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20. ABSTRACT (Continue on reverse side if necessary and identify by block number) DoD policy prohibits the enlargement of DoD spare parts inventories in anticipation of foreign military sales (FMS) unless the foreign government has agreed to and has funded a Cooperative Logistic Supply Support Arrangement (CLSSA). CLSSA requirements are included in U.S. supply system stock level computations. CLSSA requisitions are filled with the same priority given U.S. forces requisitions. Non-CLSSA requirements are not included in stock-level computations; requisitions are filled only if ample stocks are on-hand.		

20. ABSTRACT (Continued)

The purpose of this report is to (1) describe the rationale for current policy and its implications and (2) reach conclusions as to whether and, if appropriate, how policy should be changed to permit all FMS requirements to be used in setting stockage levels.

There is pressure to support U.S. interests by being responsive to a friendly foreign government's requirements, regardless of that foreign government's contribution to inventory investment. Our government often yields to that pressure. Because it omits nonrecurring FMS demands from stock-level computations, it does not have adequate inventories to do so. It thus incurs a readiness risk. That risk will grow as foreign governments acquire more U.S. weapon systems.

We are recommending that the ASD(MRA&L) revised DoD Directive 2000.8 to allow inclusion of all FMS requirements in stock-level computations, as is done for U.S. customer requirements. This will result in higher stock levels for those items normally provided via non-CLSSA FMS. We are recommending also that the funds to increase the stock levels be obtained by increasing the surcharge now applied to non-CLSSA spare parts prices. The results, we believe, will be better support to FMS customers and reduction of the readiness risk to U.S. forces.

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FOREIGN MILITARY SALES
SECONDARY ITEM REQUIREMENTS

ADA 136545

September 1983

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Executive Summary

FOREIGN MILITARY SALES SECONDARY ITEM REQUIREMENTS

The Defense Logistics Agency (DLA) has proposed changing procedures for Foreign Military Sales (FMS) of secondary items that are not covered by investments obtained under a Cooperative Logistic Supply Support Arrangement (CLSSA). The proposals would eliminate current restrictions on counting non-CLSSA requirements in stock-level computations and on issuing below the reorder point to satisfy those requirements. We agree that requirements should be counted in stock-level computations. We do not agree with the proposal to issue routinely below the reorder point.

Under a CLSSA, a foreign country estimates its recurring requirements for secondary items, provides up-front equity investment to increase U.S. stocks to support the requirements, and is thereafter permitted to draw upon those stocks the same as U.S. forces. The foreign country's CLSSA requirements are counted in stock-level calculations. Non-CLSSA FMS requirements are treated differently. Because the foreign country provides no funding to increase stock levels, their requirements are not counted in stock-level computations, and issues are made routinely only if stocks are above the reorder point. DLA's proposals would eliminate the differences in procedures for processing CLSSA and non-CLSSA requirements.

From a supply management standpoint, DLA's proposals are sound. All non-CLSSA requirements are nonrecurring.¹ Since a portion of U.S. nonrecurring requirements is counted in stock-level computations, not counting FMS

¹In this summary, we equate non-CLSSA to nonrecurring. In fact, some CLSSA requirements also are nonrecurring, but that is an anomaly of minor import to the principal issues of the report.

nonrecurring requirements leads to stock levels lower than otherwise would be available to support both U.S. and foreign customers' needs. Though the reorder point constraint on filling FMS nonrecurring requisitions is intended to safeguard U.S. readiness, issue below the reorder point frequently is directed. Counting non-CLSSA requirements in stock-level computations in the same manner as is done for U.S. nonrecurring requirements would increase U.S. stock levels and would eliminate the readiness risk inherent in current procedures.

The issue, however, is not so easily resolved. If non-CLSSA requirements are counted and stock levels increased accordingly, someone must pay for the additional stocks, and the cost would be about \$90 million (\$64 million for DLA alone). In addition, elimination of the distinction between treatment of CLSSA requirements and treatment of non-CLSSA requisitions would eliminate the prime incentive for foreign governments to make the up-front equity investments required by CLSSAs.

We believe the best means for funding the additional stocks is to adjust the surcharge on non-CLSSA FMS requisitions. The surcharge would avoid the need for large, one-time U.S. or foreign investments by gradually obtaining the funding from FMS customers as they requisition secondary items. Surcharges already are levied on FMS of secondary items. In fact, the new surcharge could be offset, in part, by reduction of the current spot-buy surcharge on non-CLSSA requisitions. The adjustments can be tailored to individual stockage policies of DLA and Military Departments. Though some foreign customers may object to larger surcharges, alternative funding schemes -- such as U.S. appropriations, the Special Defense Acquisition Fund or additional, up-front foreign country investment -- are either much more complicated or even less likely to receive foreign and U.S. Government support.

The reorder point constraint on filling non-CLSSA requisitions, however, should be retained. Without it, foreign countries would be likely to perceive payment of the surcharge as an attractive alternative to making the up-front equity investments required of CLSSAs. Additionally, the Department of Defense (DoD) needs to continue to protect U.S. readiness. We conclude that only on an exception basis should stocks be issued below the reorder point in response to non-CLSSA FMS requirements.

We recommend, therefore, that the Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics):

- Change DoD Directive 2000.8, "Cooperative Logistic Supply Support Arrangements," to permit inclusion of non-CLSSA requirements in stock-level computations.
- Coordinate with the Assistant Secretary of Defense (Comptroller) and the Assistant Secretary of Defense (International Security Affairs) to set surcharges that reflect practices of counting nonrecurring requirements in DLA and the Military Departments.
- Make no change in procedures for releasing non-CLSSA requirements below the reorder point.

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1. INTRODUCTION

BACKGROUND

The Defense Logistics Agency (DLA) has proposed¹ revising Department of Defense (DoD) policy on processing of non-programmed² Foreign Military Sales (FMS) requirements for secondary items. For DLA-managed stock fund items, DLA proposes to:

- Include non-programmed FMS demands in stock-level computations (for replenishment items).
- Allow automatic issue of all non-programmed FMS requisitions against stocks below the reorder point but above the 90-day level.
- Allow manual release of high priority non-programmed FMS requisitions against stocks below the 90-day level.

Including non-programmed FMS requirements in stock-level computations would increase DoD stock levels, assuming other factors affecting stock levels remained unchanged. These stock level increases, however, would represent material procured with U.S. funds in anticipation of a later sale to a foreign government, and that, in general, is prohibited by U.S. Public Law, unless the foreign government has committed itself contractually to the later sale. The issue, then, is how to obtain authority and funding for the inventory increases which would result from DLA's first proposal.

¹The DLA proposals are contained in DLA memorandum for Deputy Assistant Secretary of Defense (Logistics and Materiel Management), dated 18 August 1982, subject: "Inclusion of [Direct Foreign Military Sales (FMS)] Demands in Stock Fund Levels."

²For purposes of this study, FMS secondary item requirements are classified as either "programmed" or "non-programmed." Programmed requirements are demands against inventories funded by foreign country equity investment. All other FMS requirements are classified as "non-programmed," a term corresponding to "Direct Foreign Military Sales Demands," as used in the DLA proposal.

The second and third DLA proposals, which would allow DLA to issue FMS non-programmed requirements against stocks below the reorder point, are dependent upon how the more complicated first proposal is resolved, but nevertheless will require treatment as a separate issue.

OVERVIEW OF THE REPORT

The Office of the Secretary of Defense (OSD) can respond to the DLA proposals in one of two ways:

- Maintain current procedures and reject the DLA proposals.
- Change current DoD policies and procedures permitting acceptance of the DLA proposals, either individually or totally.

Changes to current DoD policies and procedures can be:

- Based upon obtaining new legislative authority; or
- Restricted to changes possible within the constraints of present law.

To address the DLA proposals and their implications, this report proceeds as follows: Chapter 2 describes current FMS secondary item procedures and business levels; Chapter 3 presents the Public Law relevant to the DLA proposals and discusses the implications of that law; Chapter 4 discusses whether or not current procedures can be changed to allow for a positive response to the DLA proposals; Chapter 5 discusses the implications of no change, delayed change, or change now to current FMS policy and procedures; Chapter 6 provides recommendations; Appendices A, B, and C provide calculations related to discussion of the alternative procedures.

2. CURRENT BUSINESS

This chapter reviews current FMS secondary item procedures and provides a statistical overview of secondary item business volume.

PROCEDURES

FMS secondary item requirements are processed in accordance with procedures which vary according to case type, category of demand, Military Department, and other factors specific to particular requisitions. The following sections describe those procedures.

Types of FMS Cases

Foreign requirements for secondary items enter the DoD supply system under three types of FMS cases:

- Defined Orders provide the foreign countries with their initial secondary item stocks, with secondary items in support of subsequent end-item procurements, and with one-time requirements for secondary items.
- Cooperative Logistic Supply Support Arrangements (CLSSAs) provide continuing follow-on support from U.S. stocks. Under CLSSAs, foreign countries make equity investments to increase U.S. stocks and receive support equivalent to that provided U.S. forces. (See DoD Directive 2000.8, "Cooperative Logistic Supply Support Arrangements," February 12, 1981.)
- Blanket Orders provide follow-on support from U.S. stocks but without foreign country equity investment to increase U.S. stocks. (Under Blanket Orders, foreign countries receive support on a "not-to-interfere" basis.)

Before CLSSA requisitions receive treatment equal to that provided requisitions from U.S. forces, CLSSAs, and individual items added to CLSSA equity lists, are "aged" to allow for procurement lead time. Requests for not-yet-aged CLSSA items, most nonrecurring CLSSA demands, all Blanket Order

requisitions, and all Defined Order requisitions receive the so called "non-CLSSA response." That is, issues are not permitted below the reorder point, and longer procurement lead times associated with such unplanned requirements can be expected.

Programmed and Non-Programmed Requirements

For purposes of this study, FMS secondary item requirements (or demands) are classified either "programmed" or "non-programmed":

- Programmed demands are recurring¹ CLSSA demands against inventories funded by foreign country equity investment. They are demands planned for in the DoD supply system.
- Non-programmed demands are defined as nonrecurring demands under any of the three types of cases:
 - Under CLSSAs, the demands are one-time truly nonrecurring requirements not covered by foreign country equity investment. They are demands not planned for in the DoD supply system.²
 - Under Blanket Orders and Defined Orders, all demands are considered non-programmed, regardless of whether the originators designate them recurring or nonrecurring. The demands are not supported by foreign country investment and therefore are not planned for in the DoD supply system.

Demand Projection

As implied above, recurring foreign country requirements for secondary items must be obtained under CLSSAs, which provide up-front equity investment and dependable undertakings.³ Having obtained these investments in U.S.

¹"Recurring" and "nonrecurring" requirements (or demands) refer to whether or not the originator considers the demand one-time or repetitive, in accordance with DoD supply system procedures.

²United States Air Force (USAF) defines "programmed" and "non-programmed" somewhat differently than defined here. For example, USAF labels as "non-programmed" issues in excess of quantities specified in a CLSSA equity list.

³A dependable undertaking is a contractual commitment between the foreign government and the U.S. Government (see page 3-1).

stocks, the Military Departments can then include in their stock-level computations all recurring demands received under CLSSAs.

Foreign country requirements processed under Blanket Order and Defined Order procedures cannot be included in stock-level calculations. The Military Departments and DLA differ in their treatment of nonrecurring requirements requisitioned under CLSSAs. The Air Force encourages use of CLSSAs by perpetuating the foreign country's "N" (nonrecurring) demand code and providing "non-CLSSA (non-programmed) response" to the requisitions. This treatment permits the foreign country to use a CLSSA both for recurring requirements (which must be supported by equity investment) and nonrecurring requirements (which are not supported by equity investment).

The Navy channels nonrecurring demand into Blanket Orders and Defined Orders and channels recurring demand into CLSSAs. This is accomplished at the Navy International Logistics Control Office (NAVILCO) by changing nonrecurring demand codes on CLSSA requisitions to recurring, providing CLSSA (programmed) treatment to the requisitions, and projecting the demand in future stock-level computations. Similarly, NAVILCO changes recurring demand codes ("R") on requisitions received under Blanket Orders or Defined Orders to "N." This process motivates foreign countries to use CLSSAs to obtain recurring requirements only, as all demands submitted under Navy CLSSAs impact equity calculations.

Insofar as possible, the Army aligns treatment of nonrecurring requirements received under CLSSAs with its treatment of similar U.S. requirements. For requisitions against items for which equity investment has been obtained, the Army perpetuates the "N" demand code and projects the demand in the same way as it projects similar U.S. demands. If the requisition is for

an item for which equity investment has not been obtained, the Army does not include the demand in stock-level computations.

DLA includes a demand in stock-level projections only if the requirement is recurring and is submitted under a mature CLSSA.

Thus, while the Military Departments and DLA differ in the details of their treatment of FMS secondary item demand, they all require foreign country equity investment before stocks are procured to support FMS demand.

Table 2-1 summarizes Military and DLA policies regarding projection of nonrecurring demands in stock-level computations.

BUSINESS BREAKDOWN

We estimate that DoD secondary item business in FY 1982 totaled about \$15 billion, of which approximately \$1.5 billion (10 percent) represented FMS secondary item requirements (exclusive of clothing and medical). Nonrecurring FMS requirements accounted for approximately \$865 million (56 percent) of the \$1.5 billion FMS secondary item total.

Table 2-2 shows a breakdown of FMS secondary item business for FY 1982. Note that the secondary items managed by DLA are consumables. If the procedures proposed by DLA were applied to the Military Departments, reparables also would be involved.

Note also that the FMS case category breakdown includes all FMS business received by the Military Departments. The portion of that total business which is passed to DLA is indicated separately.

For the most part, the estimates in Table 2-2 were derived ad hoc from special data processing runs and conversations with DoD personnel. As approximations, the estimates provide sufficient information regarding FMS secondary item business to permit discussion of the DLA proposals.

TABLE 2-1. PROJECTION OF STOCKS BY TYPE OF DEMAND AND CUSTOMER

<u>DoD Component</u>	<u>U.S. Customer</u>	<u>CLSSA Customer (FMS)</u>	<u>Non-CLSSA Customer (FMS)</u>
USA			
Recurring	Yes	Yes	No
Nonrecurring	Factored (88%) ^a	Factored (88%) ^b	No
USN			
Recurring	Yes	Yes ^c	No ^c
Nonrecurring	No	Yes ^c	No
USAF			
Recurring	Yes	Yes	No
Nonrecurring	Factored (10%)	No	No
DLA (Current)			
Recurring	Yes	Yes	No
Nonrecurring	Factored (98%)	No	No
DLA (Proposed) ^d			
Recurring	Yes	Yes	No
Nonrecurring	Factored (98%)	Factored (98%)	Factored (98%)

^a"Factored" means that only part of the category is included in stock-level computations. In this case, Army inventory managers overall project 88 percent of their nonrecurring demands from U.S. customers.

^bArmy projects nonrecurring CLSSA requirements if the demand is against an item for which equity investment has been obtained.

^cNavy changes all CLSSA nonrecurring demands to "R" (recurring) and all non-CLSSA recurring demands to "N" (nonrecurring).

^dDLA has proposed that it be allowed to project nonrecurring FMS demands in accordance with the final line of the table.

SUMMARY

We have divided FMS secondary item requirements into two categories: programmed (recurring CLSSA demand) and non-programmed. The non-programmed

TABLE 2-2. FMS SECONDARY ITEM BUSINESS
(FY82 Estimated)

Breakdown By Case Category:

<u>DoD Component</u>	<u>Defined Order</u>	<u>Blanket Order</u>	<u>CLSSA</u>	<u>Total</u>	<u>Percent of Total U.S. & FMS Business</u>
USA	\$387.9M	\$108.3M	\$207.8M	\$ 704.0M	16%
USN	127.4M	139.3M	55.7M	322.4M	7%
USAF	3.7M	82.7M	431.2M	517.6M	9%
Total	\$519.0M	\$330.3M	\$694.7M	\$1544.0M	10%
DLA ^a	-----\$154.2M-----		\$159.7M	\$ 313.9M	13%

Breakdown by Item Category:^b

<u>DoD Component</u>	<u>Reparables</u>	<u>Consumables</u>
USA	37%	63%
USN	75%	25%
USAF	36%	64%
Total	45%	55%
DLA ^a	-0-	100%

Breakdown by Demand Code Category:^b

<u>DoD Component</u>	<u>Recurring</u>	<u>Non-recurring</u>
USA	27%	73%
USN	24%	76%
USAF	75%	25%
Total	44%	56%
DLA ^a	51%	49%

CLSSA Percentages:^b

<u>DoD Component</u>	<u>CLSSA</u>	<u>Non-CLSSA</u>
USA	30%	70%
USN	17%	83%
USAF	86%	14%
Total	45%	55%
DLA ^a	51%	49%

Distribution of Military Department Demands for Consumables:^b

<u>Military Department</u>	<u>Percent Passed to DLA</u>
USA	32%
USN	59%
USAF	38%
Overall	37%

^aDLA demands are included in the totals above. All secondary item FMS requisitions for DLA stocks are passed to DLA by the Military Departments.

^bPercentages are of dollar totals.

category includes nonrecurring CLSSA demands, all Blanket Order demands, and all Defined Order demands. Equity investment is obtained for programmed requirements only, and only those requirements are included in stock-level computations.

DLA and the various Military Departments differ in the details of their treatment of FMS demands. However, in general, requisitions are processed in accordance with the CLSSA versus non-CLSSA rationale of DoD Directive 2000.8. Additionally, all the Military Departments and DLA require foreign country investment before stocks are procured in anticipation of subsequent FMS requirements.

3. LEGAL ISSUES

This chapter discusses Public Law relevant to the DLA proposals.

PUBLIC LAW RELEVANT TO THE FIRST DLA PROPOSAL

To understand the legal basis for the generally known prohibition against procurements in anticipation of later sale to foreign governments, three citations from Public Law are required.

First, 31 U.S. Code 1301(a) restricts expenditure of appropriated funds to particular purposes specified by Congress:

Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law.

This restriction on expenditures is long-standing and has been interpreted broadly and clearly by the courts. If Congress has not authorized a particular expenditure, or category of expenditure, then the expenditure is prohibited. Expenditures from revolving funds (such as the Defense Stock Fund), which are established, maintained, and increased from appropriated funds, are included in the overall restriction of expenditures to specified purposes.

Section 21(a) of the Arms Export Control Act (AECA) provides authorization to sell stocks of defense articles to foreign countries:

The President may sell defense articles and defense services from the stocks of the Department of Defense to any eligible country or international organization if such country or international organization agrees to pay in United States dollars....

Section 22(a)(1) of AECA permits procurement of defense articles for later sale to foreign countries on the basis of a dependable undertaking:

Except as otherwise provided in this section, the President may, without requirement for charge to any appropriation or contract authorization otherwise provided, enter into contracts for the procurement of defense articles or defense services for sale for United States dollars to any foreign country or international

organization if such country or international organization provides the United States government with a dependable undertaking (1) to pay the full amount of such contract which will assure the United States government against any loss on the contract, and (2) to make funds available in such amounts and at such times as may be required to meet the payments required by the contract and any damages and costs that may accrue from the cancellation of such contract, in advance of the time such payments, damages, or costs are due.

Thus, there are two key issues to consider regarding DLA's proposal to include non-programmed demands in stock-level computations:

- Authorization must be obtained to procure additional material to meet stock levels raised as a result of projecting non-programmed demands, in the absence of either equity investments or dependable undertakings from the foreign countries.
- Funds must be appropriated to pay for the additional stocks, again in the absence of either equity investments or dependable undertakings from the foreign countries.

Recently, the AECA has been amended to establish the Special Defense Acquisition Fund (SDAF). Section 51(a)(1) states that the SDAF is to be used to finance acquisition of defense articles in anticipation of later sale to a foreign country:

Under the direction of the President and in consultation with the Secretary of State, the Secretary of Defense shall establish a Special Defense Acquisition Fund (hereafter in this chapter referred to as the "Fund"), to be used as a revolving fund separate from other accounts, under the control of the Department of Defense, to finance the acquisition of defense articles and defense service in anticipation of their transfer pursuant to this Act, the Foreign Assistance Act of 1961, or as otherwise authorized by law, to eligible foreign countries and international organizations, and may acquire such articles and services with the funds in the Fund as he may determine.

Section 51(c)(1) of AECA sets limits to the size of the SDAF:

The size of the Fund may not exceed such dollar amounts as is prescribed in Section 138(g) of title 10, United States Code. (Section 138(g) of title 10, U.S.C. as added by Section 109(b) of Public Law 97-113 (95 Stat. 1524), provides that the Special Defense Acquisition Fund 'may not exceed \$300,000,000 in fiscal year 1982 and may not exceed \$600,000,000 in fiscal year 1983 or any fiscal year thereafter.')

Section 47(3) of AECA defines "defense article" to include:

- (A) any weapon, weapons system, munition, aircraft, vessel, boat, or other implement of war;
- (B) any property, installation, commodity, material, equipment, supply, or goods used for the purpose of making military sales;
- (C) any machinery, facility, tool, material, supply, or other item necessary for the manufacture, production, processing, repair, servicing, storage, construction, transportation, operation, or use of any article listed in this paragraph; and
- (D) any component or part of any article listed in this paragraph....

Thus, the AECA provides authorization to implement DLA's first proposal to include non-programmed FMS demands in stock-level computations. The SDAF can be used to finance acquisition of defense articles (including secondary items) for later sale to foreign countries. If the size of SDAF needs to be increased to finance stocks procured to satisfy nonrecurring FMS requirements, that increase can be justified and requested in annual SDAF budget submittals.

However, administratively complex accounting requirements placed on the SDAF manager may preclude direct use of the fund to procure stocks in anticipation of non-programmed FMS requirements. This matter will be discussed in more detail later, but here it is noted that obligation and expenditure authority can be transferred from SDAF to DLA or the Security Assistance Accounting Center (SAAC). Either DLA or SAAC could then act as SDAF's agent for procurement of these special stocks.

The point is that SDAF does provide authority and can provide funding to implement DLA's first proposal. Specific congressional authorization, through the Defense Appropriations Bill, would be required prior to using any other DoD funds to procure stocks in anticipation of later FMS sale.

To summarize, Public Law requires that one of the following actions must occur before DLA can procure stocks in anticipation of non-programmed FMS

secondary item requirements:

- Foreign countries must increase their equity investments for that purpose; or
- SDAF funds must be made available for that purpose; or
- Congress must appropriate funds for that purpose.

PUBLIC LAW RELEVANT TO THE SECOND AND THIRD DLA PROPOSALS

Public Law relevant to the second and third proposals, involving issue of stocks below reorder point, is contained in Section 21(i)(1) of AECA:

Sales of defense articles and defense services which could have significant adverse effect on the combat readiness of the Armed Forces of the United States shall be kept to an absolute minimum. The President shall transmit to the Speaker of the House of Representatives and the Committees of Armed Services and Foreign Relations of the Senate on the same day a written statement giving a complete explanation with respect to any proposal to sell, under this section, any defense articles or defense services if such sale could have a significant adverse effect on the combat readiness of the Armed Forces of the United States.

Thus, it is left to the Executive to establish policies and procedures to minimize sales of defense articles or services when such sales could have a significant adverse effect on U.S. force readiness. If OSD were to conclude that force readiness would not be significantly adversely affected by releasing non-programmed FMS requisitions against stocks below the reorder point, OSD would be free to revise DoD Directive 2000.8 to permit such issues from stock.

4. ALTERNATIVE IMPLEMENTATION PROCEDURES

The first part of this chapter discusses alternative implementation procedures available to OSD, if OSD decides to include non-programmed FMS requirements in stock-level computations (the first DLA proposal). The second part of the chapter discusses the implications of permitting automatic release of non-programmed FMS requisitions against stocks below the reorder point but above the 90-day level (the second and third DLA proposals).

INCLUSION OF FMS NONRECURRING REQUIREMENTS IN STOCK-LEVEL COMPUTATIONS

A straightforward approach to resolving the legal issues associated with the DLA proposal to project non-programmed demands could be for DLA to seek Defense Appropriations Bill language such as the following:

DoD stock funds may be used to procure secondary items in anticipation of non-programmed foreign country requirements.

Such authorization would apply to all DoD stock funds. More specific language could restrict authorization to the Defense Stock Fund or to a new fund established especially for these items. In any case, Congressional authorization of SDAF would serve as legislative precedent for the new legislation. However, because the suggested legislation would reduce incentives for CLSSA investment by foreign countries, it probably would not be approved by Congress. Accordingly, this approach is probably impractical.

Therefore, the next four sections of this chapter concentrate on a discussion of alternative implementation procedures necessitating no change to current law, but which would permit projection of nonrecurring FMS demands in DoD stock-level computations.

The alternative implementation procedures presented are:

- Alternative Implementation Procedure A: require increased up-front equity investment in CLSSAs by foreign governments. (This will be referred to as the "All-CLSSA" alternative.)
- Alternative Implementation Procedure B: fund the increased up-front equity requirement with SDAF. (This will be referred to as the "SDAF-CLSSA" alternative.)
- Alternative Implementation Procedure C: require increased up-front equity investment by foreign governments, but for DLA items only. Establish separate CLSSAs for DLA items. (This will be referred to as the "DLA-CLSSA" alternative.)
- Alternative Implementation Procedure D: require increased investment by foreign governments, but on an incremental basis. Adjust the surcharge on non-programmed FMS requisitions but otherwise maintain current CLSSA procedures. (This will be referred to as the "Surcharge" alternative.)

These implementation alternatives were developed to meet the following objectives:

- No changes to current legislation will be required to implement the new procedures.
- U.S. stock levels will properly reflect all requirements placed upon them, programmed and non-programmed, whether from domestic sources or from FMS customers.
- Only minor changes to DoD, DLA, and Military Department FMS directives and instructions will be required to implement the new procedures.

Alternative Implementation Procedure A: The "All-CLSSA" Alternative

In this alternative, all FMS customers would obtain all of their secondary item requirements, recurring and nonrecurring, under CLSSAs. One CLSSA would be established between the foreign government and each Military Department. The foreign government would be required to provide the necessary increased equity investment.

The Foreign Military Sales Orders (FMSO) I case¹ corresponding to each CLSSA would include a listing of all weapon systems supported, plus an

¹CLSSAs are established through two FMSOs. FMSO I provides for the foreign government's purchase of equity in the DoD inventory. FMSO II provides for the foreign government's withdrawal of stocks procured under the FMSO I.

"all other" category. Periodic updates (semi-annual or annual) would keep the FMSO I equity lists current.

Each foreign country would provide estimates of its planned recurring and nonrecurring requirements for consumables and reparable. Requirements for reparable would be listed individually by National Stock Number and priced. Requirements for consumables would be on a money-value-only basis, with individual secondary items not specified. (A Military Department could specify individual consumable items if it so desired.)

To the country's estimate of planned requirements would be added a fixed percentage to cover unanticipated requirements, recurring and non-recurring. (In an illustration referred to later as Appendix A, a three percent factor is applied to the country's estimate of planned requirements to provide for unanticipated requirements.)

Annually, each Military Department and DLA would estimate its total nonrecurring FMS demand requirements. Those estimates would then be multiplied by the percent of nonrecurring requirements included by each Military Department and DLA in their stock-level computations.

Each country's required equity investment would be calculated as follows:

- Investment requirement for recurring demand would equal 42 percent of total estimated recurring requirements. The 42 percent figure assumes that the country will capitalize on five months' requirements stocked for it by the U.S. supply system ($5/12 = .4167$).
- Investment requirements for nonrecurring demand would be established through application of the standard 42 percent figure factored by the percent of total nonrecurring requirements projected by the Military Departments and DLA.

(Appendix A illustrates the equity investment calculation, aggregated for total FMS business.)

All foreign country secondary item requisitions would cite a CLSSA; Blanket Order cases would be eliminated and secondary items would not be included in Defined Order cases. (If the U.S. should choose to exclude a foreign country from investing in U.S. inventories, a CLSSA providing for only nonrecurring demand would be appropriate.) Foreign countries would assign demand codes to their requisitions, and the Military Departments would perpetuate those assignments. Requisitions citing recurring demand for matured secondary items would receive a "CLSSA response." Requisitions citing nonrecurring demand (or requisitions citing not-matured recurring demand) would receive a "non-CLSSA response."

Compared to present procedures for processing FMS secondary item requisitions, the Navy would no longer change demand codes to fit a CLSSA versus non-CLSSA rationale, as all of a country's secondary item requirements would be handled under a single CLSSA. The Army's current procedure for obtaining equity investment for nonrecurring CLSSA requirements would be expanded to cover all nonrecurring requirements. The Air Force procedures for processing non-programmed demands would not change.

The All-CLSSA Alternative is attractive for several reasons. First, it would be consistent with current CLSSA procedures, including those relating to the FMSO I maturing process and the related DoD supply system response requirements.² Second, it would permit nonrecurring FMS demands to be included in stock-level computations. Third, it would simplify secondary item support procedures, with each service managing only one follow-on support case for each country. Finally, these procedures would accommodate a country's

²The FMSO I portion of the CLSSA provides that a period of time (at least 17 months) must elapse before requirements covered by the CLSSA can receive treatment equal to that provided U.S. forces. During that period, stocks financed by the FMSO I are procured.

decision to do business with the U.S. on either a recurring or nonrecurring basis.

This alternative is expensive, however. It would require foreign countries to increase their equity investment by as much as \$89.7 million (see Appendix A). They would be asked to make large immediate investments to obtain promised future benefits to be derived from gradually increasing stock levels. Consequently, the foreign countries may well perceive that they would be charged for a service now received "free." Also, the foreign countries may have difficulty in preparing the necessary FMSO I requirement estimates, and they may find the entire process cumbersome.

If this alternative is implemented, the Army and Navy would be required to implement now-planned changes to FMSO I equity management procedures. Implementation would also require changes to policy documents, instructions, and procedures. Tracking recurring and nonrecurring demand would be a new FMS requirement.

In summary, the All-CLSSA Alternative is a logical step forward in providing FMS support of secondary items. Its problems are its cost to FMS customers and its complexity.

Alternative Implementation Procedure B: The "SDAF-CLSSA" Alternative

In this alternative an additional FMS case, called an "SDAF-CLSSA," would be established for each country to provide for the country's nonrecurring requirements. The SDAF-CLSSA would work the same as the foreign country CLSSA, except that the SDAF would provide the up-front equity investment required to fund stock levels increased as a result of projecting nonrecurring demands in stock-level calculations. The regular foreign country CLSSA would support recurring requirements only.

The SDAF-CLSSA would be established after the SDAF manager had designated the Security Assistance Accounting Center (SAAC) as SDAF's agent to

procure stocks to be held in anticipation of non-programmed FMS secondary item requirements. (The SDAF manager would do this by providing SAAC with "Advice of Obligation and Expenditure Authority.") Procedurally, to carry out its responsibilities, SAAC would then direct the International Logistics Control Offices (ILCOs) to establish the SDAF-CLSSAs, using SDAF cash obtained through routine cash requirement determinations during the budget cycle. The ILCOs would, in turn, provide Special Program Requirements (SPRs) to DLA, authorizing DLA to procure stocks to be held in anticipation of requirements generated under the SDAF-CLSSAs.

Procedures for calculating the equity investments required of SDAF would be the same as outlined under the All-CLSSA Alternative.

The SDAF-CLSSA Alternative has all the attractions of the previous approach, and it would not require new investment by foreign countries. It would provide the SDAF manager with a means to control and account for items procured under the SDAF. However, SDAF funds are very limited, and the necessary implementation procedures are complex and cumbersome. Further, the SDAF-CLSSAs would reduce incentives for CLSSA investment by foreign governments.

Alternative Implementation Procedure C: The "DLA-CLSSA" Alternative

In this alternative, a separate FMS case would be established to cover each foreign country's requirements for DLA items. This DLA-CLSSA would be negotiated and managed in the same manner as the Military Department CLSSAs described in the All-CLSSA Alternative. The single DLA-CLSSA established for each country would cover all of that country's requirements for DLA items (DLA items would not be included in Blanket Orders, Defined Orders, or Military Department CLSSAs).

The FMSO I case corresponding to each DLA-CLSSA would include a listing of all weapon systems supported, plus an "all other" category.

Periodic updates (semi-annual or annual) would keep the FMSO I equity list current. The foreign country would provide estimates of its planned recurring and nonrecurring requirements by stock number or on a money-value-only basis. To the country's estimate of planned requirements would be added a fixed percentage to cover unanticipated requirements, recurring and nonrecurring.

DLA would then estimate the percent of its total nonrecurring requirements to be included in its stock-level computations. The total required equity investment would be calculated as follows:

- Investment required for recurring demand would equal 42 percent of total estimated recurring requirements.
- Investment required for nonrecurring demand would equal the standard 42 percent figure factored by the percent of total requirements projected by DLA.

Foreign countries would assign demand codes to their DLA requisitions, and DLA would perpetuate those assignments. Requisitions citing recurring demand for properly matured secondary items would receive a "CLSSA response." Requisitions citing nonrecurring demand (or requisitions citing not-matured recurring demand) would receive a "non-CLSSA response."

Implementation of the DLA-CLSSA Alternative would permit DLA to include nonrecurring FMS requirements in stock-level computations. It offers the advantage of being consistent with current CLSSA procedures. Demand codes would reflect foreign customer supply decisions, and a country's decision to change its way of doing business with the DoD supply system (for example, to switch from a nonrecurring demand basis to a recurring demand basis) would be simple to effect.

A further advantage of the DLA-CLSSA Alternative is that DLA would deal with its FMS customers directly, rather than through the Military

Departments. The Military Departments would not be required to process requirements for DLA items.

However, this alternative is expensive (\$63.5 million), and it may be difficult to persuade the foreign governments to make the required investment. As with the All-CLSSA Alternative, the foreign government would be required to make an immediate investment to obtain future benefits that would gradually result from increasing stock levels. They may perceive that they were being charged for a formerly free service.

Another problem is that the foreign countries may find the procedures difficult to implement, especially since they would have to understand more about the details of the DoD supply system than they do now.

Additionally, the weapon system orientation of current FMS procedures would be compromised by requiring the foreign country to deal with alternative DoD supply systems, depending upon which organization managed the item required (rather than dealing with only one Military Department for all items supporting any particular weapon system.) The Military Department responsible for managing a weapon system end-item case would not be entirely responsible for providing the secondary item support. This alternative also would complicate end-item procurements, which now include secondary items in end-item cases.

DLA would be required to establish an ILCO, or one of the Military Department ILCOs would be required to act as DLA's agent, to manage these DLA CLSSAs.

Finally, this alternative does not resolve the issue of whether or not the Military Departments should be allowed to include nonrecurring demands in stock-level computations.

In summary, while the DLA-CLSSA Alternative is feasible, it is costly and complex.

Alternative Implementation Procedure D: The "Surcharge" Alternative

In this alternative, the surcharge presently applied to non-programmed FMS requisitions³ would be adjusted to obtain the equity investment on an incremental basis.

The first step in determining the surcharge adjustment would be for each Military Department and DLA to estimate its total annual nonrecurring FMS requirements for secondary items. They also would identify the inventory increases required to project nonrecurring FMS demands in their stock computations.

The required equity investment then would be collected from FMS customers over a period of time. The time periods over which payments logically could be spread are the following:

- 17 months, which corresponds to the present time period required for a CLSSA to mature.
- 29 months, which assumes that procurement lead time is 24 months, rather than the 12 months built into the 17-month CLSSA maturing period.
- 60 months, which permits spreading the investment over a longer, but still reasonable, time period.
- an indefinite period, which calculates the surcharge on a present value basis.

Regardless of which period is selected, a special surcharge, representing a cost to the U.S. of stocking in anticipation of non-programmed FMS requirements, would be applied to all nonrecurring demands. (The surcharge would equal required equity investment divided by estimated total supply system nonrecurring FMS requirements. The new surcharge could be offset, in part, by reduction of the current spot-buy surcharge on non-CLSSA requisitions.) For all but the indefinite period, the foreign country would be required to

³Reference ASD (Comptroller) memorandum dated 21 October 1981: DoD 7290.3-M, "Foreign Military Sales Financial Management Manual."

guarantee that it would reimburse the U.S. government for any equity investment dollars not collected. This dependable undertaking would protect the U.S. in the event the foreign country chose to cease doing business with the U.S. supply system prior to expiration of the stated investment period. (See Appendices B and C for the calculation procedure and selected options.)

If the surcharge is based on present value calculations (the indefinite period method) an interest charge, representing a "cost-of-money" reimbursement to the U.S. government, would be added to the required equity investment.

In contrast to present procedures, the Army would cease obtaining equity investment for nonrecurring CLSSA requirements, relying instead on the surcharge to provide the required equity investment. The Navy would perpetuate foreign country demand codes. Air Force procedures for processing non-programmed requirements would not change. All three Military Departments could use CLSSAs alone to provide all requirements now supplied under CLSSAs and Blanket Orders. Requisitions citing nonrecurring demand (or requisitions citing non-matured recurring demand) would receive a "non-CLSSA response."

The Surcharge Alternative offers many advantages. First, it permits projection of nonrecurring FMS requirements in stock-level computations. It can be applied selectively or across-the-board (for any or all DoD components). It can be implemented with the current mix of FMS case types (Blanket Order, Defined Order, and CLSSA), or it can be implemented under a variety of single-CLSSA per-country approaches. The individual Military Departments and DLA would have the flexibility to apply the surcharge in conformance with the peculiarities of their individual inventory control systems.

The Surcharge Alternative eliminates special handling of FMS requirements. A country's demand code decision can be routinely perpetuated by the DoD supply system. The surcharge percentage can be systematically computed and the calculations can be audited. The surcharge collection process can be integrated with the CLSSA maturation process as a routine case management function.

This alternative does not require separate investment calculations for individual countries. The investment pattern can be made to match either the CLSSA maturation process, the demand generation pattern, or the U.S. Government's cash expenditure pattern. This alternative would also strengthen incentives for CLSSA participation by foreign countries.

The present value approach to calculating the surcharge is simple to effect administratively, and it is financially proper for foreign governments to reimburse the DoD supply system for its cost of doing business.

However, implementation of the Surcharge Alternative would not be without problems. If the new surcharge is not offset by reducing the current non-CLSSA surcharge, foreign countries may perceive that these new procedures result in charges for previously free services. Basing the surcharge upon present value calculations, dollars collected may not equal dollars paid out, in instances of short procurement lead times. The Army and Navy would be required to implement now-planned changes to FMSO I equity management. Changes to policy documents, instructions, and procedures would be required; and tracking recurring and nonrecurring demand would be a new FMS requirement. In addition, SAAC would be required to account for the surcharges collected and, with ASD (Comptroller) authorization, make periodic transfers to the appropriate stock fund managers.

In summary, the Surcharge Alternative is simple conceptually and could be implemented efficiently. Its disadvantages are small, compared to other alternatives for responding positively to the first DLA proposal.

IMPLICATIONS OF RELEASING FMS NONRECURRING REQUIREMENTS
AGAINST STOCKS BELOW THE REORDER POINT

DLA's second and third proposals are to substitute the 90-day level (safety level) for the reorder point as the threshold below which nonrecurring FMS requirements will not be released for issue. The proposals would, in effect, give nonrecurring FMS demand requirements treatment equal to U.S. and CLSSA recurring requirements.

It will be recalled that each implementation alternative described earlier in this chapter retained the "non-CLSSA response" feature of current FMS procedures. Retention of this feature means that issuing nonrecurring requirements below the reorder point would still be controlled, in spite of the fact that these alternatives provide the means to increase stock levels in anticipation of nonrecurring FMS demands. The reason this is necessary is that neither the front-end investments nor the surcharge devised by these alternatives apply to recurring demand now covered by CLSSAs or to that significant portion of nonrecurring FMS requirements which under U.S. inventory management practices would not be included in stock-level computations; i.e., that portion of nonrecurring demand not projected by DLA and the Military Departments.

If the reorder point constraint on filling nonrecurring FMS requirements were removed -- giving the FMS customer the opportunity to receive treatment equal to the U.S. customer for both recurring and nonrecurring demand -- the foreign customer would be strongly motivated to finance all his requirements by means of the front-end investment or surcharge devised to support only that portion of nonrecurring demand that is projected. He could do this by simply

declaring all his requirements to be nonrecurring. He would then avoid the CLSSA front-end investment now required to gain treatment equal to U.S. forces.

Therefore, we see the reorder point constraint, functioning as it does under current procedures, as necessary to motivate foreign customers to make adequate equity investments to support recurring requirements. It does this by differentiating between how planned (recurring demand) and unplanned (nonrecurring) requirements are treated by the U.S. supply system.

5. ALTERNATIVE POLICY RESPONSES

As discussed in Chapter 2, there is very little systematic evidence available to support analysis of the first DLA proposal. Our estimates of the cost of implementing the proposal are ad hoc, not the product of the Military Departments' ordinary management information systems. Virtually no data are available to measure the future readiness gains obtainable from implementing DLA's first proposal. Further, there is no systematic evidence showing that either U.S. or foreign force readiness is now being adversely affected by current FMS secondary item policies.

Accordingly, it is clear that OSD will have to consider non-quantitative arguments in its review of the DLA proposal. These non-quantitative arguments proceed along three lines:

- OSD should maintain its current FMS secondary item support policies and reject the DLA proposal. The present system is generally working satisfactorily, and DLA's particular concerns involve too small a portion of overall DoD secondary item business to justify the expense and effort required to effect the proposed changes; or
- OSD should set aside the DLA proposal until such time as systematic evidence is available to support their rigorous evaluation; or
- OSD should approve DLA's proposal in order to avoid future readiness problems and in order to make the system more efficient.

The remainder of this chapter will present the arguments supporting these possible responses to the first DLA proposal.

ARGUMENTS AGAINST CHANGE

DoD policies pertaining to non-programmed FMS requirements are understood throughout the DoD supply system and are understood by the FMS customers. Implementing procedures are imbedded in the DLA and Military Department inventory control systems and these procedures are working.

The Military Departments have expressed no interest in obtaining the proposed policy changes. They do not find the present procedures burdensome, nor do they find that excluding nonrecurring FMS demands from stock-level calculations is now creating U.S. force readiness problems.

FMS customers seem generally satisfied with current procedures for providing secondary item support. If a foreign country becomes dissatisfied with U.S. procedures for processing its non-programmed requirements, it can obtain treatment equivalent to U.S. forces by incorporating those requirements into a CLSSA, provided that immediate financial considerations do not preclude the required up-front equity investment.

Implementing the first DLA proposal throughout the DoD supply system would result in stock level increases of approximately \$90 million -- \$64 million for DLA alone (see Appendix A for calculations). Whether these costs are borne by the U.S. or foreign governments, the provider of funds will have to be shown the benefits to be derived from the investment.

The primary benefit from implementing the first DLA proposal would be improved readiness protection for both U.S. forces and foreign forces upon which the U.S. depends. An assessment of the readiness impact on U.S. forces of non-programmed FMS requirements necessitates information which is not currently available, such as the subsequent impact on U.S. requirements in cases where FMS requirements were released against stocks below the reorder point. Similarly, an assessment of the impact on the readiness of foreign forces requires such information as the number and lead times of backorders and spot buys, programmed and non-programmed, for FMS requirements. FMS program managers do not see justification for acquiring that information, in the absence of evidence that force readiness is now being jeopardized as a result of current policies and procedures.

Even the superior method of implementing the DLA proposals -- the "surcharge" alternative -- would require DoD-wide changes to policy documents, instructions, and procedures. Tracking recurring and nonrecurring demand would be a new FMS requirement. In addition, SAAC would be required to account for the surcharges collected and, with Assistant Secretary of Defense (ASD) (Comptroller) authorization, make periodic transfers to the appropriate stock fund managers.

Furthermore, obtaining foreign country cooperation in implementing the changes proposed by DLA could be difficult. They may perceive that they were being charged for a service now provided "free." And, if the proposals were implemented via the All-CLSSA or DLA-CLSSA alternatives, the foreign countries may object to making very large immediate investments to obtain promised future benefits. If the proposals are implemented via application of a surcharge based upon present value calculations, dollars collected may not equal dollars paid out, in instances of short procurement lead times.

Non-programmed FMS requirements processed by DLA probably account for no more than one percent of total DoD secondary item business. Considering that there is neither evidence nor a consensus that current policy is adversely affecting the readiness of U.S. or foreign forces, resolving DLA's particular problems with current policy do not seem to justify expending substantial resources. It is entirely possible that implementation of the DLA proposal would produce no traceable change in the quality of support provided either foreign or U.S. customers.

ARGUMENTS FOR DELAYING DECISION

The problem with the DLA first proposal is not whether the policy changes would improve supply support to U.S. and foreign forces. There is no question

that it would benefit both foreign country and U.S. force readiness. The problem is to identify the dollar cost of obtaining those readiness benefits and to compare those costs with the value of anticipated benefits. As was pointed out in Chapter 2, however, information required for a rigorous cost-benefit analysis is not available.

The data required for the cost side of the analysis would be similar to that displayed in Table 2-2. Such data, generated regularly and formally over time, would permit development of a precise estimate of the dollar cost of implementing the DLA proposal and would improve management's understanding of the importance of FMS secondary item business in relation to their overall activity. In the absence of clear indications, however, that FMS secondary item support is a problem, and in the absence of a clear understanding of the size of FMS secondary item business, Military Department and DLA FMS program managers do not presently see justification for generating the data displayed in Table 2-2. The dilemma is that without reliable cost data those same managers cannot assess the DLA proposal.

As to the benefit side of the required cost-benefit analysis, the primary benefit from implementing the first DLA proposal would be improved force readiness protection. However, as was indicated in the preceding section, an assessment of the proposal's readiness impact would require analysis of information not available. Further, as with the required cost data, FMS program managers do not see justification for requiring that information, in the absence of evidence that force readiness is being jeopardized as a result of current policies and procedures.

Because it is not now possible to perform an economic analysis justifying the DLA proposal, and because there is no persuasive evidence that present policies are jeopardizing U.S. force readiness, DLA's proposals should be set

aside. The Military Departments and DLA should establish systems and procedures to accumulate the necessary cost-benefit data and subsequently perform a rigorously quantitative analysis of the proposals. (An improved information system would better support day-to-day monitoring of FMS secondary item business, regardless of its value in producing data in support of a specific, analytical requirement.)

Of course, if a future analysis shows that DLA's proposal is cost effective, any of the implementation procedures outlined in Chapter 3 can be adopted. Meanwhile, it seems questionable to spend millions of dollars with no idea of the value of expected benefits.

ARGUMENTS FOR CHANGE

Present U.S. support to foreign governments is different from that which was provided when current policies and procedures were established:

- Modern, sophisticated weapon systems are now being provided to FMS customers, whereas earlier FMS sales were comprised mainly of weapons deemed obsolescent in U.S. forces.
- These foreign forces, equipped with modern weapons, are increasingly being integrated into U.S. contingency planning.
- Procurement lead times to support these modern weapon systems are significantly longer than they were when the present policies were established. These lengthened lead times have increased the risk of out-of-stock conditions occurring and enduring.

Thus, it has become increasingly important to U.S. interests that DoD supply system planning provide for responsive support to FMS customers and integrate FMS requirements into U.S. inventory levels.

Present policy requires the DoD supply system to treat non-programmed foreign requirements differently than U.S. requirements, and these different procedures result in stock levels lower than would occur if all requirements were treated the same. The Military Departments already are (or are considering) projecting nonrecurring U.S. requirements in their stock-level

computations. (The Army projects about 88 percent of its nonrecurring U.S. requirements; the Air Force projects about 10 percent; and the Navy is considering doing so. DLA projects about 98 percent of its nonrecurring demands from U.S. forces.) If projecting nonrecurring demands from U.S. forces is appropriate, and if legal impediments to projecting nonrecurring FMS demands can be overcome, then the difficult position to defend is the one which advocates not projecting nonrecurring FMS demands.

U.S. force readiness is being adversely affected to the extent that nonrecurring FMS demands are for items required by U.S. forces. Based on the calculations presented earlier, U.S. stocks may be \$90 million smaller than they would be if FMS requirements were treated the same as U.S. requirements, and that \$90 million deficiency is one that should be remedied by the FMS customers. In reality, U.S. forces are providing a part of that \$90 million investment in the form of increased readiness risk. Again, it is not clear that there is any reason for the U.S. to accept any part of that risk, given the absence of legal impediments to a feasible solution.

If the surcharge alternative for implementing the first DLA proposal were adopted, the U.S. could correct, in a gradual and flexible manner, the inventory distortions brought about by present policies. Foreign governments would no longer be able to use non-CLSSA requisitioning procedures to avoid making appropriate investments in U.S. stocks.

Current procedures are causing problems, at least at DLA, where many so-called "nonrecurring" FMS requirements are processed for issue. While DLA is frequently required to issue non-CLSSA requisitions against stocks below the reorder point, it is precluded from employing its ordinary procedures to plan for these requirements. As a consequence, not-in-stock conditions occur, requiring extraordinary measures to re-establish stock levels, in order to

minimize the possibility of adversely affecting U.S. force readiness. The effort DLA expends in handling these stock replenishments would not be necessary if foreign requirements were included in stock-level computations, the same as U.S. requirements.

It is worth noting that DLA's role in weapon system support is increasing. If DLA is experiencing not-in-stock conditions now for some personnel support and hardware items, it is probable that future problems will involve secondary items supporting critical weapon systems. (To the extent that Military Departments treat nonrecurring demand the same as DLA, the weapon system support problem already exists.)

Implementation of the first DLA proposal could be quite flexible and simple. The surcharge alternative can be applied for DLA or any of the Military Departments selectively, or it can be applied across-the-board. It can be implemented with the current mix of FMS case types (Blanket Order, Defined Order, and CLSSA), or it can be implemented under a variety of single-CLSSA-per-country approaches. The surcharge percentage can be systematically computed and the calculations can be audited. Separate investment calculations for individual countries would not be required.

The final argument for change is that implementation of the DLA proposal can simplify secondary item support procedures, for both U.S. forces and FMS customers. Further, implementing the DLA proposal now would not interfere with developing the improved information systems required regardless of the merits of the DLA proposal.

As counter arguments to those put forward in support of the status quo or of delaying acceptance of DLA's first proposal, three points should be noted. First, while the readiness benefits to be obtained from the proposed changes have not been quantified, and may never be quantified, there is no question

that readiness benefits would result. Readiness benefits obtainable at foreign government expense should not be rejected because a rigorous quantitative analysis is not available to measure their net value: no contrary analysis has shown that the benefits are worth less than their cost.

Second, regardless of the present impact of non-programmed FMS requirements upon U.S. force readiness, all indications are that the future impact of current FMS policy will be increasingly negative. (The extreme impact would be felt during mobilization and wartime scenarios.) It makes sense to fix the procedures now, gradually, rather than later when problems are acute and large.

Third, the change proposed by DLA would improve support provided to U.S. allies and would further integrate their support with that provided U.S. forces. There is cost, in the form of unnecessary risk to force readiness, in delaying actions to integrate readiness support provided to U.S. forces and their allies.

CONCLUSION

The Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics) (ASD(MRA&L)) should accept the first DLA proposal, but continue current procedures requiring a "non-CLSSA response" to all nonrecurring requirements. Force readiness and support system efficiency can be improved in a timely way by doing so, at little cost to the U.S. Government, while a differentiation can be continued that recognizes the advantages to both the U.S. Government and foreign governments in the latter's investing in U.S. stocks.

6. RECOMMENDATIONS

We recommend that ASD(MRA&L) change DoD Directive 2000.8 guidelines to:

- Include non-programmed FMS demands in stock-level computations.
- Fund the resulting increase in stock levels by requiring increased foreign country equity investment.
- Obtain the foreign funds incrementally over time via a surcharge imposed on non-programmed FMS requirements.
- Require each Military Department (if the Military Department projects nonrecurring FMS demands) and DLA to obtain the required equity investment by applying a surcharge against only its own FMS secondary item demands.
- Spread the surcharge collection over an indefinite period using present value techniques to calculate the surcharge.
- Continue the current policy of providing "non-CLSSA response" to all nonrecurring FMS requirements.

These procedures can be implemented within the constraints of present law. They do not require establishment of the complex accounting procedures that would be required if SDAF were used to provide the increased equity investment. Foreign governments would not be required to make large, immediate increases in their FMSO I cases, and the recommended procedures would permit a DoD-wide solution to the problem of integrating FMS and U.S. secondary item requirements.

Because an information system which would provide the data approximated in Table 2-2 would assist managers in monitoring day-to-day FMS secondary item business, we recommend that DLA and the Military Departments establish procedures to accumulate such information.

Finally, to simplify and streamline current procedures, we recommend that FMS policies and procedures be changed to:

- Establish one CLSSA for each Military Department involved in each country. The single CLSSA would support both recurring and nonrecurring foreign country requirements.
- Require a CLSSA equity list update at least annually.
- Eliminate use of Blanket Orders for secondary item requirements. The single CLSSA will eliminate need for a separate FMS case type to handle nonrecurring follow-on requirements.

APPENDIX A

TABLE A-1. UP-FRONT INVESTMENT CALCULATION

EQUITY INVESTMENT

<u>Category</u>	<u>Estimated Annual Requirements</u>	<u>Equity Investment</u>
Planned Requirements		
Recurring	\$ 651,549,000 ^a	\$273,651,000 ^b
Nonrecurring	846,131,000 ^a	\$ 87,009,000 ^c
Unanticipated Requirements		
Recurring	\$ 20,151,000 ^d	\$ 8,463,000 ^b
Nonrecurring	<u>26,169,000^d</u>	<u>\$ 2,691,000^c</u>
Total Requirements	\$1,544,000,000	\$371,814,000 ^e
Recurring	\$ 671,700,000	\$282,114,000
Nonrecurring	\$ 872,300,000	\$ 89,700,000 ^c

^aTo be estimated by foreign countries. Figures here are derived from FY 1982 actuals.

^bForty-two percent of estimated annual requirements.

^cThe equity investment for nonrecurring demand will be required for consumables only. Currently, if DLA projects 98% of their total nonrecurring demand and USA projects 88% of their nonrecurring CLSSA demand, then:

- DLA equity investment requirement = \$313.9 (total demand) x 49.12% (total nonrecurring demand) x 98% (projection factor) x 42% (5 months/12 months) = \$63.5 million.
- USA equity investment requirement = \$704.0 (total demand) x 30% (total CLSSA demand) x 42% (USA CLSSA nonrecurring demand) x 80% (net of DLA items) x 88% (projection factor) x 42% (5 months/12 months) = \$26.2 million.
- \$63.5 million (DLA) + \$26.2 million (USA) = \$89.7 million.

^dThree percent of planned annual requirements.

^eAdministrative charge and storage assessment are additional.

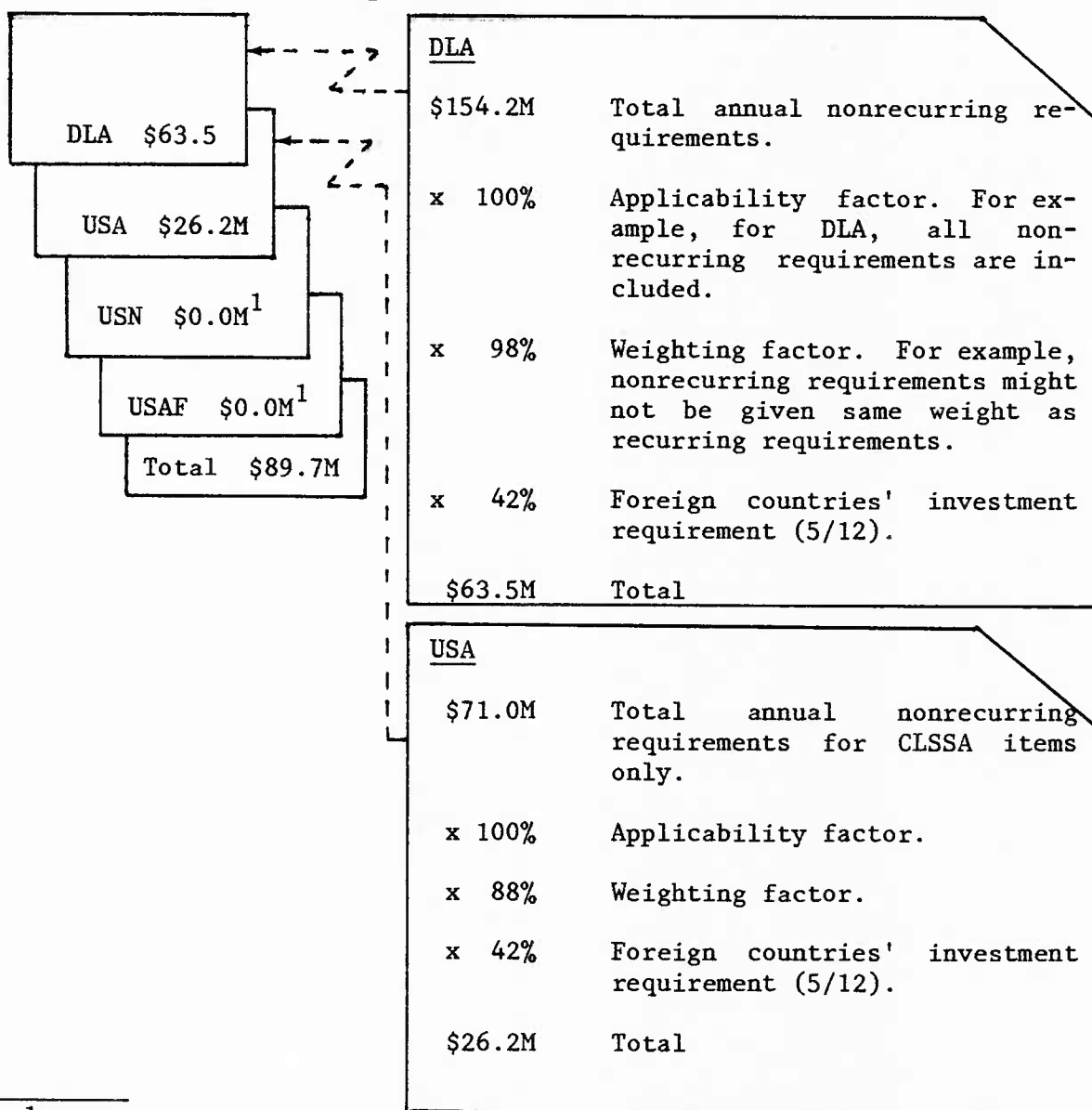
APPENDIX B

SURCHARGE CALCULATION PROCEDURE

Illustrative surcharge calculations are presented for a 60-month payback period and for an indefinite payback period using present value techniques to calculate the surcharge.

The following three-step procedure applies to the 60-month payback period.

- Step 1: Determine dollar value of inventory increases for Military Departments and DLA:



¹USN and USAF do not now project nonrecurring FMS demand.

- Step 2: Calculate the annual equity investment which, over five years (60-months), is equivalent to the total investment requirement calculated in Step 1:

\$89.7M ²	Total equity investment re- quired.
60 months	Time period selected.
\$17.9M	Annual payment, which, if paid for 5 years, is equivalent to an immediate investment of \$89.7M.

- Step 3: Calculate surcharge percentage by comparing the annual payment requirement, calculated in Step 2, and total nonrecurring FMS requirements:

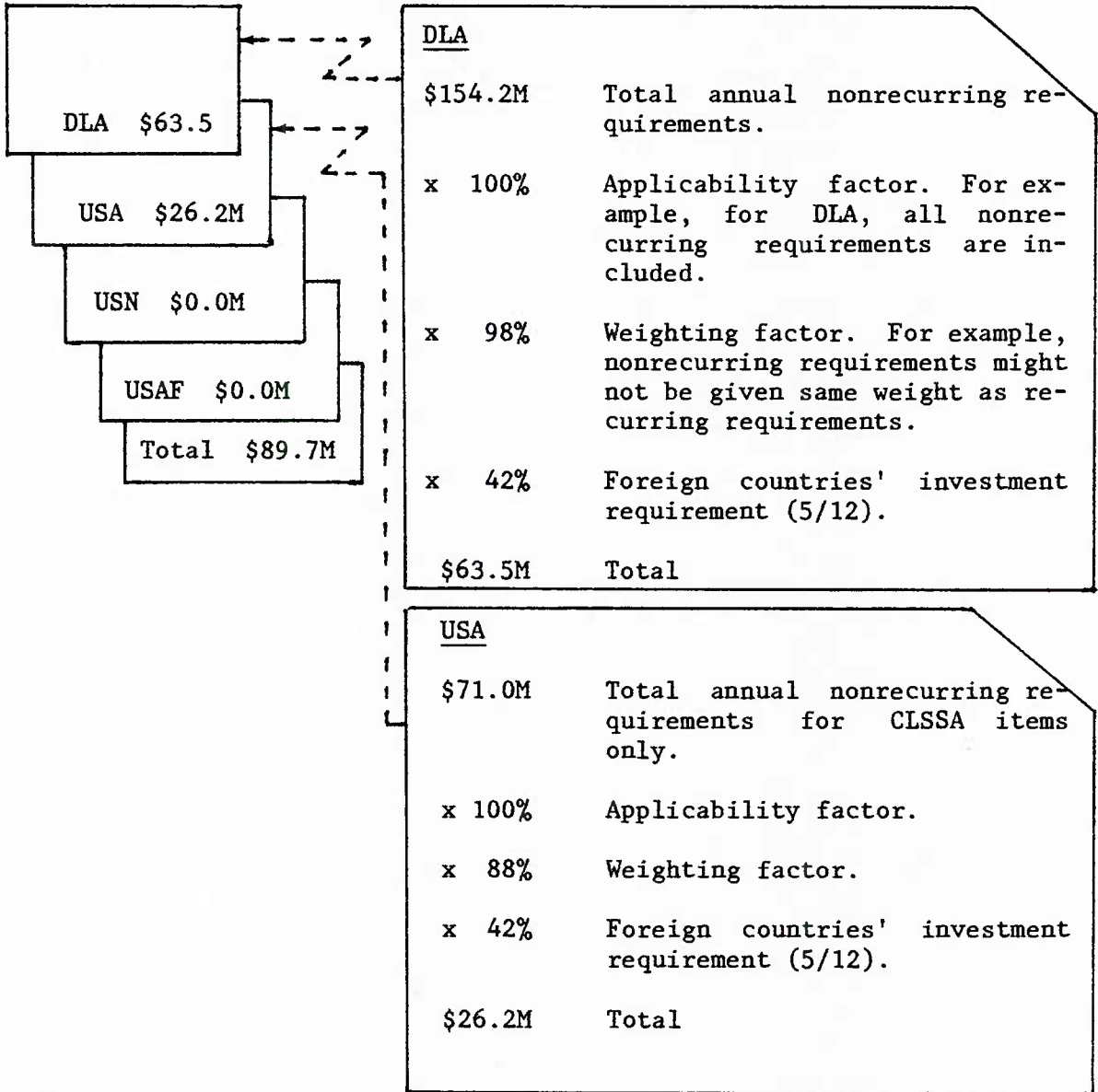
\$17.9M	Annual payment requirement.
÷\$871.2M ³	Total nonrecurring requirements.
2.1%	Surcharge applicable to nonre- curring requirements.

²Equity investment required is for consumable items only.

³Surcharge is applied to all nonrecurring demands (for consumables and reparable) for simplicity. Figure is obtained by summing each Military Department and DLA.

The following procedure applies to the indefinite payback period, with present value techniques used in the calculations.

- Step 1: Determine dollar value of inventory increases for Military Departments and DLA:



- Step 2: Using present value techniques, calculate the annual equity investment which is equivalent to the total investment requirement calculated in Step 1:

\$89.7M	Total equity investment required.
120 months	Time period (assumed average duration of customer participation).
10%	OMB-specified discount rate.
\$13.3M	Annual payment, which, if paid for 10 years, is equivalent to an immediate investment of \$89.7M.

- Step 3: Calculate surcharge percentage by comparing the annual payment requirement, calculated in Step 2, and total nonrecurring FMS requirements:

\$13.3M	Annual payment requirements.
÷\$871.2M	Total nonrecurring requirements.
1.5%	Surcharge applicable to non-recurring requirements.

APPENDIX C
SURCHARGE CALCULATION OPTIONS

As indicated in Appendix B (page B-4), using present value techniques to calculate the surcharge results in a 1.5 percent surcharge, which would be applied to all FMS nonrecurring demands. If it were decided that only DLA nonrecurring demands would be projected in stock-level computations, the surcharge percentage would drop to 1.1 percent. If all the Military Departments joined DLA in projecting nonrecurring FMS requirements, the surcharge could be as high as 4.8 percent. Finally, if each Military Department and DLA were required to collect the equity investment by applying a surcharge against only its own FMS secondary item demands, a variety of surcharge percentages results.

Table C-1 shows how the surcharge percentages vary, depending upon which supply systems project nonrecurring FMS requirements and depending upon what base the equity collection is calculated. Note that if the Military Departments and DLA maintained their present practices regarding projection of nonrecurring demand, FMS customers of the Navy and Air Force Supply Systems would be unaffected by a policy change permitting projection of nonrecurring FMS demands.

TABLE C-1. SURCHARGE CALCULATION OPTIONS--PRESENT
VALUE TECHNIQUE

Supply System:	USA	USN	USAF	DLA
Projection Factor:	0.88	0.50 ^a	0.10 ^a	0.98
1. Current MILDEP and DLA projections of nonrecurring demand (DLA \$63.5M + USA \$26.2M = \$89.7M) distributed over all FMS nonrecurring demand	1.5%	1.5%	1.5%	1.5%
2. DLA-projected nonrecurring demand only (\$63.5M) distributed over all FMS nonrecurring demand	1.1%	1.1%	1.1%	1.1%
3. All MILDEPs and DLA project nonrecurring demand; total (DLA \$63.5M + USA \$95.8M + USN \$11.0M + USAF \$2.6M = \$172.9M) projected over all FMS nonrecurring demand	4.8% ^a	4.8% ^a	4.8% ^a	4.8% ^a
4. MILDEP and DLA nonrecurring demand projections distributed over respective MILDEP or DLA nonrecurring demand				
-- worst case	3.5% ^a	0.8% ^a	0.4% ^a	6.1% ^a
-- current MILDEP procedures; DLA proposal	1.6%	0.0%	0.0%	6.1%

^a"Worst case" assumption; USA does not now project nonrecurring demand for non-CLSSA requirements, but does for all other requirements; USN does not now project nonrecurring demand for either U.S. or FMS requirements (.50 factor selected for estimating purposes); USAF does not now project nonrecurring demand for FMS requirements, but does project about 10 percent of its U.S. nonrecurring requirements.

Tables C-2, C-3, and C-4 are similar to Table C-1, except that the payback periods vary.

TABLE C-2. SURCHARGE CALCULATION OPTIONS--17 MONTH PAYBACK

Supply System:	USA	USN	USAF	DLA
Projection Factor:	0.88	0.50 ^a	0.10 ^a	0.98
1. Current MILDEP and DLA projections of nonrecurring demand (DLA \$63.5M + USA \$26.2M = \$89.7M) distributed over all FMS non-recurring demand	7.3%	7.3%	7.3%	7.3%
2. DLA-projected nonrecurring demand only (\$63.5M) distributed over all FMS non-recurring demand	5.1%	5.1%	5.1%	5.1%
3. All MILDEPs and DLA project nonrecurring demand; total (DLA \$63.5M + USA \$95.8M + USN \$11.0M + USAF \$2.6M = \$172.9M) projected over all FMS nonrecurring demand	14.0% ^a	14.0% ^a	14.0% ^a	14.0% ^a
4. MILDEP and DLA nonrecurring demand projections distributed over respective MILDEP or DLA nonrecurring demand				
-- worst case	16.4% ^a	3.7% ^a	1.9% ^a	29.1% ^a
-- current MILDEP procedures; DLA proposal	4.5%	0.0%	0.0%	29.1%

^a"Worst case" assumption; USA does not now project nonrecurring demand for non-CLSSA requirements, but does for all other requirements; USN does not now project nonrecurring demand for either U.S. or FMS requirements (.50 factor selected for estimating purposes); USAF does not now project nonrecurring demand for FMS requirements, but does project about 10 percent of its U.S. nonrecurring requirements.

TABLE C-3. SURCHARGE CALCULATION OPTIONS--29 MONTH PAYBACK

Supply System:	USA	USN	USAF	DLA
Projection Factor:	0.88	0.50 ^a	0.10 ^a	0.98
1. Current MILDEP and DLA projections of nonrecurring demand (DLA \$63.5M + USA \$26.2M = \$89.7M) distributed over all FMS non-recurring demand	4.2%	4.2%	4.2%	4.2%
2. DLA-projected nonrecurring demand only (\$63.5M) distributed over all FMS non-recurring demand	3.0%	3.0%	3.0%	3.0%
3. All MILDEPs and DLA project nonrecurring demand; total (DLA \$63.5M + USA \$95.8M + USN \$11.0M + USAF \$2.6M = \$172.9M) projected over all FMS nonrecurring demand	8.2% ^a	8.2% ^a	8.2% ^a	8.2% ^a
4. MILDEP and DLA nonrecurring demand projections distributed over respective MILDEP or DLA nonrecurring demand				
-- worst case	9.6% ^a	2.2% ^a	1.1% ^a	17.0% ^a
-- current MILDEP procedures; DLA proposal	2.6%	0.0%	0.0%	17.0%

^a"Worst case" assumption; USA does not now project nonrecurring demand for non-CLSSA requirements, but does for all other requirements; USN does not now project nonrecurring demand for either U.S. or FMS requirements (.50 factor selected for estimating purposes); USAF does not now project non-recurring demand for FMS requirements, but does project about 10 percent of its U.S. nonrecurring requirements.

TABLE C-4. SURCHARGE CALCULATION OPTIONS--60 MONTH PAYBACK

Supply System:	USA	USN	USAF	DLA
Projection Factor:	0.88	0.50 ^a	0.10 ^a	0.98
1. Current MILDEP and DLA projections of nonrecurring demand (DLA \$63.5M + USA \$26.2M = \$89.7M) distributed over all FMS non-recurring demand	2.1%	2.1%	2.1%	2.1%
2. DLA-projected nonrecurring demand only (\$63.5M) distributed over all FMS non-recurring demand	1.5%	1.5%	1.5%	1.5%
3. All MILDEPs and DLA project nonrecurring demand; total (DLA \$63.5M + USA \$95.8M + USN \$11.0M + USAF \$2.6M = \$172.9M) projected over all FMS nonrecurring demand	4.0% ^a	4.0% ^a	4.0% ^a	4.0% ^a
4. MILDEP and DLA nonrecurring demand projections distributed over respective MILDEP or DLA nonrecurring demand				
-- worst case	4.7% ^a	1.1% ^a	0.5% ^a	8.2% ^a
-- current MILDEP procedures; DLA proposal	1.3%	0.0%	0.0%	8.2%

^a"Worst case" assumption; USA does not now project nonrecurring demand for non-CLSSA requirements, but does for all other requirements; USN does not now project nonrecurring demand for either U.S. or FMS requirements (.50 factor selected for estimating purposes); USAF does not now project non-recurring demand for FMS requirements, but does project about 10 percent of its U.S. nonrecurring requirements.