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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20543

74-0123

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AUG 8 1973

B-156489



The Honorable Harry F. Byrd, Jr.  
United States Senate

Dear Senator Byrd:

In your letter of March 30, 1973, you requested our comments as to the accuracy of the \$4.1 billion balance of payments offset figure stated in testimony by the Secretary of Defense. The figure was related to U.S. participation in the North Atlantic Treaty Organization (NATO) for fiscal years 1972 and 1973.

The Department of Defense (DOD) has apparently changed its position regarding the offset figure as you pointed out on the floor of the Senate (Congressional Record - June 8, 1973). This change reflects the annual adverse balance of payments cost in NATO as \$1.5 billion, as compared with the \$200 million annual deficit previously cited. Irrespective of the position change, your office advised us on June 27, 1973, that an analysis is still desired from the General Accounting Office as to the accuracy of the \$4.1 billion.

The \$1.5 billion figure is more in line with a \$1.7 billion one which we computed from Department of Commerce data (enclosed) for calendar year 1972, and is in general agreement with testimony by a Department of State official at appropriation hearings before the Senate Committee on Foreign Relations in April 1973.

On April 17, 1973, we provided to you the composite elements of the earlier \$4.1 billion figure taken from DOD data sheets. The net U.S. adverse balance of payments impact relating to U.S. participation in NATO as computed by DOD for fiscal years 1972 and 1973 was as follows:

	<u>Billions</u>
Gross DOD expenditures in NATO	\$ 4.5
Total DOD offset	-0.4
Net adverse balance	\$ 0.4

The \$4.1 billion figure is not, in our opinion, an accurate measure of offsets to DOD balance of payments expenditure in NATO. While some of the elements in this offset figure are accurate, in

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our opinion other elements lack relationship as defense offsets and are not accurate in the dollar amounts stated.

Balance of payments concepts include a substantial variety of economic theories related to total international transactions. Contrasted with the 2-year \$400 million net DOD deficit presented by the Secretary of Defense, we have recently updated an analysis which indicated a \$1.7 billion foreign exchange cost for calendar year 1972 alone.

We are enclosing this analysis for your use. It does not include some of the offsets used by DOD; however, it is a conventional measurement of net deficits recognized by the Department of Commerce.

GROSS DOD EXPENDITURES  
IN NATO - \$4.5 BILLION

DOD data indicate that gross U.S. military expenditures in NATO for fiscal years 1972 and 1973 were \$4.5 billion. These expenditures consist generally of:

- expenditures for U.S. military and civilian personnel and their dependents;
- expenditures for foreign goods and services by nonappropriated fund activities;
- direct and contract hire of foreign nationals;
- procurement including major equipment, construction, petroleum and oil and lubricants, materials and supplies;
- services; and
- other payments.

DOD computations did not take into consideration:

- accounts into which deposits are made in the United States but from which checks are drawn by European banks;
- cashed savings bonds;
- money which is spent by forces from funds sent by parents for special trips or purchases; and
- savings accounts which may be expended by personnel apart from pay received.

DOD OFFSET ITEMS

As indicated in your letter, DOD has stated that the above expenditures are offset by \$4.1 billion, computed by DOD as follows:

<u>DOD Computed Offsets</u> <u>Fiscal years 1972 and 1973</u>	(Billions)
Cash receipts from NATO military purchases in the United States	\$1.5
Cash receipts from NATO commercial military purchases in the United States	.5
Increased U.S. exports from U.S. expenditures in Europe	.9
Purchase of U.S. securities by Germany	.7
Barter exports offsetting U.S. defense expenditures overseas	<u>.5</u>
Total DOD computed offsets	\$4.1

Described below is our analysis of each element in the DOD computation.

Cash receipts from NATO military purchases in the United States - \$1.5 billion

The DOD explanation of the \$1.5 billion figure attributes \$900 million to German military purchases and \$600 million to the remaining NATO allies.

The \$600 million figure from other NATO allies is based on actual receipts of about \$300 million from these nations during fiscal year 1972 plus an assumed like amount during fiscal year 1973. We examined DOD figures for cash receipts from the other NATO countries during fiscal year 1972 which indicate the \$300 million amount is correct.

We have no basis for commenting upon DOD's assumption that such receipts for fiscal year 1973 will be a like amount, but believe it to be a fair projection.

DOD officials indicated, however, that the \$900 million German portion is not derived from actual cash receipts in accordance with their standard footnote on receipts.

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We believe the \$900 million in DOD cash receipts from Germany during fiscal years 1972 and 1973 is misleading because the DOD explanation for this figure does not point out that, under the terms of the offset agreement, over one-half (about \$517 million) of the total payments will be financed from funds on deposit with the U.S. Treasury prior to fiscal year 1972, since the German funds on deposit are used to offset military purchase prepayments made prior to the agreement period. We do not believe that the portion on deposit should be considered as an applicable offset for fiscal years 1972 and 1973.

Cash receipts from NATO military purchases in the United States  
(direct commercial) - \$2.5 billion

DOD estimates that receipts through commercial sales channels during fiscal years 1972 and 1973 will be \$300 million from Germany and \$200 million from other NATO countries. Our examination of DOD and Bureau of Census figures detailing such purchases during part of the period in question and before indicates that the estimates are not inflated and, in our opinion, may be somewhat conservative.

DOD instructions direct that the commercial sales of military equipment will be reported as DOD balance of payments transactions if "DOD has exercised a 'demonstrable influence' which has presumably resulted in increasing commercial exports of military materiel." It is questionable, however, that all such DOD-influenced commercial purchases of military materiel are even an indirect result of our defense expenditures in those countries. We believe that a substantial amount of these commercial sales would be made no matter what the level of DOD expenditures. For example, France has continued to make commercial military purchases without substantial U.S. defense expenditures there.

Increased U.S. exports from DOD expenditures in Europe - \$2.9 billion

DOD also states that 40 percent of the \$4.5 billion of U.S. defense expenditures are assumed to return to the United States through exports to Germany and other NATO countries. They state that since about 1962 under offset agreements, Germany generally has been given credit for a 30 percent feedback effect. There is no reference to such a feedback effect in the agreements themselves, and DOD was unable to provide us with documentation of the figure in offset negotiations. The only justification furnished was a 1965 study based on data prior to 1963 which estimated the effect of U.S. defense spending in Western Europe on those nations' imports from the United States.

One example of the study's findings was that a reduction of 210 million in DDB spending in Germany would result in a 31.9 million reduction in Germany's trade with the United States. From this, DDB indicated that 20 percent of U.S. defense expenditures in Germany are returned by exports to Germany in addition to military sales levels sustained in offset agreements. This 20 percent feedback is extended to the rest of Western Europe under the same assumptions.

Although it is difficult to assess the actual return from U.S. defense expenditures in terms of feedback to the economy, we have been advised by an expert in the field of balance of payments that in both 1971 and 1972 Germany reported less than 2 percent of its gross national product from the United States. We were not able to find any basis for the assumption that income derived from one source (i.e., U.S. defense expenditures, which constitute a portion of the German gross national product) should return more to our economy in terms of goods exported than any other source.

A recognized authority on international economics, while testifying before Congress on this issue, expressed the opinion that while U.S. defense expenditures do create an impact and a consequent significant feedback effect on underdeveloped areas, the same does not hold true for developed areas. Also it is interesting to note that while both Germany's gross national product and U.S. defense expenditures increased from 1971 to 1972, U.S. exports to Germany decreased.

There may be other factors which could account for the aforementioned decline in U.S. exports to Germany, but it appears that if the 20 percent feedback effect were accurate, it would have had some increasing effect on U.S. exports to Germany.

Purchase of U.S. Securities by Germany - 1972, 1973

Under the terms of the current offset agreement between the United States and Germany, the German Central Bank is to purchase approximately 260 million of 4-1/2 year, 7-1/2 percent U.S. Treasury securities during the next year (1973 and 1974). In addition, about 130 million is to be paid to the United States by Germany in settlement of the U.S. interest obligations on the securities. These amounts were rounded by DDB to 200 million and were considered an additional offset to the balance of payments deficit.

Information provided by the Department of Commerce shows that during fiscal years 1972 and 1973, the German Central Bank purchased about 200 million worth of Treasury securities under the current

offset agreement. During this same period, Germany has redeemed approximately \$635 million worth of securities purchased under the 1968 and 1969 agreements. While DOD includes the purchase by Germany of such securities on the offset side of its balance of payments, it does not include the redemption on the expenditure side.

The interest payment figure would not have a balance of payments impact because, under the agreement terms, this amount may be paid from funds already on account, as in the case of some German military procurement.

Therefore, we believe the inclusion of purchased securities as an offset to expenditures is misleading. The receipts from the purchased securities are largely canceled by the payments the United States has been making to Germany during the same period for redemption of matured securities purchased under previous agreements.

Barter exports offsetting  
U.S. defense expenditures  
overseas - \$5 billion

DOD further states that barter exports offsetting U.S. defense expenditures overseas totalled \$500 million and that DOD receipts associated with barter exports for NATO Europe are about \$250 million each year. This amount is considerably understated. For fiscal year 1972 the amount actually totalled \$462 million, and for fiscal year 1973 as of April 1973, the amount was about \$383 million. The fiscal year 1973 figure, if projected in light of the total world barter export increase, could well exceed the 1972 figure. If these amounts were used in the offsets, the DOD analysis would show a break-even or possibly favorable balance of payments situation as a result of our troop commitment to Europe.

We would also like to call to your attention that the term "barter" is a misnomer for the program, and that it is currently being carried out differently than the original program. The name preferred by Department of Agriculture officials for the program as it currently exists is "the destination export subsidy and credit program." The barter program was initiated at a time when the U.S. Government was procuring strategic materials for stockpiling for which it traded surplus commodities; this type of activity ceased about 10 years ago. Currently the United States does not have surplus commodities for disposal.

The main function of barter is not to offset defense expenditures, but rather to encourage the export of more commodities. Also, Agriculture officials recognize that barter, as it now exists, is not what creates or holds back exports of commodities but rather it is the competitive pricing on the world market.

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Although we agree that the barter export program had a positive effect on the U.S. balance of payments deficit, we do not see any direct relationship between barter and DOD expenditures to allow DOD to take credit for the offsets.

In addition, we were informed by Agriculture officials that the barter program has been temporarily suspended due to a strong demand for U.S. agricultural commodities which makes unnecessary the export incentives provided by the program.

CONCLUSION

We recognize that in balance of payments transactions some of the above DOD offsets could apply directly to the expenditures in NATO, and reduce the deficit from U.S. military spending. Based upon our analysis and the changed DOD position, we do not believe that the earlier \$4.1 billion figure stated by the Secretary of Defense is accurate.

In our discussion with DOD representatives we requested further support for these elements. DOD has not, however, provided additional data to support the validity of its offsets.

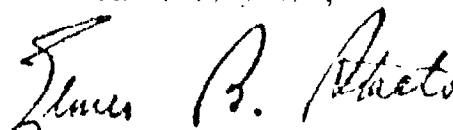
Considering these factors, we believe that the figures in the enclosed table are more representative of the true deficit relating to DOD expenditures in Europe.

We have not submitted this report to DOD for formal comment; however, we have discussed our views and conclusions regarding the offset figure with DOD officials.

We plan to make no further distribution of this report unless copies are specifically requested and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report.

We hope this information will be helpful to you. Please let us know if we may be of any further assistance.

Sincerely yours,



Comptroller General  
of the United States

Enclosure

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Source: U.S. Department of Defense, Office of Economic Analysis, "U.S. Military Expenditures Abroad, 1971-1972" (Washington, D.C.: GPO, 1973), p. 10.

Country	U.S. Military Expenditures Abroad (in billions of dollars)			
	1971	1972	1970	1971
Algeria	1,237.1	1,530.0	193.9	59.1
Germany	251.3	323.7	175.0	104.5
Japan	107.5	125.5	48.5	60.5
South Korea	50.1	51.7	9.7	11.6
Taiwan	52.5	50.2	8.6	10.3
Philippines	36.0	43.7	9.6	12.1
Thailand	7.4	7.6	20.7	15.7
Other Southeast Asia	65.9	65.9	26.7	35.7
Other Asia	103.9	113.2	61.9	64.7
Other Europe	62.1	67.1	21.4	21.6
Other Africa	1,950.4	2,161.3	596.2	936.6
Total	4,996.0	5,896.2	1,096.8	1,696.8

Source: U.S. Department of Defense, Office of Economic Analysis, "U.S. Military Expenditures Abroad, 1971-1972" (Washington, D.C.: GPO, 1973), p. 10.

U.S. military expenditures abroad in 1972 exceeded those in 1971 by 15.5 percent. Expenditures in 1972 were 15.5 percent higher than in 1971. Expenditures in 1970 were 15.5 percent lower than in 1971. Expenditures in 1971 were 15.5 percent higher than in 1970. Expenditures in 1971 were 15.5 percent higher than in 1970.

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