



MAY 11, 2016

U.S. INDUSTRY PERSPECTIVES ON THE DEPARTMENT OF DEFENSE'S POLICIES, ROLES, AND RESPONSIBILITIES FOR FOREIGN MILITARY SALES

UNITED STATES SENATE, COMMITTEE ON ARMED SERVICES, SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS

ONE HUNDRED FOURTEENTH CONGRESS, SECOND SESSION

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**U.S. Industry Perspectives on the Department of Defense's Policies, Roles, and Responsibilities for Foreign Military Sales
Testimony before the Committee on Armed Services
United States House of Representatives
Subcommittee on Oversight and Investigations**

**M. Thomas Davis
Senior Fellow
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Wednesday, May 11, 2016

Chairwoman Hartzler, Ranking Member Speier, and Members of the Subcommittee, thank you for the opportunity to testify this morning. I appear before you this morning in my capacity as Senior Fellow at the National Defense Industrial Association (NDIA). NDIA is defense industry's oldest and largest association promoting national security, and is comprised of over 1,600 corporate members and nearly 90,000 individual members.

While today's hearing focuses on the specifics of the Department of Defense's (DoD) involvement in the Foreign Military Sales (FMS) process, it is important to recognize that the FMS process itself is merely one component within a broader governance regime over arms transfers, which is a vital component of U.S. security cooperation. Over the past two decades, the FMS process has come under fire from a number of critics including those interested in protecting the vital technological advantage enjoyed by U.S. forces, and those interested in the health of the defense industrial base during a period of budgetary constraint and major market change. Industry shares the concern that FMS delays compromise U.S. national security interests; however, the core problems with FMS are not actually problems with the FMS process, but rather the burdens of associated components within the broader governance regime overseeing arms sales and technology transfers.

With that in mind, my statement this morning will attempt to frame FMS and the broader governance over arms transfers within the context of the 21st century international security environment. This Committee has recognized this environment and the challenges it poses in its approach to acquisition reform – FMS should be no different. Security threats and technology are rapidly evolving, and FMS, as a mechanism for advancing U.S. security cooperation interests, must be capable of meeting the needs of our partners and allies. My testimony today will be driven by the following observations:

1. Foreign military sales are an integral component of our national defense strategy;

2. Criticism of the FMS process has been too narrowly focused;
3. The governance regime for foreign sales needs to adapt to the challenges of the 21st century international security environment; and
4. Foreign sales play a key role in sustaining a robust defense industrial base.

Before I go any further it is important to remember that FMS is contingent on a determination that it is in the best interest of U.S. national security. This is best encapsulated in the Defense Security Cooperation Agency's mission statement, which is to "Lead the Security Cooperation (SC) community in developing innovative security cooperation solutions that support mutual U.S. and partner interests." Thus, the end goal for FMS reform is to optimize the FMS process to enhance U.S. security cooperation objectives, not simply to make the process faster to generate more sales for industry.

FMS is an integral component of our national defense strategy.

The United States has maintained the most powerful military since the conclusion of World War II. There is no reason to believe that will change anytime soon, however the present-day dynamics of the international security environment and domestic concerns over our long-term fiscal position will alter how we utilize our military to achieve our national security goals and the resources we dedicate to do so. In his assessment of the 2014 Quadrennial Defense Review, General Martin Dempsey, then-Chairman, Joint Chiefs of Staff, highlighted reliance on allies and partners as a main area of higher risk for the U.S. military to meet the updated national defense strategy. FMS, by enhancing security cooperation, helps mitigate that risk.

Allow me to elaborate a bit on our current condition regarding the nation's defense industrial base. We no longer have the military-industrial complex described by President Eisenhower fifty-five years ago; we now live in a new era of military-industrial complexity where important technologies are being derived from commercial sources, where component technologies are often as vital as the end-items that house them, and where globalization has proliferated technologies across the globe. This means the list of dual-use items is growing, while at the same time globalization is ensuring that new items and services that were once only available in the U.S. market are now readily available from foreign sources.

These changes have occurred during a period in which the American defense industrial base is itself undergoing major change and significant contraction. Whereas in 1961 there were 14 companies on the in the top 100 companies of the *Fortune* 500 who were significant defense entities, today there are four – and when the next *Fortune* 500 is released next month there will probably be only three. In 1981, when President Reagan re-started the B-1 bomber program, there were fourteen American companies capable of

designing and manufacturing high-performance military aircraft. Today there are three.

This contraction naturally reflects the changed strategic condition that resulted from the end of the Cold War in 1991, but continues today as a result of many fewer programs being pursued by the Department of Defense, and the effects of budget restrictions. All of these factors have combined to make international sales relatively more important to the companies remaining in the defense industrial base. The quality of the military products we produce makes them very attractive to foreign customers; but the often laborious process for securing the approval of a sale often reduces their appeal and general competitiveness.

One of industry's major concerns is that uncertainty and lengthy delays in the FMS process force other nations who are seeking to do business with U.S. companies to deal with and ultimately buy products and services from other nations including adversaries such as China and Russia, even when U.S. vendors offer better value. This undermines our international standing, while allowing our near-peer competitors, China and Russia, who do not always share our foreign policy objectives, to forge greater ties with other nations.

FMS, and direct commercial sales, give the United States numerous advantages by "Building Partner Capability." Not only can we operate better when necessary with countries having equipment compatible with our own, but the training and sustaining of the equipment produce enduring military-to-military and company-to-company connections that can prove invaluable. The situation in Egypt during the 2011 Arab Spring provides a good example. Moreover, FMS can also be used to 'reward' good behavior. Allowing 'access' to superior U.S. capabilities can be used as an incentive for other countries to align their national security interests with those of the U.S.

Further, as witnessed in the global coalition to combat the Islamic State, and cooperation within NATO to deter Russian aggression in Eastern Europe, it seems inconceivable that the U.S. will ever face an adversary, from near-peers to non-state actors, without a coalition of support from partners and allies. The reduced size of our own forces and our greatly reduced global basing footprint requires such an approach. FMS enables greater collective capability in military operations with our partners and allies through greater interoperability and training. As the U.S. seeks to reduce its footprint on the ground abroad, it will increasingly rely on allies and partners to carry out the operations necessary to provide for global security. As Winston Churchill commented decades ago, "There is only one thing worse than fighting with allies, and that is fighting without them."

Criticism of the FMS process has been too narrowly focused.

Industry has been pleased by recent efforts by the Defense Security Cooperation Agency (DSCA) to improve the FMS process, and further reform efforts should take into account the broader interagency governance regime. Foreign sales are subjected to an interagency review process, comprised of multiple parties with different missions. Changes to FMS will have to balance the roles and responsibilities of various parties to ensure proper oversight, while taking into consideration how delays and the uncertainty of the current process undermine our security cooperation goals.

As for areas where DoD should focus its efforts for improvement, industry suggests two components that bookend the actual FMS process. First, the technology release process, managed by military departments (MILDEPs) and the Office of the Secretary of Defense (OSD), is obtuse, stovepiped and prone to delays. Based on estimates from our members companies, it takes on average between two and three years for a new program of record to navigate the process. This is further complicated by the fact that many technology release processes have not been updated to reflect a number of factors including partner burden-sharing, cyber security, existing inventory integration, or compliance monitoring, to name a few.

Second, some of the biggest delays occur following contract award, which is managed by the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (OUSD [AT&L]). This is largely a resourcing and human capital problem. Simply put, domestic programs take a higher priority over FMS programs, and the internal staffing within DoD is insufficient to review licensing requests in a timely manner. Although DoD is making headway with efforts such as the Defense Export Feasibility Pilot program, which has been applied to fifteen programs, more needs to be done. Industry has been concerned that FMS case management billets have been reduced substantially across the Services to focus managerial interest on the Pentagon's own programs of record, and often staffing is already insufficient to manage FMS contracts in the first place. The Air Force, for instance, staffs billets for 18 month, whereas the average FMS case lasts 3 years.

The governance regime for foreign sales needs to adapt to the challenges of the 21st century environment.

Over the last several Administrations, the United States has encouraged our allies to undertake a greater share of the cost burden for defense. Unfortunately, the governance regime for arms sales is not properly aligned to enable that through FMS. In combination with the changing dynamics of the international security environment in the 21st century, institutional reforms are necessary.

Industry's experience is that the aforementioned governance regime is designed to operate transactionally, rather than strategically. As it is currently stands, the system is optimized to simply deliver an end item that has already been procured by the U.S.

government. But that's not what FMS customers want, nor how the system should operate. Our allies and partners need a complete package including training, integration with existing capabilities, and configuration management throughout the lifecycle. And, FMS customers in many cases want capabilities that the U.S. government has not already procured, but for those capabilities, without a domestic program office to standup an FMS program office or a MILDEP to champion the sale, sales take far longer and run a higher risk of languishing.

DoD also needs to take a more strategic approach towards exportability planning. The Design of System for Export program should be supported robustly to fund industry efforts to integrate exportability early in the development cycle. This would enable a full guarantee of export approval to industry for a defense article absent a foreign policy issue. Funding for this effort can also come from foreign partners or the Special Defense Acquisition Fund. This is not simply paying industry so that they can profit later off foreign sales, but a strategic approach to inject considerations for enhanced future security cooperation early in the acquisition process.

Foreign sales provide for a more robust industrial base.

Finally, Foreign Military Sales have a number of positive impacts for our domestic industrial base and workforce at a time when the long-term budget climate for DoD is, quite frankly, bleak. Continued growth in mandatory spending will put pressure on DoD's top line, while continued growth in Operations and Maintenance and Military Personnel accounts within the defense budget will drive reductions in acquisition spending (Procurement and Research, Development, Test, and Evaluation accounts). Equally concerning as the DoD's top line is the declining number of new program starts.

The major concern here is that a growing portion of the defense budget goes for paying the forces and providing for its training and readiness. As the committee is well aware, over the past few years health care has been the fastest growing portion of the defense budget. From the defense budget perspective, the modernization accounts are discretionary spending. The irony we face, therefore, is although we have shifted from a military force that is capital rather than labor intensive, the portions of the budget supporting this essential capital intensity are the ones most under stress. In that regard, starting and continuing modernization programs for international customers provide an increasingly important buffer preventing further contraction of the defense manufacturing base.

Injecting additional revenues through foreign sales will boost the health of the industrial base throughout the supply chain, help sustain a larger industrial base to increase competition for domestic programs, make domestic firms more competitive in the international marketplace, and provide additional incentive to invest in innovation.

Added FMS revenues also put industry in a better position to attract and retain a highly skilled workforce.

Conclusion

Again, it is important to remember that DoD's role in FMS is contingent on a determination that the sale is in the best interest of U.S. national security, and that FMS is a 'tool' to enhance security cooperation. Accordingly, foreign sales should not be an afterthought. Such sales not only increase our strategic reach and operational capability, they also support a defense industrial base that many feel has contracted further than desired. International defense sales should be treated and resourced on par with domestic programs. To accomplish this, the governance regime encompassing FMS should be strategically aligned to meet national security objectives and to operate in the 21st century international security environment. Adequate resources should be dedicated to enable system design for exportability and to support FMS programs even when a domestic program of record may not exist, and OSD and the Services should provide an acquisition workforce sufficient in size and skill to manage FMS programs and expedite approvals when and where needed.

Thank you again for the opportunity to testify this morning and I'm happy to take any questions you may have.



Testimony of Mr. Remy Nathan
Vice President, International Affairs
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“U.S. Industry Perspectives on the Department of Defense’s Policies, Roles and Responsibilities for Foreign Military Sales”

Subcommittee on Oversight and Investigations
House Committee on Armed Services
United States House of Representatives

May 11, 2016

The Aerospace Industries Association (AIA) appreciates the opportunity to present our views to the House Armed Services Subcommittee on Oversight and Investigations on the *Department of Defense's Policies, Roles and Responsibilities for Foreign Military Sales*.

My name is Remy Nathan, Vice President of International Affairs at the Aerospace Industries Association. AIA is the premier trade association representing major aerospace and defense manufacturers and suppliers in the United States. More than 300 of our member companies embody every high-technology manufacturing segment of the U.S. aerospace and defense industry from commercial aviation and avionics, to manned and unmanned defense systems, to space technologies and satellite communications. AIA and our members are very proud of the fact that we produce the best technology at the best price for the U.S. warfighter, as well as our close allies and partners who share our interests and our commitment to global security and stability.

AIA's members actively engaged with the previous and current presidential administrations and Congress to support reform of the U.S. export control regime to improve security cooperation and build partner capacity. Today, we need continued bipartisan commitment to support improvements to the broader interagency Security Cooperation Enterprise that ensure decisions on exporting U.S. military technology are synchronized, more timely, and supportive of American national security and foreign policy priorities. Indeed, a single sale of a U.S. defense platform can reenergize a strategic relationship with an ally, build the foundation for an emerging regional partnership, or provide a critical deterrent to military conflict. These transactions also create and grow high skilled, high wage U.S. jobs, and provide significant savings to the U.S. taxpayer via the sharing of research and development costs with our partners and the lowering of unit production and support costs.

U.S. industry recognizes the "built-in inefficiency" of the necessary checks and balances in the Security Cooperation Enterprise that ensure defense exports are consistent with U.S. national security and foreign policy interests. As the "arsenal of democracy," our industry is committed to making certain that America's warfighters always have technological superiority against any potential adversary. However, the dynamics of the current global security environment are placing greater and greater demands on the Security Cooperation Enterprise that will challenge the system in the future.

Many of our international partners and allies – the potential purchasers of American defense equipment – do not possess a deliberate budget cycle, a professional acquisition corps, a systems life-cycle manager, or even an effective strategy development process for their security needs. They are operating with much shorter time horizons, and timeliness in meeting their needs is increasingly the most important discriminator as they try to identify their "partner of choice" who supplies them with defense equipment.

The international market is also intensely competitive. U.S. companies are often competing against foreign companies who are heavily subsidized and supported by their governments –

often at the highest levels – from an approval process, price, and advocacy perspective. Foreign buyers are increasingly dissuaded by our competitors from “buying American” through claims that they are easier to work with and quicker to deliver. The extent to which these assertions can be corroborated by our partners’ experiences affects the United States’ ability to realize the above-stated benefits of international defense article and technology transfers.

We must consider the question of whether or not the Security Cooperation Enterprise is able to manage on a sustainable basis Foreign Military Sales (FMS), Direct Commercial Sales (DCS), and hybrid cases that are growing in complexity, number, and urgency. In the absence of greater resources, training, and a focus on Security Cooperation Enterprise Reform, we will discover the answer is no at the worst possible time.

Let us be clear – we in industry are not calling for reforms that are simply going to change “No” to “Yes” during reviews of whether or not a defense export is in the national interest. If the answer is “no,” then industry can accept that answer. However, let it be a quick and early “no” with industry-government consultation to develop alternative proposals to meet our partners’ needs and advance U.S. national security objectives. Let us also have a sense of urgency and focused attention on the “yes” calls so that when a partner seeks to purchase military equipment they turn to the U.S. first, and not to countries like Russia and China, which are becoming increasingly aggressive in using defense exports as tools to advance their strategic geopolitical objectives. If we do this, our industry will be in a much better position to make the right technology investments and business development decisions in the right timeframe to generate the capabilities that best support our warfighters and our allies and partners.

Before I go any further, I should acknowledge the successes of the FMS system in managing over \$34 billion in sales in FY14 and exceeding \$47 billion in FY15. The Defense Security Cooperation Agency (DSCA) has announced about \$29 billion in FMS cases through April 2016. Industry is deeply appreciative of the efforts of Vice Admiral Joseph Rixey, Director of DSCA, and his interagency and military partners in the Security Cooperation Enterprise, to manage this significant and increasingly burdensome workload. We also welcome the opportunities industry has been provided to engage with the Security Cooperation Enterprise to support and suggest additions to their reform proposals that will help address the challenge of getting to the right security cooperation decisions at the right time.

My remaining testimony will focus on three areas of suggested reform and improvement in the Foreign Military Sales (FMS) system, specifically areas that are within the purview of the Department of Defense. For instance, industry has put forward recommendations to address the selection of types of contracts for FMS transactions, namely Fixed Price Incentive Fee (FPIF) contracts versus Firm Fixed Price (FFP) contracts. Many of our foreign customers wish to avoid FPIF contracts because of the requirement to commit excess funds -- averaging 5-10% above what would be required in a traditional FFP contract -- for the entire period of performance. This commitment is required even though it is unlikely these funds will ever need to be utilized. Additionally, an FPIF contract must remain open until all contract obligations have been

completed. In many instances this extends the period of performance by 5-10 years after final delivery is complete, further prolonging the period during which excess funds have to remain committed. Taking these financial burdens into account, foreign partners who believe FFP contracts make the most sense should not be hindered from utilizing that contract vehicle. While we appreciate the Committee's report language asking the Government Accountability Office to look into this issue, we believe stronger action is needed now to streamline this aspect of the FMS contracting process.

Industry is appreciative of the Committee's consideration of and support for language requiring contracting officers to definitize FMS contracts within 180 days of a qualifying proposal submission. A number of these Undefined Contract Actions (UCAs) are now over 1,000 days old. Such delays are unacceptable from an efficiency and execution standpoint, and place an unnecessary and burdensome level of risk on the U.S. contractor and foreign customer. This issue is also illustrative of the challenge faced by the Security Cooperation Enterprise to process FMS contracting in a timely fashion through an acquisition workforce constrained by personnel cuts and often lacking the requisite FMS training and expertise.

Finally, it should be noted that every FMS case requires a DoD disclosure review to determine whether the technology is releasable to a foreign partner. Industry continues to engage with DoD's Technology Security & Foreign Disclosure (TSFD) process to encourage consultations, reforms, and resources to make that system more predictable, efficient, and transparent. Action in this area, coupled with continued export control reform initiatives aimed at technologies remaining on the U.S. Munitions List (USML), will be critical in ensuring industry can continue to support security cooperation and build partner capacity most effectively.

In conclusion, it is clear that America needs our allies and partners to step up and work with us to promote and protect global peace and stability. We therefore need Security Cooperation Enterprise Reform to ensure that America remains their first and best security partner of choice.

BIOGRAPHY



REMY NATHAN
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Remy Nathan, Vice President for International Affairs is responsible for monitoring, analyzing and recommending actions on issues as they affect international commercial and military aerospace markets.

Nathan oversees international trade and market access, export financing, international negotiations, export controls, foreign military sales, and international cooperative programs.

Prior to joining AIA in 2003, Nathan was responsible for supporting US companies active in Malaysia, as well as the Defense Working Group of the US-ASEAN Business Council. He holds a B.A. in Government and Foreign Affairs and China Studies from the University of Virginia and an M.A. in International Economics and Southeast Asian Studies from The Johns Hopkins University School of Advanced International Studies (SAIS).