

Coproduction under FMS: A Case Manager's Headache

By

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There have been numerous articles written on the subject of compensatory trade agreements, to include coproduction agreements. Coproduction can be a direct commercial agreement, a foreign military sales agreement, or a combination of both. The possibility of a Foreign Military Sales (FMS) program or a mixed commercial-FMS program creates a challenge for a case manager. In the first instance the case manager is involved in a program under which the purchaser (foreign government or international organization) has a major piece of the action, including management responsibilities. In the second instance, the headache is amplified by having an additional entity (U.S. industry) as a part of the program and its management.

This paper will discuss the authority for entering into such agreements and the responsibilities of the United States Government (USG) activities involved in these agreements. A brief description of current coproduction programs with the United States Air Force (USAF) is also included.

Initiation of discussions which could lead to a coproduction agreement must first be approved by the Secretary of Defense. The Assistant Secretary, International Security Affairs, or International Security Policy, has the responsibility to insure the development and coordination of the Department of Defense (DOD) position with respect to a specific coproduction effort being contemplated, and to conduct specific negotiations leading to an international agreement, or to delegate authority to the appropriate DOD component. DOD effects coordination and approval with the Departments of State, Treasury, and Commerce, plus Congress and others as necessary.

When completed, agreements are formalized in either a Memorandum of Agreement (MOA), Memorandum of Understanding (MOU), or directly in Letters of Offer and Acceptance (LOA). These agreements delineate specific responsibilities for the respective military departments, the foreign government, and the prime contractor.

Coproduction programs have been initiated under a variety of differing circumstances, including foreign government requests, DOD initiated discussions, and contractor sales efforts. It has been USAF experience that there is not a set pattern of established procedures which cover all circumstances relating to coproduction programs. However, it is important to emphasize that there are established procedures which require Department of Defense approval before the military services can proceed with detailed discussions or commitments for coproduction.

When authorized by DOD to proceed with planning and implementation of an FMS case which involves coproduction activation, the USAF will utilize its standard FMS procedures for a major weapons systems sale. These are:

1. Secure approval from DOD and State of the Letter of Request (LOR).

2. Identify and resolve questions relating to exceptions to National Disclosure Policy (NDP).
3. Develop the data and submit to the Defense Security Assistance Agency (DSAA) the information for Congressional notification.
4. Prepare Price and Availability (P&A) information and draft special conditions for the Letter of Offer and Acceptance (LOA).
5. Coordinate the LOA with the Air Staff and the affected Major Commands.
6. Obtain DOD countersignature and furnish the LOA to the customer.
7. Prepare the program directive for FMS case implementation upon receipt of an accepted LOA.
8. Maintain case management responsibility until the case has been completed.

Once a coproduction program is established, it tends to follow a predictable pattern, as the country concerned develops its industrial capability. In the initial phase there is a country-to-country agreement for an FMS case which at the coproduction level might involve a very basic industrial capability, such as a system assembly. As experience is gained, the program will move toward in-country manufacture of some components and assemblies. This phase is characterized by both direct commercial licensing and FMS agreements. Finally, the capability for complete production is achieved with a direct contractor-to-foreign government relationship. To a limited extent, FMS management for follow-on support to the weapon system continues.

With respect to direct offsets, the USAF complies with DOD policy, as follows:

It is DOD policy not to enter into government-to-government offset arrangements because of the inherent difficulties in negotiating and implementing such arrangements. Any foreign government requesting offsets should be informed that the responsibility for negotiating any offset arrangement resides with the U.S. contractor involved. The U.S. Government will not commit a U.S. contractor to an offset commitment without having its prior concurrence.

The United States Air Force addresses coproduction proposals in accordance with DOD guidelines and regulations. Generally, as much flexibility as possible is desired, recognizing that each case is unique in terms of military, political, and economic considerations. Normally, coproduction is generally preferable to no sale at all if our national security objectives and requirements are considered and satisfactorily addressed. With respect to offsets we recognize that this is an element for consideration when dealing in the international arena. Nevertheless, the Air Force complies with the DOD policy on offsets, which places responsibility for any agreement dealing directly with offsets on the prime contractor.

SUMMARY OF USAF PROGRAMS

Japan F-15

In June 1978, DOD and the Japan Defense Agency (JDA) signed an MOU for the FMS purchase of 14 F-15 aircraft, plus 86 aircraft to be produced in Japan under license. In December 1984, both agencies signed a revised MOU increasing the total number of aircraft from 100 to 155. Congressional notification on 27 July 1984 permitted JDA the option of purchasing seven aircraft

through FMS or all of the additional 55 aircraft through licensed production. JDA intends to produce all 55 aircraft. The revised MOU specifically states that Japanese industry is "not to further disclose or use such technical data, information and documentation for any purpose other than the production purpose of this MOU without the prior written approval of the USG." Japanese licensed production requires direct licenses with U.S. contractors; no third country transfers are involved, and Japanese manufactured components are not to be exported to the U.S. There are no known offsets involved with this licensed production program.

Korea F-16

The Republic of Korea Air Force (ROKAF), on 24 May 1980, requested through FMS channels 30 F-16A and six F-16B aircraft with support equipment, spare parts, training, and technical assistance. The LOA was signed by the ROKAF on 1 December 1981 and amended at ROKAF request to reflect 30 F-16C and six F-16D aircraft. The first deliveries will begin in April 1986. There is no coproduction associated with this FMS program. Any offset agreements associated with this program were accomplished by General Dynamics and the Republic of Korea and are not part of any portion of the LOA. Total cost of the LOA is \$931M.

Turkey F-16

The Turkish sale covers 160 F-16C/D aircraft and all associated support, including avionics intermediate stations, ground support equipment, spares, spare engines, flight and maintenance trainers, flight and maintenance training, technical services, publications, aircraft delivery services, and program management. Aircraft cost, \$3.422 billion; support, \$778 million. The program incorporates but does not guarantee a Turkish Industrial Participation program. The funding of the program is arranged so that FMS credits and grant aid are used only on material and labor in the United States. Turkish funds are used for all material and labor within Turkey, with the excess of Turkish funds applied to United States material and labor. The pricing of the LOA recognizes that Turkish industry will be involved in the production of the airframe, engines, and some avionics components. Four different contractors are involved.

Israel F-16

On 15 August 1978, an LOA was accepted by Israel to purchase 40 F-16A/B aircraft for an estimated total cost of \$758,804,240. The LOA was changed on 15 September 1978 to include a total of 75 F16A/B aircraft at an estimated total cost of \$1,134,277,850. No offset agreements were established for this case. On 19 August 1983, a system case was signed between the USG and Israel for 75 F-16C/D aircraft at an estimated total cost of \$2,238,690,927. As stated in the LOA: "The USG will have no responsibility for any private offset for coproduction arrangements with contractors." However, offsets/coproduction agreements between Israel and contractors do exist and impact on the program. Contractors include General Dynamics, Westinghouse, Singer-Kearfott, Astronautics, and General Electric.

Israel F-15

The F-15 program for Israel provides for a total of 51 aircraft, acquired under three LOAs. Initiated in 1976, the original program cost was estimated to be \$1.5B. Although there are no offset/coproduction agreements included in the LOAs, the Government of Israel does provide certain items of government furnished equipment (GFE). Included in this category are: inboard and centerline pylons, MAU 12 bomb racks, AIM-7 launchers, UHF radios and control panels, 600 gallon fuel tanks, and other associated equipment.

European Participating Governments (EPG) F-16

The MOU between the U.S. and the EPG (Belgium, Denmark, The Netherlands, and Norway) was signed in 1975, prior to the current DOD policy, and made an offset commitment of 58 percent on the procurement value of the initial 348 F-16 aircraft purchase by the EPG. Also, a commitment for 15 percent offset to the EPG on all third country sales was made. Third country FMS coproduction is expected to continue indefinitely. The EPG/U.S. contract was \$2.8 billion.

No matter how you "cut the mustard," these programs are not normal FMS transactions and they also contain split management responsibilities. Only time will tell how successful these programs will be.

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