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Corporate Welfare for Weapons Makers
The Hidden Costs of Spending on Defense and Foreign Aid

by William D. Hartung

Executive Summary

The defense and foreign aid budgets are the largest single source of government funding for private corporations. More than half of U.S. weapons sales are now being financed by taxpayers instead of foreign arms purchasers. During fiscal year 1996 (the last year for which full statistics are available), the government spent more than $7.9 billion to help U.S. companies secure just over $12 billion in agreements for new international arms sales. The annual $7.9 billion in subsidies includes taxpayer-backed loans, grants, and government promotional activities that help U.S. weapons makers sell their products to foreign customers. Also, the provision of low-cost facilities and extensive subsidies for research and development and mergers and acquisitions to major contractors fosters a "risk-free" environment in which weapons makers have little economic incentive to produce effective systems at affordable prices. Furthermore, a portion of the $120 billion the Pentagon spends each year on contracts with U.S. defense contractors is being wasted on defense pork—that is, redundant or unneeded weapons systems. Such subsidies and spending for defense pork can interfere with the fulfillment of legitimate security needs.

In concordance with a recommendation made by the Presidential Advisory Board on Arms Proliferation, government subsidies for arms exports should be phased out. Federal subsidies to corporations in the national security sphere should be the *exception* rather than the rule. The executive branch and Congress should establish an independent commission to conduct an annual review of corporate-targeted contracts, tax breaks, and price subsidies contained in the military and foreign aid budgets. Only those subsidies fulfilling important national security objectives *that could not be accomplished without government assistance* should be maintained. The overall review should be supplemented by a separate panel, modeled on the Defense Department's Base Realignment and Closure (BRAC) panel, which would put forward an annual list of pork-barrel military procurement projects that should be terminated. To limit "horse-trading," the list of unnecessary projects would have to be voted up or down in its entirety—much like BRAC procedure for military base closures.

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Introduction

After a year of bitter partisan squabbling over impeachment, President Clinton and the Republican-controlled Congress finally found something they could agree on: a multiyear, multi-billion-dollar increase in Pentagon spending. The only disagreement about the budget among the major players in Washington was over *how much* to increase it.

The president opened the bidding on January 2, when he used the occasion of his first national radio address of 1999 to call for the largest sustained increase in Pentagon spending since the Reagan era—$112 billion over six years. Three days later, the Senate Armed Services Committee upped the ante when John Warner (R-Va.), the new chairman of that body, joined other senior Republicans on the committee in urging the Joint Chiefs of Staff to seek the larger $150 billion increase that they had outlined in testimony to the Senate in September 1998.

Once the impeachment matter had been resolved in the Senate, the bidding continued. In mid-February, the Senate rammed through a military pay increase that would cost billions more than the raises already in the Pentagon's own budget proposal. And in March both the House and the Senate passed bills declaring that it is the policy of the United States to deploy a National Missile Defense system—a commitment that the Congressional Budget Office has estimated could cost at least $18 billion to $28 billion over the course of the next decade. Meanwhile, Reps. Curt Weldon (R-Pa.) and Norman Dicks (D-Wash.) are spearheading a coalition of conservative Republicans and Democrats from defense-dependent districts that has pledged to work for an increase in the fiscal year 2000 Pentagon budget. The increase would be $8 billion *more* than the $12.6 billion increase that the Clinton administration has already requested.[1] Will all of this additional funding result in greater security for the nation?

With the prospect of large increases in the Pentagon budget, it is fair to ask who will benefit from this spending spree. Will it be the men and women of our armed forces, as President Clinton and Republican congressional leaders have claimed? Or will it be such weapons-making conglomerates as Raytheon, Boeing, and Lockheed Martin? The "Big Three" weapons makers already receive more than $30 billion per year in Pentagon contracts—or one of every four dollars of the $120 billion per year that the Pentagon hands out for everything from rifles to rockets.[2] Those figures could skyrocket if the proposed military buildup is approved in anything close to its current form.

The details of the Pentagon's own six-year budget projections demonstrate that the largest increases will go to arms contractors, not to the personnel of the armed forces. Spending on weapons procurement, the pot of money that most directly benefits the big companies, is slated to rise by 53 percent between now and 2005. Funding will increase from $49 billion per year to $75 billion per year. Spending on personnel is slated to rise by 22 percent over that same time period—less than half the rate of increase in spending for big-ticket weapons systems.

Only a fraction of the increased expenditures for personnel will make it to those people most likely to leave the armed services. Moreover, some of the money for pay increases will go to top-ranking officers, including admirals and generals, who are already well compensated, and to hundreds of thousands of civilian bureaucrats. Those bureaucrats, under the current Pentagon proposal, would get the same 4.4 percent annual increase as would troops, who could potentially be sent into conflict.[3]

Before Congress and the public sign off on the largest peacetime military buildup since the Reagan administration, it is appropriate to know how much of our military and foreign aid budgets is being spent on corporate welfare for weapons manufacturers. Are all of these subsidies necessary for defending the country, or are some of them being used primarily to maintain or expand the profit margins of the Big Three weapons makers?[4]

What Is Corporate Welfare?

Where you stand on corporate welfare depends on where you sit. Or, as Willard Workman of the U.S. Chamber of Commerce put it, "One man's corporate welfare is another man's paycheck."[5] At a July 1998 Cato Institute Forum, Joel Johnson, vice president–international of the Aerospace Industries Association, similarly described the billions of dollars in well-documented government subsidies for U.S. arms-exporting firms as nothing more than "payment for goods and services." If you take the positions of Workman and Johnson to their logical conclusions, *no* form of government support for industry—no grant, no industry-specific tax break, no targeted regulatory relief, no market-distorting price subsidy—would be classified as corporate welfare.

Luckily for the taxpaying public, such extreme positions don't hold up to scrutiny. There have been numerous independent studies in recent years that have documented massive corporate welfare programs in the federal budget. The estimates of the total cost of those programs range from tens of billions of dollars to more than $150 billion a year.[6]

All forms of government interaction with corporations are not illegitimate, of course. When there are specific national objectives that can be most effectively advanced by contracting with the private sector, it may make sense to use taxpayer funds to pay qualified companies for necessary goods and services. Which payments are necessary investments and which are corporate welfare? To cite an oft-used phrase, "the devil is in the details."

It may be difficult to establish hard-and-fast rules for determining which government expenditures are corporate welfare. However, clear cases would include buying unnecessary or excess goods and services as a result of special-interst lobbying, overpaying for widely available equipment, and providing tax breaks or subsidies to "encourage" or "support" activities that would occur without those subsidies.[7] The best policy would be to make government subsidies to corporations in the defense sector the *exception* rather than the rule. Exceptions for corporate-targeted payments, subsidized loans, carefully targeted tax breaks, price subsidies, and preferential regulatory relief should be permitted *only* when they can be demonstrated to fulfill an important national security objective *that could not have been fulfilled without government assistance*. As part of such a policy, all subsidies for the defense sector should be reviewed annually to see if they are meeting their stated objectives. If they are not, the subsidies should be repealed.

We have a long way to go before corporate welfare becomes only an occasional tool of federal government policy instead of "business as usual." A review of the corporate subsidies in the Pentagon and foreign aid budgets provides a good indication of how far we have to go.

Some recent analyses of corporate welfare excluded national security programs entirely, either because national security is considered a "special case" or because taking on the Pentagon budget was seen as too controversial.[8] Those sentiments, while understandable, are not justifiable. If corporate welfare consists of inefficient subsidies for unnecessary goods and services, then it is *especially* important to ensure that funds for the national defense are not squandered on questionable pork for private companies.

This paper is an attempt to describe the billions of dollars of corporate welfare that are in our military and foreign aid budgets. It is hoped the paper will be a starting point for a serious national debate on reducing corporate welfare in the military and foreign aid budgets and on finding more efficient methods for accomplishing national security objectives.

Welfare for Weapons Dealers

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One of the most lucrative sources of government support for arms contractors comes in the form of taxpayer-backed loans, grants, and promotional activities that help the contractors sell their wares to foreign customers.

Table 1
U.S. Government Subsidies for Arms Exports, FY96
(annualized average, in millions of dollars)

Agency	Expenditure
Financing and Aid Programs	
U.S. Department of Defense	
Foreign military financing	3,317.8
Defense Export Loan Guarantee fund[a]	16.7
Forgiven/bad loans	1,000.0
Excess defense articles/emergency drawdowns	750.0
No-cost leases of U.S. equipment	63.2
Repeal or waiver of recoupment fees	200.0
U.S. Agency for International Development: Economic Support Funds[b]	2,042.3
Export-Import Bank Loans[c]	33.7
Subtotal	7,423.7
Promotional and Support Programs	
U.S. Departments of Defense, State, and Commerce	
Government personnel costs for promotion/support[d]	410.0
Government support for air shows/weapons	34.2
Subtotal	444.2
Total: All U.S. government support for arms sales	7,867.9

Sources: U.S. Departments of Defense, State, and Commerce; U.S. Export-Import Bank; U.S. Agency for International Development; and the Congressional Budget Office. For further details on sources and methodology for Table 1, see William D. Hartung, *Welfare for Weapons Dealers 1998: The Hidden Costs of NATO Expansion* (New York: World Policy Institute, March 1998), www.worldpolicy.org.

[a] Subsidy value of loans guaranteed to date.

[b] The figure cited represents only $2 billion of the $2.3 billion in Economic Support Funds for 1996. The remainder of that aid was not an offset for the costs of weapons purchases by major buyers of U.S. arms, such as Egypt and Israel.

[c] Represents the subsidy value.

[d] To support 6,300 personnel at the Pentagon and State and Commerce Departments.

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in the form of taxpayer-backed loans, grants, and promotional activities that help the contractors sell their wares to foreign customers. Many of those U.S. arms clients, such as Turkey, Colombia, and the now-defunct Mobutu regime in Zaire, could never have afforded to buy costly armaments from U.S. companies without U.S. government support.

In fact, during FY96, the government spent more than $7.9 billion to help U.S. companies secure just over $12 billion in new international arms sales agreements. Table 1 gives figures for FY96, the last year for which data on all categories of subsidies were available; figures in the text for some of the categories may be more recent. *Thus, more than half of U.S. arms sales are now being financed by U.S. taxpayers—not by foreign arms clients.*[9] That directly contradicts claims by U.S. arms-exporting firms that weapons exports provide a significant benefit to the U.S. economy.

As Table 1 shows, the U.S. government supplies arms export subsidies through various programs administered by separate agencies. Those subsidies are frequently listed under innocuous budget titles that don't seem to have anything to do with weapons exports: excess defense articles, emergency drawdowns, and Economic Support Funds (ESF), for example. That budgetary sleight of hand has made it difficult to keep track of U.S. arms export subsidies, much less reduce them. As a step toward introducing greater transparency and accountability to the government's arms export subsidy programs, this paper will examine the details of the programs, beginning with those at the Pentagon.

Financing Weapons Exports: Pentagon Grants, Loans, and Giveaways

Of the $7.9 billion in arms export subsidies provided by the U.S. government, only a tiny fraction comes out of the Pentagon budget—about $1.2 billion. That sum consists of $400 million per year for the promotion of arms exports plus about $800 million in free leases and giveaways of surplus weaponry. The $3.3 billion Foreign Military Financing (FMF) program is administered by the Department of Defense, but the funds come out of the foreign operations budget. The Defense Department's annual $1.2 billion costs for arms export loans that were written off and royalty fees for arms technology (known as "recoupment fees") that were waived are charged against the federal government's general accounts, not the Pentagon's budget.

As a result of those budgetary anomalies, the Pentagon uses billions of taxpayer dollars on behalf of U.S. arms-exporting firms but rarely pays a price (nor do the exporting firms that benefit from those subsidies) when any of those subsidized arms deals goes bad. In fact, to finance the budget of the Defense Department's Defense Security Cooperation Agency (DSCA), formerly known as the Defense Security Assistance Agency, the Pentagon takes a percentage off the top of major arms deals brokered through the department's Foreign Military Sales program. An analysis by the Office of Technology Assessment has charged that such an arrangement gives the Pentagon an unhealthy economic incentive to *promote* major weapons exports to fill its own coffers, regardless of the effects of those sales on U.S. security.[10]

A key question throughout the analysis of corporate welfare programs for arms makers is whether current financing arrangements for weapons development, procurement, and export provide adequate incentives for the Pentagon and its contractors to make prudent choices about how to spend taxpayer dollars. Have the financing arrangements created a "risk-free" environment in which neither the government nor the corporate bureaucracies involved have any *economic* incentive to seek effective solutions at an affordable cost? The arms export financing programs administered by the Pentagon provide a good case in point.

The Foreign Military Financing Program. The largest single subsidy program for U.S. weapons exporters is the Pentagon's Foreign Military Financing (FMF) program, which received $3.35 billion in taxpayer funds in the FY99 budget to support grants and loans for the provision of U.S. military equipment and services to more than two dozen countries. Although the bulk of the FMF funds goes to Egypt and Israel, which received $3.16 billion of the program's total allocation of $3.35 billion in FY99, other recipients of FMF grants and loans during the past few years have included Albania, Bulgaria, Cambodia, the

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Czech Republic, Estonia, Georgia, Greece, Hungary, Jordan, Kazakstan, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Slovakia, Slovenia, Turkey, Turkmenistan, Ukraine, and Uzbekistan. In addition, regional funds were allocated for the Caribbean and Africa.

The FMF programs outside of the Middle East are relatively modest in size, ranging from $450,000 for Turkmenistan to $15.7 million for Poland. However, once the aid spigot is opened, it can be extremely hard to turn it off.[11] NATO politics, pressure from ethnic and military lobbies, and the desire of ambassadors and State Department desk officers to "please" their client states can all combine to turn a modest new program into an expensive, long-term commitment. For example, the $3 billion-plus annual FMF commitments to Israel and Egypt, initially set two decades ago at the time of the Camp David peace accords, are maintained to this day.

Of the new commitments undertaken by the FMF program, those most likely to grow in the coming years involve support for new and prospective members of NATO. In FY96 through FY98, the U.S. government authorized over $1.2 billion in grants, loans, and financing for military training and exercises designed to prepare allied nations in Eastern and Central Europe and the former Soviet republics for possible entry into NATO. The bulk of those funds came from the Pentagon's FMF program, including $187 million in grants and $644.5 million in lending authority under the newly created Central European Defense Loan fund. That fund was created to "assist in the gradual enlargement of NATO by providing FMF loans to creditworthy Central European and Baltic states for acquisition of NATO-compatible equipment."[12] To accommodate the Central European Defense Loan program, loans under the Pentagon's FMF program increased from $544.1 million in FY96 to $657 million in FY98. The share of FMF loans allocated for prospective NATO members rose even more dramatically, from nothing in FY96 to 61.2 percent in FY98.[13]

Because of congressional concerns about the creditworthiness of loan recipients and the soundness of requirements for borrowers to obtain credit in the FMF program, new funding for the loan portion of FMF is scheduled to be phased out in the FY 2000 budget. (But key states in Eastern and Central Europe will still have access to the hundreds of millions of dollars in lending authority that have been built up in the Central European Defense Loan fund over the past few years.) In place of the loan funding, prospective NATO member states are slated for an increase in grant funding—up to $81 million for FY 2000 alone. That sum represents nearly half of the grant funding allocated to those countries during the three years from 1996 to 1998.[14]

At a time when new NATO members Poland, Hungary, and the Czech Republic have been lagging behind in their commitments to bring their forces up to NATO standards and have put off major weapons purchases for 5 to 10 years, it is questionable whether maintaining the Central European Defense Loan fund is desirable. What good purpose is being served by stockpiling subsidized loans to help NATO members and candidates upgrade their armed forces when those nations are not ready to commit their own resources to meet that objective? Does it really make sense to use U.S. taxpayers as the lenders of first resort for weapons sales to Eastern and Central Europe?

The Defense Export Loan Guarantee Fund–On the Brink. The Defense Export Loan Guarantee (DELG) fund is a stand-alone program that is authorized to make up to $15 billion in U.S.-government-guaranteed loans to over three dozen nations in Europe and Asia. DELG has long been viewed by the arms industry and the Pentagon as an added source of subsidized loans for countries that are not serviced by the FMF program. In June 1997 Deputy Under Secretary of Defense for International and Commercial Programs Page Hoeper underscored the potential importance of DELG in financing NATO expansion: "We see a tremendous opportuni-

ty in using this facility to help ease some of the financial and tax flow burdens of enlarging NATO."[15] In reality, the impact of DELG has been modest. In its first two years in operation, DELG guaranteed one loan of about $17 million (subsidy value) to support a sale by the U.S.-based AAI Corporation of unmanned aerial vehicles to Romania. Under DELG's original authorizing legislation, the costs of operating the program were supposed to be financed by fees charged to client countries that were using the fund's services, *not* by general tax revenues. But the original $500,000 that Congress appropriated to start the fund has been exhausted. Absent an unlikely rush of new loans for arms exports under the program, the only way to keep DELG running is by providing an infusion of taxpayer funds to cover administration and staff costs.[16]

The DELG fund has been used sparingly because skeptics like former senator Dale Bumpers of Arkansas and Sen. Paul Sarbanes (D-Md.) inserted a requirement that countries using the program would have to pay the "exposure fees" on DELG loans. The calculations of exposure fees, which help provide a reserve against future defaults or delays in loan payments, were based on the creditworthiness of the client nation. Most of the eligible countries chose not to pay the potentially significant exposure fees up front, which is why the program is in its current predicament.

In early 1999, on the basis of the program's performance and a critical review by the General Accounting Office (GAO), Under Secretary of Defense Jacques Gansler decided to terminate the DELG program. Representatives of the arms export lobby, including the director of the Aerospace Industries Association and officials of several major exporting firms, objected strongly and argued that it would be better to "fix" the program than to eliminate it. The "fix" that the industry had in mind would allow governments that use DELG loan guarantees to pay their exposure fees *out of the money they receive from their U.S.-government-guaranteed loans*. Although that arrangement would no doubt make the fund more attractive to potential borrowers, it would also increase the risk of default on those loans. If countries with risky credit ratings are allowed access to guaranteed loans without risking their own funds, a flood of questionable loans could come back to haunt U.S. taxpayers.

At a recent meeting with the Defense Policy Advisory Committee on Trade (a panel of weapons industry executives that provides confidential advice to the secretary of defense and the U.S. trade representative on defense export policy), Secretary of Defense William Cohen indicated that he would try to accommodate the industry's demand that DELG be "fixed" instead of terminated.[17] Such a move to loosen the criteria for providing loans for arms exports could end up costing U.S. taxpayers billions of dollars.

Covering Bad Loans—Bailing Out Arms Companies and Their Clients. Since 1991 U.S. taxpayers have been forced to pick up the tab for roughly *$10 billion* in loans for arms sales and military technology that have been either forgiven for political reasons or written off for financial reasons. That sum represents a significant hidden cost of the government's loan programs for arms sales. The most costly episode occurred when the Bush administration forgave $7 billion in outstanding Foreign Military Sales (FMS) loans to Egypt to reward Cairo for providing political support to the U.S.-led coalition that fought the 1991 Persian Gulf War. Other major write-offs included roughly $2 billion in government-guaranteed loans that were provided to Iraq to buy technologies related to arms production prior to the Gulf conflict and $7 million each for bad loans to the West African nations of Niger and Senegal.[18]

To address the chronic problems associated with loans for arms exports—in which politics often trumps sound economic analysis—Congress voted last year to close down the Pentagon's FMF loan program and offer all future FMF assistance only in the form of grants.[19] The FMF decision, the troubles in the DELG program, the stockpiling of large-

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In addition to providing grants and subsidized loans to U.S. weapons-exporting firms, the Pentagon and the State and Commerce Departments provide extensive marketing assistance to those companies.

ly unused lending authority in the Central European Defense Loan fund, and the long history of bad loans for foreign arms sales all suggest that the U.S. government should eliminate its exposure in arms export lending. U.S. taxpayers should ask why arms dealers and foreign nations are being subsidized to conduct arms transfers, some of which could cause regional conflicts or instability. In the interests of a sound foreign policy *and* a sound fiscal policy, the era of "creative financing" and back-door, off-budget support for arms exports should be brought to an end.

Surplus and Leasing—The Pentagon's Weapons Giveaway Programs. In addition to financing arms exports through grants and loans, the Pentagon has also been leasing or giving away massive quantities of highly capable U.S. weapons that have been declared "surplus" relative to current needs. According to a path-breaking report in 1996 by the Arms Sales Monitoring Project of the Federation of American Scientists, from 1990 to 1995 the United States gave away (or sold at a steep discount) weaponry that had originally been purchased by the U.S. government for a total of $8.7 billion. Not only are those items being dumped on the market at much less than their actual value, but, as the report states, "the services appear to be giving away still useful equipment to justify procurement of new weaponry." As a result, taxpayers end up paying twice: once for forgone proceeds from the sale to foreign nations of the still-useful equipment and a second time for the purchase of even costlier replacement items. For example, the Air Force and the Navy are buying expensive new fighter aircraft (the F-22 and the F-18E/F, respectively) to counter the proliferation of advanced fighter aircraft such as the U.S.-built F-15, F-16, and earlier model F-18, some of which the armed services are now in the process of giving away as surplus.[20]

A cheaper and smarter alternative would be to keep planes like the F-15, the F-16, and the current model of the F-18 in service for another decade or so, which could easily be done without threatening U.S. air superiority. The GAO estimates that with modest upgrades, current-generation F-15s are more than adequate to defeat any likely U.S. adversary until at least 2014.[21] Keeping existing aircraft in the inventory instead of retiring them prematurely would allow the Pentagon to slow down or cancel manufacture of the costly F-22 and F/A-18E/F fighters and concentrate its resources on the next-generation Joint Strike Fighter. That approach could save tens of billions of dollars and would also slow the pace of conventional weapons proliferation by reducing the stockpile of combat fighters the Pentagon has for the world market.

During FY97, under its Excess Defense Articles program, the Pentagon gave away military equipment with an original acquisition value of $973 million. Those giveaways went to 24 countries. The recipients of the largest giveaways were Turkey ($271 million), Jordan ($183 million), Greece ($100 million), Morocco ($91 million), Israel ($68 million), and Argentina ($66 million). Even allowing for depreciation, the Pentagon estimates the current value of those weapons at $309 million. Given the Pentagon's well-documented history of underestimating the current value of surplus weapons, the true figure could be 25 to 50 percent higher. In addition to those grants of surplus weapons, the Pentagon sold 14 nations over $526 million worth of surplus weapons at a steep discount (at prices averaging *85 percent lower* than the original acquisition value of the weapons). The recipient of most of those discounted weapons was wealthy Australia, which received weapons originally worth $483 million for roughly *one-tenth* of their original price.[22]

Another way the Pentagon unloads surplus U.S. weaponry is through leasing arrangements. In FY97 the Pentagon leased to 13 countries equipment with an original acquisition value of over $103.4 million. The recipient of most of that weaponry was Turkey, which received equipment originally valued at over $54 million for a rental price of $19.9 million.[23]

It would seem that surplus giveaways would undercut U.S. arms exporters by providing free or deeply discounted equipment to countries that might otherwise buy new weapons from U.S. firms. The actual effects are more complex. In some cases, surplus sales or leases can serve as "loss leaders" that are used to introduce cash-strapped foreign customers to U.S. equipment and set them up for possible sales of new weaponry in the future. For example, the hotly contested race to see which U.S. fighter manufacturer—Boeing or Lockheed Martin—can get Poland to lease *its* aircraft (either the Lockheed Martin F-16 or the Boeing F-18) is a first step toward selling Warsaw advanced combat aircraft.

After making exaggerated claims a few years ago about the possibility of buying as many as 200 modern Western combat aircraft, the Polish government has recently taken a much more deliberate attitude toward modernizing its air force. Poland may begin by entering into a $100 million leasing arrangement for about a dozen surplus U.S. F-16 or F-18 aircraft. The lease could be followed by purchase of a few dozen new combat aircraft in 5 or 10 years' time. Similar leasing deals are being offered to Hungary and the Czech Republic, but Poland is closer to making a decision.

The fighter lease for Poland, which is worth next to nothing in its own right, has sparked an aggressive competition between Boeing and Lockheed Martin to see which company can "get its foot in the door" of the Polish arms market. Each company hopes that once Poland becomes familiar with the firm's equipment, the firm will be in a stronger position to make a sale of large numbers of new aircraft to Poland early in the next century. When Polish defense minister Janus Onyszkiewicz visited Washington in January 1999, he was courted by U.S. arms makers. His official schedule included meetings at Boeing, Lockheed Martin, Pratt and Whitney (which makes engines for fighter aircraft), and the U.S. Committee to Expand NATO (whose president, Bruce L. Jackson, is also Lockheed Martin's vice president for strategic planning). Boeing used its meeting with Onyszkiewicz as an opportunity to offer a major arms package, which included the lease and sale of F-18 fighter aircraft, Polish participation in the L-159 trainer aircraft project (which Boeing is carrying out with its Czech partner, Aero Vochody), licensed manufacturing of Boeing's Hellfire II anti-armor missile, and a new avionics package for Poland's Soviet-built Mi-24 helicopters. Boeing spokesman Jim Schleuter described his company's rationale for this impressive package as follows: "We are committed to being a strategic partner for Poland right across the military aerospace spectrum. We support their military modernization process."[24] Boeing is obviously willing to invest time and resources now to lock up a chunk of the Polish arms market in the future. If Boeing can use free surplus fighters from the U.S. government as part of the bait, so much the better.

The Clinton administration is following its predecessor not only in pressing embassy personnel into service on behalf of U.S. weapons exporters but also in promoting weaponry at air shows.

Targeted Tax Breaks for Weapons Contractors and Their Foreign Clients. Although U.S. weapons manufacturers often claim that their appeals for new government subsidies are required to "level the playing field" between defense exports and other products, the reality is that arms producers receive a steady stream of government support for research, development, and production far exceeding what the government provides for any other industry or product. If the government wanted to level the playing field between the weapons industry and other sectors, it would have to *reduce* weapons subsidies, not increase them.

Despite the weapons sector's obvious advantages over industries that have to finance most of their own research and development and tailor their products to the needs of a diverse customer base, the weapons industry has frequently succeeded in winning new favors from the government on the specious grounds that certain government practices "discriminate" against arms manufacturers.

"Recoupment fees" are charges to buyers of U.S. arms to help reimburse the U.S.

Three-quarters of the federal government's R&D budget is devoted to military projects. The bulk of those funds goes to private contractors.

Treasury for a portion of the "nonrecurring research and development costs" incurred by the government for major systems like the F-16 fighter or the M-1 tank. The debate over recoupment fees is an example of how the arms industry has managed to win favorable treatment for itself and its clients by misrepresenting the facts about government subsidies. As far back as November 1988, the industry-dominated Defense Policy Advisory Committee on Trade broached the subject of pursuing changes in the prices of weapons exports that "would have reduced or eliminated research and development surcharges."[25] The industry followed up that suggestion with a multiyear lobbying effort that convinced the Bush administration to eliminate the recoupment fees for R&D on commercial arms sales, which involve sales of items on the U.S. munitions list that are licensed for export by the U.S. Department of State. Commercial arms sales have been an average of roughly 25 percent of U.S. arms exports over the past decade.

The arms industry also successfully sought repeal of recoupment fees for arms sales under the Pentagon's FMS program. But since the fees on those deals were written into law, it took longer to get them repealed. Because the other 75 percent of U.S. arms sales are supplied through FMS channels, repealing recoupment fees on FMS sales was a particularly lucrative accomplishment.[26]

In FMS deals the Pentagon acts as a broker (in commercial sales, the supplier sells to the buyer without a broker). The Pentagon's responsibilities in an FMS deal include negotiating the terms of the deal with the foreign client, collecting funds from the foreign client, disbursing them to U.S. contractors as the work proceeds, and supplying logistics and spare parts for the weapons system.

As a first step toward eliminating the charges on FMS deals, the arms industry was successful in obtaining a provision that allowed the president to waive recoupment fees on FMS sales to close allies—NATO members, Japan, Australia, and New Zealand. From 1991 to 1994, over $773 million was waived in fees that would have gone to the U.S. Treasury to reimburse the taxpayer funds that went into developing U.S. weapons systems.

In 1996 the industry finally won congressional approval for a provision that would allow the president to waive recoupment fees on any FMS sale, as long as provisions were made to find an alternative source of revenue equivalent in value to the fees that were waived. The first installment of those alternative revenues was provided by William Cohen. Prior to assuming his current post as secretary of defense, Cohen was a pro-defense senator from Maine who regularly went to bat for the interests of weapons makers in his home state. Late one night in the summer of 1996, Senator Cohen quietly slipped a provision into a defense bill that authorized the Department of Defense to sell items from the strategic stockpile, a Pentagon-administered reserve of critical raw materials that was established during the Cold War, and to use the proceeds to offset the costs of waiving recoupment fees on foreign arms sales.[27]

A recent GAO report demonstrated that even when recoupment fees had not been waived, the Pentagon had been remiss in collecting them. The report identified $183 million in uncollected recoupment fees on FMS deals administered by the Air Force and the Navy, including a case involving the delivery of 48 F-16 aircraft to South Korea for which no fees were collected.[28]

The cumulative result of waiving (or failing to collect) recoupment fees has been a loss to the U.S. Treasury of hundreds of millions of dollars per year. And even those arms deals for which forgone recoupment fees were "offset"—by selling off materials from the strategic stockpile—represented a transfer of wealth from the taxpayers to particular companies. Because arms manufacturers are rarely asked to open their books to public scrutiny, there is no way of knowing for sure whether those reduced fees have resulted in lower prices for the buyers of U.S. arms or higher profits for U.S. weapons exporters. What is clear is that those fee reductions were not needed to "level the playing field" for U.S. manufacturers. New

figures from the Arms Control and Disarmament Agency suggest that the U.S. share of the global arms market in the mid-1990s—55 percent—is greater than the shares of all other supplier nations in the world combined.[29] The Pentagon predicted a few years ago that U.S. companies are likely to dominate the world arms market for years to come *with or without special government financing arrangements or tax breaks:*

> The forecasts support a continuing strong defense trade performance for U.S. defense products through the end of the decade and beyond. In a large number of cases, the U.S. is clearly the preferred provider, and there is little meaningful competition with suppliers from other countries. An increase in the level of support the U.S. government currently provides for arms exports is unlikely to shift the U.S. export market share outside a range of 53 to 59 percent of worldwide arms trade.[30]

Despite the U.S. arms industry's dominance of the global market (and corresponding lack of need for special tax breaks), its advocacy of the repeal of recoupment fees received support from at least one independent source: the Presidential Advisory Board on Arms Proliferation Policy. In its 1996 report to Congress, the board, which was chaired by Janne E. Nolan of the Brookings Institution, expressed sympathy with the industry's arguments that R&D recoupment fees are "discriminatory." The board argued that the fees "have no such parallel in other industries where the U.S. government has made major R&D investments in developing and purchasing capital equipment—for example, power generation, telecommunications, computer systems, and nuclear reactor technology." The board also agreed with the suggestion by U.S. arms manufacturers that the fees could be a "clear and significant price discriminator against [U.S. arms manufacturers] as they compete for sales in third countries against foreign producers" who have "no equivalent added costs."[31]

Although other U.S. industries have been given some funding by the government over the years, no industry has received the consistent level of support received by the weapons companies. As we will see, U.S. weapons manufacturers are the major recipients of government R&D funding, and arms exporters have been major beneficiaries of this generous R&D funding policy.

To cite just two examples: the Boeing F-15 fighter, which has been the subject of multi-billion-dollar export packages to Israel and Saudi Arabia, received $2.9 billion in government R&D support; and the Lockheed Martin F-16, which has been one of the most successfully exported fighters in history, garnered $1.8 billion in Pentagon R&D support during its development phase.[32] Most private companies must fund their own R&D of new products. U.S. weapons manufacturers receive huge R&D subsidies from the government for items that they are then permitted to sell on the world market for a substantial profit. Is it really so unfair to ask that weapons manufacturers and their buyers reimburse the U.S. Treasury for a small portion of the R&D funds that made those systems possible? The alternative is for the U.S. government to require defense contractors to fund their own R&D, as former chief of naval operations Mike Boorda advocated.

In arguing against the repeal of recoupment fees, the Congressional Budget Office has suggested that the industry's arguments for repeal of the fees be put in the context of all the other advantages those firms receive from the government:

> U.S. defense industries have significant advantages over their foreign competitors and thus should not need additional subsidies to attract sales. Because the U.S. defense procurement budget is nearly twice that of all Western European countries combined, U.S. industries can realize

The tens of billions of dollars that major weapons makers receive in government R&D funding provide them with an exclusive advantage over both U.S. commercial firms and foreign weapons makers.

> economies of scale not available to their competitors. The U.S. defense research and development budget is five times that of all Western European countries combined, which ensures that U.S. weapon systems are and will remain technologically superior to those of other suppliers. The military and political ties with the United States associated with the sales are also an important benefit to many foreign countries.[33]

The Congressional Budget Office's arguments against repealing R&D recoupment charges could be applied equally to a new tax break that is being sought for U.S. weapons-exporting firms in Rep. Sam Johnson's (R-Tex.) "Defense Jobs and Trade Promotion Act of 1999." Johnson's bill, which has the strong support of the Aerospace Industries Association, would permit weapons-exporting firms to set up foreign sales corporations. The corporations would allow U.S. arms companies to shield a portion of their export profits from U.S. taxes. The tax benefit would ensure that U.S. firms would not be at a disadvantage compared with European arms companies, which pay a value-added tax on goods sold domestically but are not taxed on their exports. The Aerospace Industries Association estimated that taking full advantage of foreign sales corporations could save its member companies 15 to 30 percent of the current federal tax burden on their export profits—a move that the Congressional Joint Committee on Taxation estimates could result in $350 million in lost tax revenues over the next five years.[34]

Major contractors often receive government-built plants and equipment at little or no cost through government-owned, company-operated facilities.

Furthermore, asserting that "putting defense and non-defense companies on the same footing would encourage defense exports that would promote standardization and interoperability of equipment among our allies," Deputy Secretary of Defense John Hamre has supported Johnson's approach.[35] Like recoupment fees, the fundamental issue raised by Representative Johnson's bill is whether—as Hamre put it—defense and non-defense exporters are "on the same footing" in terms of their treatment by the U.S. government. A cursory look at the facts suggests that the answer is a resounding no. There are no other commercial enterprises that receive the massive R&D and procurement contracts that arms manufacturers receive. Unlike many weapons producers, no commercial firms receive free or low-cost production equipment and facilities from the government. And only the arms industry receives $7.9 billion per year in grants, subsidized loans, and promotional support to help sell its wares on the international market. Considering those massive subsidies to weapons manufacturers, granting additional tax breaks to an industry that is being so pampered by the U.S. government makes no sense. As the Presidential Advisory Board on Arms Proliferation Policy recommended, a top priority of U.S. arms export policy should be to "support the goal of reducing or eliminating subsidies on a global basis."[36] Changes in policies on recoupment fees or the tax treatment of arms sales should be dealt with as part of a larger review of U.S. government subsidies for military exports.

Financing and Aid Programs of Other Government Agencies

In addition to Pentagon programs, other agencies provide subsidies for sales of weapons.

Economic Support Funds: Indirect Subsidies for Arms Exports. After the Pentagon's FMF program, the second-largest stream of subsidies for U.S. arms makers and their clients comes from the ESF program. The program is administered by the Agency for International Development and funded out of the international affairs budget (which is distinct from the Pentagon budget). ESF, which has been funded at over $2 billion per year throughout this decade, provides to major U.S. security partners cash assistance, financing for imports of commodites, and a small amount of funding for specific projects. Because 90 percent of ESF funding goes to major importers of U.S. arms, such as Israel, Egypt,

and Turkey, the principal effect of the program is to help those nations defray the costs of purchasing weaponry from U.S. companies. As a matter of U.S. law, Israel is allowed to use ESF funding from the United States to write down its outstanding loans from the U.S. government for purchasing arms. In the case of Turkey, virtually all of its ESF funding over the past decade has come in the form of cash payments in amounts that correspond almost exactly to the level of that nation's outstanding military debt to the U.S. government. And even in Egypt, where some ESF money is earmarked for specific projects or imports of commodities, the funding still has the effect of freeing other government funds to be used to sustain Egypt's ongoing program of purchasing major weapons systems from U.S. companies.[37]

In the FY99 budget ESF funding was set at $2.4 billion. In recent years 23 countries have been served by ESF. For FY99 major recipients include Israel ($1 billion), Egypt ($775 million), Jordan ($150 million), and the Palestinian Authority in the West Bank and Gaza Strip ($75 million).[38] (In Table 1, only about 85 percent of the total ESF funds were counted as subsidies to U.S. arms exporters because approximately 15 percent of the aid was not an offset for the cost of weapons purchases by major buyers of U.S. munitions.)

"Dual Use" Funding: Military-Related Loans by the Export-Import Bank. Another source of funding for military exports is the U.S. Export-Import Bank (Ex-Im Bank). For over two decades, the bank was prohibited from financing military exports. That ban resulted from abuses of the agency's loan programs for military purposes during the Vietnam War. But starting in the late 1980s, arms industry lobbyists succeeded in getting Ex-Im Bank back into the business of financing arms sales.

The bank's funding of military exports has included a $1.3 billion loan for the sale of Sikorsky Black Hawk helicopters to Turkey and a $1.4 billion loan for Raytheon's SIVAM radar project in Brazil. Other significant Ex-Im Bank loans in recent years have included $44 million to Indonesia for spare parts for U.S.-supplied military transport aircraft and Textron Bell 205A helicopters. The biggest commitment in recent years was a $90 million loan to Romania for the purchase of five Lockheed Martin FPS-117 radar systems.[39] For the four years from FY95 through FY98, Ex-Im Bank also approved loans worth a total of $326 million for civilian items that had a military use. The taxpayer subsidies used to float those loans totaled more than $33 million.

Arms Sales Promotion at the Pentagon and State and Commerce Departments

In addition to providing grants and subsidized loans to U.S. weapons-exporting firms, the Pentagon and the State and Commerce Departments provide extensive marketing assistance to those companies.

At the Pentagon, promotional activities for arms sales are centered in the DSCA, which is involved in promoting, brokering, administering, and financing billions of dollars' worth of arms sales annually under the FMS program. In FY96, the agency and the military services had 5,877 personnel involved in those activities at a cost of $378.2 million. As noted above, the Pentagon's arms sales activities are funded by a surcharge on FMS deals brokered by the agency. As the post–Gulf War boom in U.S. arms sales has died down, U.S. exports have settled into a range of roughly $12 billion to $15 billion per year—down from the near record level of $33 billion in 1993. That lower sales volume, combined with a move by some companies and countries to buy major weapons on the commercial market, has led to a sharp drop in the value of the FMS surcharges that have traditionally been used to finance DSCA. As a result, DSCA is now in a budget crunch, which has prompted the Pentagon to consider restructuring the agency and the FMS program. In any restructuring, DSCA should be funded out of the budget instead of being financed from fees on FMS sales. That reform would facilitate congressional scrutiny. The change might also make it easier to

Subsidies for military contractors to defray the costs of merging with or acquiring other firms have cost taxpayers over $1 billion.

Over the past four years, Congress has added a cool $30 billion to the Pentagon budget—mostly for big-ticket weapons systems built in the districts or states of congressional leaders.

separate the appropriate regulatory aspects of the FMS program (for example, making sure U.S. sophisticated weapons are not sold to outlaw states) from the promotional, pro-sales activities that have been encouraged in part because DSCA's entire budget is dependent on posting a relatively high volume of FMS sales every year.[40]

The State Department, which is supposed to be the lead policymaking body in the federal government on arms sales, has a split personality concerning military exports. The department's bureaus on human rights and arms control are often voices for restraint on sales of particular dangerous technologies or on exports to particularly repressive regimes. But the department's Office of Defense Trade Controls, which oversees the licensing of commercial export of items on the U.S. munitions list, was "retooled" during the Bush administration to be more "transparent and user-friendly." The new openness redounds to the benefit of U.S. arms-exporting firms—*not* to the average taxpayer, who may have concerns about the kinds of regimes that are getting U.S. military technology. Ever since the Bush administration, State Department personnel at overseas embassies have been graded for promotion in part on how helpful they are to U.S. defense firms. Furthermore, the department coordinates the Defense Trade Advisory Group—a panel made up almost exclusively of executives from weapons-exporting companies—which has had great influence in recent years on such issues as lifting the ban on sales of advanced U.S. combat aircraft to Latin America (just one of many matters on which the Clinton administration took the Defense Trade Advisory Group's advice). A conservative estimate of State Department resources devoted to arms export promotion is $3.7 million and 75 personnel.[41]

The Commerce Department also plays a significant role in pitching U.S. defense equipment to foreign buyers. Since the late Ron Brown took over as secretary of commerce in the first Clinton term, promoting sales of U.S. defense equipment has become part of the secretary's job description and an important item on the agenda of many of the department's foreign trade missions. The department's Office of Strategic Industries includes a "defense advocacy" function that promotes arms exports both within the U.S. government and with potential foreign buyers. The office has also published a series of "defense market assessments," which give U.S. firms detailed data on the state of the arms market in key regions such as Europe, Asia, and Latin America. The assessments also provide step-by-step instructions on how to do business in those regions. The following excerpt from the department's description of "How to Do Business in Indonesia" gives a flavor of the agency's attitude toward foreign arms sales:

> Sales to the Indonesian military require the use of a local agent. . . . Companies will need to identify an appropriate military products manager, often a retired military official. . . . The local representative or agent can set up appointments with projects officers, and market, promote, and demonstrate defense products on behalf of the manufacturer. Selecting the right agent is a critically important step for your company, and assistance with preliminary selection can be provided by the USF&CS [the Commerce Department's U.S. Foreign and Commercial Service].[42]

Given recent revelations about the levels of cronyism and corruption in Indonesia prior to the downfall of the Suharto regime in 1997, the matter-of-fact tone of the Commerce Department's advice on finding former Indonesian military officers to help U.S. weapons exporters market their wares in Jakarta is stunning. The Commerce Department's dismissive attitude toward human rights in Indonesia is equally troubling:

> Instances of human rights abuses have given rise to concern in the U.S.

from time-to-time, the most significant being the decision of Congress to suspend military training assistance in 1992, *but the overall relationship provides opportunities for U.S. defense companies to benefit from the pace of economic growth and concomitant defense needs of the Armed Forces of the Republic of Indonesia (ABRI)*.[43]

In short, the Commerce Department's message to arms exporters is to not worry about congressional human rights concerns because money can be made in Indonesia. Now that the Suharto regime's persistent corruption and repression have resulted in a full-fledged political and economic crisis in that country, the Commerce Department's implication that U.S. companies doing business there should essentially go along with the atmosphere of influence peddling and repression looks painfully shortsighted.

The Commerce Department's most important role in the marketing of U.S. weapons systems, though, is as the lead organizer for U.S. participation in overseas arms shows such as the Paris, Farnborough, and Singapore air shows and the FIDAE (Chile) and IDEX (Abu Dhabi) weapons exhibitions. But since the agency receives important support in those efforts from the Pentagon and the military services, the issue of U.S. government participation in weapons exhibitions deserves separate treatment.

Promotion of U.S. Weaponry at Air Shows and Military Exhibitions

The Clinton administration is following its predecessor not only in pressing embassy personnel into service on behalf of U.S. weapons exporters but also in promoting weaponry at air shows. The 1991 Paris Air Show (held just three months after the end of the Persian Gulf War and one month before a major meeting at which the "Big Five" weapons-exporting countries were to discuss limits on arms sales to the Middle East) marked the first time in years that the U.S. government sent large numbers of military personnel and government-owned weaponry to an overseas air show. That practice—known as "direct Pentagon participation"—has since become routine. U.S. fighter planes, helicopters, and even F-117 stealth fighters and the B-2 bombers are now frequently sent to foreign air shows at taxpayer expense. Accompanying the aircraft are large delegations of U.S. military pilots, security personnel, and government public relations representatives. As Charles Sennott documented in the *Boston Globe,* U.S. pilots who are sent to overseas weapons exhibitions testify about how well an aircraft or helicopter performed in combat, which is an invaluable marketing boost to U.S. weapons makers.[44]

During FY96, the Pentagon sent equipment and personnel to 19 overseas weapons shows at a cost of more than $5.1 million. But many of the costs of U.S. participation are hidden. For example, the price of transporting weaponry and replacing lost or damaged equipment is routinely excluded from the cost estimates that the department submits to Congress for military participation in weapons shows. But even a rough estimate of the full costs of fuel, transport, insurance, and salaries of personnel suggests that the Pentagon's projections of its participation costs in such shows are off by a factor of at least twenty.[45]

Defense pork wastes billions of dollars that could be put to more productive uses, such as returning some of the funds to the public through a tax cut.

Absorbing Risks: Government Funding for R&D, Factories, and Equipment

As noted in the previous section, U.S. weapons makers benefit from massive government subsidies well before the firms are in a position to offer finished weapons systems on the world market. The subsidies begin at the earliest stages of R&D. Three-quarters of the federal government's R&D budget is devoted to military projects. The bulk of those funds goes to private contractors. During the 1990s Pentagon spending on research, development, testing, and evaluation of weapons systems has averaged in excess of $35 billion per year. Since 1981 the government has spent over $500 billion on military R&D.[46] In addition to those gener-

U.S. taxpayers should ask why arms dealers and foreign nations are being subsidized to conduct arms transfers, some of which could cause regional conflicts or instability.

ous R&D subsidies, major contractors often receive government-built plants and production equipment at little or no cost through Government-Owned, Company-Operated (GOCO) facilities. So when a major firm like Lockheed Martin or Boeing undertakes a major weapons program, the company can rely on the taxpayers to shoulder virtually all the major financial risks involved in developing that system.

Government Funding of R&D

Military R&D is a big business for military contractors. In FY98 each of the Big Three weapons makers received over $1 billion in R&D funding—Lockheed Martin led at $4.8 billion, followed by Boeing at $2.2 billion, and Raytheon at $1.1 billion.[47] No other private company could even dream of receiving anywhere near those levels of government support for basic research and product development.

Some level of government support for R&D of defense equipment may be appropriate. But when the government begins investing billions of dollars in a project, an irresistible political momentum to build and deploy that system can be created, even if the system does not meet an urgent security need. For example, the Air Force's state-of-the-art F-22 fighter plane (a $64 billion program) has built up such a strong congressional constituency during its extended and costly R&D phase that it will be extremely difficult to eliminate, even though the aircraft is redundant and not needed in the current benign international security environment.[48] As noted above, the U.S. armed forces are developing three new fighter projects (the F-22, the F/A-18E/F, and the Joint Strike Fighter) at a time when many analysts believe that current U.S. fighters are more than adequate to defeat any likely adversary for at least another 15 years.

Similarly, the staying power of the Pentagon's ballistic missile defense efforts may have been partly the result of the huge quantities of taxpayer funding that have gone into those programs: an average of $3 billion to $4 billion annually in recent years and a total of $55 billion since Reagan's March 1983 "Star Wars" speech. Little evidence suggests that the recent upsurge in support for missile defenses is based on any great technical breakthrough in this area—85 to 90 percent of the tests of missile interceptors conducted during this decade have failed. In one high-profile project involving Lockheed Martin's Theater High Altitude Area Defense system test failures have occurred in six out of seven attempts. The problems with the project have been so severe that the Pentagon considered removing Lockheed Martin as the prime contractor or merging the Theater High Altitude Area Defense program with the Navy's Theater Wide Missile Defense effort.[49] The R&D efforts for missile defense are so sizable that Congress and the taxpaying public have inherent difficulty sorting out the pork from the useful research.

At a minimum, the sheer size (and decidedly mixed results) of the Pentagon's multibillion-dollar annual R&D effort suggests a need for greater scrutiny of private contractors' spending of taxpayer money. One useful step would be to give more clout to the Pentagon's independent Office of Operational Testing and Evaluation, which has provided extremely useful critiques of major programs like the ballistic missile defense effort.[50] Another step would be to fund smaller firms to do simulations of potential new systems and evaluations of the R&D efforts of military behemoths like Lockheed Martin, Boeing, and Raytheon. And when a project is plagued by repeated failures and cost overruns, the public should put pressure on Congress and the executive branch to cancel the program.

However the Pentagon approaches management and oversight of R&D, one point is clear: the tens of billions of dollars that major weapons makers receive in government R&D funding provide them with an exclusive advantage over both U.S. commercial firms *and* foreign weapons makers (which receive nowhere near the same levels of R&D sup-

port from their own governments). That R&D advantage should be factored in when Congress and the executive branch consider requests from the arms industry for additional favors from the government, such as tax breaks or export subsidies.

Government Funding for Factories and Equipment

Major military contractors like Lockheed Martin and General Dynamics also benefit from low- or no-cost government-supplied equipment and factories. In some cases, the government-owned facilities, known as GOCOs, have their origins in the transfer of government-built plants to private contractors during the demobilization that occurred after World War II. Beyond providing four walls and a roof, the Pentagon often picks up the tab for complex pieces of production equipment, such as multiple-axis machine tools or automated painting machines. The largest GOCOs are Air Force Plant 6, which forms part of Lockheed Martin's F-16 production complex in Fort Worth, Texas, and the two massive M-1 tank plants run by General Dynamics in Warren, Michigan, and Lima, Ohio. In exchange for the use of government-furnished facilities and equipment, the contractors pay modest leasing fees. As of this writing, a full accounting of the number and cost of GOCOs that are being provided to private military contractors is not available. However, in 1981, the last time a full accounting was done—in Gordon Adams's *The Iron Triangle,* a classic account of the politics of Pentagon contracting—GOCOs were widespread and encompassed over a dozen major facilities with hundreds of thousands of feet of floor space.[51]

In any comprehensive review of government subsidies for weapons makers, the Pentagon should provide Congress and the public with an accounting of government-provided plant and equipment, including an estimate of the value of those assets to the private contractors that benefit from such arrangements. The availability of government-furnished production resources might make more difficult the closure of unneeded production lines and the reorientation of the defense industrial base to the demands of an information-based "revolution in military affairs." If the contractors had to assume more of the costs of those facilities, they might be less resistant to changes in contracting patterns and more amenable to embracing the next generation of weaponry.

Further Risk Absorption: Pentagon Subsidies for Defense Industry Mergers

One of the most blatant federal subsidies for military contractors is a relatively new phenomenon: the provision by the Pentagon of so-called restructuring costs to weapons companies to help them defray the costs of mergers and acquisitions with other defense firms. Over the past several years, this new subsidy for consolidation of an oversized defense industrial base has cost taxpayers well over $1 billion. But such consolidation could have been carried out without government financial assistance.[52] Mergers and acquisitions occur naturally in any industry with declining demand (the budget for weapons procurement has declined since the end of the Cold War) because companies profit from economies of scale, taking over new lines of business or reducing overhead by eliminating redundant production capacity. Such consolidation usually increases market capitalization (stock price x shares outstanding) for the companies involved, which results in a bonanza for the shareholders, without a dime of federal subsidies.

The notion that taxpayers should directly shoulder the burden for merger-related expenses—such as bonuses for top executives or the costs of shutting down factories and moving equipment—was the brainchild of then Lockheed Martin chief executive officer Norman Augustine. In the summer of 1993 Augustine raised the idea in letters to William Perry and John Deutch, who were at that time the second- and third-highest officials, respec-

Although other U.S. industries have been given some funding by the government over the years, no industry has received the consistent level of support received by the weapons companies.

Only the arms industry receives $7.9 billion per year in grants, subsidized loans, and promotional support to help sell its wares on the international market.

tively, at the Pentagon. Unbeknownst to Congress and the public, Perry and Deutch signed off on Augustine's suggestion in time for the new policy to apply to the merger of Lockheed and Martin Marietta.

When this quiet policy shift was revealed to Congress in the summer of 1994 (nearly a full year after it was implemented), many eyebrows were raised. Some members of Congress lampooned the merger payments as a boondoggle that benefited weapons industry shareholders and executives at the expense of taxpayers and those defense industry workers who lost their jobs in the downsizing that accompanied the merger. Rep. Bernard Sanders (I-Vt.), who joined with Rep. Chris Smith (R-N.J.) in an effort to curb the merger payments, dubbed the subsidies "payoffs for layoffs" because their main effect was to finance special compensation packages for defense industry executives and board members, while doing little or nothing for production workers who lost their jobs in the mergers. (For example, Lockheed Martin announced 19,000 layoffs in conjunction with the Lockheed–Martin Marietta merger.)[53]

Among the more embarrassing revelations in the payoffs for layoffs fiasco was that $31 million of the $92 million that executives and board members of Martin Marietta was to receive in special merger compensation would be paid by the Pentagon as part of the new policy of subsidizing "restructuring costs." Norman Augustine, who went from chief executive officer of Martin Marietta to the top job at Lockheed Martin within a year and a half of the merger, received $8.2 million in merger-related bonuses—of which $2.9 million was directly paid for by taxpayers. And Lamar Alexander, who ran as a populist, anti-Washington candidate in the 1996 presidential election, received a $236,000 bonus financed by the government in compensation for giving up his position on Martin Marietta's board as a result of the merger. Fiscal hawks have long criticized government spending that subsidizes inactivity, such as the practice of paying farmers not to grow crops, but Alexander may be the first person in American history to receive a government subsidy for *not* attending the board meetings of a major corporation.

The aura of impropriety surrounding the merger payments was further underscored when *Newsday*'s Patrick Sloyan revealed that both Perry and Deutch had been granted waivers from government conflict-of-interest rules in order to rule on Lockheed Martin's request for merger subsidies. The waivers were necessary because both men had lucrative financial ties to Martin Marietta prior to joining the Clinton administration in January 1993. Under normal circumstances, they would have been required to wait at least a year before ruling on any matter that would directly benefit their former employer. Perry and Deutch have since left government service and continue to profit from the merger-and-acquisition trend in the weapons industry that they helped finance while at the Pentagon. They have joined several of their other former Pentagon colleagues in a venture called Global Technology Partners, which provides advice and financing to companies interested in selling or acquiring military and high-technology firms.[54]

Although government subsidies for defense mergers have clearly been a bonanza for Lockheed Martin, Perry, and Deutch, it is hard to determine exactly how much the policy has cost the taxpayers. According to a December 1998 report by the GAO, the Pentagon estimates the costs of subsidies for seven mergers in the defense industry at $856.2 million.[55] The Pentagon's figure was undocumented and almost certainly too low. According to an article by Norman Augustine that ran in the "Outlook" section of the *Washington Post,* Lockheed Martin alone has already received over $850 million in merger-related payments from the federal government. But the unsubstantiated Pentagon estimate calculated payments to Lockheed Martin at less than half that amount—$405 million. Substituting Lockheed Martin's figure for that of the Pentagon would raise the estimate of the total

subsidies for the seven mergers to more than $1.3 billion. If the costs of subsidizing other major mergers were similarly understated, the full price tag to the taxpayer could be $1.8 billion or more.

Advocates of subsidizing mergers in the Pentagon and the arms industry argue that paying restructuring costs actually *saves* taxpayers money in the long term by encouraging weapons manufacturers to dump unproductive assets and lower their overhead costs, thereby providing cheaper weapons to the Pentagon. But according to Lawrence Korb, the current director of studies at the Council on Foreign Relations and a former top official in the Reagan Pentagon, no evidence suggests that the unit costs of *any* major weapons system have gone down as a result of subsidizing mergers. In its recent survey of restructuring costs, the GAO made the same point, albeit in a more understated fashion:

> While we determined that selected restructuring activities had lowered the operational costs of the business combinations by hundreds of millions of dollars, *it was not feasible to develop a methodology for precisely determining how contract prices were affected.*[56]

The GAO is confident that the companies have saved money as a result of the recent spate of industry mergers, but it has no way of determining how much of those savings have been passed on to the Pentagon in the form of lower prices. And according to economist Ann Markusen, the consolidation of the U.S. defense sector into essentially three big firms—Lockheed Martin, Boeing, and Raytheon—could easily result in *higher costs* to the Pentagon and the taxpayers in years to come. Those three massive industrial combinations might use the Pentagon's dearth of alternative suppliers, as well as their political clout on Capitol Hill, to press for higher prices.[57]

Whether any portion of the cost savings from mergers is being passed on to the Pentagon and the taxpayers is secondary to a more fundamental question: could those mergers have proceeded *without* government subsidies? The authors of the restructuring policy have argued that the combinations might not have occurred. In a number of instances, the government was locked into fixed-price, long-term contracts with both sides of a potential merger. According to that argument, the companies benefiting from the fixed-price arrangements would not have much incentive to merge. Even if the companies did merge, they would not necessarily close redundant facilities if they had to relinquish a steady flow of government revenue under a fixed-price contract. The validity of that argument is difficult to determine, but even if true it speaks more to the need to reform the Pentagon's contracting procedures that lock the government into those costly, long-term, fixed-price deals than it does to the value of subsidizing mergers.[58]

In summary, although the costs of subsidizing mergers in the defense industry are clear, the *benefits* of doing so are not supported with anything more than undocumented assertions on the part of the Pentagon and the major weapons manufacturers. Unless there is evidence that those subsidies hold benefits for taxpayers, the subsidies should be eliminated.

Military Pork: The Waste That Keeps on Wasting

The main reason that the Pentagon budget has been plagued by pork-barrel spending in recent years is straightforward: that's where the money is. Although the military budget has declined to 16 percent of the total federal budget, it is still very large in absolute terms—current spending on defense is roughly 85 percent of the average expenditures during the Cold War. Expenditures for defense remain at about 50 percent of federal discretionary spending (spending that is not locked in each year by legislative mandates). Once major entitlement programs like Social Security and Medicare are factored out, the Pentagon remains the "king of the hill" when

U.S. defense industries have significant advantages over their foreign competitors and thus should not need additional subsidies to attract sales.

The Pentagon predicted a few years ago that U.S. companies are likely to dominate the world arms market for years to come *with or without special government financing arrangements or tax breaks.*

it comes to federal spending. The Department of Defense is also by far the biggest source of federal funding for private companies. The department writes contracts for roughly $120 billion per year to purchase goods and services for everything from cruise missiles to paper clips.[59]

The sheer size of the Pentagon's budget for contracting virtually ensures that military spending will be a political football. Companies, constituencies, and members of Congress attempt to tilt the department's budget toward programs that benefit them. The pork-barrel politics of defense spending has been particularly egregious since the Republicans took control of both houses of Congress in January 1995. Over the past four years, Congress has added a cool $30 billion to the Pentagon budget beyond what the department requested—mostly for big-ticket weapons systems built in the districts or states of congressional leaders or members of key committees.[60]

The most conspicuous examples of pork-barrel spending are congressional add-ons and earmarks. An add-on is a project that the Department of Defense or the military services have not requested but is included in the defense budget at the request of a specific member of Congress. Add-ons often appear as part of catchall supplemental appropriations; for example, the $8.3 billion that was added to the Pentagon budget as part of the omnibus appropriations bill agreed upon by the White House and congressional leaders in October of 1998. An earmark is a project that is usually inserted by a senator or representative in an armed services or appropriations committee markup of the Pentagon budget. The main difference between an earmark and an add-on is the effect on the rest of the Pentagon budget: an add-on is *added to* everything else for which the Pentagon has requested funding; an earmark usually comes *at the expense* of other Pentagon projects.[61]

At a time when the Pentagon and the armed services are seeking additional funding for military pay, increased training, and other expenditures to improve military readiness, earmarks and add-ons can be particularly controversial. They take money that might have been used for readiness and allocate it instead to the pet projects of particular members of Congress and companies. The contradiction between congressional prerogatives and the priorities of the armed forces erupted in a congressional hearing in the fall of 1998. Gen. Henry Shelton, the head of the Joint Chiefs of Staff, chastised members of Congress for forcing the military to buy aircraft and ships that the Pentagon had not requested in lieu of other higher-priority items.[62]

Now that President Clinton has agreed to add at least $112 billion to the Pentagon budget over the next six years, public bickering between the Joint Chiefs and key members of Congress has subsided for the moment. But the question raised by General Shelton remains a valid one: does it make sense to let members of Congress front for their favorite home-state contractors in the Pentagon budget process? And—to go beyond General Shelton's point—if a program is inserted in the budget primarily to help the fortunes of a particular company, is that not corporate welfare at its worst?

Sen. John McCain (R-Ariz.), a decorated military veteran and a recognized expert on security matters, has provided a useful, albeit narrow, definition of military pork: anything Congress adds to the military budget that has not been requested by the Pentagon or the military services in their budget submissions. (That definition excludes huge amounts of pork already built into the Pentagon submissions, for example, weapons that are unneeded or left over from the Cold War.) McCain argued that the last few years have been plagued by the "worst military pork" that he had seen during his tenure in the Senate. McCain estimates that his colleagues on Capitol Hill added at least $4.5 billion in unnecessary spending to the FY99 military budget.[63]

Pork-barrel politics is a bipartisan pursuit. In the deliberations over the FY99 budget, Senate Majority Leader Trent Lott (R-Miss.) inserted $94 million for a space-based laser

program based in his home state of Mississippi and a $50 million down payment on a $1.5 billion helicopter carrier that will be built at a shipyard in his hometown of Pascagoula, Mississippi. Former speaker of the House Newt Gingrich was instrumental in adding seven C-130 aircraft to the budget, at a cost of nearly $400 million. Senator Lott is a C-130 booster as well; of the more than two dozen C-130s that Congress has added to the military budget in recent years, more than half will be based at Keesler Air Force Base in Mississippi.[64] Congressional Democrats haven't exactly been sitting on their hands in the race for military pork. At a cost to taxpayers of $258 million, Senate Armed Services Committee member Daniel Inouye last year inserted in the Pentagon budget 31 separate projects for his home state of Hawaii. And Rep. John Murtha (D-Pa.) has joined with his home-state Republican counterparts Rep. Joseph McDade and Rep. Curt Weldon to secure extra funding for Pennsylvania-based projects, including $25 million for the Q-70 radar system and $78 million for the V-22 "tiltrotor" aircraft for the Marines.[65]

Military pork increases the revenues of major contractors by extending the production runs of weapons systems that the Pentagon had hoped to terminate. Corporate profits are particularly high when a "mature" production line (production costs have been reduced over time) can be kept open. The payback for legislators is twofold: not only do they get hundreds of thousands of dollars in campaign contributions from the contractors, but they get to claim credit for bringing to their states and districts high-profile contracts that produce jobs. But this self-serving process has serious costs. First, defense pork wastes billions of dollars that could be put to more productive uses, such as returning some of the funds to the public through a tax cut. Second, pork undermines security by distorting the spending patterns within the Pentagon budget.

The C-130 transport aircraft illustrates how a seemingly innocuous add-on can become an example of egregious waste. Since 1978 the Air Force has requested a total of *five* C-130s, but Congress has purchased *256.* That 50-to-1 ratio of aircraft purchased to aircraft requested may well be a record in the annals of pork-barrel politics. Congress has been buying C-130s at such a rapid pace since 1991 that the Air Force has been forced to retire 13 perfectly capable C-130Es, each of which has more than a dozen years of useful life remaining. In addition, according to the GAO, because Congress never budgeted the funds needed to operate the extra C-130s, the Pentagon will have to come up with an additional $1 billion to operate and maintain those aircraft over the next six years.[66] Unrequested fighter aircraft, helicopters, combat ships, submarines, and even ballistic missiles can eat up tens of billions of dollars in procurement and operations funding each year.

Pork-barrel politics is not limited to the relatively small portion of the Pentagon budget that is added by members of Congress. Some critics have argued that entire programs—such as the three new fighter projects in the Pentagon's budget—are sustained by parochial politics. Although a defense project can be both necessary and lucrative, another important question must be asked: how many fighter aircraft, bombers, attack submarines, combat ships, and other items are being supported at artificially high procurement rates merely to keep the contracts flowing to key companies and communities? A full discussion of what might be called "redundancy pork"—weapons spending that exceeds what is needed for national defense—goes beyond the scope of this paper, but the concept is worth keeping in mind as Congress and the public scrutinize the nation's current military buildup.[67]

A comprehensive review of changes in Pentagon contracting from the peak of the Reagan buildup in 1986 through the spending "trough" in 1996 suggests that steering projects to the states and districts of key members of Congress has become a driving force in defense procurement. Over that time period, the total value of Pentagon contracting declined by 36 percent, but nine states managed to *increase* the value of their total

U.S. taxpayers are doling out billions of dollars in corporate welfare to the defense industry under the veneer of national security.

Ways need to be found to ensure that substantial portions of the defense budget are not squandered on profligate subsidies that are not the best investments for the security of the nation.

Pentagon contracts: Idaho (58.9 percent), West Virginia (48.8 percent), South Carolina (47 percent), Virginia (43.9 percent), Nevada (41.9 percent), Missouri (24 percent), Nebraska (21.5 percent), Colorado (18.7 percent), and Maine (5.5 percent). All of the nine "winning" states in the Pentagon contracting wars were represented by senior members of Congress on the armed services committees or the defense subcommittees of the appropriations committees.

The winning states also had some of the most powerful members of Congress acting for them: West Virginia, represented by Robert Byrd, a master of pork-barrel politics who serves on *both* the armed services and defense appropriations panels; South Carolina, which has two senators that are members of the Senate Armed Services Committee—Democrat Ernest Hollings and Republican and former committee chairman Strom Thurmond—and the chairman of the House Armed Services Committee, Republican Floyd Spence; and Virginia, home to John Warner, Senate Armed Services Committee chairman, and Charles Robb, senior Democratic Armed Services Committee member. The ability of those key members to "bring home the bacon" is a testimony to the power of pork-barrel politics in shaping decisions on military procurement.[68]

Although it would be naive to think that politics can be removed from defense contracting, the distorting impact of military pork suggests the need for reform. One approach might be an analogue to the moderately successful BRAC process that has been helpful in closing unneeded military bases. Under BRAC, an independent commission draws up a list of unneeded facilities, and then Congress is required to vote up or down on the whole list. The process avoids the kind of congressional horse-trading ("I'll vote to keep your base if you vote to keep mine") that made base closures so difficult in the past. Unfortunately, President Clinton violated the spirit of the BRAC process during the run-up to the 1996 elections when he announced that he would "privatize" bases that had been slated for closure in the vote-rich states of California and Texas. In response to Clinton's self-serving actions, Senator Lott and Senate Minority Leader Tom Daschle (D-S.Dak.) got a bill passed that put the entire BRAC process on hold.[69] Nonetheless, when it was in operation, BRAC was moderately effective in short-circuiting pork-barrel politics.

A similar principle might be applied to weapons systems: the creation of an independent panel that would take input from the military, the White House, and both parties in Congress. Each year, the panel would create a list of unneeded weapons; the list could then be voted up or down in its entirety by Congress. The visibility of the process might embarrass members into public votes against weapons that they would have been willing to slip into the budget in the dead of night.

Conclusion

Weapons manufacturers are not ordinary companies. They operate in a very specialized market with one customer—the government. Given the cost and complexity of the systems they produce and the limited market for those items, the expectation that weapons makers could operate in a totally free market is unrealistic. Defense companies will probably always be dependent on the government for research funds and procurement contracts.

The wide array of government subsidies for arms makers described in this paper raises a number of issues. U.S. taxpayers are doling out billions of dollars in corporate welfare to the defense industry under the veneer of national security. Overly generous subsidies to arms makers actually reinforce poor performance. Ways need to be found to scale back, restructure, or even eliminate government subsidies for weapons makers to give those companies greater economic incentives to produce quality products at more affordable prices.

Such important issues need to be addressed to ensure that substantial portions of the defense budget are not squandered on politically driven projects or profligate subsidies that are not the best investments for the future security of the nation.

Notes

1. Information on proposed military budget increases is drawn from Office of Assistant Secretary of Defense for Public Affairs, "Department of Defense Budget for FY 2000," Press release, February 1, 1999; and Philip Finnegan, "U.S. Lawmakers Arm for Budget Offensive," *Defense News*, February 8, 1999.

2. Data on military prime contracts are calculated by the author and are based on statistics from the U.S. Department of Defense, Directorate of Information, Operations and Reports, *100 Companies Receiving the Largest Dollar Volume of Prime Contract Awards—Fiscal Year 1998* (Washington: U.S. Department of Defense, 1999).

3. Statistics on pay and increases in procurement in the FY 2000 budget are from "Department of Defense Budget for FY 2000."

4. For an overview of recent subsidies and other favorable policy changes obtained by military contractors, see William D. Hartung, "The Military Industrial Complex Revisited: How Weapons Makers Are Shaping U.S. Foreign and Military Policies," *Foreign Policy in Focus*, November 1998, www.foreignpolicy-infocus.org.

5. Quoted in David E. Rosenbaum, "Corporate Welfare's New Enemies," *New York Times*, February 2, 1997.

6. For estimates on the costs of corporate welfare, see Donald L. Barlett and James B. Steele, "Special Report: Corporate Welfare," *Time*, November 9, 1998, www.cgi.pathfinder.com/time/magazine/1998/dom/981109/cover1.html; Dean Stansel and Stephen Moore, "Federal Aid to Dependent Corporations: Clinton and Congress Fail to Eliminate Business Subsidies," Cato Institute, Briefing Paper no. 28, May 1, 1997; Charles M. Sennott, "The $150 Billion 'Welfare' Recipients: U.S. Corporations," *Boston Globe*, July 7, 1996; and Robert J. Shapiro and Chris J. Soares, "Cut and Invest to Grow: How to Expand Public Investment while Cutting the Deficit," Progressive Policy Institute, Policy report no. 26, July 1997.

7. For another definition of corporate welfare, see Stansel and Moore, p. 2: "Corporate welfare should be defined as any government *spending* program that provides unique benefits or advantages to specific companies or industries. It includes subsidies, grants, cut-rate insurance, low-interest loans and loan guarantees, trade restrictions, and other special privileges that confer benefits on targeted firms or industries."

8. For example, in early 1997 House Budget Committee chairman John Kasich promoted a package of reductions in corporate welfare that was compiled by a right-left coalition of taxpayer and governmental reform organizations and that explicitly excluded military-related subsidies. For a description of that package, see Rosenbaum.

9. On subsidies for arms exports, see William D. Hartung, *Welfare for Weapons Dealers 1998: The Hidden Costs of NATO Expansion* (New York: World Policy Institute, March 1998). For more detail on the methodology used to arrive at the estimate of subsidies for arms exports, see William D. Hartung, *Welfare for Weapons Dealers: The Hidden Costs of the Arms Trade* (New York: World Policy Institute, 1996). Both of these publications are available in full text versions on the World Policy Institute's Web site, at www.worldpolicy.org (click on "arms control").

10. See, for example, U.S. Congress, Office of Technology Assessment, *Global Arms Trade*, OTA-ISC-460 (Washington: Government Printing Office, June 1991), pp. 30–31.

11. Secretary of State, *Congressional Presentation for Foreign Operations, Fiscal Year 1999* (Washington: U.S. Department of State, 1998), pp. 996–99.

12. Secretary of State, *Congressional Presentation for Foreign Operations, Fiscal Year 1998* (Washington: U.S. Department of State, 1997), p. 486.

13. Hartung, *Hidden Costs of NATO Expansion,* p. 3.

14. Calculations on relative military aid funding to Eastern and Central Europe are based on figures in ibid., p. 2; and "Your Tax Dollars at Work: FY 2000 Military Assistance Request," *Arms Sales Monitor,* no. 39 (February 1999): 6–7.

15. Quoted in Barbara Opall, "Pentagon Touts Loan Guarantees," *Defense News*, June 16–22, 1998.

16. Barbara Opall-Rome, "Pentagon Loan Program Faces Insolvency," *Defense News*, March 1, 1999.

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20. Paul F. Pineo and Lora Lumpe, *Recycled Weapons: American Exports of Surplus Arms, 1990–1995* (Washington: Federation of American Scientists, 1996), pp. 16–17.

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22. Secretary of State, *Congressional Presentation for Foreign Operations, Fiscal Year 2000* (Washington: U.S. Department of State, 1999), pp. 1142–46.

23. Ibid., pp. 1147–48.

24. Quoted in Douglas Barrie, "Boeing Sweetens Polish Package," *Defense News*, February 22, 1999.

25. Defense Policy Advisory Committee on Trade, "A Report Outlining U.S. Government Policy Options Affecting Defense Trade and the U.S. Industrial Base," November 1988, p. 18.

26. Calculations on the relative proportion of U.S. arms exports accounted for by the FMS program are from U.S**.** Department of Defense, Defense Security Assistance Agency, *Foreign Military Sales, Foreign Military Construction Sales, and Military Assistance Facts as of September 30, 1997* (Washington: U.S. Department of Defense, 1998).

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36. "Report of the Presidential Advisory Board," p. 16.

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48. U.S. Department of Defense, "SAR Program Acquisition Cost Summary as of September 30, 1998."

49. Colin Clark and Robert Holzer, "Pentagon to Combine Theaterwide, THAAD," *Defense News*, January 18, 1999; and "Pentagon Anti-Missile System Fails Fifth Test in a Row," *New York Times*, May 13, 1998.

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60. Data on Pentagon add-ons for FY96 through FY98 were provided by Steven Kosiak of the Center for Strategic and Budgetary Assessments. For FY99, see Tim Weiner, "$9 Billion to Pentagon, with Missile Defense," *New York Times*, October 16, 1998; and William Greider, "And the Winner Is . . . The Pentagon," *Rolling Stone*, December 10, 1998.

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