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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 10:00 a.m.
Tuesday, March 31, 1981

STATEMENT OF
FRANK C. CONAHAN
DIRECTOR, INTERNATIONAL DIVISION
U.S. GENERAL ACCOUNTING OFFICE
BEFORE THE
COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE



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ON

[LEASING OF DEFENSE PROPERTY]
[TO FOREIGN GOVERNMENTS]

Mr. Chairman and Members of the Committee:

We are pleased to discuss with you our review of the appropriateness of the procedures used to lease defense property to foreign governments. We are in the process of finalizing a report to you on this subject.

At the request of your Committee, we reviewed the implementation of the defense property leasing authority contained in 10 U.S.C. § 2667. This included an analysis of the countries involved; the type, quantity, and value of property leased; and the terms and durations of the leases. It also included an analysis of the extent to which this authority has been used to circumvent congressional controls over arms transfers and military assistance.

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10 U.S.C. § 2667 authorizes the Secretaries of the Military Departments to lease nonexcess property when it is determined to be in the public interest or will promote the national defense. This section originates from Public Law 80-364 which was enacted in 1947. It was originally intended to aid the industrial facilities standby programs of the military services following World War II by authorizing the lease of defense plant production equipment, and real property to private commercial interests and State and local governments. Current leases of defense property to foreign governments under authority of the statute include rent-free and nominal rent leases of major weapons systems.

The law, as enacted, required the Secretary of War or the Navy to submit a report of all leases entered into under the provisions of the act to the Congress twice yearly. Subsequently in September 1951, Public Law 82-155 repealed the reporting requirements of Public Law 80-364 to reduce the volume of real estate transactions needed to be reviewed by the Congress. This also totally eliminated the reporting requirement for leases of property such as military equipment to foreign governments. There remained no requirement for reporting the transfer of military equipment to foreign governments through lease agreements to the Congress until a reporting provision was added as a free-standing section of the International Security and Development Cooperation Act of 1980 enacted December 16, 1980. This was done as an effort to prevent further transfers of major military equipment property items to foreign governments without congressional oversight. However, leases can continue to be used to provide

property on a rent free or nominal rent basis to countries ineligible to receive such property under the Foreign Assistance Act. GAO believes that transfers of military equipment on this basis are tantamount to grant aid which should only be authorized under the Foreign Assistance Act. The alternative is to sell the equipment under the Arms Export Control Act if the provisions of that Act are otherwise met.

Use of Section 2667

Over the years, military equipment has been transferred to foreign countries primarily on a grant basis under the Foreign Assistance Act or through sales made under the Arms Export Control Act and predecessor legislation. In recent years, sales have increased as the Congress has reduced the number of countries to which military equipment could be granted (e.g., from 31 in fiscal year 1974 to 4 in fiscal year 1981--Spain, Portugal, Sudan, and the Philippines).

As mentioned above, section 2667, originally intended to permit the lease of defense equipment to certain public and private sector interests in the United States, has also been used to transfer military equipment to foreign countries. This has been particularly so in recent years. In 1980, military equipment valued at \$48.4 million was leased rent-free to Turkey, Honduras, and the Dominican Republic. In January 1981, 6 helicopters valued at \$5.9 million were leased rent-free to El Salvador.

The value of property included in leases initiated during the period 1960 through January 1981, amounted to about \$168 million.

This property consists of such items as aircraft, ships, and weapons production equipment. A listing of the leases made to foreign governments between 1975 and January 1981 is included in Exhibit A.

Leases have been made to North Atlantic Treaty Organization and other western countries as test samples to facilitate foreign military sales and also to test the performance of preproduction property under unique conditions found in those countries. The United States appears to have benefited from these leases as much as the lessee government either by facilitating a sale or prospective sale of a U.S. manufactured defense item or by gaining valuable performance information on property not yet put into production. Leases made for these purposes are not of great concern because they do not appear to conflict with the intent of the Arms Control requirements. However, most of the equipment has been leased rent free or at nominal rent to countries with weak economies to improve their defense capability which is tantamount to the grant aid assistance provided by the Foreign Assistance Act. A schedule showing the amount of property leased on a rent free/rent payable lease basis between 1975 and January 1981 is included as Exhibit B.

APPARENT AVOIDANCE OF
ARMS TRANSFER STATUTES

The Arms Export Control Act property value thresholds for reporting transfers of property valued at over \$1 million to the Congress, and the Foreign Assistance Act restrictions on countries eligible to receive grant aid military assistance have been avoided when property is leased using 10 USC § 2667. The adoption of the

Arms Export Control Act dollar threshold in the recent legislation will prevent further avoidance of the reporting requirements in the Arms Export Control Act; however, the country eligibility restrictions contained in the Foreign Assistance Act can continue to be avoided. A publicized recent example of this is the rent free lease of the six UH-1H "Huey" type helicopters to the Government of El Salvador to improve its defense capabilities. Another example is the rent free lease of defense property manufacturing equipment valued at \$3 million to Turkey in October 1980. Other examples of this kind will be included in our report.

INAPPROPRIATE VALUATION
OF LEASED PROPERTY

Most often the value of leased property is based on an acquisition cost that is often several years old and not equivalent to the cost for replacing the property or similar property should it not be returned. Property eligible for lease must be non-excess and is therefore expected to be returned to U.S. inventories and used again at a later date. An appropriate method for valuing this property that is consistent with the provisions pertaining to the sale of property expected to be replaced is contained in section 21 (a) (2) of the Arms Export Control Act. This provision states that in the case of a defense article intended to be replaced at the time such sales agreement is entered into, the estimated cost of replacement of such article, including the contract or production costs less any depreciation in the value will constitute

its selling price. Air Force and Army officials have said that they believe replacement cost to be the most appropriate value to place on leased property but have not done so because of the lack of instruction on how leased property is to be valued.

Property values based on acquisition costs much lower than values based on replacement costs could result in some leased property not being reported to the Congress. To comply with the recent requirement to report the lease of property valued over established dollar thresholds, the leased property value should be based on the estimated replacement costs.

THE NEED FOR ACCOUNTABILITY
AND CONTROL OVER LEASED PROPERTY

There is no procedure or instruction that has been established by any of the Military Departments or the Defense Department that requires leases to be managed to ensure the lessee country complies with the terms and conditions contained in the lease agreements. As a result of this, the use, care and maintenance of the property is not routinely verified during the time it is leased. Property managers within each Military Department often do not know how the lessee government is using the property or what care it is receiving.

As a consequence of not having had an established standard policy for billing and collecting lease associated payments,

officials cannot always determine the status of lease payments. Officials said there is no present system or requirement to monitor lease-associated payments to ensure that timely payment is made.

Our final report will include recommendations concerning those matters which we believe will improve the congressional oversight on defense property leased to foreign governments.

LEASES TO FOREIGN GOVERNMENTS 1975 THROUGH JANUARY 1981

EXHIBIT A

EXHIBIT A

<u>COUNTRY</u>	<u>ITEMS</u>	<u>DATE</u>	<u>DURATION</u>	<u>TOTAL RENT</u>	<u>LESSOR</u>	<u>VALUE</u>	<u>PURPOSE</u>
El Salvador	4 ea. UH-1H Helicopters	1/16/81	1 yr.	None	Army	\$3,700,000	Military Assistance
El Salvador	2 ea. UH-1H Helicopters	1/14/81	1 yr.	None	Army	\$2,238,470	Military Assistance
Turkey	Weapons Production Equipment	10/17/80	10 yrs.	None	DOD	\$3,000,000	Military Assistance
Dominican Republic	ATA-193 YO-213, Yard Oiler YO-215, Yard Oiler ATA-208, Auxiliary Ocean Tug Fleet Ocean Tug Harbor Tug	10/15/80	5 yrs.	None	Navy	\$2,893,232	Military Assistance
Turkey	M48A5 Tank Location/Inspection Fixtures and Associated Equipment	10/7/80	5 yrs.	None	Army	\$ 564,994	Military Assistance
Commander, Iberian Atlantic Area a/	2 ea. AN/BRR-3(A), Submarine Radio Broadcast Receivers	9/22/80	5 yrs.	None	Navy	\$ 22,920	Quid Pro Quo
Netherlands	Pave Penny Targeting and Control Systems	9/15/80	3 mos.	None	Air Force	\$ 90,000	Test/ Evaluation
Belgium	72 ea. TER-9A, F-16 Triple Ejection Bomb Racks	6/30/80	5 yrs.	\$14,017	Air Force	\$ 129,456	Military Assistance
Israel	F-16 Radar Test Bench	6/17/80	5 mos.	\$41,051	Air Force	\$ 612,104	Test/ Evaluation
Turkey	Destroyer (DD-822)	6/5/80	5 yrs.	None	Navy	\$8,416,666	Military Assistance
Turkey	Destroyer (DD-842)	6/5/80	5 yrs.	None	Navy	\$7,858,562	Military Assistance

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Honduras	10 ea. UH-1H Helicopters	4/25/80	1 yr.	None	Army	\$9,452,278	Military Assistance
Greece	90 mm Recoilless Rifle Specifications/Tolerance Gauges	4/15/80	1 yr.	\$5,025	Army	\$ 33,716	Military Assistance
Pakistan	16 ea. T-37B Jet Aircraft	4/3/80	2 yrs.	\$268,354	Air Force	\$ 2,659,376	Military Assistance
Canada	6 ea. LAU-57/A and LAU-58/A Missile Launchers and Associated Equipment	3/8/80	1 mo.	\$1,161	Air Force	\$ 108,000	Military Assistance
India	M198 Prototype 155 mm Howitzer and Associated Equipment	2/29/80	3 mos.	\$13,009	Army	\$ 1,300,000	Test/Evaluation
Switzerland	4 ea. TOW Missile Launchers and Associated Equipment	2/20/80	2 mos.	\$13,908	Army	\$ 235,016	Test/Evaluation
Turkey	Submarine (SS-563)	2/8/80	5 yrs.	None	Navy	\$16,200,000	Military Assistance
Canada	2 ea. Aircraft Cargo Loaders	2/8/80	1 yr.	\$ 3,159	Air Force	\$ 76,200	Military Assistance
Australia	Test Equipment for AN/ALE - 40(V) Chaff Dispensing System	2/6/80	2 mos.	\$ 92	Air Force	\$ 5,216	Test/Evaluation

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Korea	2 ea. C-47 Aircraft Engines	1/15/80	4 mos.	\$257	Air Force	\$12,000	Military Assistance
Switzerland	AN/TRS-2 Platoon Early Warning System	12/17/79	1 yr.	None	Army	\$10,155	Test/ Evaluation
Turkey	M48A5 Tank and Associated Equipment	11/6/79	5 yrs.	\$224,030	Army	\$407,331	Military Assistance
Switzerland	UH-60A Blackhawk Helicopter (leased to Sikorsky Co. for Swiss use)	10/26/79	2 mos.	\$2,112 per flight hour	Army	\$4,477,332	Test/ Evaluation
Singapore	2 ea. AIM-9P Missile Guidance Control Sections	10/19/79	3 mos.	\$224	Air Force	\$ 24,000	Test/ Evaluation
Pakistan	6 ea. T-37B Jet Aircraft	10/10/79	2 yrs.	\$191,088	Air Force	\$ 997,266	Military Assistance
Turkey	ARS-25 Auxiliary Repair Ship	9/28/79	5 yrs.	None	Navy	\$2,515,481	Military Assistance
Norway	84 ea. TER-9A, F-16 Triple Ejection Bomb Racks	9/25/79	3 yrs. 2 mos.	\$6,810	Air Force	\$151,032	Military Assistance
Denmark	70 ea. TER-9A, F-16 Triple Ejection Bomb Racks	9/7/79	5 yrs.	\$19,686	Air Force	\$125,860	Military Assistance
Japan	Air Transportable Hydrant Refueling System	8/27/79	1 mo.	\$220	Air Force	\$ 29,300	Test/ Evaluation
Philippines	AFDL-10, Floating Dry Dock	8/22/79	5 yrs.	None	Navy	\$639,150	Military Assistance
Norway	NAVSTAR Global Positioning System	8/20/79	1yr.	None	Air Force	\$ 500,000	Quid Pro Quo
Spain	4 ea. P-3A, Jet Aircraft	6/22/79	3yrs. 4 mo.	\$2,962,333	Navy	\$13,232,964	Military Assistance
Canada	AN/SSR-1 and OE82A Communications/Electronics Systems	4/13/79	1 yr.	None	Navy	\$103,000	Test/ Evaluation

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Netherlands	M198 Prototype 155 mm Howitzer	4/29/79	8 mos.	\$ 30,563	Army	\$1,300,000	Test/ Evaluation
Australia	AN/WSC-3 Satellite Communications Terminal Equipment	3/9/79	1 yr.	None	Navy	\$ 160,000	Quid Pro Quo
England	31 ea. Trucks, 1 ea. Ambu- lance, 13 ea. Cargo Trailers, 2 ea. Water Tanks and 10 ea. Radio Sets	2/28/79	2 mos.	\$10,211	Army	\$485,060	Military Assistance
New Zealand	Communications/Electronics Equipment	2/15/79	2 yrs.	None	Navy	\$ 48,000	Military Assistance
Japan	Air Transportable Hydrant Refueling System	1/23/79	10 days	\$129	Air Force	\$ 29,300	Test/ Evaluation
Canada	5 ea. LAU 57/A and LAU 58/A Missile Launchers and Associated Equipment	1/12/79	1 mo.	\$252	Air Force	\$108,000	Military Assistance
Netherlands	100 ea. TER-9A, F-16 Triple Ejection Bomb Racks	1/1/79	3 yrs.	\$17,613	Air Force	\$179,800	Military Assistance
Switzerland	AGM-65A Maverick Missile System	12/15/78	1 yr. 10 mos.	\$23,184	Air Force	\$26,218	Test/ Evaluation
Taiwan	77 ea. Nike Hercules Warhead Containers	8/10/78	4 yrs.	\$29,722	Army	\$74,305	Military Assistance
Jordan	3 ea. T-37B Jet Aircraft	7/22/78	4 yrs.	\$147,467	Air Force	\$ 498,633	Military Assistance
Jordan	2 ea. T-37B Jet Aircraft	6/10/78	4 yrs.	\$ 98,311	Air Force	\$ 332,422	Military Assistance

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Saudi Arabia	M76 Redeye Missile System, Test Equipment and Spare Parts	5/4/78	1yr. 6 mos.	\$29,551	Army	\$235,600	Military Assistance
Ecuador	AN/FRT-39 Radio Transmitting Set	4/5/78	5 yrs.	None	Navy	\$20,000	Military Assistance
Sweden	AGM-65A Maverick Missile Helicopter Mounting Equipment	4/15/77	2yrs. 8 mos.	\$3,200	Air Force	\$26,218	Test/Evaluation
Australia	2 ea. APQ-128 Computers	2/4/77	8 mos.	\$1,632	Air Force	\$ 3,184	Military Assistance
Jordan	2 ea. T-37B Jet Aircraft	1/6/77	1 yr.	\$37,276	Air Force	\$ 332,422	Military Assistance
Israel	105 mm Artillery Ammunition Repair Equipment	12/20/76	1yr. 6mos	None	Army	\$629,135	Military Assistance
Ecuador	Communications/Electronics Equipment	11/10/76	5 yrs.	None	Navy	\$74,370	Military Assistance
Germany	OH-58A Helicopter, with Improved Scout Target Acquisition/Recognition System (ISTAR)	6/22/76	3 mos.	\$4,483	Army	\$410,923	Test/Evaluation
Saudi Arabia	6 ea. M109A1 155 mm Self-Propelled Howitzers, 6 ea. M548 Cargo Carriers, and Associated Equipment	5/27/76	2yrs. 8 mos.	\$93,339	Army	\$2,777,592	Military Assistance

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Pakistan	17 ea. T-37B Jet Aircraft	11/12/75	4 yrs.	\$893,520	Air Force	\$ 2,825,587	Military Assistance
Israel	FADAC Artillery Fire Direction Control Computer System	11/1/75	2yrs. 6mos.	NONE	Army	\$ 94,548	Military Assistance
Jordan	6 ea. T-37B Jet Aircraft	9/7/75	1yr. 6mos.	\$167,742	Air Force	\$ 997,266	Military Assistance
Bolivia	Communications/Electronics Equipment	7/9/75	10 yrs.	None	Navy	\$ 14,000	Military Assistance

a/This is a NATO Command located in Lisbon, Portugal.

PROPERTY LEASED ON A
RENT FREE/RENT PAYABLE BASIS

During the period 1975 - January 1981, the value of property leased for other than to obtain performance information and to facilitate a foreign military sale, on a rent free basis was about \$58 million. The following table shows the value of leases of this type made each year calendar year 1975 - January 1981:

	<u>Rent free</u>	<u>Rent payable</u>	<u>Totals</u>
------(000 omitted)-----			
1975	\$ 109	\$ 3,823	\$ 3,932
1976	704	2,778	3,482
1977	0	336	336
1978	20	1,141	1,161
1979	3,203	15,687	18,890
1980	48,386	3,304	51,690
January 1981	<u>5,938</u>	<u>0</u>	<u>5,938</u>
Total	<u>\$58,360</u>	<u>\$27,069</u>	<u>\$85,429</u>