

GAO

Report to the Chairman, Subcommittee on
Investigations, Committee on Armed
Services, House of Representatives

April 1988

U.S.-KOREA COPRODUCTION

A Review of the M-16 Rifle Program



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United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-229047

April 11, 1988

The Honorable Bill Nichols
Chairman, Subcommittee on
Investigations

Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

This is an unclassified version of our issued report, U.S.-KOREA COPRODUCTION: A Review of the M-16 Rifle Program (GAO/C-NSIAD-88-11, dated January 29, 1988). Accordingly, some of the matters discussed in that report are limited in presentation in this report or they have been deleted entirely.

The report responds to your April 1987 request that we review the Republic of Korea's compliance with its Memorandum of Understanding (MOU) with the United States on coproducing the M-16¹ rifle. Specifically, we examined Korea's compliance with MOU provisions and amendments that (1) specify the number of rifles to be produced in Korea and (2) restrict the sale and transfer of rifles to third parties without U.S. government consent. We also examined U.S. government involvement in and oversight of the program.

Our findings were as follows:

- Korean M-16 rifle and rifle parts production exceeded the level authorized by the MOU, as amended.
- Korea has entered into M-16 sales agreements with third parties without prior U.S. government consent. From the information available to us, we could establish that one sale resulted in an actual delivery of rifles in 1983.

The M-16 coproduction program was part of the U.S. security assistance policy and effort to improve South Korea's self-sufficiency in defense production. The M-16 coproduction MOU concluded in 1971 served as the umbrella agreement, provided overall program objectives, and specified production and sales limits and restrictions. The MOU was implemented in 1971 by commercial licensed production and technical assistance

¹References to the M-16 rifle throughout the report relate only to the M-16A1 version.

agreements between the U.S. firm Colt Industries and the Korean Ministry of National Defense. During 1982, the ownership and operation of the M-16 plant established in Korea were transferred to Daewoo Precision Industries. The commercial agreement was later rescinded and a legal dispute developed between Colt and Korea over commercial matters, including patent rights and royalties.

According to figures submitted by the Korean government and other records, Korean production exceeded the authorized number of rifles and spare part rifle equivalents.² Defense records indicate that Korean M-16 rifle and/or parts production continued at least through 1986. However, we were unable to verify or determine the total actual production to date because Korea would not provide us with the data for the full years 1983 through 1987. Although the MOU does not specifically require Korea to provide production data to the U.S. government, some data was submitted; however, it was not independently verified.

Korea entered into M-16 sales agreements with third parties. Before entering into these agreements, Korea had not requested or obtained prior U.S. consent, as required by the MOU. Also, various sources have alleged and documented several additional incidents of Korean M-16 sales and marketing activities. From the information available to us, we could establish that one sale resulted in an actual delivery of rifles in 1983. Defense and U.S. Customs officials told us that detection of M-16 rifles and spare parts shipments and deliveries would be extremely difficult. Unlike aircraft and tanks, rifles and rifle parts can easily be disguised as other merchandise.

The 1971 MOU has not been legally terminated by mutual agreement of both parties. Since Korean production exceeded the authorized limits, we questioned the Korean government on its position regarding the status of the MOU. In a letter responding to our written questions, the Korean Ministry of National Defense, Defense Industry Bureau, expressed the view that since the M-16 patents had expired and the commercial contract had been rescinded, amending the MOU to authorize additional M-16 production in Korea was not necessary. The letter further stated that the MOU covered only the use of foreign military sales credits and facilitated the State Department's approval of the commercial licensed production agreement.

²Spare parts are counted and authorized under the MOU in terms of rifle equivalents.

Defense Department officials said that they did not agree with the Korean interpretation of the MOU and requested clarification from a high-level official in the Korean Ministry of Defense. According to the Deputy Director, Defense Security Assistance Agency, in an October 1987 meeting with higher-level Ministry officials, the Korean representatives stated that (1) they did not intend to imply that a rescinded commercial agreement negates an MOU and (2) an MOU takes precedence over a commercial agreement. Nonetheless, the issues in the case of the M-16 MOU were not addressed.

U.S. government monitoring and oversight of the program have been limited. Defense and State Department officials told us they were not responsible for managing the program. Defense directives authorize certain organizations, such as the Defense Security Assistance Agency, to negotiate coproduction agreements but are ambiguous as to which organizations are responsible for managing coproduction programs to ensure compliance. The military departments are required to submit quarterly status reports on coproduction programs to the Defense Security Assistance Agency. According to Defense officials, when an MOU is implemented by a commercial licensed production agreement, generally the U.S. company manages the program.

The U.S. Army liaison officer for the M-16 program with Korea relied on production and other information from Colt and the Joint U.S. Military Assistance Group (JUSMAG) in Korea. For production data, however, Colt and the JUSMAG relied on figures provided voluntarily by the Korean government. Once the production program was underway, for the most part, U.S. government involvement in the program was limited to responding to (1) Korean requests to amend the MOU, (2) Colt's initial requests for assistance in resolving its commercial dispute outside the court system, and (3) allegations of Korean sales of M-16 rifles to third parties. Some activity reports were written by the JUSMAG until litigation began between Colt and Korean entities. Based on our review of all available records, there is no indication these reports or all amendments to the MOU were forwarded to Defense, State, or the U.S. Army.

Because of the limited scope of our review, we could not determine if the problems we identified in this program were systemic or widespread. However, at the request of your office, we are initiating a worldwide review of U.S. management and controls over coproduction programs. In this follow-on review, we will examine these issues on a broader basis and make recommendations if appropriate.

We requested official comments from the Departments of State and Defense on a draft of this report. State provided oral comments and suggested two clarifications, which we made. Defense did not provide official comments within the 30 days required by legislation and did not request an extension. We did discuss a draft of this report with representatives of various defense agencies and, where appropriate, incorporated changes to reflect their views. Details of our findings and a description of our objectives, scope, and methodology are in appendix I.

As arranged with your office, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the Chairmen, House Committee on Foreign Affairs, Senate Committee on Foreign Relations, House and Senate Appropriations Committees, House Committee on Government Operations, Senate Committee on Governmental Affairs, and House and Senate Committees on Armed Services; the Secretaries of State and Defense; and other interested parties.

Sincerely yours,

A handwritten signature in cursive script that reads "Frank C. Conahan".

Frank C. Conahan
Assistant Comptroller General

The United States-Republic of Korea M-16 Coproduction Program

The M-16 Coproduction Arrangement

The M-16 coproduction arrangement emerged from a Republic of Korea (ROK) initiative in the late 1960s to equip its ground forces with modern rifles and achieve parity with North Korea's indigenous small arms production capability. The Departments of State and Defense incorporated the proposal into the overall U.S. security assistance program designed to (1) promote ROK self-reliance, (2) assist economic development, (3) encourage increased burden sharing, and (4) eventually reduce the U.S. military presence in Korea.

In June 1969 the U.S. government agreed in principle to establish an M-16 plant in Korea and provide foreign military sales (FMS) credits to support production equipment, raw materials, technical assistance, construction, royalty fees, and training. Colt Industries, a U.S. firm, was selected to technically implement the program. Although Colt would have preferred a direct commercial sale of M-16s, it was encouraged by the Defense Department—as a matter of U.S. policy—to enter into a licensed production agreement as part of the U.S. effort to help develop Korea's defense industrial base.

Shortly after the U.S. government decision, Colt Industries representatives began negotiations with ROK officials to produce M-16 rifles under a commercial licensing agreement. ROK was authorized 100-percent rifle manufacturing capability, involving 124 individual parts ranging from springs to buttstocks. Colt's U.S. factory produced about 12 parts, and the remaining components were manufactured by 70 vendors.

In March 1971, the U.S. and ROK governments signed the M-16 coproduction Memorandum of Understanding (MOU), which specified the total quantity of rifles authorized for production in Korea. This total included both complete rifles and rifle equivalents in spare parts. The MOU also (1) authorized \$42 million in FMS credits, (2) prohibited ROK from transferring rifles or components to a third party without the consent of the United States, and (3) could be terminated only by mutual agreement. According to Defense officials, the MOU has not been terminated.

Licensing and technical assistance agreements, also signed in 1971 by Colt and the ROK Ministry of National Defense, implemented the MOU, established royalty fees, and provided training, production know-how, and technical assistance. By the end of 1974, with the use of FMS credits, facilities had been constructed, equipment had been installed, and Korea had begun producing the rifles.

The MOU was amended on four occasions. In 1975, the Korean Ministry of National Defense requested an additional \$10 million in FMS credits to fund the escalating costs of raw materials. In July 1976, Defense approved the request and incorporated the additional \$10 million into the program. Later, the MOU was amended to cover the transfer of the arms plant from ROK ownership to Daewoo Precision Industries, a Korean civilian firm. Neither the ROK nor the private contractor was authorized to export rifles or components to a third party without the consent and prior approval of the U.S. government. As early as March 1979, the Ministry had informed the United States of its plan to transfer the arms plant to Daewoo. About one year later, Ministry officials told Joint U.S. Military Assistance Group (JUSMAG) officials that they were examining whether such a changeover would allow the contractor to increase M-16 production and export without U.S. approval. In July 1981, U.S. officials raised concerns over potential problems associated with the pending transfer, including unauthorized M-16 rifle exports. Despite these concerns, the transfer occurred and Daewoo Precision Industries assumed ownership of the plant in January 1982.

Between 1982 and 1983, problems developed between Colt and Korea over commercial issues in the M-16 program. In September 1982, Colt informed the State Department that the Ministry of National Defense had stopped paying royalty fees. The Ministry stated that payments had ceased because certain M-16 patents held by Colt had expired. Colt and the Ministry discussed the issues until early 1983 when Colt terminated the license agreement for default. The Ministry, in turn, rescinded the license agreement in February 1983 but requested that the MOU remain in effect. While the commercial agreement was rescinded, Korean capability to produce the M-16 rifle and parts remained intact. Also, by this time, Daewoo had begun producing other small arms in the plant.

MOU Provisions: Korean Compliance and U.S. Management/ Enforcement

Records from various sources, including the ROK, show that Korea has produced more M-16 rifles and spare parts than authorized by the MOU. In addition, the U.S. government's role in monitoring and enforcing the MOU provisions has been limited, apparently because the program has been considered a commercial arrangement under the purview of the U.S. company—Colt. Finally, Korea has entered into M-16 sales agreements without U.S. government consent, as required by the MOU.

**Korea Exceeded
Authorized Production
Levels**

According to the production figures included in a Korean M-16 production report submitted to JUSMAG for the period ending 1982, the authorized production level had been exceeded. We were unable to determine M-16 production levels beyond the end of 1982. The Ministry of National Defense did not provide us production information for the full years 1983 through 1987, and, in a letter responding to our questions, its Defense Industry Bureau expressed the view that M-16 production is no longer governed by MOU limits.

Defense Department officials said they did not agree with the Ministry's position and requested a clarification from the Korean government. In October 1987, the Deputy Director, Defense Security Assistance Agency met with high-level Korean Ministry officials. According to the Deputy Director, the Korean officials stated that they did not mean to imply in their letter to us that a rescinded commercial agreement negates an MOU. They stated that an MOU would take precedence over a commercial agreement. However, the Ministry did not specifically address the issues surrounding the M-16 MOU.

There are various indications that Korean M-16 rifle and/or parts production continued at least through 1986. For example, at about the same time Korea rescinded its commercial licensing agreement with Colt in February 1983, the Ministry was planning additional rifle production. We found no evidence that the Defense Department requested actual production data from Korea. However, responding to a separate, mid-1984 Defense Department requirement for information on certain U.S.-origin equipment produced in Korea,¹ the Ministry reported some additional M-16 rifle production. M-16 parts production has continued at least through 1986.

**U.S. Government Role in
the Program**

U.S. government oversight of the program has been limited. Defense and State Department officials in various agencies and locations told us that they were not responsible for managing the program. Defense directive 2000.9 authorizes certain organizations, such as the Defense Security Assistance Agency, to negotiate coproduction agreements but does not clearly assign specific responsibility for managing coproduction programs to ensure compliance. Defense Directive 5105.38 requires the military departments to submit quarterly status reports on coproduction programs to the Defense Security Assistance Agency. These reports are

¹This reporting requirement is tied to U.S. government royalty fees on production and sales of specific items.

to include information on the quantities of weapons being coproduced and any third-country sales authorized. However, we were told by Defense officials that, in practice, when an MOU is implemented by a commercial licensed production agreement, generally the U.S. company manages the program.

Defense and State Department roles in administering the M-16 coproduction program with Korea were limited mainly to responding to Korean requests for MOU amendments and to Colt's and Korea's requests for assistance in resolving the commercial dispute. The Secretary of Defense signed the MOU, and JUSMAG served as the liaison office until 1978. The liaison function was transferred to what is currently the U.S. Army Armament, Munitions and Chemical Command, Rock Island, Illinois, to monitor and coordinate the program under the MOU.

According to Defense officials, the management function was left largely to Colt. For example, although the U.S. Army liaison officer at Rock Island was responsible for preparing the Army's coproduction status report on the Korean M-16 program, he relied on Colt and the JUSMAG for production and other information. In addition, JUSMAG officials told us that they are not required to micro-manage or actively track coproduction programs in Korea where there are commercial licensed production arrangements.

Although JUSMAG's Joint Program Directorate deals with production and sales, JUSMAG officials stated that the Directorate's role in coproduction programs is limited to facilitating and coordinating the initial phases of negotiations. JUSMAG files indicate some activity reporting, but there was no indication that reports were forwarded to Defense or the U.S. Army. In addition, some amendments negotiated in Korea by the JUSMAG apparently were never sent to Defense. The offices of record at both the State and Defense Departments did not have the two most recent amendments to the MOU.

However, Colt's cognizance of and control over program activities were also apparently limited. According to Defense officials, when a government-to-government MOU and a commercial licensed production agreement are in effect for a coproduction program, the two should be closely coordinated, amended, and implemented. However, the U.S. and Korean governments agreed on production increases far in advance of Colt's amendment to the licensing agreement.

For example, one MOU amendment predated the licensing amendment with the same content by 21 months. In July 1979, when the licensing agreement was amended to permit production beyond the original quantity authorized, Korea had already exceeded that level of production. In another case, an MOU amendment predated the licensing amendment by 8 months.

The JUSMAG and the embassy assisted Colt in attempts to resolve the royalty dispute outside the courts. However, once litigation began, U.S. government monitoring of the program became even more limited. The Korean Ministry of National Defense rescinded the licensing agreement but was planning additional production. In response, the Defense Security Assistance Agency directed JUSMAG to advise the Korean government that any M-16 production beyond the amended MOU would require prior U.S. approval and further MOU amendment. JUSMAG was also instructed to remind the Korean government that the terms and conditions of the amended MOU would remain in force until terminated by mutual agreement. There was no indication in the Defense and JUSMAG records we reviewed that action was taken.

Once litigation between Colt and Korean entities began in 1984, U.S. government oversight nearly ceased. JUSMAG M-16 program activity reports were no longer prepared on a regular basis. In addition, an Army liaison officer was no longer assigned, the Army coproduction status reports were no longer updated, and the Army categorized the program as suspended or in a close-out phase. Although the MOU remained in force and Korea continued to produce M-16s/parts, Defense and State apparently saw no need to press the issue of noncompliance with the MOU production limits with the Korean government. The Director of JUSMAG's Joint Program Directorate acknowledged that overproduction would have been a violation of the MOU but said that he saw no major difficulty with Korea exceeding MOU production restrictions as long as the excess production was for indigenous use.

Unauthorized Korean M-16 Sales Agreements

The MOU clearly prohibits sales of Korean-made M-16 rifles or parts without prior U.S. consent. According to various U.S. officials, Korean M-16 marketing is not technically prohibited. Nonetheless, signing M-16 sales agreements without prior U.S. government consent is prohibited under the MOU.

Since the inception of the M-16 licensed production program, ROK has periodically attempted to obtain U.S. government approval to export

M-16 rifles. In fact, in September 1982, ROK described third-country sales of the M-16 rifle as "indispensable." ROK requests for M-16 export approval have always been denied. The ROK government has stated on several occasions that its policy is not to sell M-16 rifles or components without prior U.S. government approval.

Korea has entered into M-16 sales agreements with third parties without prior U.S. government consent. For example, in September 1983, a Korean M-16 sales agreement was concluded between Daewoo Precision Industries and a U.S. company to supply 12,500 spare parts for about \$127,000. Delivery of the parts was stopped by a court injunction brought by Colt Industries against the U.S. company. In January 1984, the State Department concluded that although no deliveries were made, Daewoo's intention to sell the spare parts was clear. As such, the agreement contravened the MOU provision prohibiting unauthorized sale of rifles and components. From information available to us, we could establish that one sale resulted in an actual delivery of rifles in 1983.

Various sources have alleged and documented several additional incidents of Korean M-16 sales and marketing activities. Defense and U.S. Customs officials told us that, unlike large end items, small arms and parts shipments and deliveries are extremely difficult to detect. For example, small arms parts being shipped from Korea could easily be listed on a manifest as general merchandise or sewing machine parts.

U.S. Government Response to Third-Party Sales Reports

The U.S. government, through the State Department, U.S. embassy, and JUSMAG, has responded to most M-16 sales allegations and reports, except the case in which rifles were actually delivered in 1983. In that case, we found no evidence that the State Department registered an official protest with the ROK government. In response to our inquiry, State said it could not determine whether it had received all the pertinent information concerning the case. In other instances, between 1983 and 1987, where sales or potentially damaging marketing activities surfaced, the State Department and JUSMAG did raise concerns with the ROK government. According to State and JUSMAG officials, however, the United States has never delivered a demarche—a strong official protest—to the Korean government over M-16 rifle sales.

When State was informed of Daewoo's 1983 contract with a U.S. firm to sell M-16 spare parts, State instructed the U.S. embassy to (1) request an explanation from the Koreans concerning the apparent violation of the MOU and (2) remind Korea of the seriousness attached to unauthorized

transfers. In response to another case, State instructed the U.S. embassy, Seoul, to remind appropriate ROK officials of government-to-government and commercial documents that prohibit sale of M-16s to third countries without U.S. government approval. State also pointed out that the Koreans should not market items without prior U.S. consent.

JUSMAG officials told us that the JUSMAG role does not include actively checking or reporting on third-country sales. They stated that their role is to coordinate with their Korean counterparts when allegations are made by other entities or a demarche is to be delivered at the military level. For example, in March 1987, JUSMAG presented allegations to the Ministry that primarily concerned a November 1986 M-16 sales agreement for spare parts. JUSMAG stated to the Ministry that "should this allegation prove to be true or appear to be true, great damage to ROK-US relations could result." The Ministry denied authorizing the sale. JUSMAG officials said that they did not have the technical expertise to determine the validity of the documentation and did not pursue the matter further.

Objectives, Scope, and Methodology

Our objectives were to (1) examine ROK compliance with the MOU provisions restricting production and third-party sales of the M-16 rifle and (2) review U.S. government involvement in managing the coproduction program.

We conducted our review from April to September 1987 in Washington, D.C.; the U.S. Pacific Command; and the Republic of Korea. We obtained information from the Departments of State and Defense and other federal agencies, the U.S. embassy and the Joint U.S. Military Assistance Group in South Korea, and Colt Industries. Korean government and Daewoo officials would not meet with us but did provide some information in response to our written inquiry. The MOU states that each government will provide the other with reports, technical information, and access to facilities "as may be necessary to ensure the orderly and successful accomplishment of the Program." However, the MOU does not explicitly require the Korean government to produce or permit access to its program records. The Korean government has chosen to interpret this provision conservatively. As a result, we were unable to independently verify production information.

Except for the lack of verification of production information, our work was performed in accordance with generally accepted government auditing standards.

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