



UNITED STATES GENERAL ACCOUNTING OFFICE

Not to be released outside the General Accounting Office except by the approval of the Office of Congressional Relations, WASHINGTON, D.C. 20548

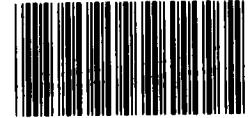
122 144  
OK  
22655

NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

RELEASED

September 30, 1983

B-208698



122749

The Honorable John Glenn  
United States Senate

Subject: Potential Impact of Expanding Coverage  
of the 1982 Amendment to the Arms  
Export Control Act (GAO/NSIAD-83-53)

Dear Senator Glenn:

P.L. 97-392, 96 Stat. 1962 (1982) authorizes the President to sell U.S. defense articles and services to U.S. companies for incorporation into end items for commercial export only if:

"(1) the end item to which the articles apply is to be procured for the armed forces of a friendly country or international organization, (2) the articles would be supplied to the prime contractor as government-furnished equipment or materials if the end item were being procured for the use of the United States Armed Forces, and (3) the articles and services are available only from United States Government sources or are not available to the prime contractor directly from United States commercial sources at such times as may be required to meet the prime contractor's delivery schedule."

The Senate Foreign Relations Committee, in its report on the legislation (S. Rep. No. 97-586), stated that it intended to limit the scope of this authority to those defense articles:

"\* \* \* that are in fact being provided by the United States Government to the prospective United States private purchaser or its U.S. competitor in connection with United States Government procurements of similar end items for the use of the Department of Defense."

On May 31, 1983, you asked for our comments on a proposal to modify the language of the Senate Foreign Relations Committee report to allow Government arsenals to sell defense articles and services to contractors for assembling at contractors' plants and subsequent commercial export, whether or not the contractors currently receive such defense articles and services for incorporation into end items delivered to the Department of Defense (DOD).

527018

(463712)

LEGISLATIVE CHANGE  
MAY BE BEST APPROACH

The most effective way to broaden the contractors' authority to purchase Government furnished equipment (GFE) probably would be to amend section 30 of Pub. L. No. 97-392. Language in a Senate committee report subsequent to the enactment of this statute will not accomplish this objective.

Such language is inappropriate for two reasons. First, the Defense Security Assistance Agency (DSAA), the agency responsible for implementing section 30, has interpreted it to provide Government contractors with limited authority. Although a Senate committee could request DSAA to reconsider its interpretation, only an amendment to section 30 will change its meaning, if DSAA's position remains unchanged.

Also, if DSAA's interpretation is based largely on language in the Senate Foreign Relations Committee report on Pub. L. No. 97-392, language in a committee report, prepared after enactment of the statute, will be of little value. Courts do not regard such subsequent congressional views as a strong indication of congressional intent. Consumer Products Safety Commission v. GTE Sylvania, Inc., 447 U.S. 102, 118 (1980).

POTENTIAL IMPACT OF  
CHANGING THE LAW

In implementing the statute, DSAA followed the stated intent of the Senate Foreign Relations Committee. DOD regulations issued in July 1983 provide that the only defense articles authorized for sale are those "that currently are in fact being furnished by the U.S. Government" to a U.S. company that is or has been under contract to the Department of Defense for final assembly or final manufacture into an end item for use by U.S. armed forces. The sale of associated services is similarly restricted.

DOD recently rejected several requests by companies to buy GFE in connection with sales to foreign countries. These rejections were based on the fact that the DOD, not the companies, performed the final assembly of items.

If the law were amended to allow companies to purchase and resell GFE even though the company is not currently producing an end product, more companies would qualify under the authority. As of July 11, 1983, 19 companies had made 25 inquiries to DOD concerning participation under this law. Of these 25, 20 were turned down. The 20 turndowns were based on DOD's interpretation that the new law did not allow these sales. The specific rationale for the turndowns included, (1) items were intended for resale, (2) items were available from commercial sources, and (3) final assembly was not conducted at the requestor's facility. If the law was amended to allow contractors not

involved in the final assembly to purchase GFE for commercial export, only the two cases involving commercially available items would continue to be ineligible. The 18 other cases could have been approved. The 18 sales requests were for such items as gun tubes and mounts for modification kits, mortars, ammunition, and various small arms parts. In at least eight cases, the companies were expected to simply resell the item.

We believe that the overall volume of commercial sales would very likely increase because of two factors:

- Companies would be able to deal directly with countries unwilling to enter into a government-to-government foreign military sales (FMS) agreement. India is often cited as an important market where U.S. companies are unable to compete because of India's reluctance to purchase through FMS channels.
- Companies will increase profits because they will be able to apply profit margins to the GFE which is provided to the contractor based on U.S. Government cost. This will create incentive for more companies to actively pursue more sales. Companies cannot make profit on GFE if it is sold through FMS.

DSAA officials believe that the capacity to make profits on GFE may be more important to the U.S. companies than selling to countries that do not want to enter into an FMS case. Other than India, there are few countries that may fall into this category. Even India has made some FMS purchases recently, e.g., \$839,000 in fiscal year 1982 and an estimated \$500,000 more in fiscal year 1983.

If the law were amended, recent activities by two companies demonstrate that the legislation would be used to sell to countries willing to use FMS channels. BMY, the producer of the self-propelled howitzer, has sales agreements with four countries, all of whom have purchased U.S. arms through FMS channels in the past. BMY is also negotiating sales with 35 other countries. CONDEC has requested an advisory opinion from the Department of State on the sale of towed howitzers to 24 countries. The Department of State has determined that there is no objection, in principle, to the sale of howitzers to 19 of these countries. CONDEC produces about one-third of the towed howitzer. It wants to sell the complete howitzer rather than sell its part commercially with the balance sold through FMS. CONDEC says this way it can base profit margins on the whole weapon.

DSAA officials are concerned with the proposed expansion of the authority in that almost any U.S. defense item in the DOD inventory could, under certain conditions, be construed as GFE.

Items in U.S. inventory but not available from commercial sources at the time the contractor requires them could be eligible for sale under this authority. Under these guidelines, some DOD officials believe that many companies are likely to request stocks for commercial export.

Other DOD and Department of State officials envision no such demand on U.S. inventories. They believe it is unfair that CONDEC cannot get gun mounts and tubes because the towed howitzer is assembled at a Government arsenal whereas BMY can obtain the same items because the self-propelled howitzer is assembled at BMY facilities. These officials do not believe allowing CONDEC to sell GFE would set a precedent leading to an unlimited scope of the new authority. In fact, CONDEC developed criteria that, if adopted, would likely open the authority to a very few companies (see enc. I for CONDEC's suggested eligibility criteria). It assumes that the authority would be expanded to only those weapon systems currently assembled at Government arsenals. There appears to be some merit in CONDEC's supposition because most weapon systems purchased by the U.S. Government are produced by private contractors and contain only a small amount of GFE.

The issue remains, however, that if the current authority is expanded, it will possibly generate increased pressure to expand the authority to include a wider range of cases in the future. DSAA officials believe that the limited scope of the present authority, which has been emphasized by the Senate Foreign Relations Committee, could eventually be eroded.

Of course, the law could be amended with restrictive language, as CONDEC suggests, to limit the number of eligible contractors. However, this step would probably upset other contractors and they would very likely enlist congressional help to make an exception for them.

PROPONENTS BELIEVE  
CHANGE BENEFICIAL

Supporters of an expanded scope believe change could bring benefits, both to the U.S. Government and to the economy. Increased orders would mean more work for both the arsenals and private industry, increased foreign sales would help improve the U.S. balance of payments, and sales to countries who do not now buy U.S. arms may increase U.S. influence and improve trade relations.

An Army briefing document, prepared in support of this proposed change, listed nine potential benefits. It would:

- Keep industrial base warm (both Government-owned and commercial);

- result in sales the United States might otherwise not obtain;
- encourage rationalization, standardization and interoperability with NATO forces;
- help offset the loss of FMS sales because foreign governments want to avoid the long lead times involved;
- aid current economic conditions;
- eliminate need for total U.S. Government management/execution (contractors would be responsible for providing service, training, etc.);
- allow sale of excess components held by the arsenals;
- enhance balance of payments; and
- be a viable option to foreign production.

Officials at the Army's Armament Materiel Readiness Command, and its Rock Island and Watervliet Arsenals, feel that an expanded authority is very important because the arsenals need additional orders to keep their production lines operating. The orders on hand will keep them operational at their current production levels through mid-1984 but the arsenals desire a larger backlog of orders.

Industry and some Government officials claim this change will generate new sales (although it may also divert sales from the FMS program). Some officials feel U.S. firms can lure arms business away from foreign competitors if they can sell commercially.

In addition, Department of State officials favor the modification because it could result in new sales of U.S. armaments to countries who do not want to buy directly from the U.S. Government, particularly India.

OPPONENTS BELIEVE CHANGE COULD  
CREATE SERIOUS PROBLEMS FOR U.S.  
READINESS AND THE SECURITY ASSISTANCE PROGRAM

Officials opposed to changing the law feel it serves its intended purpose best as it is currently written. To them, the purpose of Pub. L. No. 97-392 is to allow companies which are already assembling military hardware to sell these items commercially without going through the time-consuming administrative steps required for Government-made parts sold through FMS channels. They feel the law did not change the production roles of the U.S. Government, prime contractors and subcontractors. The

change was that the U.S. Government did not have to make a sales agreement with the foreign buyer.

While opponents to change do not oppose CONDEC selling towed howitzers, they believe that if the authority is expanded, other companies, some of which are primarily brokers and add little or nothing to the GFE, might also be able to participate. If any company should subsequently discontinue operations or production of a particular weapon, sale agreements may not be honored. If this were to happen, the buyer would likely turn to the U.S. Government for support and expect it to complete the agreement. Turning down requests from our allies for needed spare parts, maintenance, and training could upset them and damage the reputation of the U.S. security assistance program.

DSAA also believes that expanded coverage under the authority could increase the potential for untested and perhaps faulty products being sold to friends and allies. This could develop into political and diplomatic problems for the U.S. Government even though it did not make the sale.

The readiness of U.S. forces could be affected, Government officials argue, if U.S. contractors gain unlimited access to DOD inventories including GFE they can sell overseas. They noted that congressional pressure, on behalf of the contractors, and diplomatic pressure (from the State Department) on behalf of the foreign buyer, could force DOD to give contractor's orders a higher priority than those for U.S. forces.

#### CONCLUSIONS

The most effective way to broaden the contractors' authority to purchase GFE would be to amend section 30 of Pub. L. No. 97-392. There are two distinct schools of thought on revising Pub. L. No. 97-392. Those opposed to change are concerned about what would happen if limitations were so weakened that almost any company could buy GFE and resell it overseas whether they added much to it or not. They do not think that allowing one company to be covered under the authority would do significant damage by itself, but they feel this first step could lead to additional changes which could render current limits ineffective. They also feel that, as more changes are made, more companies will likely seek additional changes through their congressional representatives to expand coverage by an amendment.

Proponents of change say it will benefit both the Government and the economy. Businesses will be able to increase their sales. Government arsenals would also increase sales which will help keep their production lines operational. They do not believe allowing one company to buy GFE would seriously affect the scope of the present authority.

In other words, if one supports increased sales through commercial channels, rather than FMS, an expansion of the authority should be supported. If one generally opposes increased sales through commercial channels, the current authority should remain limited. The ultimate decision is up to the Congress.

We made our review in accordance with generally accepted government audit standards. Our work was performed at the Departments of State and Defense. It included interviews with officials from these departments as well as with officials from five companies including CONDEC and BMY and an analysis of inquiries made by U.S. companies since the enactment of the amendment. As agreed with your office we did not obtain agency comments on the report.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 5 days after its issuance to you. At that time, we will send copies to the Chairman, Senate Committee on Foreign Relations; Chairman, House Committee on Foreign Affairs; Chairmen, House and Senate Committees on Appropriations; Chairmen, House Committee on Government Operations, and Senate Committee on Governmental Affairs; the Director, Office of Management and Budget; the Secretaries of State and Defense; the Directors of the Defense Security Assistance Agency, and the Arms Control and Disarmament Agency; and other interested parties.

Sincerely yours,



Frank C. Conahan  
Director

Enclosure

CONDEC PROPOSAL TO SELL GFE UNDER  
P.L. 97-392 WITH RETENTION OF RESTRICTIONS  
THAT PREVENT UNLIMITED PARTICIPATION

The following was prepared by CONDEC officials so they could buy and resell GFE under P.L. 97-392, while allaying DOD fears that such sales would be unnecessarily opened to others.

Under P.L. 97-392, current procedures allow defense articles to be sold to American contractors when those articles are already being supplied to that contractor as GFE for final assembly of a system at that contractor's facility. However, CONDEC stated there may be a need to sell such defense articles to contractors who are not presently receiving them as GFE. In order to retain the spirit of the procedural limitations, articles can be sold in the latter case only when the contractor, or the defense articles meet the following conditions:

Fairness issue. This means someone already does it; permits someone else otherwise qualified to do so:

Limits to cases where USG presently does final assembly:

To apply for this you have to already be supplying a major component:

1. Substantially the same defense article(s) are presently being supplied to a contractor as GFE; and
2. The defense articles(s) are also being used in a related weapons system with final, assembly of that system taking place at a U.S. Government arsenal; and
3. The contractor not presently receiving the articles(s) as GFE, does presently supply a major component of the system in #2 to that Government arsenal; and
4. The component in #3, supplied by the contractor to the U.S. Government arsenal, when assembled with the defense articles(s) in question, will result in a complete end item; and



Said component(s) and GFE must substantially equal finished product; applicant must have existing physical capacity.

USG otherwise approves action.

5. The contractor can assemble the same end item of #4 at his facility, using the articles of #2 and the major component of #3 and #4 already being produced by the contractor; and
6. The Government arsenal or cognizant command approves and qualifies the contractor for the final assembly of the end item. Costs for such qualification would be paid by the contractor.
7. The proposed commercial sale is otherwise approved.