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A Comparison of Government Support in the United States and Three Major Competitors





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Declining U.S. defense spending has placed defense-related jobs and some domestic industrial capabilities at risk. U.S. defense companies are using a variety of strategies to adjust to the decline. One such strategy is to increase defense export sales. Export proponents point out that such sales maintain industrial base capabilities and lower the cost of weapons to the U.S. government. Proponents also argue that more government support for exports is needed to level the playing field against foreign (mostly European) competitors. Opponents of providing additional U.S. government support argue that such support could delay restructuring of the defense industry and jeopardize longer-term national security by increasing global weapons proliferation.

Because of the continuing congressional debate on how much support to provide to defense exporters, we reviewed (1) conditions in the global defense export market and (2) the tools used by France, Germany, the United Kingdom, and the United States to enhance the competitiveness of their defense exports. Specifically, we compared the U.S. position in the global defense market relative to its major competitors and analyzed the various factors that can contribute to a sale, including export financing and other types of government support. We are providing this report to committees for their use in debating these issues.

Background

Governments are heavily involved in most defense export transactions and they support exports for a variety of reasons. European governments support defense exports primarily to maintain a desired level of defense production capability. Their national markets are not large enough to sustain the full range of weapon systems they believe necessary for their national security. The United States has traditionally supported defense exports to meet national security and foreign policy objectives through its security assistance program. In the United States more recently, however, the impact of exports on maintaining the industrial base has gained support as a rationale for providing additional assistance to defense exporters.

Defense exports in general have a positive impact on the balance of trade.¹ In 1993 defense exports represented about 0.3 of total exports for Germany, 1.7 percent for France, 2.2 percent for the United States, and 2.4 for the United Kingdom. The impact of defense exports to total exports, however, shows a general downward trend since 1990 for three of the four countries we reviewed. During 1990 defense exports represented 0.4 percent of total exports for Germany, 3.2 percent for France, and 3.4 percent for the United States. In the United Kingdom defense exports to total exports remained at about 2.4 percent in 1990 and 1993.

Deliveries of global defense exports have declined 64 percent since 1987, when deliveries were \$77 billion.² In 1993 deliveries were \$28 billion. The end of the Cold War and changes in the political and economic structure of the former Soviet Union were considered significant factors contributing to the overall decrease in arms trade.

Results in Brief

The United States has been the world's leading defense exporter since 1990; by 1993 its market share had increased to 49 percent of the global market. The increased U.S. market share occurred during a period of worldwide decreases in total defense exports. The three European countries we reviewed had in 1993 a combined global market share of about 32 percent of total defense exports, which also increased since 1990. In the short term, at least, the United States will likely remain strong in the world market, based on the level of orders placed but not yet filled. However, further growth in its market share will be limited by a number of factors, including U.S. national security and export control policies to reduce dangerous or destabilizing arms transfers to certain countries and certain major foreign country buyers' practices of diversifying weapons purchases among multiple suppliers.

Government involvement in the defense industry's sales affects the position of defense manufacturers in overseas markets. However, various other factors also influence the outcome of a defense sale. These factors include technical sophistication and performance of the equipment, the cost and availability of follow-on support and training, price, financing,

¹Defense exports refer to major weapon systems and items such as tanks, artillery, combat and transport aircraft, and missiles. Data is based on value of sales.

²All dollar figures in this report are expressed in 1993 constant dollars. The last year data for all four countries was available was 1993.

and offset arrangements.³ It should be noted that government policies and programs can also affect these other factors. Government support targeted to increase overseas sales may become more significant as global defense markets decrease and companies fight to maintain market share. However, because each sale has its own unique set of circumstances, it is not possible to quantify or rank the contribution of any one factor across the board.

The U.S. government has long recognized the positive impact that defense exports can have on the defense industrial base. In 1990, the Secretary of State directed overseas missions to support the marketing efforts of U.S. defense companies as in all other areas of commercial activity.

Governments in France, Germany, the United Kingdom, and the United States generally provide comparable types of support. These include (1) government-backed or -provided export financing, (2) advocacy on behalf of defense companies by high-level government officials, and (3) organizational entities that promote defense exports.

Although all four countries generally provide comparable types of assistance to their defense exporters in these areas, the extent and structure of such assistance varies. In particular, central organizations support defense exports in France and the United Kingdom, while in the United States several government agencies share in supporting defense exports. In addition, all three European countries provide government-backed guarantees for commercial bank loans; in the United States, financing is provided primarily through the Foreign Military Financing (FMF) program in the form of grants and loans and available only to a small group of countries.⁴ In fiscal year 1994, about 79 percent of U.S. government financing was in the form of grants. With the exception of annually specified amounts, which Congress mandates for financing purchases in Israel, FMF generally is available only to finance purchases of U.S. defense articles and services. Accordingly, providing grant funding for purchases in the United States generally eliminates the competition from other countries for those exports.

³The term "offsets" is used to cover a variety of arrangements by which sellers direct new or additional purchases to the industry of the buying nation as part of the sale agreement. Direct offsets are directly related to the product delivered to the customer, such as producing a component of the system in question. Indirect offsets consist of the purchase of unrelated products or services.

⁴Grants represent assistance for which the United States receives no dollar reimbursement. Loans generally refer to direct loans or repayable foreign military sales credits that are made at either market or concessional rates.

In the Short Term, the United States Is Likely to Remain Strong in the World Market, but Further Growth Will Be Limited

While the global defense export market has declined since the late 1980s, the United States has become the world's leading defense exporter.⁵ The United States had the largest share of global arms deliveries at 32 percent in 1990 and increased its share to 49 percent in 1993.⁶ The overall increase in the U.S. market share from 1990 to 1993 was due, in part, to decreased sales by the former Soviet Union. In 1990 the Soviet Union's arms deliveries were \$17 billion. By 1993 Russia's defense exports had decreased 82 percent to less than \$3 billion.⁷ The dollar value of U.S. arms deliveries also decreased during this time, declining 22 percent from \$18 billion in 1990 to \$14 billion in 1993. Arms deliveries data for calendar year 1994 is not yet available. However, the Department of Defense (DOD), which collects data on a fiscal year basis, reported that fiscal year 1994 U.S. arms deliveries were about \$10 billion. According to defense analysts, U.S. arms deliveries are likely to remain at about \$10 billion annually for the rest of the decade.

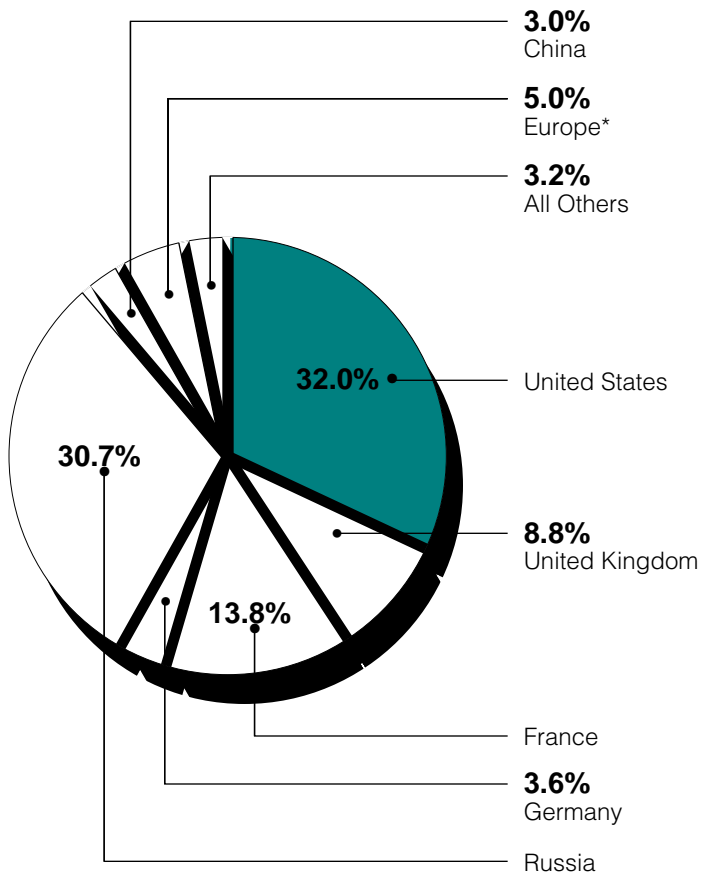
The market share of France, Germany, and the United Kingdom combined has increased from 26 percent of total arms deliveries in 1990 to 32 percent in 1993. Of these three countries, only the United Kingdom increased its market share, raising it from 9 percent in 1990 to 15 percent in 1993. The French market share declined from 14 percent to 13 percent during the same period, while Germany remained constant at about 4 percent of the arms market in 1990 and 1993. The total value of arms deliveries for the three European countries combined declined 40 percent, from \$15 billion in 1990 to about \$9 billion in 1993. Preliminary 1994 delivery data for France and the United Kingdom suggests a decline from 1993 levels. French and U.K. defense exports for 1994, in terms of deliveries, are estimated at \$2.2 billion and \$2.8 billion, respectively. Delivery data for Germany for 1994 is not yet available. Figures 1 and 2 show the percentage of global arms deliveries for 1990 and 1993 by supplier country.

⁵The market share of all four countries of our review changed following release of more current data on French defense exports. Previous data on French defense exports, in terms of deliveries, for 1993 was \$600 million. Current data on French defense exports released by the U.S. government shows an increase to \$3.7 billion in 1993. As a result of the increase of French defense exports in 1993, the U.S. market share for 1993 decreased from 55 percent to 49 percent.

⁶Data for U.S. defense export deliveries includes exports sold commercially and through the foreign military sales program.

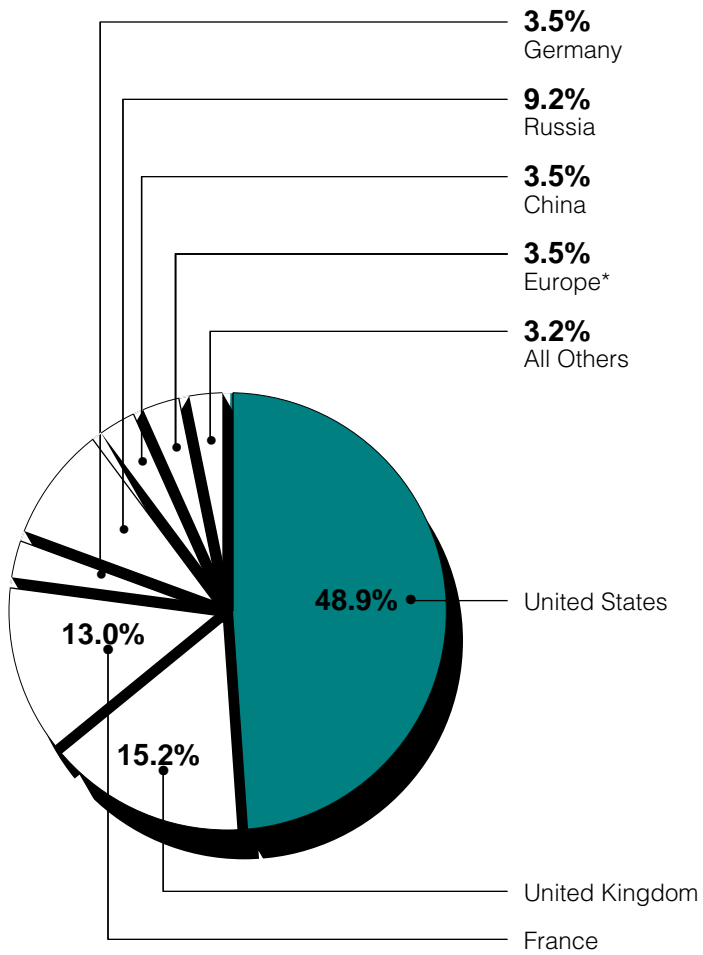
⁷All data for years prior to 1992 represent transactions of the Soviet Union as a whole. Of the former Soviet Republics, Russia was the principal arms producer and exporter. Therefore, 1992 and 1993 data reflect only Russian sales.

Figure 1: 1990 Global Arms Deliveries, by Supplier



*Includes all other European countries, except France, Germany, and the United Kingdom.

Figure 2: 1993 Global Arms Deliveries, by Supplier

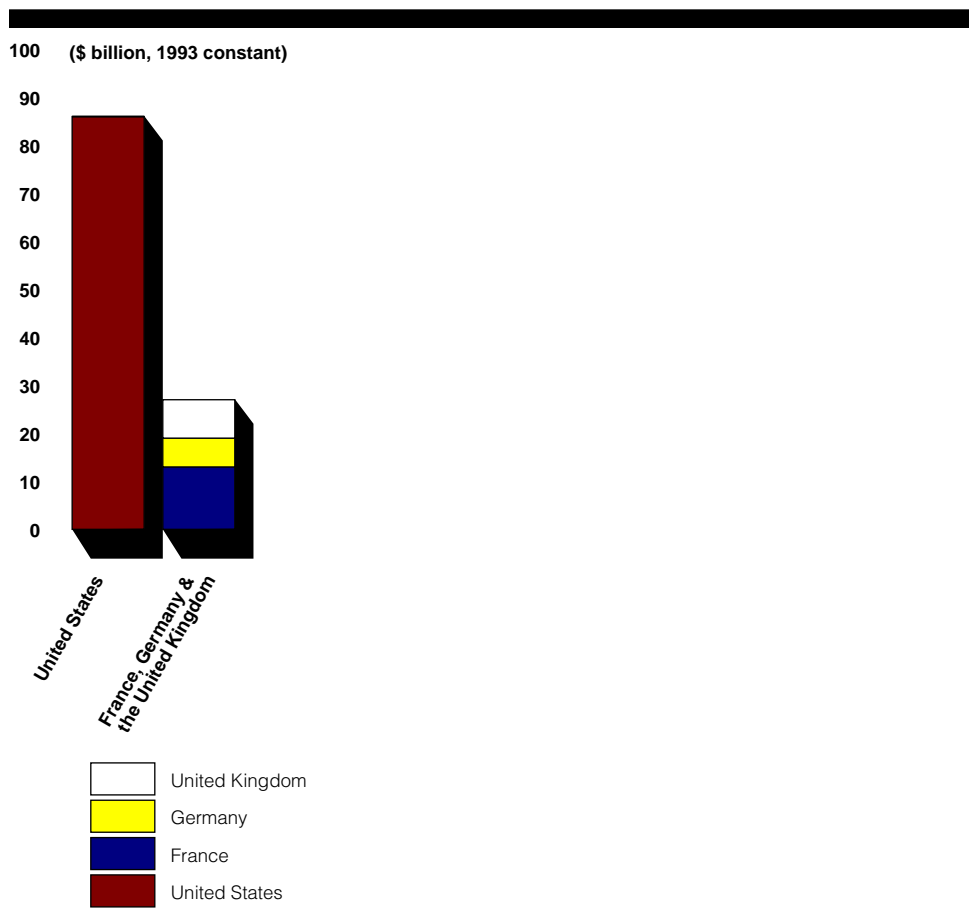


*Includes all other European countries, except France, Germany, and the United Kingdom.

In the short term, at least, it is likely that the United States will remain strong in the world market; it has \$86 billion in defense orders placed from 1990 to 1993, while France, Germany, and the United Kingdom combined have \$27 billion in defense orders from the same period. Although 1994

data for the three European competitor nations, in terms of defense orders, is not yet available, U.S. defense orders for fiscal year 1994 were about \$13 billion—a 59-percent decrease from fiscal year 1993 levels, when orders were \$32 billion. Figure 3 shows the total value of defense orders placed with France, Germany, the United Kingdom, and the United States from 1990 to 1993.

Figure 3: Defense Orders, 1990-1993



Further growth in the U.S. market share will be limited by several factors, including U.S. national security and export control policies. For example, in order to reduce dangerous or destabilizing arms transfers, the United States does not sell its defense products to certain countries, as part of its

national security objectives. Those countries include Cuba, Iran, Iraq, Libya, North Korea, Syria, and several countries of the former Soviet Union. According to the State Department, U.S. sales to other countries are reviewed on a case-by-case basis against U.S. conventional arms transfer policy criteria. Certain major foreign country buyers' practices of diversifying weapons purchases among multiple suppliers further limits U.S. market share. For example, Kuwait announced in 1994 that it planned to diversify its weapons purchases among all five permanent members of the United Nations Security Council.

Numerous Factors Contribute to Successful Defense Export Sales

Prior studies conducted by the Office of Management and Budget (OMB), the Office of Technology Assessment (OTA), and our office have concluded that there are numerous factors affecting defense export sales and that no one factor is paramount in every sale.⁸ These studies indicate that (1) each sale has its own unique set of circumstances and (2) the outcome is dependent on various factors. For example, the OMB study on financing defense exports concluded that each customer's decision-making process on defense acquisitions is sufficiently different that it is impossible to draw definitive conclusions about the relative importance of any one factor. While the study was conducted to determine the need for defense export financing, it found that other factors influence defense sales, such as price, technical sophistication of the equipment, the cost and availability of follow-on support, system performance, lead time from placement of order to delivery, the availability of training, political influence, and the financial and economic conditions of purchasing countries.

The OTA study identified co-production and technology transfer as factors that can influence a defense sale. This study noted countries that desire to develop their own defense industries are likely to consider access to technology when buying defense goods.

In our May 1991 testimony before the House Committee on Banking, Finance and Urban Affairs on a proposal to finance defense export sales, we pointed out that it is difficult to quantify the effect of financing on defense sales because of all the other factors involved in the decision-making process. In addition to the factors cited by OMB and OTA,

⁸Financing Defense Exports (Office of Management and Budget, Nov. 1990); Global Arms Trade: Commerce in Advanced Military Technology and Weapons (Office of Technology Assessment, June 1991); and The U.S. Export-Import Bank: Review of a Proposal to Finance Military Exports (GAO/T-NSIAD-91-16, May 2, 1991).

we noted the importance of offsets to a buying country when deciding between competitors in a defense sale.

U.S. and European Officials Cite Numerous Factors Important to Defense Export Sales

Industry representatives and government officials in the United States and Europe cited numerous factors that are important to defense export sales, but had differing views on what factors contributed to winning a specific defense sale. These officials cited the same factors identified by earlier government studies, including offsets, political ties, and price and quality of a product. However, when discussing the reasons behind any particular sale's outcome, U.S. government officials and industry representatives identified different reasons for the outcome of the sale. For example, in the recent German tank sale to Sweden, U.S. government officials identified offsets as the deciding factor in the sale, while an industry representative believed that the historical ties between Sweden and Germany was the reason why the German tank was chosen. In a sale of French tanks to the United Arab Emirates, U.S. government officials considered offsets to be the more important determinant in the sale, while an industry representative cited historical relationships between the buyer and the seller as the primary factor.

Moreover, several U.S. and European government officials and industry representatives stated that potential customers abroad view domestic procurement of a product as an important endorsement of confidence and one that helps lower unit costs by increasing the economies of scale associated with a system. These officials added that it is very difficult for a company to sell a defense article if its own country's defense department or ministry does not use the equipment. For example, according to a U.S. government official, Northrop's F-20 was designed specifically for export; however, Northrop was unable to sell the aircraft overseas, in part, because the U.S. government did not purchase it for domestic use. Further, because of the large size of the U.S. domestic defense market, European businesses feel that they are at a disadvantage with respect to their U.S. competitors, according to a 1992 survey conducted by the major French land-defense industry association and the consulting firm Ernst & Young.

Governments Generally Provide the Same Types of Assistance to Defense Exporters

We found that France, Germany, the United Kingdom, and the United States generally provided the same types of assistance, but the extent and structure of the assistance varies.

Government-Backed or -Provided Export Financing

All three European countries provide some form of government-backed export credit guarantees for both non-defense and defense exports as a means to provide security assistance and promote sales of their defense products. Data on the value of guarantees for defense exports, however, was available only in the United Kingdom. During fiscal year 1993/1994,⁹ the United Kingdom guaranteed \$2.9 billion in defense exports. France and Germany report total export financing and do not differentiate between defense and non-defense export financing. Therefore, we were unable to obtain information on the extent of guarantees provided to defense exports in either country.

In the United States, government financing is provided through the FMF program. According to DOD officials, FMF is provided as an instrument to advance U.S. foreign policy and national security interests rather than a means to promote U.S. exports. In fiscal year 1994 the United States used the program to provide about \$3.1 billion in grants, mostly to Israel and Egypt, and \$0.8 billion in loans to Greece, Turkey, and Portugal. Applicable U.S. legislation provides that FMF grants are generally intended to fund purchases of U.S. military goods and related services. It is unlikely U.S. contractors would lose sales to foreign competitors for FMF grant-funded purchases.¹⁰ The U.S. government is fully funding the purchase of U.S. military goods and services by other countries, thus giving U.S. companies an advantage over foreign competitors that are only offering government guarantees on loans. In addition, in fiscal year 1994, the Defense Security Assistance Agency waived about \$273 million in research and development costs on foreign military sales to nine allied countries.

U.S. commercial banks provide some financing of defense exports; however, the U.S. government does not guarantee such financing. The Export-Import Bank of the United States is prohibited from providing

⁹The fiscal year in the United Kingdom is from April 1 of one year to March 31 of the following year.

¹⁰See Military Exports: Concerns Over Offsets Generated With U.S. Foreign Military Financing Program Funds (GAO/NSIAD-94-127, June 22, 1994).

loans or guarantees for purchasing defense articles or services unless requested to do so by the President.¹¹ Limited export financing is also provided at the state level. For example, from July 1988 to November 1994 the state of California provided about \$26 million in loan guarantees to California-based defense companies.

Advocacy on Behalf of Defense Companies

The French and U.K. governments have historically sent high-level government officials, such as ministers of defense, ambassadors, or prime ministers, to persuade foreign buyers to buy their national defense products. The German government has generally avoided using high-level government officials to promote defense exports, in part because defense exports are a politically sensitive issue in Germany. In the United States, defense exports have traditionally been approved to further U.S. national security and foreign policy goals. Nevertheless, as part of the U.S. government's emphasis on overall export promotion efforts, high-ranking U.S. officials have been increasingly willing to intervene to influence competitions in favor of U.S. defense companies. However, DOD policy indicates that U.S. officials should support the marketing efforts of U.S. companies but maintain strict neutrality between U.S. competitors.

During the competition for the United Kingdom's Skynet-4 Satellite launch vehicle, U.S. government officials intervened at a high level on behalf of U.S. defense exporters. According to an industry representative involved in this sale, the U.K. Ministry of Defence split the contract between the U.S. company and the French as a result of intervention by the U.S. Ambassador and the Secretary of Commerce. The official stated that without U.S. government involvement, the French manufacturer would have received the entire \$1-billion contract.

Organizations That Support Defense Exports

France and the United Kingdom each have a single organization within their respective defense ministries with responsibility for identifying defense export opportunities abroad, promoting and facilitating defense exports, providing assistance with defense equipment demonstrations and trade shows, and providing advice to industry regarding offsets. In France this organization is known as the Delegation for International Relations. In the United Kingdom this organization is known as the Defence Export

¹¹Recent legislation (P.L. 103-428-Oct. 31, 1994) allows the Export-Import Bank to provide financing on its own initiative, subject to certain conditions, for the export of nonlethal defense articles and services when the primary end use will be for civilian purposes. The new law provides an exception to the previous prohibition on the Bank financing of exports of any defense articles and services, but only in those cases where the article to be exported is both nonlethal and the primary end use is for civilian purposes, for example, radar for air traffic control systems.

Services Organisation. Although Germany does not have a defense ministry organization comparable to that of France or the United Kingdom, German companies involved in cross-border collaborative efforts with those countries are able to benefit indirectly from the export promotion activities of the French and U.K. organizations. While the United States has no centralized government organization with a comparable export promotion role, the Departments of Defense, Commerce, and State each provide similar support for U.S. defense exports.

Agency Comments

The Departments of Commerce, Defense, and State were given the opportunity to comment on a draft of this report. Defense concurred with the report. Commerce wrote that it had reviewed the draft report and did not have any comments. State, in general, agreed with our analysis and conclusions and found the draft report to be an accurate reflection of the international competition for military export contracts.

State also commented that offsets play a major role in determining which firms obtain contracts and foreign governments are eager to support offset arrangements to obtain a competitive advantage. In addition, State noted that sales of conventional arms are a legitimate instrument of U.S. foreign policy deserving U.S. government support when they help friends and allies deter aggression, promote regional stability, and increase interoperability of U.S. and allied forces. However, State pointed out that an examination of the dynamics of regional power balances and the potential for destabilizing changes in the region is required for each specific sale.

We have made minor factual revisions to the report where appropriate based on technical comments provided by Defense and State.

We did our work between January 1994 and February 1995 in accordance with generally accepted government auditing standards. A discussion of our scope and methodology is in appendix I. More information on government support to enhance the competitiveness of defense products is provided in appendix II. The comments of the Departments of Defense, State, and Commerce are presented in appendixes III, IV, and V, respectively.

We are sending copies of this report to the Secretaries of Defense, Commerce, and State and the appropriate congressional committees. Copies will also be available to other interested parties on request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix VI.

A handwritten signature in black ink that reads "David E. Cooper". The signature is written in a cursive style with a large, prominent "D" and "C".

David E. Cooper
Director, Acquisition Policy, Technology,
and Competitiveness Issues

List of Committees

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United States Senate

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Abbreviations

CRS	Congressional Research Service
DCI	Défense Conseil International
DESO	Defense Export Services Organisation
DOD	Department of Defense
DRI	Delegation for International Relations
ECGD	Export Credits Guarantee Department
FMF	Foreign Military Financing
FMS	Foreign Military Sales
OMB	Office of Management and Budget
OTA	Office of Technology Assessment

Scope and Methodology

Because of the continuing debate on how much support to provide to defense exporters, we reviewed conditions in the global defense export market and the tools used by France, Germany, the United Kingdom, and the United States to enhance the competitiveness of their defense exports. Specifically, we compared the U.S. position in the global defense market relative to its major competitors and analyzed the various factors that can contribute to a sale, including export financing and other types of government support.

For our review, we selected France, Germany, and the United Kingdom because they (1) represent the major competitors to U.S. defense exporters in terms of the value of exports sold and (2) sell to approximately the same buyers. In 1993 these four countries represented 81 percent of the world's total defense market. Together, Russia and China represented 13 percent of the total market, but were not part of this review because a large share of Russian and Chinese defense products are sold to countries to which the United States would not sell.

While several U.S. government agencies collect information on defense exports, it is difficult to compare their analyses because each agency uses different methodologies for collecting and reporting the data. We used mostly Congressional Research Service (CRS) data on defense exports for calendar years 1990 to 1993 to compare the U.S. position in the global defense market relative to its European competitors. We also used more current data on French defense exports, in terms of deliveries, provided by the U.S. government. This new data increased the level of French defense exports, both in absolute and relative terms, previously reported by CRS. Further, we use calendar year data rather than fiscal year data because data on European defense exports is reported on a calendar year basis. We did not independently verify CRS data, but the data is generally accepted among government agencies as dependable. In addition, we used the State Department's Office of Defense Trade Controls data on deliveries of U.S. direct commercial sales, because CRS does not include that data in its annual reports on global arms sales.

To determine the U.S. position in the global defense market in the near future, we used the value of U.S. defense orders as reported by CRS. However, the value of these orders includes only those placed through the Foreign Military Sales program and does not include orders placed by direct commercial means. While the State Department reports the value of export licenses approved for direct commercial sales, it does not report the value of actual defense orders placed as a result of those licenses. The

value of direct commercial sales deliveries as a result of those licenses, according to government documents, may be as little as 40 to 60 percent of the value originally reported when the license was approved. The State Department reported that it issued about \$87 billion in licenses from fiscal year 1990 to 1993.

In analyzing the various factors that contributed to winning a defense sale, we held discussions with U.S. government and defense company officials responsible for tracking U.S. defense sales. In addition, we reviewed prior government reports on the subject.

To obtain information on U.S. defense export promotion efforts, we reviewed numerous government and nongovernment studies and reports on the subject. In addition, we interviewed officials at the Departments of Defense, Commerce, and State, and the Defense Security Assistance Agency; U.S. defense company officials located in the United States and Europe; and trade organizations. We also spoke to officials from the Office of Management and Budget, the Export-Import Bank, the Banker's Association for Foreign Trade, and six commercial banks, to obtain additional information on defense export financing.

To obtain information on European countries' export promotion programs, we discussed with, and analyzed documents from, officials involved in their countries' defense export promotion activities. This group included officials from national governments, academia, and European defense companies. We also met with officials from the Department of Defense's Office of Defense Cooperation and the Department of Commerce's U.S. and Foreign Commercial Service offices. We also attended the Eurosatory Land Show in Paris, France, to observe U.S. exporters and their competitors at a major defense trade show.

To convert French francs and British pounds to U.S. dollars, we used the following exchange rates. To report on France's Delegation for International Relations annual budget, we used the average calendar year 1994 exchange rate. To report on the U.K.'s Defence Export Services Organisation annual budget and the amount of defense export financing provided by the Export Credits Guarantee Department, we used the exchange rate at the end of the U.K. fiscal years ending March 31, 1993, and March 31, 1994.

We sought to report on multilateral agreements on defense trade and found that no such agreements exist.

Types of Government Assistance

Defense Export Financing

Approaches to financing defense exports vary among the four countries. Such financing includes the use of various financial instruments, including grants, loans, and guarantees.

U.S. Defense Export Financing Primarily Provided Through the Foreign Military Financing Program

In the United States, most financing is provided through the government's Foreign Military Financing (FMF) program, with limited financing provided by commercial banks. Some financing is also available at the state level. A 1992 decision to cancel fees on some sales that recovered part of the government's investment in a weapon system was made to increase the competitiveness of U.S. firms.

In fiscal year 1994 the United States used the FMF program to provide about \$3.1 billion in grants—mostly to Israel and Egypt—and \$0.8 billion in loans to Greece, Turkey, and Portugal. The FMF program enables U.S. allies to buy U.S. defense goods and related services and training. Congress often specifies the extent of assistance to certain countries. Most grants and loans are used to purchase U.S. defense products, although a designated amount of FMF funding is permitted to be spent on procurement in Israel. In fiscal year 1994 Israel was permitted to spend at least \$475 million of its grant assistance on procurement in Israel. The FMF program has decreased since 1990, when the program provided over \$4.8 billion in loans and grants.

The U.S. government does not guarantee commercial financing for defense exports. Further, the Export-Import Bank of the United States is prohibited from providing loans or guarantees for purchasing defense equipment. Therefore, according to U.S. bank officials, U.S. commercial banks provide few financial services for defense exports, partly because of concerns that such services might generate negative publicity. Senior bank managers approve defense export financing transactions on a case-by-case basis. Financing is provided for defense transactions that are low risk and will carry a short repayment schedule. According to bank officials, repayment terms of commercial loans for defense exports generally do not exceed 2 years. These officials further stated that commercial banks are reluctant to provide financing to foreign countries without some type of U.S. government guarantee program. Moreover, even with such a program, some banks would still be reluctant to provide financing to defense exports, because of concerns about negative publicity.

Some export financing is provided at the state level. For example, the state of California provides export financing for its defense companies. From

July 1988 through November 1994 California provided about \$26 million in loan guarantees for 77 transactions to California-based defense companies. At the time of this review, 30 states provided export financing. However, data on export financing is not separated out by defense and nondefense exports; therefore, we were not able to determine how many states, other than California, provided financing for defense exports.

For years the price of U.S. military exports generally included a Department of Defense (DOD) charge to recover a portion of its non-recurring research and development costs. In 1992 the policy of recovering these costs when the sales were directly between the U.S. contractor and a foreign government was canceled. The recovery of U.S. government costs were canceled in an effort to increase the competitiveness of U.S. firms in the world market. In addition, the Arms Export Control Act, which generally requires recovery of such costs on government to government sales, permits DOD to waive or reduce such charges on sales to North Atlantic Treaty Organization countries, Australia, New Zealand, and Japan in furtherance of standardization and mutual defense treaties. In fiscal year 1994, DOD recovered \$181 million in such costs but waived about \$273 million. Recently, the executive branch has proposed that Congress repeal the requirement to collect such charges on future government to government sales.

European Export Financing Provided Through Government-Backed Export Credit Guarantees

All three European countries provide some form of government-backed export credit guarantees for both nondefense and defense exports. Export credit guarantees are a form of insurance covering risk of loss due to such factors as exchange rate fluctuations or buyer nonpayment. They can allow access to financing for exporters extending credit to their buyers and for overseas buyers borrowing directly from banks. Data on the value of guarantees for defense exports, however, was available only in the United Kingdom. France and Germany report total export financing and do not differentiate between defense and nondefense export financing. Thus, we were unable to obtain information on the extent of guarantees provided to defense exports in either country.

During fiscal year 1993/1994, the United Kingdom's Export Credits Guarantee Department (ECGD) guaranteed about \$6.1 billion in exports, of which \$2.9 billion (or 48 percent) was for defense exports. About 90 percent of the \$2.9 billion was for defense equipment sold to countries in the Middle East, mostly to Kuwait, Oman, Qatar, and Saudi Arabia. Among industry sectors, military aircraft represented about 40 percent of

the \$2.9 billion total, military vehicles represented about 39 percent, and naval vessels represented about 21 percent. In fiscal year 1992/1993, ECGD guaranteed about \$5.8 billion in exports, of which \$2.4 billion (or 42 percent) was for defense exports. About 57 percent of the \$2.4 billion was for defense equipment sold to countries in the Far East and about 43 percent of the total was for equipment sold to the Middle East. Among industry sectors, naval vessels represented about 39 percent of the \$2.4 billion total, military aircraft represented about 32 percent, and munitions and missiles represented about 27 percent.

Advocacy by High-Level Government Officials

The French and U.K. governments have historically sent ministers of defense, ambassadors, or prime ministers to persuade foreign buyers to buy their national defense products. The German government has generally avoided using high-level government officials to promote defense exports, in part because such exports are a sensitive political issue in Germany. In the United States, defense exports have been approved to further U.S. national security and foreign policy goals. Nevertheless, as part of the U.S. government's emphasis on overall export promotion efforts, high-ranking U.S. officials have been increasingly willing to intervene to influence competitions in favor of U.S. defense companies.

An example of high-level government advocacy is the Swedish government's purchase of the German Leopard 2 tank. The German Chancellor and Minister of Defense advocated on behalf of the German Leopard 2 tank, which, according to U.S. government officials, led to Sweden purchasing it over the French or U.S. tank. Other factors contributing to Sweden's choice included the German manufacturer's promise to buy Swedish defense material and services worth full value of the tanks they were exporting to Sweden.

Organizational Entities That Support Defense Exports

France and the United Kingdom each have a single organization within their respective defense ministries with responsibility for identifying defense export opportunities abroad, promoting and facilitating defense exports, providing assistance with defense equipment demonstrations and trade shows, and providing advice to industry regarding offsets. Although Germany does not have a defense ministry organization comparable to those of France or the United Kingdom, German companies involved in cross-border collaborative efforts with those countries are able to benefit indirectly from the export promotion activities of the French and U.K.

organizations. While the United States has no centralized government organization with a comparable export promotion role, several U.S. government agencies provide similar support for U.S. defense exports.

France and the United Kingdom Each Have a Single Organization to Support Defense Exports

In France, the Ministry of Defense's Delegation for International Relations (DRI) is responsible for facilitating and promoting French global defense sales. DRI assigns defense attachés overseas to promote military and armament relations with other countries. DRI also subsidizes missions for small business to participate in events such as trade shows. DRI employs roughly 200 staff—about 60 are involved in facilitating and promoting defense sales with the remaining staff involved in export control activities and oversight of cooperation activities with allied nations. DRI has an annual budget of \$7 million which is used in a variety of ways, including Ministry of Defense participation in trade shows and subsidizing small business missions to participate in those shows. DRI also serves as a liaison between the Ministries of Defense and Industry, which, according to DRI officials, is the most important support provided to the French defense industry. While DRI promotes and facilitates sales, sales are primarily handled either by defense companies themselves or by various marketing and sales organizations. The French government owns 49.9 percent of the Défense Conseil International (DCI). DCI serves as a consultant to buying countries to help them define their operational needs, weapon requirements, and specifications. The remaining 51.1 percent is owned by private-sector marketing and sales organizations.

In the United Kingdom, the Ministry of Defence's Defence Export Services Organisation (DESO) is responsible for assisting in the marketing and sales efforts of U.K. defense companies overseas, whether manufactured nationally or in collaboration with others. DESO serves as a focal point for all defense sales and service matters, including advising firms on defense market prospects on a worldwide, regional, or country basis; providing marketing and military assistance in support of sales; organizing exhibitions, missions, and demonstrations; providing advice on export and project financing; ensuring that overseas sales consideration is given due weight in the U.K. Ministry of Defence's own procurement process; briefing companies new to the defense sector and to exporting; and monitoring offset agreements. DESO's budget for fiscal year 1992/1993 was about \$25.9 million. DESO has approximately 350 staff—about 100 in marketing services, 50 in general policy, and 200 in direct project work. DESO concentrates primarily on supporting higher-value exports, although smaller companies also benefit from DESO guidance on such matters as

how best to pursue potential subcontracts. In addition, larger companies rely on DESO to serve as a liaison with high-level U.K. and foreign government officials.

Several U.S. Government Agencies Provide Support of Defense Exports

The Departments of Defense, Commerce, and State each provide support in promoting U.S. defense exports. Moreover, the U.S. government has long recognized the positive impact that defense exports can have on the defense industrial base.

Beginning in 1990 the U.S. government began to give more prominence to the economic value of defense exports. At that time, the Secretary of State directed overseas personnel to assist defense companies in marketing efforts. The Secretary added that individuals marketing U.S. defense products should receive the same courtesies and support offered to persons marketing any other U.S. product.

More recently, the U.S. government announced its National Export Strategy, which is designed to establish a framework for strengthening U.S. export promotion efforts. Although the strategy does not target defense exports, some recommendations for improving export promotion activities could benefit defense exports. For example, the strategy recommended that overseas posts prepare country commercial guides. The guides are to include information on the host country's best export prospects for U.S. companies, which may include defense exports. These guides are to be made available to the public through the Department of Commerce's National Trade Data Bank.¹

In February 1995, the President announced his conventional arms transfer policy which included, as one of its principal goals, enhancing the U.S. defense industry's ability to meet U.S. defense requirements and maintain long-term military technological superiority at lower costs. The announcement indicated that once a proposed arms transfer is approved, the U.S. government will take such steps as (1) tasking U.S. embassy personnel to support overseas marketing efforts of American companies bidding on defense contracts, (2) actively involving senior government

¹The National Trade Data Bank is a computerized information system containing export promotion and international trade data collected by 17 U.S. government agencies. The data bank is released on CD-ROM disks.

officials in promoting sales of particular importance to the United States, and (3) supporting DOD participation in international air and trade shows.²

As part of the U.S. security assistance program, the Defense Security Assistance Agency and the military services implement the Foreign Military Sales program, through which most U.S. defense sales are made. U.S. security assistance personnel stationed overseas are primarily responsible for security assistance and defense cooperation activities in the host country. When requested, these personnel provide information and support to U.S. industry on business opportunities in the host country, including information on the buying countries' defense budget cycle, national procurement process, and estimates of equipment the country currently needs to fill defense requirements or likely future procurement plans. In addition, the Defense Security Assistance Agency coordinates DOD participation in international air shows and trade exhibitions. The military services lease equipment to U.S. defense companies for display or demonstration at such events.

The Department of Commerce has primary responsibility for export promotion and has recently expanded its export promotion activities to include defense exports. For example, Commerce prepares market research reports on various countries. These reports identify trade opportunities in the host country, including those in defense trade. Other information on the host country included in these reports includes information on market assessment, best sales prospects, the competitive situation, and market access. These reports are made available to the public through the National Trade Data Bank. Other activities include preparing U.S. and Foreign Commercial Service Officer guidance on supporting defense exports. This guidance directs officers to provide information similar to that provided by the Defense Security Assistance Agency and the military services. Moreover, the Departments of Commerce, State, and Defense participate in defense industry liaison working groups to assess improving U.S. government support for U.S. defense exporters.

²The announcement recognized that, in accordance with existing law, participation in such exhibitions must have the Secretary of Defense's determination that participation would be in the national interest and Congress must be notified.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON, DC 20301-2800

0 8 MAR 1995

I-000851/95

Mr. David E. Cooper
Director, Acquisition Policy, Technology
and Competitiveness Issues
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "MILITARY EXPORTS: Comparison of U.S. and Foreign Government Support," dated February 22, 1995 (GAO Code 705042), OSD Case 9867. The DoD concurs with the report.

Technical accuracy annotations to the subject draft report have been provided separately to GAO staff. The Department appreciates the opportunity to review and comment on the draft report.

Sincerely,

A handwritten signature in cursive script, appearing to read "Diana L. Blundell".

Diana L. Blundell
Director, Plans

See comment 1.

The following is GAO's comment on the Department of Defense's (DOD) letter dated March 8, 1995.

GAO Comment

1. We have not included DOD's technical annotations to our draft report but have incorporated them in the text where appropriate.

Comments From the Department of State

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



United States Department of State
Chief Financial Officer
Washington, D.C. 20520-7427

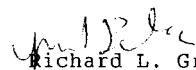
MAR 17 1995

Dear Mr. Hinton:

We appreciate the opportunity to provide Department of State comments on your draft report, "MILITARY EXPORTS: Comparison of U.S. and Foreign Government Support," GAO/NSIAD-95-86, GAO Job Code 705042.

If you have any questions concerning this response, please call Mr. Gilbert Sperling, PM/EXP, at 647-0709.

Sincerely,


Richard L. Greene

Enclosure:
As stated.

cc:
GAO/NSIAD - Ms. Schinasi
State/PM/EXP - Mr. Sperling

Mr. Henry L. Hinton, Jr
Assistant Comptroller General,
National Security and International Affairs,
U.S. General Accounting Office.

**Appendix IV
Comments From the Department of State**

**GAO Draft Report: "Military Exports: Comparison of U.S.
and Foreign Government Support,".
GAO/NSIAD-95-86, GAO Job Code 705042**

See comment 1.

In general, the Department of State agrees with the report's analysis and conclusions and finds it to be an accurate reflection of the international competition for military export contracts. The one area we believe could be emphasized more is the major role offsets play in determining which firms obtain contracts for major military systems. Our policy prohibits government agencies from encouraging U.S. firms to enter into offset arrangements and it is recognized that offsets present special problems when they involve controlled technology. However, foreign governments see offsets as providing real competitive advantages in a tight world arms market. Foreign governments are eager to support their industries by encouraging such technology transfers and offsets will continue to play a role in arms trade.

See comment 1.

The President's February 17 announcement of the Administration's Conventional Arms Transfer Policy, which established U.S. policy on the issue of support for defense exports, should be mentioned in the GAO report. This policy reflects an approach towards arms transfers that has guided the Administration's decisions over the last two years. Specifically, the United States continues to view transfers of conventional arms as a legitimate instrument of U.S. foreign policy -- deserving U.S. government support -- when they enable us to help friends and allies deter aggression, promote regional security, and increase interoperability of U.S. forces and allied forces. Judging when a specific transfer will meet that test requires examination of the dynamics of regional power balances and the potential for destabilizing changes in those regions. We have provided suggested language for inclusion in the GAO draft.

See comment 2.

In addition, attached is a list of other suggested editorial changes that we believe will contribute to the overall accuracy of the report.

The following are GAO's comments on the Department of State's letter dated March 17, 1995.

GAO Comments

1. We have modified the report to reflect this comment.
2. We have not included the attached list of suggested editorial changes but have incorporated them in the text where appropriate.

Comments From the Department of Commerce



THE SECRETARY OF COMMERCE
Washington, D.C. 20230

MAR 15 1995

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
United States General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Hinton:

We thank you for the opportunity to review the draft GAO report *Military Exports: Comparison of U.S. and Foreign Government Support* (GAO Code 705042). The Department of Commerce has reviewed the draft report and does not have any comments at this time.

Sincerely,

A handwritten signature in black ink that reads "Ronald H. Brown".

Ronald H. Brown

Major Contributors to This Report

National Security and
International Affairs
Division, Washington,
D.C.

Ernest A. Doring
John Neumann
Katherine V. Schinasi
James F. Wiggins

European Office,
Frankfurt, Germany

Mary R. Offerdahl
Cherie M. Starck

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