
Defense Policy Advisory Committee on Trade: 1989 Year-End Review

[The following represents a reprint of the 1989 Year-End Review of the Defense Policy Advisory Committee on Trade (DPACT), dated 28 February 1990. This group of approximately thirty-five senior officers of U.S. defense industries, functions under the authority of Subsection 1103, of the Trade Agreements Act of 1979 (P.L. 96-39) to provide independent general defense policy advice to the Secretary of Defense and the United States Trade Representative. The excerpt opens with the introduction and the executive summary of the 1989 report. This is followed by the detailed report reflecting the committee's expanded discussion of the issues and its recommendations on future defense trade, cooperation, and competitiveness issues. It should be noted that the statements, opinions, recommendations, and conclusions in the following report, do not necessarily represent the official position of the Department of Defense or the Office of the U.S. Trade Representative.]

INTRODUCTION

In the past year, the structure of East-West relations has changed more than at any time since the end of World War II. Our most fundamental assumptions as to the threat we face and the resources required to counter it are being called into question. After forty years of tension, we may possibly be entering an era of peaceful East-West relations.

We are only beginning to grapple with the implications of this transition for the U.S. defense industry. Transition periods historically are turbulent and unstable. As we move into a new and a less confrontational era, we must be careful to maintain a healthy defense industrial base, technologically strong and capable of reacting to unexpected or threatening changes in world events. It's called keeping your powder dry.

Political pressures are already mounting for substantial cuts in U.S. defense spending. If East-West tensions continue to ease, this is entirely appropriate, but at the same time we must be careful that neither the U.S. nor other Western democracies rush precipitously to divest themselves of the very military strength that, by making Eastern aggression unprofitable, made the end of the Cold War possible.

From an industrial perspective, these political changes are complicated by such issues as the integration of the European community and the plans for reunification of Germany. On the other side of the world increasing trade tensions between the U.S. and Japan, and the emergence of strong defense industries in newly industrialized countries, present additional challenges to the U.S. defense industry.

Since its establishment, the DPACT has repeatedly called attention to the mounting difficulties facing the U.S. defense industry. The increasing globalization of the world market makes it imperative that we export competitively. It also dictates that we enter into increasingly complex cooperative projects with our allies. Yet we are hindered in those goals by a somewhat cumbersome, increasingly outdated U.S. export control system. A proliferation of new laws and regulations have contributed to the erosion of the industry's financial health and its ability to invest in R&D and new technology.

All these problems pose even greater concern for the future of the industry as we consider how best to deal with the many complex changes now in progress. As defense budgets decline, as the international defense marketplace becomes smaller and more fiercely competitive, and as we debate how strong our defense capabilities must remain to ensure that the present trend toward peaceful East-West relations continues, the U.S. must look to the health of its defense industry as

the only acceptable insurance against the uncertainties of history. As the Cold War winds down, peace through strength remains an essential principle.

EXECUTIVE SUMMARY

Defense Trade and Cooperation Issues

Exports of defense products from the U.S. become increasingly important as a means for maintaining a strong U.S. defense industrial base as defense budgets decline. However, in recent years the U.S. has lost many key export orders to European and other competitors. This not only results in lost exports and U.S. jobs, but U.S. influence and control with the buying countries is reduced. International cooperative R&D programs will also become more important as the defense budgets decline. Given the escalating costs for development of individual defense systems, allied countries often cannot afford to develop competing and similar systems themselves. The U.S. government needs to re-examine its policies, organization, and resources devoted to providing an environment which provides strong support for defense trade and cooperation.

Facilitating Defense Exports. The Secretary of Defense and U.S. Trade Representative should encourage the President to promulgate a new policy on defense exports to friends and allies which recognizes the current domestic and international environments, and the highly competitive nature of the global defense industry. That policy should emphasize that defense exports make a contribution to national security, provide a basis for defense cooperation by facilitating standardization and interoperability, reduce U.S. defense costs, and assist in the economic well being of the nation. The policy should be accompanied by implementing instructions to government departments and embassies. Other issues which need focus within the framework of the policy include: better assessment of the economic implications of defense trade; clarification of a government offset policy, possibly accompanied by multilateral negotiations and bilateral discussions to reduce offsets; more efficient use of resources to process export licenses; better DOD organization and coordination of international defense issues; elimination of administrative disincentives to defense exports and reform of administrative surcharge policies.

Technology Transfer. While controlling access to technology by our adversaries or potential adversaries is an important U.S. objective, it often clashes with objectives to stimulate exports and arms cooperation with our allies. DPACT does not believe clear policy guidance exists with respect to how these conflicting objectives are to be resolved. Fundamental changes are needed in current U.S. policies, statutes, and mechanism which better define the security, trade cooperation, and industrial base aspects of the technology transfer system. Such changes should include a more sharply focused and limited effort to control technology, a clear understanding of the trade-offs between the economic benefits of exports and the security or foreign policy benefits of controls, an emphasis on multilateral rather than unilateral efforts at such control, a greater commonality between controls imposed on military and commercial technologies, development of a West-West technology control policy, greater consideration for foreign availability in control decisions, liberalization of third country transfer controls with allied countries, and more efficient use of Government resources for administering the export control process.

European Integration. Despite the positive aspects of European integration which are evident in most commercial sectors, DPACT has concluded that if current trends prevail, then U.S. and European defense markets will become more polarized in the near future. It is too early to tell whether or not the European defense market itself will become more united. DPACT views the greatest challenge to the U.S. defense industry, resulting from possible European integration, to be increased competition in developing countries and increased efforts by Europe to penetrate the U.S. defense market. DPACT supports efforts to develop a more unified transatlantic defense market with our NATO allies as long as both European and U.S. companies have fair and open access to the total market. It is not in our national interest to allow the situation to be polarized

such that U.S. companies must compete against a consolidated defense industry for a greater piece of a smaller pie. In order to move towards this goal and, at the same time, protect the interests of U.S. industry, the U.S. government should: 1) significantly modify U.S. technology transfer restrictions to allied countries; 2) develop a proactive and supportive arms transfer policy to developing countries; 3) continue to work to open European defense markets to the U.S. products; 4) strengthen NATO through implementing the Conventional Armaments Planning Systems (CAPS) and developing a better model for future cooperative development programs; and 5) implement acquisition reforms to strengthen the U.S. domestic defense industrial base.

U.S./Japan Defense Trade and Cooperation. Cooperative programs with Japan are becoming more controversial as evidenced by the recent FSX debate. At the same time it is recognized that certain Japanese technologies may enhance U.S. defense capabilities in certain areas. U.S. government policymakers need to encourage greater defense cooperation with Japan without fueling public fears of greater Japanese industrial competition. To carry out such a policy, both DOD and the U.S. Trade Representative (USTR) need to devote additional resources to manage defense trade and technology transfer between the U.S. and Japan. Greater interagency cooperation and better communication with Congress early in a program are also required. Above all, both DOD and industry need to develop a broader public consensus on the appropriate boundaries for technology cooperation with all serious international competitors.

DOD International Management and Coordination. It is not entirely clear to U.S. industry where the focal point for various international programs reside, either within the government as a whole, or within the Department of Defense. Different agencies have responsibility for coordinating different programs depending either on the country involved or the specific product in question. Within DOD, several organizations have differing responsibilities in the overall approval process, and this is often complicated by the role of each of the services. With the increasing importance of international programs, the Secretary of Defense should initiate a management review of international program activity within DOD as a whole similar to the recent management review which was conducted on the acquisition systems. The objective of such a study should be a more streamlined international program decision making and management process. The Secretary of Defense should designate one senior-level individual whose primary responsibility is to manage the process, expand defense trade where appropriate, and promote international cooperation with our allies.

Defense Trade Competitiveness Issues

While the U.S. has the best, most competitive defense industrial capability in the world, there has been a narrowing of that competitive edge in recent years. This has occurred in part because of the globalization of industry as a whole and the availability of sophisticated technologies in other developed countries. However, the worsening of government and industrial relations in the U.S., coupled with excessive legislative and regulatory changes to the process, have caused many subtier contractors to exit the defense business altogether. The financial condition of many prime contractors as well as that of subtier contractors is of continuing concern and has been the subject of several studies over the past few years. Technical leadership, the cornerstone of strength for the U.S. defense industry, is narrowing *vis-a-vis* the rest of the world—in part due to certain U.S. government policies. U.S. government policymakers need to focus more attention on defense industrial base issues before the industry is further weakened.

Foreign Dependence. Increasing reliance on foreign supplied components, technology, and capital, including foreign ownership of U.S. defense companies, have caused policymakers to debate the national security implications of these trends. Of greatest concern to industry is the impact these events will have on the capability of the U.S. technology base to design and develop technically superior future generation products. The wisest policy for government to pursue is to ensure that mechanisms are in place which will enable industry to keep ahead, both technologically

and economically, of the foreign competition. Specific recommendations include: giving DOD a greater voice in establishing overall U.S. economic and trade policy; systematically centralizing existing data to better access the current state of the defense industrial and technology base; developing a more proactive defense trade and cooperation policy; aggressively enforcing current trade laws to minimize foreign targeting of selected U.S. industries important to national security; streamlining the acquisition process and stabilizing defense budgets.

Preserving Technological Leadership. Many current acquisition policies and procedures discourage technically innovative solutions to defense requirements and, in some cases, encourage defense contractors to reduce discretionary R&D and engineering efforts. Commercial technology, which could often provide leading edge solutions to defense problems, is not readily available because of stringent DOD acquisition requirements. In order to improve the climate for technical leadership, DOD should review its policies concerning: dual sourcing when insufficient quantities are planned to justify its use; data rights for privately developed technology; early communication of technical requirements; IR&D/B&P funding and process; the practice of technical levelling in procurements; and improving the acquisition process for commercial products.

Economic Health. The financial condition of U.S. defense contractors as a whole has deteriorated over the last several years. Many legislative and regulatory changes implemented in the early 1980s have had a particularly severe effect on subtier contractors, many of whom have exited the DOD market altogether. This situation has been made worse by unfavorable tax law changes eliminating the *completed contract* method of accounting. DOD policies which should be reviewed to improve the financial health and economic competitiveness of the U.S. defense industrial base include: development of an integrated financing and industrial base plan; more equitable progress payment rates; elimination of contractor financing of special tooling costs; elimination of fixed-price production options until completion of full scale development; the inappropriate withholding of progress payments; and the use of the *completed contract* method of tax accounting.

Government Industry Relations. A general deterioration in the relationship between the defense industry and the U.S. government, particularly the Department of Defense, has resulted from an increase in negative publicity and criminal investigations into alleged cases of waste, fraud, and abuse, many of which were brought about by differing interpretations of ambiguous rules and regulations. Since DOD is both regulator and customer, a method should be sought to involve industry more actively in the policy/rulemaking process. Greater rather than less dialogue should be encouraged between DOD and industry, and higher level management review should be required before allegations of defective pricing and fraud are submitted for criminal investigation.

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I. DEFENSE TRADE AND COOPERATION ISSUES

A. Facilitating Defense Exports

Issue: Defense exports can make a significant contribution to U.S. foreign policy, national security, and economic strength. They provide a basis for defense cooperation, reduce unit production costs, extend production lines, create jobs, and enhance U.S. economic competitiveness. Yet, the importance of defense exports is not fully reflected in the policies and practices of the government, where changes have not kept pace with the requirements for remaining internationally competitive. An overall defense export policy is needed, which takes into account the current domestic and international environments, and which will be implemented with attention to eliminating disincentives to exports.

Discussion: The Bush Administration has not yet issued a general policy statement to set the tone for governmental consideration of defense exports. Since the Carter and Reagan policies were articulated several years ago, international competition has intensified. Multibillion dollar contracts have been lost to foreign sellers, most with few end-use controls. The U.S. surplus of defense trade with NATO/Europe has nearly vanished, and the U.S. global share of the defense market has been significantly eroded.

Recent developments in the USSR and Eastern Europe further complicate U.S. defense industry's export prospects. As domestic defense budgets decline both in the U.S. and Europe, the competition for export markets will become even more intense, with supplier nations, including those in Eastern Europe and the Soviet Union itself, trying to keep their domestic defense industries healthy as necessary insurance against possible unwelcome reversals in the current warming trend in East-West relations. If the U.S. hopes to maintain a strong domestic defense industrial base, it must put far stronger policy backing behind defense exports or find itself steadily losing overseas markets to other suppliers whose governments give them strong and active support.

Domestic considerations also impel a new policy statement. The USTR and Commerce have recently been added to the list of government organizations which formulate overall defense trade policy. The \$13.8 billion average annual sales of the industry in the 1980s has sustained an employment base of almost a million workers, and Congress is increasingly alert to the economic impact of defense transactions.

Issues needing focus within the framework of overall defense export policy include offsets, the export licensing process, DOD organization to enhance defense trade, [and] administrative disincentives to export and surcharge policies. Purchasing nations continue to demand offsets. Industry is concerned about the lack of clarity in U.S. offset policy and about activities, both in the Congress and the Administration to develop an offset policy without adequate industry consultation. The DPACT has recommended against unilateral U.S. measures to control offsets, but does favor multilateral negotiations to reduce or eliminate them.

The licensing process in the Center for Defense Trade Controls (CDTC) is a serious problem. Excessive licensing requirements combined with inadequate CDTC resources have overloaded the system, resulting in inordinate delays and lost sales. Improvements at CDTC over the past 20 years have not begun to keep pace with demands arising from dramatic increases in the number and complexity of license applications. Industry needs better access to licensing officers, processing time needs to be cut sharply, and wide categories of unnecessary licensing requirements need to be eliminated. More basically, the system must be realigned so that there is an incentive to approve the license. [Editor's note: for a related item see "New State Department Organization Replaces the Office of Munitions Control" in the Security Assistance Community section of this issue.]

Within DOD, technical reviewers in the military departments need better defined OSD guidance as to the criteria for releasability of equipment and technology. Industry's perception is that DOD is overly controlling even non-critical technology and products at the expense of defense trade.

Despite improvements, government-imposed disincentives continue to disadvantage industry in the international marketplace. Administrative surcharges, the poverty of export financing, restrictions on contractor-initiated requests for exceptions to National Disclosure Policy and plant visits by foreign officials, and the inflation of sales prices due to the escalation of non-recurring sales charges, are all examples of continuing disincentives. FMS surcharges, although reduced as

a result of the Defense Appropriations Act of 1990, continue to limit the availability of security assistance for many countries.

Recommendations

1. The Secretary of Defense and the U.S. Trade Representative should encourage the President to promulgate a policy statement on defense exports emphasizing the contribution to national security, defense cooperation, and the well being of the national economy and defense industrial base. The statement should be accompanied by implementing instructions to government departments and embassies stating that such exports, which are consistent with foreign and national security policy, should be facilitated to the same extent as any other American export.
2. U.S. offset policy should be formulated in full consultation with industry, to include the publication in the *Federal Register* for industry comment of any rules or guidelines on offsets. Industry favors a policy of negotiating the reduction or elimination of offsets, and opposes unilateral U.S. offset controls in the face of foreign competition. The government should consider restricting offsets only when agreed to by industry and no foreign competition exists. [Editor's note: a new Presidential "Policy on Offsets in Military Exports" was issued on April 16, 1990, and is reprinted elsewhere in this issue of *The DISAM Journal*.]
3. DOD should take the lead in recommending reductions in licensing requirements under the ITAR [International Traffic in Arms Regulation]. The Secretary of Defense and the U.S. Trade Representative should support efforts to upgrade the CDTC. The DOD and the USTR should examine the licensing system with a view toward consolidation of licensing authority to coordinate government policies and procedures. DOD should also initiate a management review of international trade and defense cooperation activities, with a goal of streamlining DOD organization and improving performance in defense trade.
4. With respect to disincentives to export, the Secretary of Defense should eliminate all export fees not required by statute, and allow contractor-initiated requests for exemptions to National Disclosure Policy and plant visits by foreign contractors and government officials. He should consider DOD funding for the administration of security assistance as any other DOD mission and, together with the USTR, recommend a government guarantee program for loans which support defense exports.

B. Technology Transfer

Issue: There is a deep concern in industry that U.S. controls on technology transfer—related to both defense equipment and dual-use items—are too often imposed unilaterally and applied inefficiently. While industry accepts the basic right of government to impose such controls, it objects when controls are imposed on technologies which are available from other sources, and the net result is not to deny the target country a technology or product, but simply to shift its purchases to our competitors.

Discussion: The U.S. government imposes controls on technology transfer for two basic reasons: security—to prevent potential adversaries from obtaining technology which could erode our technological lead; and foreign policy—to pressure countries to change domestic or foreign policies or to express our moral indignation with such policies. Recently, some in government are also encouraging controls of technology transfer as a means of inhibiting future foreign competitors.

While U.S. export control policy has always generated controversy, several recent trends have heightened concern with existing statutes and the administration of those statutes:

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- **Capabilities of Other Countries:** There are few U.S. products or technologies which are not now available from other sources.
 - **Dual-Use Technology:** It is increasingly difficult to distinguish between military and commercial products, particularly components, as well as manufacturing technologies.
 - **Cooperation:** The high cost of research, development, and production of new generations of both commercial and military products, and duplication of efforts among allied countries, are leading to increased joint efforts among allied countries and companies across borders, involving mergers, acquisition, teaming, and coproduction and codevelopment.
 - **Third-Country Transfers:** Foreign producers strongly resent any effort to control the export of their products because they incorporate some U.S. components. This has led to increased efforts, particularly in Europe, to design out U.S. components in both civilian and military products.
 - **Offsets, Coproduction, and Codevelopment:** Many governments are increasingly reluctant to buy expensive capital equipment *off the shelf* without the right to assemble or produce portions of the equipment, or the equipment itself.
 - **Foreign Ownership.** The attractiveness of the U.S. market and the decline in the value of the dollar have led to a marked increase in foreign ownership of U.S. companies in both the civilian and defense sectors.
 - **European Integration.** The reforms related to EC 1992, combined with efforts by the Independent European Program Group (IEPG) to further common military research, development, production, and acquisition policies, will likely result in a consolidation of high technology civilian and military companies. U.S. technology transfer policies will play a key role in how U.S. industry can relate to those developments.
 - **Glasnost/Perestroika:** Reforms in Eastern Europe and the USSR provide strong incentives for Western European countries to increase trade and investment there, which will have profound implications for technology transfer policy.

Efforts by the U.S. to continue to pursue technology transfer objectives on a unilateral basis are likely to be even more counterproductive than they are at present. U.S. companies will continue to lose business to their competitors. Foreign companies which buy U.S. firms will be discouraged from expanding or even maintaining research and development efforts in the U.S. if they will be unable to exploit the results of that research and development. U.S. companies will be encouraged to conduct an increasing share of their own research and development offshore so as to avoid U.S. controls and to participate in growing foreign markets. A more unified Europe and dynamic Pacific Rim will continue to design out U.S. technology, replacing it with other imported technology or developing their own. The U.S. may increasingly find itself protecting an aging and obsolescent technology base from countries which are no longer interested.

Recommendations

1. **Consistent Policy and Guidelines:** The Executive Branch needs to formulate an overall policy on technology transfer in order to reduce interagency squabbling on specific transactions. In particular, DOD should consolidate current directives on technology transfer to a single directive which addresses defense trade, cooperative programs, and the industrial base.

2. **West-West Trade:** Every effort should be made to decontrol the movement of most products and technologies among COCOM members, and the COCOM list itself should be significantly reduced. Efforts to control the export of foreign produced products which contain U.S. components should be minimized.

3. **Unilateral vs Multilateral Controls:** The Executive Branch should avoid the use of unilateral controls, particularly with respect to those related to foreign policy. When export controls are deemed necessary, every effort should be made to obtain agreement of other industrial countries to make such controls multilateral in nature.

4. **Foreign Availability.** The availability of defense products from other countries should play an increasing role in determining whether to release a U.S. system to a given country. DOD should include such analysis in its recommendations to State, and State and DOD should include foreign availability information in their notifications to the Congress of proposed arms sales. If a need is identified to control an important technology which is available from other sources, the U.S. should enter into negotiations with other countries where such technology is available to develop appropriate control measures.

5. **Commodity Jurisdiction:** The Executive Branch should agree to a clear commodity jurisdiction dispute settlement mechanism so that questions as to which statute and agency have primary policy control over a product can be resolved quickly.

6. **Industry Consultation:** Industry input should be actively sought in determining foreign availability, the possible implications of specific coproduction and codevelopment MOUs, and the industrial base aspects of foreign investment or the transfer of manufacturing technology.

7. **Export Licensing Administration:** To increase the efficiency of processing export licenses, the Executive Branch should give serious consideration to consolidating the administration of export licenses [i.e., State and Commerce] into one agency.

C. European Integration

Issue: Efforts are underway in Europe to consolidate defense industries and the development, production, and procurement of defense products. A stronger, unified European defense industry will result in stronger competitors for U.S. companies and may produce better partners for U.S. cooperation, notably in NATO projects. Can DOD policymakers forge a commitment from Europe which does not compromise the U.S. competitive edge and yet offers new cooperation with the unified European defense industry?

Discussion: Despite the positive aspects of European integration which are evident in most commercial sectors, DPACT has concluded that, if current trends prevail, U.S. and European defense markets will become more polarized in the near term for several reasons. First, as pressure on budgets increases, politicians, representing taxpayers, will continue to insist that government funds be spent to support local industry. Second, both Europe and the U.S. have sophisticated defense industries that are capable of self-sufficiency in most areas. And third, U.S. government policies, particularly overly restrictive controls on technology, discourage Europeans from relying on U.S. partners, products, or components.

DPACT has also concluded that it is still too early to tell whether or not the European defense market will in fact become more unified. While one would expect a trend to co-develop/co-produce defense products within Europe to increase as program development costs escalate, defense funds will most likely continue to be spent within Europe "individually" in the providing country or on a *juste retour* [i.e., reciprocal, fair return] basis. On an industrial basis, coalescence of industry into larger companies with cross border ties will provide more coordination of

industrial activities. The efforts of the Independent European Program Group (IEPG) should help accelerate the trend to form European consortia to develop more sophisticated products. However, as events unfold in Eastern Europe and defense requirements are scaled back, the underlying premise of greater cooperation and unification in the defense sector may change dramatically.

DPACT believes the greatest European challenges to the U.S. defense industry are, first, increased competition in third country markets and, second, increased efforts by European industry to penetrate the U.S. market. Consolidation of industry into larger conglomerates will focus resources and allow them to be concentrated on these objectives. Their industry will also receive the full support of their governments in pursuing these markets.

While current policies in the U.S. make it unlikely that European industry will make large inroads into the U.S. market, relatively small gains in U.S. market share can have a substantial effect on European defense production levels. U.S. defense imports from Europe have steadily risen over the past decade while U.S. defense exports to Europe have declined. Having increased acquisitions of U.S. defense companies and made agreements with U.S. manufacturers to market European products to DOD, European industry is well poised to gradually increase its share of the declining U.S. defense market.

At an industry to industry level, European and U.S. defense companies want to work more closely with each other. Commercial companies have always teamed to develop products and pursue markets when it makes economic sense. However, political impediments in both the U.S. and Europe have limited cooperative activity in the defense industry. From a DPACT perspective, the most troublesome of these impediments are the unilateral technology transfer restrictions imposed on high technology U.S. exports, particularly limitations imposed on sales to third countries and the level of technology which the U.S. is willing to license to allied countries.

Recommendations

1. DOD should institute a more liberal technology transfer policy that encourages cooperative development between U.S. industry and European industry. The two most troublesome restrictions involve third country transfers and controls on high technology transfers.
2. DOD and USTR should encourage the President to enunciate a new defense export policy which ensures that U.S. industry can compete on equal footing with European industry in third country markets, particularly against those companies which are being supported by their governments.
3. DOD and USTR should continue to open European markets for U.S. defense products by resisting efforts of the EC to impose new tariffs on defense goods and by providing better access to individual country markets through reciprocal procurement MOUs.
4. DOD should encourage greater transatlantic cooperation through better NATO planning and by developing a more workable model for cooperative development programs which encourages early industry to industry teaming. Such a model must ensure that cooperative development programs are protected in the budget process unless all parties agree to terminate the program.
5. DOD, working with industry and Congress, should ensure the U.S. defense industry is competitively strong both technically and economically by implementing acquisition reforms outlined in the Packard Commission Report.

D. U.S./Japan Defense Trade and Cooperation

Issue: The difficulty of balancing security and economic considerations in cooperative defense R&D programs came into sharp focus in 1989 during the prolonged Congressional debate over the terms of the two countries' agreement on [the] FSX fighter program. Much of the public discussion focused on the specifics of the agreement and the Bush Administration's successful attempt to "clarify" its terms. The underlying issue has barely been touched. How does DOD and the defense industry gain public confidence in their ability to protect the U.S. technology base while conducting joint ventures with foreign partners who are strong economic competitors in industrial markets?

Discussion: The DPACT has followed the FSX issue since its inception in 1983. We believe that the competitive potential of the Japanese aerospace industry is and has been clear for some time. MITI [Japan's Ministry of International Trade and Industry] has long since stated that aerospace is one of its strategic thrusts. Despite that, the DPACT believes that U.S. interests are best served by some type of U.S. involvement in the FSX program. Early on, the DPACT supported the use of U.S. trade leverage to maximize the U.S. industrial content in the eventual production program.

Shaping the details of that involvement, particularly the two-way technology flows and the balance of industrial benefits is a complex task. Time and again in the years since 1983, the necessary working level discussions and negotiations between the two governments broke down. Only the repeated interventions of high-level political decision-makers on both sides kept the negotiations alive. As time went on, working-level deadlocks and interagency squabbles repeatedly spilled over into the wider public policy debates and contributed to increasingly negative public opinion in both countries.

Many of the negative developments in the FSX story can be traced to unfortunate circumstances. A number of key DOD players retired or changed assignments just prior to the final negotiating round. The changes in the Executive leadership in both countries more or less simultaneously was an unhappy coincidence. But the DPACT believes there are also systemic, policy related issues at the root of the FSX controversy which will continue to complicate U.S. defense trade throughout the Pacific Rim.

The recent Defense Science Board report, "Defense Industrial Cooperation with Pacific Rim countries," highlights a number of problems in DOD's general approach to the issue which are amply illustrated by the FSX story. DOD organization and staffing shortcomings were apparent at a number of points, as was the diffusion of Executive Branch authority for dealing with tech-transfer and industrial base issues.

Perhaps a more basic issue is simply that little relevant policy guidance was available throughout the extended negotiations, either to support and guide the working level discussions, to coordinate DOD and Commerce interests, or to inform the Congressional overseers.

Congressional signals on the appropriateness of high tech and defense technology cooperation with our allies in general and Japan in particular have been mixed at best. One need only look to the specific addition of Japan to the Nunn amendment funding for cooperative defense R&D during the FSX negotiations for an example.

Regarding the FSX agreement, the DPACT believes that the existing FSX deal is the best that could likely be achieved in 1989 given a global market for aerospace technology, fresh fighter design competition from Europe, and the clear resolve of the Japanese to move forward. That said, the industry believes a better agreement could have emerged, with less damage to the bilateral relationship if a clear Executive Branch policy had been consistently announced, if DOD had been

better organized to deal with the unique aspects of defense cooperation with Japan, and if DOD had listened more carefully and consistently to industry inputs, including subtier contractors, as typified by DPACT itself.

Neither DOD nor the Executive Branch as a whole can be held responsible for the absence of a broad public consensus on how to approach technology cooperation with Japan. Industry has a sizeable stake in continuing its access to the Pacific Rim markets and the technology bases developed there. It cannot afford to simply stand aside or run for cover when the difficult policy debates are joined. There are deep fissures between sectors of U.S. industry and among individual firms regarding defense trade policy towards Japan. Industry itself must take the initiative to work actively for the emergence of a positive public consensus.

Recommendations

1. DOD should conduct a thorough examination of its approach to the conduct of country-to-country negotiations that have a substantial impact on trade flows or U.S. technological competitiveness. The policy controversies engendered by such negotiations, of which the FSX agreement is only the latest example, can be damaging to DOD and our security relationships abroad.
2. When trade factors are the primary issue at stake in the negotiation, and security considerations are secondary, delegating the negotiation (but not the policy) to USTR should be considered.
3. With the events of 1989 still clearly in focus, and a new DPACT charter about to be initiated, DOD and USTR should consider how to use the DPACT to gauge industry positions on the goals and strategies of such trade negotiations.
4. Together with industry and other Executive Branch agencies, DOD should strive to encourage a broader public consensus on the ground rules for technology cooperation abroad.

E. DOD International Management and Coordination

Issue: Coordination of defense trade and cooperation issues within DOD and the services is not systematically well organized. Congress encourages DOD to cooperate with NATO and other allies in research, development, and production in order to pool scarce resources and, on the other hand, enacts laws to protect U.S. industry from foreign competition. Similarly, OSD has issued policy guidance promoting allied armaments cooperation (1985 Weinberger memorandum), but has concurrently denied export licenses of technology and products needed to accomplish cooperation. Organizationally, one Defense Under Secretary regulates and controls proposed exports either through FMS or commercial channels (USD/P), whereas the other Under Secretary promotes defense exports and imports (USD/A).

Discussion: Although the U.S. defense budget is the largest in the free world, it cannot sustain the number of projects under contract, the new starts awaiting funding, significant dual sourcing, economical long production runs, or a healthy industrial base. NATO and other allied governments, and their industries, face similar problems. Structured defense trade would provide a means for free world nations to afford effective conventional forces at acceptable resource levels.

Within DOD there is no single voice for DOD's international activities. A number of components are engaged in those activities. Within the policy cluster there are DSAA and DTSA, who are by their charters primarily regulators and controllers of exports. Within the acquisition cluster, there are Industrial and International Programs, International Logistics, and Foreign Contracting whose function it is to further the readiness of our own forces.

Further, there is no single DOD Directive that lays down the policy guidance for defense trade and cooperation which sews the varied components together in a common thread.

Recommendations

1. The Secretary of Defense should consider consolidating into a new agency the OSD components now engaged in international defense cooperation. The new agency would be responsible for the negotiation, and oversight, of all international arms collaboration agreements, including information exchange, codevelopment, coproduction, FMS, foreign acquisition, and international logistics, as well as export licensing, foreign visits to user commands and industrial facilities, and national disclosure policy.
2. The Secretary of Defense should designate one senior level individual whose sole responsibility is to manage the international decision making process, expand U.S. defense exports, and promote international cooperative R&D programs. This individual should be responsible directly to the Deputy Secretary of Defense.
3. DOD should initiate a management review of DOD international program activity as a whole, similar to the acquisition system review which resulted in the recent Defense Management Report (DMR). The objective of such a study should be to develop a more streamlined international program decision making and management process.

II. DEFENSE TRADE COMPETITIVENESS ISSUES

A. Foreign Dependency

Issue: The U.S. has become increasingly dependent upon foreign sources of components, systems, technology, and capital in order to meet its defense requirements. Increased foreign ownership of U.S. defense firms has added to the complexity of issues policymakers must consider in developing a responsible policy which balance the principles of open trade and investment on the one hand and concerns for national security on the other.

Discussion: Increased foreign dependence is a natural result of industrial globalization. As economic borders become less discernable, the U.S. is being forced to rethink traditional concepts of the defense industrial base. Several recent studies on the subject have concluded that it would be impossible for the U.S. to establish total self-sufficiency as a practical goal. Overall, the role of the U.S. *vis-a-vis* allied and other friendly countries needs clarification, not only in terms of collective security, but also in terms of collective capacity to produce and to mobilize industrially.

The importance of technology and the need to maintain technical leadership in certain critical defense related areas needs better policy focus as the defense industry becomes increasingly globalized and more dependent on commercially developed technology. So does the relationship between a strong U.S. economy and a strong national security. This is particularly true in today's world where interdependent global economic ties are essential to maintain a strong economy. Such global interdependency, when coupled with economic strength, provides a powerful means for influencing allies and adversaries. Any course of action for maintaining the U.S. defense industrial base needs to be carefully evaluated with respect to its overall effect on the economy, and on the relationships between the U.S. and its allies.

The U.S. and its major allies are fortunate to have the best industrial capability in the world. Continued collaboration with each other will insure that the collective industrial capability remains second to none. Which capabilities must continue to reside within the U.S. for national security purposes is not entirely clear. This is not due to a lack of existing government policy options to

identify and control such capabilities. Government decisions have already been made on several products and industries which must be protected for national security purposes. However, the criteria used to develop these lists, and the methodology, have not been consistently applied and are subject to external political influences.

Foreign ownership of defense related U.S. companies deserves more high level policy attention. While foreign owners may infuse needed capital into a U.S. production facility, what happens to investment in technology over a period of time is not well understood. Foreign owned U.S. companies may eventually become more dependent on parent company technology for development of future generation products. Better analysis and systematic review of this issue is required before any definitive conclusions can be drawn concerning the long term effect on national security.

An increasing part of the U.S. defense industry's current problems relates to foreign dependence or the actions of foreign competitors, but many of the industrial base problems are self-generated through short-sighted industrial planning, internal DOD acquisition policies and costly oversight of the defense industry. The acquisition system has also made it more difficult for U.S. defense contractors to compete in worldwide markets against foreign companies who receive the full support of their governments. Acquisition policies which affect prime contractors often have an even more dramatic affect on subtier suppliers. Many of these suppliers are cutting back on, or exiting altogether from defense-related business. This is likely to have important implications on our ability to innovate and to compete technologically.

Recommendations

1. The Secretary of Defense and U.S. Trade Representative should encourage the President to develop an interagency process which involves DOD in economic policy and DOC in defense policy. Such a process should include a systematic gathering of information already available throughout the government to make informed decisions concerning foreign dependency decisions.
2. The Secretary of Defense and U.S. Trade Representative should encourage the President to adopt a more proactive policy for supporting defense exports to friendly countries in order to bolster the U.S. defense industrial base and ensure that U.S. industry remains competitive on a global scale.
3. The U.S. Trade Representative should encourage the Secretary of Commerce to aggressively enforce current trade laws against countries that engage in industrial targeting of industries critical to national security, and include defense considerations during bilateral trade negotiations with major trading partners.
4. The Secretary of Defense should improve the climate for encouraging technical innovation in the defense industry and investment in facilities and people through implementing acquisition reform and working with Congress to provide a stable budgeting process.
5. The U.S. Trade Representative and Secretary of Defense should encourage Congress to resist protectionist measures as a policy option for dealing with foreign dependency situations except in very rare circumstances and only as a temporary measure. The focus should be on policies to keep U.S. industry competitive both technically and economically in critical defense industries.

B. Preserving Technological Leadership

Issue: The cornerstone of U.S. weapon systems acquisition policy for many years has been the technological superiority of the U.S. armed forces' fielded weapon systems. This technological superiority has, in fact, served effectively to counter the Soviet Union's numerical

advantage in fielded weapons and prevented a disastrous confrontation between the two super-powers.

However, the 1988 DPACT report identified six key areas where U.S. government policy was deemed to be adversely affecting industry's ability to preserve its technological leadership and maintain a strong defense industrial base. Those key areas involved the U.S. government's critical role in (1) supporting contractor independent research and development, (2) using competition effectively to encourage innovation, (3) protecting companies' proprietary interests in technical data and other intellectual property, (4) effectively communicating the government's future acquisition requirements to industry, (5) increasing the use of commercial acquisition practices and requiring more off-the-shelf and non-developmental items, and (6) maintaining a strong cadre of technical talent in both industry and the government.

Discussion: In the face of strong DOD pressures at the end of 1988 to reduce government reimbursement of industry Independent Research and Development (IR&D) expenditures, industry executives resoundingly supported the historically held view that IR&D and Bid and Proposal (B&P) activities are "necessary costs of doing business."

DPACT, in its 1988 report, recommended that "at a minimum, the FY88 budget levels of IR&D/B&P expenditures should be maintained for (FY89), adjusted for inflation and additions to the IR&D/B&P advance agreement pool, even if additional program cuts are required to sustain these levels." This opposition to reduction in the total industry IR&D/B&P cap continues to be strongly supported by industry.

The Aerospace Industries Association (AIA) went even further by stating that DOD should accept its full allocable share of all allowable IR&D and B&P costs. This position was based upon the sound rationale that competitive pressures would effectively constrain contractors to reasonable levels of IR&D and B&P expenditures. In the meantime, AIA recommended that DOD eliminate the current practice of establishing a cap on all contractor's IR&D/B&P ceilings. AIA further advocated a return to the pre-1983 practice of negotiating individual contractor IR&D/B&P advance agreements based on the needs and business of each company rather than in relation to an overall industry cap.

The July 1989 Defense Management Report (DMR) contained important statements on research and development that were consistent with the DPACT recommendations and important to all of the defense industry. Specifically, the DMR stated that "DOD will continue to recognize costs incurred by suppliers for independent R&D, and bid and proposal, as necessary costs of doing business. Through the DPRB (Defense Planning and Resource Board), it [DOD] will maintain appropriate levels of funding to defray such costs and thereby promote development of promising technologies to meet future defense needs."

In another section dealing with DOD's research and development policies, the DMR gave the Under Secretary of Defense for Acquisition (USD/A) a broad mandate to strengthen DOD's technology development programs. Specifically, the USD/A was mandated to encourage technical competition and technology driven prototyping that promise increased military capabilities; to exploit the cost-reduction potential of innovative or commercially developed technologies, and to develop procurement policies conducive to this purpose. In light of these mandates to encourage technical competition, DPACT believes that DOD should seriously re-evaluate its policy on dual source competition.

While the defense industry generally supports technical performance competitions between comparable products, including considerations of technical capability and price, dual source competitions are generally build-to-print competitions involving little, if any, competition of a technical nature. Critics are now recognizing that dual source competitions, justified initially as

cost savers, produce savings only under limited circumstances and serve as a major disincentive to contractor investment in product and process development. The current dual sourcing trend of using defense contractors solely as factories competing on labor hours and overheads (material dollars essentially being equal) seriously erodes earnings and reduces industry's ability to invest funds in IR&D, to innovate technically, and to evolve product improvements.

With respect to the government's effective use of competition to encourage innovation, the 1988 DPACT report offered two recommendations. The first recommendation concerned the use of evaluation factors other than cost in awarding competitive procurements, i.e., the "best value" approach to source selection. DPACT was gratified to see that this concept was clearly embraced in the DMR. In fact, legislative action is currently being sought to give DOD broader discretion in making awards based on considerations other than cost. The Second DPACT recommendation concerned greater DOD consideration of past contractor performance in the source selection process. Here also the DMR indicated that the USD/A would develop and implement a DOD-wide program to recognize top performers in meeting cost, performance, and schedule base lines.

Fair policy regarding rights in technical data has engendered long-standing debate. It is nonetheless a matter of fundamental importance in motivating the private sector's pursuit of innovation. It underlies the industry's technical competitiveness, particularly in international markets. In response to strong expressions of concern regarding the first interim rule issued by DOD in April 1988, a second interim rule was issued to provide for further public comment. A standing Committee of CODSIA (Council of Defense and Space Industry Association) as well as a special *ad hoc* committee of senior industry executives, has been attempting to work this problem. While only limited progress has been reported in this area to date, recent industry contacts with the Deputy Assistant Secretary of Defense for Procurement have indicated that 1990 will produce renewed DOD attention to this subject.

DPACT's report recommendations under the heading "Effective communication of future requirements" concerned access to planning and technical information that needs to be exchanged between Government and Industry. DOD initiated a review of its policy in this area in 1988, and, while not mentioned in the DMR, this review is continuing. Again, a committee of industry experts has been established under CODSIA to interface with the DOD review. We are concerned over the current lack of clarity and uniformity of rules on access to such information.

The DMR also devoted a significant amount of discussion to the subject of commercial product acquisition and the employment of commercial buying practices. Both legislative and administrative actions were proposed to foster greater reliance on commercial products and commercial procurement practices. DOD's zero-based regulatory review includes a specific focus on the identification of impediments to this area. It has also been suggested that a senior DOD management official be assigned the responsibility to implement necessary reforms to institutionalize a commercial products preference. The Defense Science Board has suggested that commercial acquisition be made the "flag ship" of procurement reform.

Finally, continuing attention must be given by DOD and industry to nourishing the pool of technical talent that is the key to U.S. industry's technical superiority. Maintenance of the defense sector's technical talent base was one of the important themes contained in Secretary Costello's 1988 report entitled, "Bolstering Defense Industrial Competitiveness." The DPACT 1988 Annual Report echoed some of the same concerns expressed by the Costello Report but framed the issue in terms of the heightening adversarial relationship between industry and government. Such an adversarial relationship is counterproductive to attracting young engineers and scientists to the defense sector.

Recommendations

1. Progress on all of these important subjects will require cooperative effort by both government and industry. It is urged that DOD consider formation of joint task forces for each of these subjects. As indicated above, industry has already established standing special committees on two of the subjects.
2. DPACT advocates a return to the pre-1983 practice of negotiating contractor IR&D/B&P advance agreements based on the needs and business of each company rather than on the basis of a predetermined cap on all contractor's IR&D/B&P ceilings. DOD should initiate steps to increase recognition of the allowability of IR&D/B&P costs with a goal of ultimately recognizing 100 percent of such contractor costs.
3. DOD should continue to push the "best value" approach to source selection and place greater emphasis on contractors' past performance in evaluating competitive proposals.
4. DPACT recommends that DOD limit the use of dual sourcing to only those procurements having sufficient production volume to justify "form, fit, and function" or product-vs-product competitions.
5. DOD should re-evaluate its stance on the release of program and acquisition information to contractors. The flow of information to contractors should include long-range program planning, acquisition strategies, technical and specification requirements, draft RFPs, and budget information. Finally DOD executives should be encouraged to meet with senior industry executives knowledgeable on the subject of technology and technical data in early 1990 to finalize balanced policy guidelines for rights in technical data.
6. DOD should follow the recommendation of the Defense Science Board task force on commercial components and make commercial acquisitions the "flag ship" of procurement reform. The initial emphasis of this reform should be on revising regulations and procedures to improve agencies' ability to procure commercial products. A single management official should be assigned the responsibility and authority to shepherd the reforms necessary to institutionalize a commercial products preference.
7. DOD needs to revitalize its endeavors to reach a mutually acceptable accord with industry balancing the government's and industry's rights in technical data.
8. DOD should seek to implement the recommendations contained in the Costello Report entitled, "Bolstering Defense Industrial Competitiveness," concerning DOD's support to our nation's education programs, from high school through postgraduate levels.

C. Economic Health

Issue: The 1988 DPACT report addressed the economic and financial issues affecting industry in a section entitled, "Ability to Modernize and Attract Capital Investment." The section's basic contention was that the disjointed and piecemeal acquisition policy initiatives of Congress and DOD during the 1984-1987 time frame were effectively destroying the financial viability of the defense industry. This squeeze on industry resulted from large shifts of financial, operating, and technical risks to industry without provision for offsetting profits and cash flows necessary for industry to cope with these risks and still attract external capital from the capital markets. Such capital is essential to maintain industry's continued investments in facilities, equipment, and productivity improvements at the levels necessary for increased international competitiveness.

Discussion. The DPACT report referred to above mentioned several of the more detrimental impacts that recent Congressional and DOD acquisition policies were having and continue to have on industry. Among those impacts was the loss of technological leadership due to fewer research and development expenditures, a less efficient industry due to declining capital investments, and a declining ability to attract highly capable individuals to the defense industry. The loss of technological leadership results in an industry more vulnerable to foreign subsidization of competitive products, less technical differentiation between U.S. and foreign products, and deteriorating cost advantages due to lost FMS sales. These deleterious impacts resulted from the following specific changes in U.S. government acquisition policies:

- Reductions in progress payment rates
- Limitations on use of the completed contract method of tax accounting
- Cost sharing on major development programs
- The use of firm-fixed price contracts for full scale development
- Financing of contract special tooling and test equipment by industry
- Reductions in target profit margins.

In 1988, DOD took steps to reverse certain of those policy changes. The progress payment rates were increased, and a revised policy was issued limiting the use of cost-sharing on development programs and the use of fixed prices for Full Scale Development contracts. However, the benefits of these changes were significantly eroded by the legislative phased elimination of the completed contract method of tax accounting and DOD rules that have allowed the award of fixed-price development contracts on an exception basis.

The Defense Management Report (DMR) of July 1989 reiterated DOD's newly enunciated policy of restricting the use of cost-sharing contracts for systems development and fixed-price type contracts for high risk development. DMR also committed DOD to periodic review of progress payment rates and to the maintenance of appropriate levels in light of prevailing interest rates and constraints on DOD outlays. While welcomed by industry, these limited statements fail to address the negative financial impact caused by the prior DOD acquisition policies of 1984-1987. In fact, perhaps less than half of those impacts have yet been felt since the contracts embodying those policies are still ongoing. The impact on industry is even more severe when coupled with elimination of the completed contract method of tax accounting.

The 1988 DPACT report also pointed out two requirements of the Defense Authorization Act of 1989 that were considered by DPACT to be important for preserving the economic health and competitiveness of the defense industry. Specially, the 1989 Authorization Act required that:

- The Secretary of Defense develop an integrated plan to ensure that DOD financing policies are structured to meet the Department's long-term needs for industrial resources and technological innovation; and,
- The Secretary of Defense establish plans and implement policies requiring an analysis of the capabilities of the defense industrial base to develop, produce, maintain, and support major defense acquisition programs.

More than a year after the development of these plans and policies was statutorily mandated by Congress, substantive information concerning either their development or content had not yet been made available. Action is needed since the two plans taken together could do much to crystalize

and integrated DOD financing and industrial base policy. These plans and policies could provide a quantitative framework for evaluating the effects that policy changes might have on the defense industry's composition and financial health. Such an integrated approach could help prevent the kinds of damaging impacts that have resulted from the unplanned, unstudied, and piecemeal DOD and Congressional approaches of the past.

Recommendation

DPACT strongly encourages DOD to develop an integrated financing plan and an industrial base plan as required by the Defense Authorization Act of 1989. Only by developing such plans can DOD and Congress evaluate the potential financial effects on the defense industry caused by changes in specific acquisition policies. Such plans and their implementing policies must consider the financial burden currently imposed on industry, including subtier contractors, by prior policies. Continued DOD attention is still needed on all of the issues raised in the 1988 DPACT Annual Report concerning the overall economic health of the industry. Such issues include increasing contractor's target profit margins, increasing progress payment rates, eliminating or severely limiting the use of fixed-price development contracting, eliminating contractor financing of special tooling and test equipment, eliminating cost-sharing on research and development contracts, finding a more equitable method of taxing contractors' "income" such as the completed contract method of tax accounting, and eliminating the government's withholding of progress payments done so for basically arbitrary reasons.

D. Government-Industry Relations

Issue: The 1988 DPACT report expressed concerns about international buyer perceptions of a continually deteriorating relationship between DOD, Congress, and the U.S. defense industry. Media accounts of government and industry mismanagement and accusations of fraud and ethical improprieties have resulted in a waive of acquisition and ethics legislation "criminalizing the defense acquisition process." Fears have been generated in industry that the likely fallout will be the rising of serious doubts in international buyers' minds about the integrity, responsibility, and competitiveness of U.S. industry. Such questioning could aversely impact U.S. industry's ability to compete in international markets. Furthermore, such rifts make it increasingly difficult for industry and government to forge the close cooperative relationship necessary to promote the export of U.S. products.

Discussion: The Defense Management Report (DMR) correctly recognizes that industry has made significant progress in the area of self-governance and challenges industry to gain an even broader consensus on and acceptance of self-governance principles and voluntary disclosure. The decision not to adopt a proposed rule mandating contractor codes of conduct was applauded by industry. However, industry, for its part, has recognized that it must persist in efforts like the Defense Industry Initiative on Business Ethics and Conduct to demonstrate a continuing good-faith commitment to ethical business practices and conduct. Such commitments are matters of high priority among all of the defense industry trade associations.

The 1988 DPACT report also pointed out, in the section on Effective Government-Industry Cooperation, the importance of clear rules to enable industry's self-governance to achieve its objective. As stated in the report, "The adversarial relationship which has developed has exacerbated the difficulty of resolving disagreements between industry and the government that develop because of ambiguities in the complex laws and regulations governing the defense procurement process. . . . Unless ways can be found to achieve 'before the fact' agreement on what is required under the regulations, individual companies and industry as a whole remain at risk to accusations of fraud and abuse in the gray areas of the procurement process."

Another problem has been the proliferation of rulemaking at all DOD levels. The DMR has set in motion a zero-based review of regulations and guidance regarding the procurement process. The elimination of duplicative and unnecessary regulations and policies can do much to clarify the rules under which the industry must operate. Further, the recent action by the Deputy Assistant Secretary of Defense (Procurement) to require that office's review and approval of all service and agency supplemental regulations and guidance establishes an important precedent in controlling the promulgation of new acquisition regulations and may serve to enhance the consistency and clarity of DOD rules. Unfortunately, we understand that such guidance has yet to be forwarded for DASD(P) approval.

In letters to DOD commenting generally on the DMR initiatives, several industry associations have urged increased DOD use of cooperative rulemaking—i.e., increased participation by industry in the development of the rules. Such an approach would be a very important step toward achieving clear and balanced acquisition rules. It is also the subject of a bill entitled the "Negotiated Rulemaking Act of 1989."

Recommendations

1. DOD should institutionalize a procedure under the auspices of a reconstituted DAR Council to review all agency procurement policies and regulations prior to implementation. The reconstituted DAR Council should report directly to the USD/A and be comprised of a professional procurement staff of OSD personnel. The DAR Council should be tasked with ensuring that DFAR and military service supplements are restricted to only those which can be justified as necessary to fulfill unique military service or agency peculiar mission requirements. The reconstituted DAR Council should ensure that all such agency regulations and policies are published in the *Federal Register* prior to their effectivity.
2. DOD should adopt the principle of negotiating rulemaking to afford industry an opportunity to provide comments on substantive issues before referral of a DAR case to a rule drafting committee. Affording industry a reasonable opportunity to affect the initial drafting of rules will avoid the ambiguities and unbalancing of interests that have occurred in the past and caused recriminations and ill will between government and industry.
3. Greater government-industry dialogue and higher level management review should be required before cases of defective pricing and fraud are submitted for criminal investigations. In addition, DOD should adopt a policy and procedures that provide for government exhaustion of administrative remedies to resolve disagreements between the parties.