THE SPECIAL DEFENSE ACQUISITION FUND: AN INITIATIVE TO IMPROVE FMS WEAPONS MANAGEMENT

By

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The overwhelming bulk of Foreign Military Sales (FMS) requirements are satisfied from production without adverse impact on U.S. forces. However, for quite some time various administrations have recognized the need to create a special system for the procurement of military equipment and service in advance of foreign requirements. U.S. national interest frequently dictates that we respond favorably to urgent foreign requests for rapid delivery of military material. Some diversion from U.S. production or withdrawals from the inventories of U.S.forces of military equipment to meet urgent foreign requirements are likely to occur in the future as they have in the past. This is true because a particular drawdown of U.S. equipment could, under some circumstances, make a contribution to U.S. national security interests which would outweigh the adverse impact on readiness resulting from the shortfall created within U.S. units. U.S. production capabilities have little slack, and lead times are long, creating a vulnerability to diversions. Historically, the $2.2 billion (FY 84 dollars) U.S. emergency military resupply effort to Israel during and immediately after the Yom Kippur War was our first experience with the impact of modern high intensity warfare on readiness. This massive effort provided Israel with large quantities of tanks, APCs, artillery, anti-tank guided missiles, ammuntions, fighter aircraft, air munitions, bombs, ECM equipment, and many other significant items through drawdown of U.S. inventories. A future October War-type emergency could, of course, arise for one or more of our allies at any time. In recent years, for a variety of politico-military reasons, we have responded to many urgent requests for security assistance -- for example, Yemen, Jordan, Thailand, Oman, El Salvador, Pakistan, and Lebanon to name a few.

Clearly, a system was needed to enhance the President's ability to fulfill urgent requirements to allied and friendly nations while minimizing adverse impacts on the modernization or readiness of U.S. forces. However, legislation mandated payment in advance and full cost recovery on an individual-sale basis, thereby making it illegal to spend any money on procurement for a foreign purchaser before a particular sales agreement was concluded.

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As a result, we frequently faced a dilemma when a foreign government requested delivery of defense articles in less than normal lead time -- often in the face of serious threats. Either we could turn down the request, and possibly impair our national security and foreign policy interests, or we would fulfill the requirement by diverting equipment from U.S. forces, thus slowing U.S. force modernization or degrading U.S. force readiness. By authorizing advance procurement of equipment likely to be required by foreign purchasers, delivery leadtimes would be reduced and there would be fewer instances of diversions from U.S. forces to meet urgent foreign requirements.

Since the Yom Kippur War experience, DOD has searched for a means to provide advance procurement of items likely to be in high demand for foreign emergencies, as well as in short supply in U.S. forces. For example, for FY 1976, DOD asked for $300 million in its budget to establish a revolving fund for procurement of defense articles in anticipation of foreign requirements. Congress rejected the proposal for a revolving fund, but indicated a willingness to consider augmenting U.S. inventories of critical items.

In its FY 1981 budget request, DOD sought approximately $48 million to procure artillery and vehicles needed by the Army, but which would be ear-marked for transfer to foreign countries to meet emergency needs. Congress denied this request, seeing it as underwriting foreign assistance in the DOD budget, and thus, in competition with high priority needs of U.S. forces.

In establishing its arms transfer policy, the Reagan Administration stated that security assistance is an essential element of our foreign policy, and that security assistance has the same budget priority as defense. In order for DOD to implement this policy effectively while limiting any adverse impact on US force combat readiness, new emphasis was given to the need for better advance planning to integrate the procurement for Foreign Military Sales (FMS) with procurement by the Military Departments.

In formulating the defense budget for FY 1982, DOD and the State Department again considered procurement in anticipation of foreign contingencies. However, we concluded that we should seek a way of doing this which would avoid competing for scarce resources in the DOD or the security assistance budget. We proposed a FY 1982 legislative change to authorize the Secretary of Defense to establish a separate account called the Special Defense Acquisition Fund (SDAF) for the acquisition of defense articles and services in anticipation of their transfer under the Arms Export Control Act or Foreign Assistance Act to eligible foreign countries or international organizations. The account was to be funded by certain receipts from previous Foreign Military Sales.

This time Congress was more amenable to our proposal. Section 108(a) of the International Security and Development Cooperation Act of 1981 added a new chapter (Chapter 5) to the Arms Export Control Act authorizing the Secretary of Defense, in conjunction with the Secretary of State, to establish a Special Defense Acquisition Fund to be used as a revolving fund separate from other accounts, under the control of the Department of Defense. The purpose of the SDAF is to finance the acquisition of defense articles and defense services in anticipation of their sale. Sales, of course, would be made in accordance with the Arms Export Control Act, the Foreign Assistance Act of 1961, as amended, or as otherwise authorized by law, to eligible foreign countries and international organizations, in the same manner as all other FMS. Thus, SDAF would:

- Enhance the President's ability to react to foreign policy requirements involving security assistance by providing the capability to fulfill urgent needs of allied and friendly governments for military equipment while minimizing the adverse impact on the combat readiness of U.S. forces;

- Provide an effective means to assist in smoothing rates or production, thus increasing efficiency and reducing costs of both foreign and Defense Department weapons procurements;

- Reduce procurement leadtimes for delivery of weapon systems to foreign governments, or, where items must be taken from U.S. forces, for payback to U.S. forces.

The law authorizes capitalization -- through time -- by certain receipts from previous Foreign Military Sales, including asset use charges (including contractor rental payments for U.S. Government-owned plant and production equipment); charges for the proportionate recoupment of nonrecurring research, development, and production costs; and FMS sales or reimbursements due to grant aid transfers of defense articles and services previously acquired with SDAF funds., We had also wanted to capitalize with collections from FMS sales of defense articles from stock not intended to be replaced. However, we have so far received this latter authority only for FY 1983. The 1981 Act authorized capitalization levels of $300 million in FY 1982 and $600 million in FY 1983. P.L. 97-252 increased capitalization to $900 million in FY 1984 and thereafter. However, the Foreign Operations Subcommittees of Appropriations restricted the amount that could be obligated in each fiscal year: $125 million in FY 1982, another $125 million in FY 1983, and $225 million in 1984, for a total of $475 million.

The day-to-day management and operation of the SDAF is under the direction and supervision of the Director, Defense Security Assistance Agency (DSAA). To the extent possible there is close synchronization of SDAF procurement planning with the budget processes of the military departments. The annual SDAF procurement plan is developed by DSAA in concert with the Department of State, the military departments and the Joint Chiefs of Staff. The primary criteria for procurement of SDAF items are as follows:

-- Items should be those, based on experience and judgment, which are most likely to be needed to meet foreign requirements in less than normal procurement lead times.

-- Items should be those whose withdrawal from active or reserve force inventories or diversion from production dedicated to active or reserve forces, would result in adverse impact on the combat readiness of U.S. forces.

-- Items should be capable of being produced from existing or expanded production lines.

-- Items should, if not transferred to meet foreign requirements, be required to meet established acquisition objectives of U.S. forces.

-- Items should be those with long procurement lead times--particularly over 24 months.

-- The production line for the item may be scheduled to close before anticipated FMS requirements can be placed on contract.

-- It may be desirable to keep the production line open for mobilization base purposes.

-- There should be no procurement of items that commercial firms have been able to capitalize on their own without an FMS contract.

-- The item should have the capability of being approved for foreign sale under current national disclosure policy.

Following the decision to procure an item using SDAF financing, DSAA authorizes the military department concerned to enter into a procurement contact.

As the SDAF operates, defense items will come off the production line and be sold to foreign military sales customers or grant aid recipients under the same AECA procedures that govern any foreign military sale. In many, if not all instances, the actual sale agreement will be completed with the foreign government at some period prior to the actual delivery of the item. Thus, the foreign government will, in many or most cases, receive the item in less than "normal" procurement lead time. In another instance, an SDAF procurement might be used to payback a diversion from production for a military department or a withdrawal from DOD stocks, whereby the "payback" lead time would be reduced.

If an item should be ready for delivery without an already identified foreign buyer, the law permits the appropriate military department to use the item on a temporary basis against its approved acquisition objectives, while paying the operation and maintenance costs associated with that use. If a foreign sale of the item is approved later, the military department will pay the cost of restoring or replacing the item. In a crisis situation, should the Secretary of Defense determine that the needs of U.S. forces are more urgent than those of the anticipated foreign recipients, he could decide to transfer the items to the military departments on a pay-back basis.

If acquisition for, and sales from, the SDAF are keyed to meeting anticipated emergency requirements for items already in Military Department inventories, the production base for the items, as well as the items themselves, must be managed carefully and synchronized with Military Department procurement planning. There is a case, as indicated by one of the criteria noted earlier, for using the SDAF on an exceptional basis to fund an increment of "new system" production capability. This could be justified when it is clear that a particular system, e.g., the Multiple Launch Rocket System (MLRS), would likely create a demand for security assistance withdrawal or diversion before U.S. force requirements were met, or where there was no additional production capacity planned for or capitalized to meet security assistance requirements. In short, we could face an instance where known, urgent requirements existed in parallel with those of our own forces for a new system, like the Super-Rapid Blooming Chaff ("SRBOC") used for defense against anti-ship missiles. In those exceptional instances, we would consider funding an increment of new production capacity to meet anticipated security assistance requirements. The U.S. would not then be faced with the dilemma of slowing down the modernization of its own forces in order to meet the urgent, parallel modernization requirements of a friend or ally. In those instances where the SDAF contributed to capitalizing new production capacity, the cost would be recouped for the fund from a surcharge added to the sale or grant of items made on the SDAF portion of the production line. This would be parallel to the current recoupment of nonrecurring production costs.

It may be useful to eliminate some possible misconceptions about the SDAF by indicating what the fund "is not." The SDAF is neither a mechanism for the Defense Department to stockpile defense articles in circumvention of the normal defense budget process, nor is it a device to underwrite Military Department Requirements with the Security Assistance Program. An essential purpose of the SDAF is to get a jump on procurement and production leadtime, and, if we have anticipated the right demand, items will be sold before they reach inventory.

The SDAF is not a scheme to undercut commercial sales by reducing the potential market and using the "power of the federal government" to keep industry from doing "its job." We would be most unlikely to procure items that commercial firms have been able to capitalize on their own and for which they maintain a continuing production base with reasonable lead time. The SDAF more likely will be concentrated on items where the expense and "intermittent" demand pose too high a risk for a purely commercial venture. Operation of the SDAF will not interfere with commercial efforts. Indeed, industry will receive the benefit of additional business, with the positive effects of a broader production base, a greater spread of overhead, production line smoothing, etc. With the SDAF as without it, if appropriate, and if the "customer" chooses, the commercial option will be available to meet a foreign government's security assistance needs.

The SDAF is not a device specifically to keep a production line open; however, it could be used for this purpose if there was a clear need. For example, if an on-going market existed for a particular item and that item was no longer being produced for U.S. forces, or if the line was about to break, it would be prudent to fund the on-going production of the item in anticipation of known foreign requirements. This would be preferable to depending on available U.S. force assets that we could ill afford to transfer before the new, replacement item was in the U.S. force inventory and the older item was being phased out. The limited obligation authority of the SDAF will not permit us to fund procurement for the sole purpose of keeping a particular line open indefinitely, except in those rare instances where there may be no alternative and where it clearly would be in the national interest in anticipation of future FMS.

The SDAF is not a device to provide equipment free to countries. We are obligated to collect a proper price for sales. Countries may pay for items with FMS credits or MAP grants made available to them, but there will be no price breaks, except as a sale is consummated sooner rather than later.

The SDAF has now been in actual operation since the initial contracts were issued in September, 1982. (See Appendix A and B for the identification of FY 82 and FY 83 SDAF procurements.) The primary problem in implementing SDAF as originally envisaged is that the Congress has not yet permitted the SDAF to operate as a genuine revolving fund. While SDAF is based on nonappropriated funding established under the DOD bills, it must go through the appropriations process of the Foreign Assistance bills each year; in FY 1982 and 1983 Congress did not provide an obligation authority to match the full funding level established in the authorizing legislation. Each SDAF obligation authority ends with the fiscal year; there is no carry-over of the one-year authority to continue programs.

For FY 1982, the Administration requested $300 million. However, the Foreign Assistance FY 1982 Supplemental Appropriations Act, passed late in the fiscal year, authorized the obligation of only $125 million that was credited to the SDAF. On 17 September 1982, SecDef approved a $125 million SDAF procurement plan which included 54 M60A3 tanks, 1,200 I-TOW ATGMs, 120 TV MAVERICKS, and 2 TPS-70 radars. The plan had to be implemented immediately because the obligation authority expired at the end of the fiscal year. All of the major programs were placed on contract during the short period before the end of FY 1982. (See Appendix A.) However, in the final analysis, $26 million could not be formally obligated and that obligation authority was thus lost to the SDAF.

In FY 1983, the administration requested an obligation authority of $475 million to bring the fund up to the authorization level of $600 million. However, P.L. 97-377, making further continuing appropriations for FY 1983, provided authority in December 1982 again to obligate only $125 million credited to the SDAF. With a normal SDAF procurement cycle in place for FY 1983, DSAA was able to obligate through the services almost $123 million for nine programs. (See Appendix B.) P.L. 98-151, making continuing appropriations for FY 1984, provided, in November 1983, an obligation authority of $225 million (vice $325 million requested) for FY 1984. While we did not get as much as requested, we again have time to conduct a deliberate procurement process. For FY 1985, the administration is requesting an obligation authority of $325 million.

At the present level of support, the SDAF is operating with a total obligation authority that is about one half of the $900 million cumulative program authorized by the Congress through FY 1984. This level of commitment has not allowed us to build the SDAF into an effective instrument for security assistance management as rapidly as planned. Although the SDAF has had a significantly favorable impact on a few selected programs (tactical radios, I-TOW, Basic STINGER, M198 howitzers, 155mm ammunition) we do not have the obligation authority yet to attack a large number of procurement problems on a broad front and resolve them to the point where the diversion or withdrawals are no long a major threat to U.S. readiness. If the SDAF is going to make larger purchases of significant items in the near term, we will have to persuade Congress to allow us to obligate funds up to the current maximum of $900 million as soon as possible and to use receipts from sales for procurement beyond the obligation ceiling. It is easy to demonstrate that the full amount is needed, and needed sooner rather than later. In 1980, the DOD completed a study of potential ground force withdrawals to meet foreign requirements caused by continuing Middle East crisis. Specific requirements valued at over $1.5 billion were identified for five countries. Most of the items identified were in short supply in Army inventories. As stated, the $1.5 billion does not include Navy and Air Force foreign requirements and only covers one "hot spot" in the world. Clearly, in FY 1984 dollars, the potential early delivery requirements for all the forces of several FMS customers, involved in two or more "hot spots," could be from three to five billion dollars over a one to two year period.

The recent record of diversions/withdrawals of defense items from U.S. forces to meet critical foreign requirements support the above projection. From FY 1978 through FY 1983, the total value of all diversions was approximately $1.9 billion. In FY 1983 alone, Army diversions totaled $426.5 million, Navy diversions totaled $7.1 million and Air Force diversions totaled $17 million. As examples, diversions since FY 1978 have included 482 tanks (equal to nine batallions), 11,763 TOW missiles, 311,442 rounds of 105mm tank ammunition, 267,197 rounds of 155mm artillery ammunition, 3,765 tactical radios, and 1,010 Manportable Air Defense System (MANPAD) missiles. Also, there were diversions of 127 tactical aircraft, representing about 1.7 fighter wing equivalents. Most of these have been paid back in due time, and the actual deficiencies at any given time are less than these figures. Nonetheless, Service stocks have been low for many of these critical items.

For example, the new light-weight M198 towed 155mm howitzer is replacing the towed M114A1 as the standard fire support weapon in the artillery battalions of infantry and airmobile divisions, and in the general support batallions at the corps level. Since Army stocks are low, large diversions from U.S. production and/or withdrawals from U.S. inventories delay unit activations and thus have an adverse impact on the Army's modernization. Yet, the M198 is in high demand by foreign customers, and diversions have been made to fill critical needs in Lebanon and Thailand. The TOW Missile system program poses another important readiness problem for the Army and Maine Corps. The Army projects that for FY 1984, it will only have 38 percent of its TOW Missile approved acquisition objective (AAO). For the same period the Army will only have 68 percent of its TOW launcher AAO. The shortage of MANPADS, especially the Basic STINGER system, is a major readiness problem for the U.S. Army. Basic STINGER replaces the 1960's technology REDEYE which, due to a deteriorating shelf-life, has been removed from unit inventories and is now held as war reserve stock only. Since the Army has only about 14 percent of its STINGER AAO, diversions from U.S. production and/or withdrawals from U.S. inventories would have an adverse impact on readiness. This type of problem exists for many other items for all three Services. It is from examination of these shortfalls that the Services recommend SDAF acquisitions. M-198s, TOWs, and Basic Stingers have figured prominently in initial SDAF procurements.

A fully funded SDAF will contribute to better management of security assistance programs. Unfortunately, there is no way to avoid a certain degree of crisis management of security assistance; that is the nature of requirements that develop in response to a changing international environment. At the same time we have discovered that it is possible to do a certain amount of planning ahead so that we can temper some of the impacts that stem from our need to bring elements of the security assistance program into congruence with our national security interests as they develop. We have a history of providing certain types of defense articles to foreign governments on an urgent basis, and we reflect this history in our SDAF planning. Without the benefit of a fully funded SDAF, our ability to use that experience to prepare in advance for a crisis is limited. Adequate SDAF acquisitions should dampen some of the possible adverse impacts on our own readiness caused by the need to help other nations. However, the SDAF is not a panacea; it is a management tool that can be used to the benefit of several communities of interest. By examining past experience and projecting somewhat into the future, we can decide those articles that are most likely to be transferred on an emergency basis. That information can be "dovetailed" with the defense budget process. The individual Military Departments will benefit because the impacts of security assistance transfers on force readiness postures will be lessened.

From the foreign policy perspective, the benefits cannot be simply described in terms of U.S. force readiness or incremental savings that may accrue in a particular weapon systems production program. The benefits come really from ability to view U.S. national security interests in a more dispassionate manner. Full implementation of the SDAF should enable us to render our decisions in a more orderly, less abrupt manner, because the available options will be more readily discernable in terms of "equipment," and some of the sting will be removed from the decision taken.

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