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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

FOR RELEASE
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STATEMENT FOR THE RECORD

BY

NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

U.S. GENERAL ACCOUNTING OFFICE

SUBMITTED TO THE

COMMITTEE ON FOREIGN AFFAIRS

SUBCOMMITTEE ON INTERNATIONAL SECURITY
AND SCIENTIFIC AFFAIRS

HOUSE OF REPRESENTATIVES

ON

GAO REVIEW OF

PRICING FOR FOREIGN MILITARY TRAINING

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to be of assistance to you and to summarize our report to the committee, Tuition Rates Charged Foreign Governments for Military Training Should be Revised (GAO/NSIAD-84-61, February 21, 1984).

There are two areas which we addressed in the report and which are summarized in this statement. The first is a chronology of the price changes which have occurred in security assistance training since 1975 and their impact on the Arms Export Control Act's requirement for recovery of full cost. The second is our analysis of the impact of the administration's proposal to establish a single price for selling military training to foreign countries.

MILITARY TRAINING PROVIDED TO FOREIGN GOVERNMENTS

The United States provides military training on both a grant and sales basis to foreign governments. The Department of State has the principal role in formulating policy for this program, as well as other security assistance programs, but the Department of

Defense through the Defense Security Assistance Agency (DSAA), implements the program. The statutory basis for the program is found in the Foreign Assistance Act of 1961, as amended, and the Arms Export Control Act of 1976, as amended.

Under the Foreign Assistance Act, the United States makes available to foreign governments grant-funded training through the International Military Education and Training (IMET) program. The IMET program totaled $46 million in fiscal year 1983; $26 million of this was for course tuition and the remaining $20 million was for travel and living allowance, medical costs, and operating costs for some of the Panama Canal Area Schools. In addition, the Arms Export Control Act authorizes Defense to sell training to foreign countries under the foreign military sales (FMS) program. About $194 million in training was provided in fiscal year 1983 under the sales program.

MULTITIER PRICING

The Acts prescribe a multitier pricing structure for training provided under the grant and the military sales programs. The Assistant Secretary of Defense/Comptroller provides guidelines to the military services to price training. The guidelines are used to compute training costs reimbursable to the services from appropriated grant funds and to determine the various tuition rates to be charged countries purchasing training under the FMS program.

The present pricing structure for security assistance training provides for four tuition rate categories: 1) IMET, the price for training provided under the grant program, 2) FMS/IMET, the price charged for training purchased by countries concurrently receiving grant assistance, 3) FMS/NATO, the price charged member countries of the North Atlantic Treaty Organization (NATO) and countries having reciprocal training agreements with the United States, and 4) FMS, the price charged all other countries. These rates differ because various cost elements are excluded from some rates and others are charged only on an incremental cost basis. A chart detailing the cost elements used in establishing the multitier tuition rates is included as Appendix I.

Under the multitier pricing structure, tuition rates for the same training differ widely. For example, the rate for a student at the Army Command and General Staff College ranges from $2,739 at the IMET rate to $28,978 at the FMS rate. A chart with additional examples of the different tuition rates is included as Appendix II.

CHRONOLOGY OF PRICING CHANGES AND THE RECOVERY OF FULL COST

In 1968, the Congress revised and consolidated legislation governing the sale of defense articles and services in the Foreign Military Sales Act. This revision required foreign countries to pay, in U.S. dollars, not less than the full value of the training provided. Since the Foreign Military Sales Act did not define "value" in terms of cost elements, Defense determined which elements constitute full cost. Some of the early pricing problems resulted from the lack of adequate pricing guidelines. Each service developed pricing procedures based on its own interpretation of the law. Over the years, we have taken exception to defense decisions to exclude certain costs in pricing foreign military sales. From November 1969 to Decmber 1975, we issued 10 reports to the Congress on problems in the foreign military sales program, some specifically addressing pricing and the inadequate recovery of training costs.

On November 5, 1975, responding to congressional and our concern over pricing of foreign training, the Assistant Secretary of Defense/Comptroller issued specific guidance for pricing training courses. The guidance included detailed procedures for computing the fixed and variable costs to be included in the tuition rates, and resulted in substantially increasing the price of training. In fact, the rates for certain flight training more than doubled.

On August 12, 1976, however, the Deputy Secretary of Defense notified the Chairmen of the House and Senate Committees on Appropriations that he had directed changes in the November 1975 pricing guidance that would result in a 20- to 30-percent reduction in tuition prices. He explained that this had been done because the sudden and substantial increase in prices had a drastic impact on foreign countries that had insufficient time to adjust their budgets for students already scheduled for training. The Deputy Secretary also said that the November 1975 guidance did not recognize the military, political, and economic benefits to be gained by the United States in training foreign students.

Both Committees strongly disagreed with these changes. In separate letters to the Deputy Secretary, the Chairmen stated the Committees recognized the benefits gained by the United States in training foreign students, but that the November 1975 guidelines should remain in effect, and the Defense budget was not to be used to subsidize the training of foreign students. Nevertheless, the Department of Defense issued the revised guidelines on September 28, 1976.

In March 1977, the Chairman of the House Appropriations Committee again questioned Defense's reasons for not obtaining full reimbursement and asked the Department to again review the pricing structure. He also asked us to participate in this review. Subsequently, in May 1977, Defense again revised its pricing policy to include much of the cost excluded by the September 1976 guidance. Defense estimated that the revisions would increase reimbursements to the service appropriations by about $24.3 million during fiscal year 1978. In addition, the Air Force determined that for FMS training alone, the revised guidance would result in $11.8 million in additional reimbursements that would be credited to miscellaneous receipts of the Treasury.

In a May 6, 1977, letter (B-159835) to the Chairman of the House Committee on Appropriations, we reported that the revisions were a major step toward providing for recovering the full cost of training foreign students.

Defense officials contend that the 1977 guidelines, which are currently in effect, essentially include all training costs for the FMS tuition rate. We have not specifically reviewed the guidelines since their implementation in fiscal year 1978.

The Arms Export Control Act of 1976 restated the requirement that foreign countries pay the full cost of training purchased including an appropriate charge for administrative services, calculated on an average percentage basis to recover the full estimated cost of administering sales made under the act.

The act also allows the President to enter into agreements with NATO countries for the cooperative furnishing of training on a bilateral or multilateral basis. These agreements may exclude reimbursements for indirect costs, administrative surcharges, and costs of housing trainees. However, consistent with the concept of full cost recovery, the act stipulates that the financial principles of such agreements be based on reciprocity.

RECIPROCAL TRAINING AGREEMENTS

Pursuant to the provisions of the 1976 act, on September 17, 1977, the Department of Defense entered into an agreement with the other members of NATO. The House Committee on Appropriations, in a report on the Defense appropriations bill for 1978 (H.R. Rep. No.95-451), expressed reservations about the reciprocal agreement.

While not objecting to the agreement, the Committee expressed its desire to study and review the actual operation of the reciprocal agreement and directed Defense to keep the Committee informed as to the number of students trained, the types of training provided, and the costs. The Committee requested the first report by March 1, 1978.

The Defense reports to the Appropriation Committee on the training costs waived to NATO countries have been irregular. Defense has not provided continuous reporting, and its two reports have covered different reporting periods, neither of which was based on a single fiscal year.

According to DSAA and Assistant Secretary of Defense/Comptroller officials, Defense has experienced difficulty in getting NATO countries to release information on the training costs waived for U.S. students. However, the partial information provided by Defense shows that about $2.7 million in training costs are waived annually for U.S. students by NATO countries. While we do not have figures for a single fiscal year on U.S. training costs waived to NATO countries, the two Defense reports, one for the 15-month period ended December 31, 1979, and the other for the 6-month period ended September 30, 1981, indicate that the United States waives about $17 million in training costs to NATO countries each year. The difference indicates that Defense appropriations absorb about $14.3 million annually in training costs.

INCREMENTAL PRICING FOR COUNTRIES RECEIVING IMET GRANT TRAINING

The International Security and Development Cooperation Act of 1980 contained several amendments to the Arms Export Control Act and Foreign Assistance Act that affect the tuition rates paid by certain countries. This legislation added Australia, Japan, and New Zealand to the group of NATO countries eligible for reciprocal training agreements. The United States signed agreements with Australia on December 23, 1981, and with New Zealand on April 19, 1982, allowing those countries to purchase training at the reduced NATO price. As yet, no agreement has been reached with Japan to furnish training at less than full cost.

The 1980 amendments to the Foreign Assistance Act and the Arms Export Control Act (1) reduced the IMET rates and (2) allowed incremental pricing of training purchased under the FMS program by countries concurrently receiving IMET grant assistance. The objectives of these amendments were to reverse the decline in the number of students trained under the grant program (from 10,000 in 1970 to about 3,800 in 1979) by reducing tuition rates and allowing countries receiving IMET grant training to purchase additional training at reduced prices under the FMS program.

The Foreign Assistance Act states that military salaries are not reimbursable to the military departments from grant funds appropriated for the IMET program. However, all other direct and indirect costs are reimbursable. The 1980 amendment now allows these costs to be calculated based on the incremental, or "additional", cost incurred by the United States in providing the training.

We reported that the exclusion of military personnel costs substantially understated the cost of the grant program. While we recognized that the law authorized not charging for the grant appropriations for certain costs, we recommended that Defense accumulate cost data so that the Congress would know the costs borne by Defense appropriations. As yet, Defense does not have a system to accumulate and report the amount of costs incurred but not charged under the grant program.

The 1980 amendment also allowed the use of incremental cost to compute tuition charges for training purchased through the military sales program by countries concurrently receiving an IMET grant. Before the amendment, the United States was required to recover the full cost of the training purchased under the FMS program. According to the Senate report (S. Rep. No. 96-732) on the 1980 act, the amendment would not result in the United States subsidizing the training purchased by foreign governments, but rather would maximize the effectiveness of appropriations for the IMET program. The House Report (H. R. Rep. No. 96-884) stated that the inclusion of only additional costs would exclude those fixed overhead costs that the United States would incur even without the grant military trainees. During March 1980 hearings before the House Committee on Foreign Affairs on the pricing change, Defense stated that it could not precisely estimate the impact the new rates would have, but minimized the effect by stating that the costs to be excluded were for such base operating expenses as cutting the grass and painting the buildings. Assistant Secretary of Defense/Comptroller officials told us that Defense had not actually studied the impact of the amendment.

At our request, the services repriced the training purchased at the FMS/IMET tuition rates during fiscal year 1982 up to the applicable full FMS or FMS/NATO rates. The results showed that the 1980 amendment reduced tuition revenues by about $16.7 million in fiscal year 1982. See chart in Appendix III for details concerning the revenue reductions.

The provision in the 1980 amendment allowing incremental pricing in the sales program also created a situation whereby a small IMET grant will allow any country to purchase training at the lowest FMS rate. The following example demonstrates how token IMET grants affect the military sales program.

--In 1982, one country received about $50,000 in grant program training and purchased $4.7 million in training under the military sales program. This same training would have cost $7.9 million if that country had not received the grant and had been required to pay the full FMS rate.

Defense is required by law to recover the "additional", or incremental, cost incurred in providing training under the grant program (excluding military salaries) and through military sales to grantee countries purchasing additional training. DSAA has informed the Congress that this means only the additional costs incurred in providing training over and above the costs associated with providing the training simultaneously to U.S. military students. However, we noted that the services conduct many training courses for foreign students only (dedicated courses). A dedicated course is one that is not normally conducted for U.S. students, exists predominately or exclusively for the benefit of the IMET or FMS training program, and may be conducted in a foreign language.

In reviewing these courses we found that in 1982 125 foreign students attended 30 of these courses under the FMS/IMET rate structure. Based on data provided by the services potentially up to $4.9 million of costs were not recovered.

ADMINISTRATION'S PROPOSED CHANGE TO THE PRICING OF FMS TRAINING WILL INCREASE U.S. COSTS

The administration has proposed amending the Arms Export Control Act to eliminate the current multitier pricing structure on the sale of training and permit only the recovery of incremental or additional, costs for both the IMET and the FMS programs. If approved, the proposal would substantially reduce the amount foreign customers pay for U.S. military training.

The services recalculated at our request, the tuition revenues for the countries currently paying the full FMS or FMS/NATO rates, to show the impact the proposed amendment would have had in 1982 if it had been in effect then. The results showed that more than $38 million in revenue would not have been received and that the countries benefiting the most are the affluent industrialized or oil rich countries. For details, see chart in Appendix IV.

The Departments of State and Defense explain that the proposed amendment would (1) reduce discriminatory treatment, that is, eliminate charging three different prices for training, (2) enable poorer countries to obtain more U.S. training, (3) eliminate the incentive to provide token levels of grant assistance in order to lower FMS tuition rates, and (4) reduce the costs of administering training sales. The Departments also state that the proposal would provide for charging purchaser countries only for the "additional," or incremental, costs incurred by the government in providing such training over and above the costs associated with providing the training simultaneously to U.S. military trainees. Our comments on the Departments position follow.

Reduce discriminatory treatment. The number of students receiving training at the reduced FMS/IMET price account for a small percentage of the total number of students being trained under the FMS program. For example, only 131, or 5 percent, of the 2,573 students receiving FMS training furnished by the Navy were charged the lower price during 1983. Only 1,959, or 16 percent, of the 12,221 FMS students being provided training by all of the services received the lowest FMS price.

Enable poorer countries to obtain more U.S. training. Historical data does not show that the decrease in prices will necessarily increase the number of students being trained. Even with the reductions in tuition rates resulting from the 1980 amendment to the Arms Export Control Act, the total number of students being trained under the FMS program declined from 17,744 in

1980 to 12,221 in 1983. Also, as can be seen by the chart in Appendix IV, the poorer countries are not the ones most affected by the proposed amendment. For example, in 1982 almost $12 million less revenue would have been received from Saudi Arabia had the proposed amendment been in effect. Virtually all of the $38 million would have been saved by the affluent industrialized or oil rich countries, such as the Federal Republic of Germany, Japan, Kuwait, and Saudi Arabia, which would appear to be able to pay the full cost for the training.

Eliminate the incentive to obtain token levels of grant assistance in order to lower FMS tuition rates. The 1980 amendment did create an incentive to obtain token levels of grant assistance in order to get the lower FMS rate. Token grant assistance to reduce tuition rates may be occurring. However, we do not think that using the grant program for this purpose is a good practice.

Reduce the costs of administering training sales. According to service officials, the administrative cost savings from the amendment would be negligible and do not approach the annual multimillion-dollar reduction in sales revenue. However, there is merit in having a single pricing structure, but we believe it should be the full FMS rate. Recognizing that the Congress has intended for some countries, because of political or national security reasons, to obtain training at a reduced price, or even at no cost, congressional desires could be accommodated by discounting the price of the training. For example, if the Congress desired that some countries receive training at a reduced price, it could authorize a 50-percent discount (or some other percentages). This would simplify the rate determination process while identifying the value of the training cost being waived.

In summary, we do not believe State's and Defense's arguments outweigh the cost of this amendment, and therefore, we do not favor adoption of the proposed amendment.

Cost Elements Used In Establishing The Multitier Tuition Rates

	Tuition Rates			
	IMET	FMS/IMET	FMS/NATO	FMS
Direct Costs:				
Civilian labor	*	*	X	X
Civilian retirement	0 1/	0 1/	X	X
Military labor	0	*	X	X
Military retirement	0	0	X	X
Materials/other	*	*	X	X
Informational program	X	X	X	X
Indirect Costs:				
Civilian labor	*	*	0	X
Military labor	0	*	0	X
Materials/other	*	*	0	X
Asset use charge	0	0	0	X
Administrative surcharge	0	X	0	X

X Full cost   0 Not charged   * Incremental cost

[1]DOD officials explained that it is the unfunded portion of civilian retirement costs that is not included.

EXAMPLES OF THE DIFFERENT
TRAINING COURSE PRICES FOR FY 1983

Course Title	IMET	FMS/IMET	FMS/NATO	Full FMS
Engineer Officer Basic	$1,045	$2,394	$5,656	$10,468
OH-58 Helicopter Repair	464	744	3,641	6,775
Improved Hawk Launcher Crew Member (Non-U.S.)	252	511	2,488	4,253
Command and General Staff Officer	2,739	4,511	19,303	28,978
Army War College Fellow	5,513	7,212	27,739	54,289
Pilot Instructor Training (T-37)	28,130	43,470	65,820	92,970
Experimental Test Pilot Course/Foreign	232,140	253,360	319,950	607,940
Electronic Warfare Operations/ Staff Officer	740	1,260	7,890	15,890
Air Command and Staff College	1,920	6,880	9,340	24,870
Air War College	4,090	16,480	25,800	49,450
Infantry Training School USMC	240	778	1,063	1,670
Officer Candidate School Coast Guard	1,177	2,881	3,464	7,488
Naval Command College	3,326	10,493	18,083	30,459
Naval Staff College	3,035	8,076	12,002	18,523
Armed Forces Staff College	2,462	6,630	15,525	18,605
Command and Staff College USMC	3,412	9,256	12,718	28,274

Reduced Revenues in FY 1982 as a Result of the 1980 Amendment to the Arms Export Control Act

Country	Army	Navy	Air Force	Totals
	-----	-----	-----thousands-----	-----
Brazil	$ 15.1	$ 41.6	$ 35.8	$ 92.4
Colombia	-	-	4.7	4.7
Ecuador	-	-	266.6	266.6
Egypt	5,318.7	8.9	2,322.5	7,650.1
Greece	-	77.7	14.7	92.4
Honduras	-	3.9	-	3.9
India	-	-	2.3	2.3
Jordan	1,159.5	4.9	75.0	1,239.4
Korea	221.9	31.3	46.2	299.4
Lebanon	-	-	2.0	2.0
Malaysia	-	3.2	117.6	120.8
Mexico	-	-	1,042.3	1,042.3
Morocco	-	-	143.5	143.5
Pakistan	198.8	9.2	914.9	1,123.0
Peru	-	-	4.1	4.1
Philippines	5.1	-	2.0	7.2
Singapore	504.9	1,923.4	734.9	3,163.2
Somalia	-	-	253.0	253.0
Spain	-	32.0	-	32.0
Sudan	-	-	282.4	282.4
Thailand	-	34.9	-	34.9
Tunisia	64.9	-	-	64.9
Turkey	-	-	2.9	2.9
Venezuela	589.2	45.1	91.4	725.7
Totals	$8,078.2	$2,216.2	$6,358.8	$16,653.2

Note: Columns may not total due to rounding.

Estimated Revenue Reduction
Resulting From Proposed Amendment
(Based on 1982 Program)

Country	Army	Navy	Air Force	Totals
	----------------thousands----------------			
Australia	$142.3	$759.0	$70.3	$971.5
Bahrain	-	35.0	5.5	40.5
Belgium	24.5	-	105.6	130.1
Canada	243.6	269.8	231.5	744.9
Denmark	182.5	14.0	77.0	273.5
France	80.7	64.5	17.2	162.4
Federal Republic of Germany	2,835.2	385.1	3,556.9	6,777.2
Greece	145.5	40.7	-	186.2
Ireland	-	12.1	-	12.1
Israel	-	72.2	222.3	294.5
Italy	47.9	898.8	709.4	1,656.0
Japan	434.4	373.8	1,582.8	2,391.0
Kuwait	2,301.0	62.0	1,035.9	3,398.9
Luxembourg	5.8	-	-	5.8
Netherlands	335.7	123.5	171.0	630.1
New Zealand	22.3	12.2	10.6	45.1
Nigeria	753.6	116.1	1,714.6	2,584.2
Norway	317.9	239.8	132.8	690.5
Qatar	44.1	20.4	17.9	82.4
Saudi Arabia	2,442.0	949.4	8,381.3	11,772.7
Sweden	.7	27.5	3.4	31.6
Switzerland	112.7	-	95.3	208.0
Taiwan	996.3	167.7	134.2	1,298.2
United Arab Emirates	23.6	37.1	1,005.7	1,066.4
United Kingdom	61.4	130.7	33.5	225.6
NATO (other)	1,269.6	-	1,288.8	2,558.4
Total	$12,823.1	$4,811.2	$20,603.5	$38,237.8

Note: Columns may not total due to rounding.

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