statements to (1) attempt to obtain NATO funding for above-criteria items on a case-by-case basis, (2) protect our investment by submitting a precautionary statement on those projects which could become eligible at some future time

<u>Conclusion 3</u> An impasse has been reached in Europe between U S Military commanders in Europe accomplishing their mission and the NATO infrastructure funding shortfall, further complicated by the unwillingness of Congress to authorize prefinancing [See GAO NOTE.]

<u>DOD RESPONSE</u> DoD concurs This situation strengthens the case for selective prefinancing and recognition by the Congress of its utility in meeting urgent U S requirements

<u>Conclusion 4</u> U S prefinancing and recoupment record could be improved by creation of a separate funding mechanism for prefinancing (p. 23)

<u>DOD RESPONSE</u> DoD agrees - the primary objective is to allow controlled prefinancing which, in turn, will result in improved rates of recoupment

<u>Conclusion 5</u> U S prefinancing and recoupment record could be further improved by expanding USEUCOM's role in the selection of projects to be prefinanced (p 23)

GAO NOTE: Section dropped from final report.

DOD RESPONSE Concur The Unified Command's primary role in the NATO theater is to determine overall U S requirements and integrated priorities access Services Lines Overall management of any prefinancing/recoupment mechanism would be retained at the OSD level

Conclusion 6 Since USEUCOM provides theater-wide management over 11 U S prefinancing and recoupment efforts, it may be in the best position to manage a "rolling fund" and at the same time provide USEUCOM with a new role in reviewing and components [See GAO NOTE.]

DOD RESPONSE DoD does not concur While USEUCOM would indeed play a major role in the establishment of priorities and selection of projects, overall management responsibilities would have to be at the OSD level (OASD, MRA&L) in accordance with current SECDEF direction The creation of a rolling fund could not be limited to just the European Theater but must include all NATO areas (e g , Iceland and the Atlantic Command) where the prefinancing of facilities may be necessary

RECOMMENDATIONS TO THE SECRETARY OF DEFENSE (RELATED TO FINDINGS A THROUGH O) Based on findings A through O (and the related conclusions), GAO recommended to the Secretary of Defense that

Recommendation 1 Before requesting any additional prefinancing for NATO-eligible construction projects, DoD develop a system like the "rolling fund," designed to provide greater incentive to the Military Services to recoup funds from NATO (p. 26)

DOD RESPONSE DoD does not concur The initiation of a prefinancing proposal is properly dictated by military need On occasion U S prefinancing is necessary because NATO can not respond quickly enough Availability of funds for prefinancing should not be tied to recoupment

Recommendation 2 USEUCOM be given greater participation in the selection of projects for prefinancing (p. 26)

DOD RESPONSE DoD agrees USEUCOM has recently become deeply involved in reviewing Service prefinancing proposals

RECOMMENDATION TO THE CONGRESS (RELATED TO FINDINGS A THROUGH O) Based on findings A through O (and the related conclusions), GAO recommended to the Congress that

Recommendation 3 Because prefinancing of some urgently needed facilities may be in the U S national interest, this alternative will need to be reconsidered but before debating prefinancing

GAO NOTE: Discussion added on page 24 of this report.

decisions, require that DoD improve its recoupment record by developing and adopting a system like the "rolling fund " (GAO noted such a new system may require changes to existing legislation) (p. 26)

DOD RESPONSE DOD agrees, however, the opportunity to approach Congress, as required, with urgent prefinancing proposals should not be deferred pending the development of any new system

FINDING P Changes in Timing of Payments for NATO Infrastructure Could Save U S Million Because the timing of payments has a direct impact on the amount of interest earned on short-term cash holding held by the Department of Treasury, GAO found significant cost-savings could be realized by changing the timing of the U S payments to the NATO infrastructure program from the current quarterly to monthly (NOTE In connection with this finding, GAO noted that for 1979 and 1981, had a monthly payment procedure been in effect, the United States could have saved $3 9 million) (p. 28)

DOD RESPONSE In the absence of statistical data, DoD cannot comment on the stated finding However, in response to the above, the U S Mission to NATO believed changing the timing of payments to be ill-advised As stated by the Mission, the reason for quarterly payments in advance is to provide NATO funds to host nations so that they do not have to advance national funds to accomplish a NATO Task Thus, if NATO made monthly payments as GAO proposes, first quarter payments should be in the hands of the host nations on the first days of each month to cover payments due to contractors in those periods NATO has found that delays in approval of quarterly pay sheets, and in the making of national payments, preclude the use of less than quarterly paysheets if, indeed, host nations are to disburse NATO funds rather than making treasury advances to cover NATO bills The Mission also notes that if monthly payments were found to be inadequate to cover the actual costs of a quarter, nations would be inspired to "over estimate" expenses in order to ensure availability of adequate funds The U S Mission also comments that there appears to be no economic advantage Within cash-flow considerations (shortfalls balancing overcontributions), the payments should be made to host countries at the midpoint of each quarter NATO procedures require a lengthy screening of the first and third quarterly payments leading to approval usually at the end of January and July, respectively When U S payments are made 30 days later, they come some 60 days into the quarter or 15 days late Second and fourth payments should be approved automatically on the first day of the quarter with U S payments 30 days later, about 15 days early Thus the average of payments would seem to protect U S Treasury interests

FINDING Q Quarterly Payments Not Requireed GAO found (1) that NATO has not issued instructions specifying when payments should be made, (2) that attempts to obtain agreement from all NATO members on when payments should be made have not been successful, (3) while nations are urged to pay as quickly as possible, payments by NATO member nations vary widely, and (4) current quarterly payments are based on U S Treasury rules, not NATO requirements (p. 29)

DOD RESPONSE DoD concurs To the best of our knowledge, the findings are factually correct and require no additional comment

FINDING R Further Refinements in Current Payment Procedures Could Save Money In response to prior GAO audits, procedures have been implemented in foreign currency transactions to eliminate the possibility of currency speculation and to require that payments be made in 30 days, but GAO found that inasmuch as effective cash management principles require that disbursements of U S funds to the infrastructure program be made as close to the actual due date as possible, spreading U S payments out over the quarter would save money by minimizing the premature disbursement of funds (In connection with this finding, GAO noted that some officials at the U S Mission to NATO and USEUCOM expressed concern that (1) any change in the U S payment procedures would be watched closely by other member nations and (2) they did not know what the overall impact of such a change would be, but believed some of the financially troubled NATO members could be adversely affected by a change to monthly U S payments) (p. 30)

DOD RESPONSE DoD notes the finding DoD agrees with the concerns expressed by the U S Mission and USEUCOM

GENERAL CONCLUSIONS (RELATED TO FINDINGS P, Q AND R) Based on findings P, Q and R, GAO concluded that

Conclusion 7 The ability to increase the availability and utilization of the government's cash resources is a major objective of better cash management in government operations and this could be accomplished through modification of current U S payment procedures to the infrastructure program, resulting in larger cash resources being made available to the U S Treasury

DOD RESPONSE Based on statistics provided at a preliminary meeting with GAO representatives, DoD notes that there might be some cash savings by modifying current procedures, it is likely this would be done at the expense of disrupting the administration of an already complex system and could prompt the Allies to modify their procedures which, in the long run could run counter to U S interests

Conclusion 8 As U S infrastructure program expenditures are expected to increase in the next few years, adopting a monthly payment schedule, particularly while interest rates remain high, could result in considerable savings to the Treasury

DOD RESPONSE DoD agrees that program expenditures are expected to increase, however, current interest rates are on the decline and are anticipated to decline further DoD notes there exists some differences between the cost saving calculations of the U S Mission and GAO

Conclusion 9 Although it was not possible to assess the impact of the proposed monthly payment change on NATO's host nations and U S officials did not know what reaction other NATO members would have, employing a monthly schedule of payments is worth considering because of the potential savings for the United States (p. 31)

DOD RESPONSE DoD agrees that allied reaction would be difficult to assess at this time, however, the following comments deserve consideration The system of quarterly paysheets and advance payments is the product of a consensus among the participating fourteen nations and, one assumes, represents the most equitable solution to the problem of payments The primary objective of the procedures is to advance host nations funds with which construction costs (to contractors) can be paid without requiring those nations to use national funds Shifting to a monthly payment schedule could be interpreted as a deviation from the primary objective and could prompt other nations to switch to individual disbursement schedules which provide maximum economic benefit to them The end result could be a completely unmanageable system The U S participation in the NATO program requires a certain degree of compromise in working with 13 other nations to arrive at procedures which are the most equitable to all

RECOMMENDATION TO THE SECRETARIES OF STATE AND DEFENSE (RELATED TO FINDINGS P, Q AND R) Based on Findings P, Q and R (and the related conclusions), GAO recommended that the Secretary of State, in conjunction with the Secretary of Defense

Recommendation 4 Task the U S Mission of NATO to pursue the feasibility with NATO authorities of changing the current payment schedule of U S payments (In connection with this recommendation, GAO emphasized that until NATO adopts more precise payment criteria and unless it can be demonstrated that a monthly schedule of U S payments will have an adverse impact on NATO program implementation, a monthly payment schedule should be used and existing payment procedures modified to reflect this change) (p. 31)

DOD RESPONSE: DoD does not fully agree. The U.S. should maintain its present schedule of payments as originally agreed in order that no disruption to the current system should occur DoD agrees that it would be useful for the U S Mission to explore the possibility of changing our payment schedule to realize the savings in interest

DEPARTMENT OF STATE
Comptroller
Washington D.C. 20520

18 OCT 1982

Dear Mr. Conahan:

I am replying to your letter of September 21, 1982, which forwarded copies of the draft report: "United States Participation in the NATO Infrastructure Program -- Where We Stand in 1982".

The enclosed comments on this report were prepared by the Deputy Assistant Secretary in the Bureau of European Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Lorin A. Jurvis
Acting

Enclosure:
As Stated.

Mr. Frank C. Conahan,
Director,
International Division,
U.S. General Accounting Office,
Washington, D.C.

GAO Draft Report "United States Participation in the NATO Infrastructure Program -- Where We Stand in 1982"

We are working closely with DOD on the problems outlined in the Draft GAO report on this subject. We have noted the recommendation in the report "that the Secretary of State, in conjunction with the Secretary of Defense, task the U S Mission to NATO to pursue the feasibility with NATO authorities of changing the current schedule of U.S. payments."

We have concluded that present procedures achieve essentially the same result as those sought by the GAO, i.e. to minimize the interest costs of U S. payments Thus, we do not believe that it would be useful to instruct the U S. Mission to NATO along the lines recommended in the report. Furthermore, the proposed change of procedures would result in political problems inasmuch as it would require our NATO Allies to advance funds due by the U.S.

DOD will elaborate on these points in more detail.

Mark Palmer

Deputy Assistant Secretary
Bureau of European Affairs

APPENDIX IV

DEPARTMENT OF THE TREASURY
WASHINGTON D C 20220

ASSISTANT SECRETARY

29 OCT 1982

Dear Mr Conahan

On behalf of Secretary Regan, I am replying to your September 21 letter requesting review and comment on the draft GAO Report "United States Participation in the NATO Infrastructure Program Where We Stand in 1982."

The Department of the Treasury has reviewed the draft proposed report. We concur with the recommendation that NATO/SHAPE Support Group should change the timing of payments in response to NATO calls from every quarter to thirty-day increments Such a schedule of payments would, by avoiding premature drawdowns of funds from the Treasury, support Treasury goals and responsibilities for improved Federal cash management (Should others commenting on the draft so disagree with that recommendation as to cause you to consider revising or dropping it from the final Report, I trust that you will consult further with us in Treasury before reaching a final decision Looking towards a future possibility - should NATO propose to issue instructions which would require USG premature, advance payments to host countries or to NATO agencies using infrastructure program contributions, please provide us an opportunity to comment)

The Department of the Treasury believes that the following three issues mentioned in the draft report warrant further consideration

(1) The Report proposes the establishment of a "rolling fund" as a new funding mechanism for the existing USG/NATO prefinancing mechanism We wish only to note our reservation it would seem that Congress itself should consider the adoption of a fund which might remove from Congressional scrutiny DOD/USG payments to the infrastructure program

(2) The last paragraph of page 43 refers to a U S Mission to NATO Support Group/Treasury agreement whereby "foreign currency purchases would be made for delivery 30 days from the date of the approval of the NATO call, or on a due date specified in writing by the U S Mission to NATO " We feel that this implies Treasury approval to some form of "forward" exchange

purchase procedure, especially in light of the fact that this statement immediately follows a sentence noting that "currency speculation in the acquisition of foreign currency had taken place " As you are aware, Treasury has never given specific authority to NATO/SHAPE to enter into "forward" exchange contracts for delivery up to 30 days. Therefore, it is our recommendation that the language contained in this paragraph be amended to eliminate any misunderstanding This might easily be accomplished by replacing the phrase "that foreign currency purchases would be made for delivery 30 days from the date of approval of the NATO call," with "that foreign currency payments would be made for contract and delivery 30 days from the date of the approval of the NATO call." A follow-up sentence "Currency purchases to cover these payments are contracted for only through the 'spot' exchange markets, as opposed to any forward exchange markets," may further clarify this matter.

(3) To support the delayed-payment recommendation, the Report cites savings imputed to Treasury resulting from the USG use of a monthly payment schedule to the infrastructure program The savings are expressed in terms of imputed interest earnings, calculated on funds not prematurely drawndown and paid out to the program - but retained in the Treasury tax and Loan Account System as part of the operating cash of the Treasury That technique, as a relative indicator of the value of the funds to the Treasury is acceptable. However, we recommend that a footnote be included on page 45 to point out the real benefit of the monthly payment schedule, i e , it ultimately would result in reduced interest expenses to the Government as a result of delayed borrowing by the Government from the public.

The suggested footnote would read as follows

> "The ultimate benefit of the changed payment schedule is that government public debt borrowings will be delayed in accordance with the revised payment schedule from quarterly to monthly, resulting in reduced interest expenses being incurred. For ease of measurement, however, instead of focusing on the reduced borrowings and hence the reduced interest expense, the Report estimates treat those delayed payments as being retained as part of the

APPENDIX IV

Treasury s excess operating cash balances which generate interest earnings For the purposes of this Report, Treasury has advised that the measurement technique employed is an acceptable indicator of the relative value of the revised payment schedule "

Sincerely,

Gerald Murphy

Gerald Murphy
Acting Fiscal Assistant Secretary

Mr Frank C Conahan
Director, International
Division
United States General
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Washington, D.C 20548

24125

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