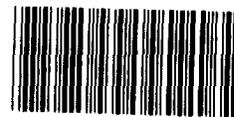


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U.S. Management of Military Coproduction
Programs Worldwide

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



Mr. Chairman, Members of the Subcommittee:

I am pleased to be here today to discuss the results of our work on U.S. government management of military coproduction programs. Our work focused on management controls exercised to ensure compliance with agreement restrictions on production quantities and third-party sales. We also examined the remedies available to the United States for dealing with cases of noncompliance with agreement restrictions. The Department of Defense (DOD) has pointed out that these arrangements are made with allied and friendly countries on the basis that they will abide by the agreement provisions. While we agree that this is generally a correct premise in dealing with our allies, there can be differences in our commercial interests, trading partners, arms export laws, and the enforcement of those laws.

We examined 18 coproduction programs governed by Memorandums of Understanding (MOU) and numerous technical data packages sold under letters of offer and acceptance (LOA) with six countries: the Federal Republic of Germany, Greece, Italy, Japan, the Republic of Korea, and Switzerland. A listing of the programs we reviewed in each of the six countries is attached. DOD is responsible for negotiating the agreements and managing the implementation of these programs, and the State Department is responsible for managing third-party sales of U.S. origin defense equipment, including that

which is coproduced. The following points surfaced during our review:

- DOD, State, and other U.S. government agencies do not directly manage or monitor coproduction programs to ensure compliance with agreement restrictions on production quantities and third-party sales. Indirect controls are exercised (1) by withholding a critical component from foreign production and (2) through commercial agreements and licensing channels, but these controls are limited in scope and effectiveness.

- DOD last updated its directive on coproduction in 1974. The directive is outdated and does not contain specific requirements for the military services or overseas security assistance organizations to manage the programs to ensure compliance with coproduction agreement provisions. The directive also does not set forth criteria for deciding when to close out or terminate oversight of coproduction programs.

- We determined from available information that unauthorized third-party sales of coproduced items had occurred in 5 of the 18 programs governed by MOUs and in numerous programs under LOAs we examined. The State Department, which is responsible for dealing with cases of noncompliance, took action on some but not all the cases. Details on the unauthorized sales are classified and therefore cannot be discussed in open session.

-- The Arms Export Control Act provides that Foreign Military Sales (FMS) credits shall be terminated if the President, through the Secretary of State, determines that a substantial violation of an agreement has occurred. But it is unclear as to whether this provision applies to all coproduction agreements. In any case, it has never been invoked. A typical response to unauthorized third-party sales is a diplomatic protest issued by State to the foreign government(s). Other administrative penalties are available to DOD and State, and we found two cases in which they were used.

I will focus my remarks for the open session on (1) DOD's guidance for managing these programs, (2) the types of program oversight and other controls we found in the programs we reviewed, and (3) the remedies available for dealing with unauthorized third-country transfers of coproduced U.S. equipment.

COPRODUCTION PROGRAM MANAGEMENT GUIDANCE

Two principal DOD directives deal with coproduction and international agreements: DOD Directive 2000.9 (1974) on coproduction and DOD Directive 5530.3 (1987) on international agreements. These directives identify the DOD offices authorized to negotiate and conclude MOUs. They also require the DOD General Counsel's legal clearance and coordination with the State Department. DOD Directive 2000.9 requires coordination with and

semiannual program status reports by the cognizant DOD components to the Assistant Secretary for Installations and Logistics--an office that no longer exists. The directive assigns clearance and coordination responsibilities but does not delineate management responsibilities for the services. Although DOD Directive 5530.3 states that DOD policy is to maintain awareness of compliance with international agreements, no mechanism has been established in coproduction programs to accomplish this objective.

DOD has not established criteria or procedures for closing out or terminating coproduction programs when the programs are no longer considered active by the responsible project offices. While programs have been categorized as closed out for management purposes, the MOUs remain in force and foreign production and sales may continue. In practice, these programs have been categorized as closed out on an arbitrary basis.

HOW COPRODUCTION PROGRAMS ARE
MANAGED TO ENSURE COMPLIANCE

We tested the 18 MOU programs for two types of management controls to ensure compliance with agreement restrictions on production quantities and third country sales: (1) direct oversight, verification, and monitoring by the U.S. government and (2) indirect controls, such as withholding a critical component from foreign production, and controls that might be exercised through the commercial munitions licensing process and the commercial

agreements that typically implement the MOUs. We also examined how coproduction programs are closed out.

Direct Controls

With few exceptions, no coproduction programs were directly monitored by either the responsible military services or U.S. government personnel overseas to ensure compliance with MOUs. Although 15 of the 18 MOUs we examined contain restrictions on both production quantities and third-party sales, they do not require or authorize direct U.S. monitoring or oversight. With the exception of recent Stinger agreements, which give the United States the right to inventory missiles produced abroad, DOD coproduction guidance and MOU provisions do not include monitoring for compliance with agreement restrictions as part of the overall program management objectives or requirements.

DOD generally relies on the foreign country to provide it with production reports, but it has not verified the reports it received in any of the programs we reviewed. In a couple of early programs, DOD stationed a representative in the foreign prime contractor's plant for a period of time for surveillance purposes, including monitoring production quantities, quality assurance, and testing. However, DOD has not done this for many years.

In the absence of more specific management requirements in the DOD guidance, the services and overseas security assistance organizations focus their efforts on ensuring that the foreign country/companies can successfully produce the agreed-upon U.S. equipment. This includes providing and coordinating delivery of technical assistance and logistical support, providing engineering changes, and exercising configuration management control. DOD's management of the programs varies depending on the level of technical support and hardware transferred through FMS channels, the role of the U.S. contractor in the program, and the maturity of the program.

Indirect Controls

Some limited indirect controls exist to prevent overproduction and unauthorized sales, but these are not totally effective. For example, in 4 of the 18 MOU programs we examined--the AIM-9L programs with Germany and Japan, the PATRIOT program with Japan, and the M-110 self-propelled howitzer program with Japan--a critical component was withheld from foreign production, and the withheld component could be purchased only through FMS channels. In addition, an FMS case manager was monitoring the quantities of components purchased to ensure they remained within MOU limits. While this is a control over the quantity of end items produced, it does not ensure against unauthorized sales of components or end items.

We also found that indirect controls exercised through the commercial licensing process and agreements are not adequate to ensure compliance with MOU restrictions. Of the 15 commercial licensed production and technical assistance agreements applicable to our review, only 2 contained quantity restrictions, 10 involved royalty payments based on quantities produced, 10 required the foreign firm to report quantities produced, and 9 had provisions for audits. Generally, the U.S. companies involved did not verify end item or parts production figures by auditing the programs. Commercial contract audit provisions were invoked in only one program we examined on one occasion in the 1970s.

In many cases, U.S. firms involved in coproduction programs maintained an in-country representative for technical assistance purposes. However, these representatives were not monitoring for compliance with MOU restrictions and in many cases were not informed of MOU provisions and restrictions, sometimes due to classification of the MOUs. In most programs we examined, the U.S. contractors' presence in the foreign plants was reduced or ended with the completed delivery of technical assistance. Once foreign plants are able to produce the equipment successfully, the U.S. contractors' services are not longer required. There have been some exceptions to this practice. In the M-113 armored personnel carrier program with Italy and the M-109 self-propelled howitzer program with Korea, the U.S. contractors were responsible

for on-site quality assurance inspections, presumably throughout the life of the programs.

The Office of Munitions Control at the State Department reviews commercial munitions export license applications and licensed production and technical assistance agreements. According to Munitions Control officials, they do not review commercial munitions licenses to ensure that quantities of parts or components purchased through this channel comply with authorized production levels specified in MOUs. They do not maintain copies of MOUs and are not aware of authorized production levels. It would be difficult to oversee or enforce compliance with commercial purchases because several vendors may supply parts, licenses frequently contain ambiguous item descriptions, and the correlation between small parts and end items is rarely clear. Munitions Control officials noted that the office relies on the integrity of the U.S. companies to submit licenses that reasonably support the coproduction programs and do not exceed MOU quantity restrictions.

Closing Out Mature Programs

A number of mature coproduction programs have been or will be considered closed out by the military services responsible for program management, even though foreign production and sales may continue and the MOUs remain in force. We examined five closed out programs, and in four of these programs, at least parts production

continues. In two of these cases unauthorized sales occurred after the programs were closed out. There is a need for guidance on closing out mature programs, including some level of continued oversight and periodic reviews of mature programs and agreements, particularly considering that programs such as the AIM-9L missile with Germany are near closeout.

Technical Data Packages Under LOAs

Another form of coproduction through which overproduction and unauthorized third-party sales of U.S. equipment can occur is through the sale of technical data packages under government-to-government LOAs. LOAs are covered in the Security Assistance Management Manual under guidance separate from coproduction MOUs. In the past, DOD has not monitored coproduction occurring through the sale of technical data packages under LOAs, and unauthorized third-party sales of items coproduced under LOAs have been detected.

Because a 1985 DOD Inspector General's report disclosed weaknesses in controls over the technical data, DOD issued more restrictive guidelines on such programs and agreements in 1987. These guidelines require production validation clauses in the LOAs that give the United States the right to physically verify quantities produced by the foreign country of the agreed-upon items or equipment. The guidelines, which are more restrictive and provide

for production validation on a spot-check basis by the security assistance organizations in the recipient countries, are applied in cases in which royalty payments to the U.S. government are required. At the time of our review, DOD had not validated or verified foreign production under the LOAs issued since March 1987.

REMEDIES AVAILABLE FOR
UNAUTHORIZED SALES

The Arms Export Control Act (section 3 (c)) provides for the suspension of FMS credits or guarantees if a foreign country is found to have substantially violated third-party sales restrictions in any agreement entered into under the act. DOD and State disagree over whether this provision applies to all government-to-government MOUs. Based on our examination of the legislation, and DOD's and State's interpretations, we believe it is unclear as to whether the remedy applies to all coproduction MOUs.

Regardless of its technical application, this penalty is considered by State and some DOD officials as too severe, the United States has not invoked the remedy, and it would not apply to violating countries that do not receive credits. In practice, a typical response to third-party sales violations is a diplomatic protest, or demarche, issued by the State Department.

U.S. industry representatives we spoke with believed that diplomatic protests would not effectively deter foreign coproducers

from future unauthorized sales. They believed that suspension of ongoing or future licensing agreements for a specified period of time would more effectively deter future noncompliance. Others suggested withholding needed U.S. parts or components from the violating company or country and blacklisting the violating foreign companies from U.S. contracts or licenses. Some believed that public denunciation of the violating country or company would be more effective than diplomatic protests. These alternative administrative remedies are already available to the Departments of State and Defense. We found two cases in which similar remedies were employed.

RECENT DOD EFFORTS TO IMPROVE
COPRODUCTION GUIDANCE

During our review, the Defense Security Assistance Agency revised its management manual to incorporate guidance on coproduction agreement provisions, DOD components' management responsibilities, and oversight functions related to ensuring compliance with MOU provisions. The revised manual provides that, on a case-by-case basis, DOD will negotiate clauses in MOUs authorizing U.S. government production verification and access to production facilities and records and storage sites. In such cases, the manual further describes specific monitoring requirements for the responsible military service program office, such as making visits and examining production records.

The revised manual may improve aspects of some agreements and program management, but we believe that the DOD coproduction directive should be updated to ensure formal implementation through the military services' regulations and by the overseas security assistance organizations. We also remain concerned about the application of the improved guidance on a case-by-case basis, as we feel it should be applied as a general rule in all programs. We are further concerned about the potential for continued overreliance on U.S. industry for program oversight.

We have made several recommendations to the Departments of State and Defense that, if properly implemented, would improve the oversight and management controls in these programs. Both agencies generally agreed with our findings and recommendations. We also made some proposals for congressional consideration.

First, as a matter of practice, DOD notifies the Congress of coproduction MOUs when they meet the congressional reporting thresholds for the related sale of defense articles and services. According to DOD, some MOUs are not reported when the value of the related sale does not meet the threshold. We have proposed that the Congress be notified of all MOUs. We have also proposed that all notifications or reports of MOUs include a section on whether or not DOD has negotiated compliance-related access provisions in the agreement. If DOD has not negotiated such a provision in the

agreement, it should explain in its notification how it is otherwise ensuring compliance with the agreement.

DOD disagrees with our congressional notification proposals because (1) they would result in a layering of reporting requirements and (2) the most significant coproduction agreements are already reported under existing requirements. We believe that our proposals are important for complete program accountability and management. Although DOD reports many MOUs as a matter of practice, it is not legally obligated to do so. It seems to us that all government-to-government agreements are significant, regardless of the dollar values of the related sales, in that they establish or enhance a foreign production capability for U.S.-origin weapons and systems.

This concludes my prepared statement. I would be happy to respond to questions.

COPRODUCTION PROGRAMS EXAMINED BY THE U.S. GENERAL ACCOUNTING OFFICEPrograms under Memorandums of Understanding (MOU)

<u>Country</u>	<u>Weapon/ system</u>	<u>MOU date</u>	<u>Responsible command</u>
Germany	AIM-9L missile	10/14/77	Naval Air Systems
	MOD FLIR night vision eqpt.	4/20/78	Army Center for Night Vision and Electro Optics
	STINGER missile system	4/27/83	Army Missile Cmd.
	UH1-D helicopter	5/30/65	Army Aviation Systems Cmd.
Italy	M-109G self- propelled howitzer	2/1/68	Army Armament, Munitions, and Chemical Cmd.
	M-113 armored personnel carrier	2/12/63	Army Tank and Automotive Cmd.
	M-60 tank	10/2/64	Army Tank and Automotive Cmd.
Japan	MK-46 MOD 5 torpedo	7/27/82	Naval Sea Systems
	HAWK/I-HAWK missile system	10/13/67	Army Missile Cmd.
	AIM-9L missile	1/27/82	Naval Air Systems
	PATRIOT air defense system	10/4/85	Army Missile Cmd.
	M-110 howitzer	2/9/82	Army Armament, Munitions, and Chemical Cmd.

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Programs under Memorandums of Understanding (MOU)

<u>Country</u>	<u>Weapon/ system</u>	<u>MOU date</u>	<u>Responsible command</u>
Korea	M-109 howitzer	12/8/83	Army Armament, Munitions, and Chemical Cmd.
	AN/PRC-77 tactical radio	8/14/73	Army Communications- Electronics Cmd.
	Ammunition (5.56-mm, 7.62-mm, .30 cal.)	3/14/72	Army Armament, Munitions, and Chemical Cmd.
Switzerland	TOW 2 missile	6/12/85	Army Missile Cmd.
	M-109 howitzer	6/3/81 ^a	Army Armament, Munitions and Chemical Cmd.
	DRAGON missile	8/5/81	Army Missile Cmd.

Technical Data Packages under Letters of Offer and Acceptance (LOA)

<u>Country</u>	<u>Program (technical data package)</u>
Greece	155-mm artillery ammunition (including M107 HE) 105-mm ammunition 20-mm and 90-mm ammunition 175-mm projectile 81-mm mortar 8-inch projectile 90-mm recoilless rifle 106-mm ammunition Fuzes (various) Grenades
Korea	155-mm, M549 RAP Projectile M18A1 antipersonnel mine 105-mm cartridges Fuzes (various) 105-mm howitzer M-110 howitzer 155-mm howitzer (M114A1) 155-mm, M198 towed howitzer

^aA follow-on MOU was signed in 1988 for additional quantities.

(cont'd)

Technical Data Packages under Letters of Offer and Acceptance (LOA)

<u>Country</u>	<u>Program (technical data package)</u>
Korea	20-mm, 30-mm, 40-mm, and 90-mm ammunition 106-mm recoilless rifle (M40A1) 60-mm and 81-mm mortars 81-mm cartridge 8-inch projectile 90-mm recoilless rifle 4.2-inch cartridge 50-caliber ammunition Explosives (various) Mines (various)