Historically defense contractors have had two primary customers for their goods and services: the U.S. Department of Defense and the rest of the world. As U.S. defense budgets wax and wane (which is dependent on various factors including the global security situation, Congressional mood, and Presidential intent), contractors either focus on their domestic customer or else look for international sales channels. (Many do both!) For example, take a look at **this** Raytheon “global presence” webpage. In recent years, nearly one-third of Raytheon’s revenue has been from international sales.

Contractors have two avenues for international sales of defense products. They can contract directly with the buying government (commonly called “direct commercial sales” or DCS) or they can use the U.S. DoD as an intermediary (commonly called “Foreign Military Sales” or FMS). Choosing one avenue over the other is not an easy decision; there are pros and cons with both approaches. Often, the decision is made for the contractor. For example, if a foreign government wants U.S. financial assistance with paying for the weapons it wants, the U.S. Government may insist that FMS be used. (See our article on security assistance **here** . Further, we have uploaded a 2013 DoD presentation on the topic, intended for DCMA contracting officers, on this site’s knowledge resources page.) Even when the choice is available, the decision can be a tough one to make.

As the Government Accountability Office (GAO) recently wrote: “According to DOD and State officials, FMS provides multiple benefits to foreign governments and the U.S. government. Foreign governments that choose to use FMS rather than direct commercial sales receive greater assurances of a reliable product, benefit from DOD’s economies of scale, improve interoperability with the U.S. military, and build a stronger relationship with the U.S. government … although using FMS is generally not the quickest or least expensive option for foreign governments.”

We want to unpack that last point a bit. Why should FMS transactions be any more expensive than DCS transactions?

One answer to that question is that the Defense Security Cooperation Agency (DSCA)—the DoD component that administers FMS transactions---charges governments a transaction fee for their services. As GAO recently noted, “DSCA charges purchasers certain overhead fees to cover the U.S. government’s costs for operating the FMS program. These fees include the administrative fee, which covers costs such as civilian employee salaries, facilities, and information systems, and the contract administration services (CAS) fee, which covers the costs of quality assurance and inspection, contract management, and contract audits. These fees are collected in separate accounts in the FMS trust fund, which is used for payments received from purchasers and disbursements made to implement FMS.”

In other words, foreign governments that directly contract with U.S. defense contractors are responsible for administrating and managing their contracts; whereas governments that contract through DSCA via the FMS program have those services provided by DoD entities—for a price. That price covers the listed services, and within those listed services one finds contract administration and quality assurance (DCMA) and contract audit (DCAA). Presumably, CAS provides assurance that the foreign customers are getting what they are paying for, and that the price they are paying is considered to be fair and reasonable. GAO reported that “The base CAS fee has three subcomponents, which are currently set at (1) 0.5 percent for quality assurance and inspection, (2) 0.5 percent for contract management, and (3) 0.2 percent for contract audits.”

The U.S. government intends that its FMS administration fee—currently 3.5% of the FMS agreement (or case) value—is a break-even fee. It is not intending to profit from the fee. In fact, GAO reports that the Standard FMS Terms and Conditions “indicates that the U.S. government will not profit from the FMS program.”

The problem is that the U.S. Government is profiting to the tune of billions of dollars.

GAO report **GAO-18-401** , published May 10, 2018, told Congress and the public that “The FMS administrative account balance *grew by over 950 percent* from fiscal years 2007 to 2017—from $391 million to $4.1 billion—due in part to insufficient management controls, including the lack of timely rate reviews.” (Emphasis added.) Further, GAO reported that “The FMS CAS account grew from fiscal years 2007 to 2015 from $69 million to $981 million, due in part to insufficient management controls …”

So when DSCA and other DoD officials blithely note that FMS transactions are neither the quickest nor the least expensive option for foreign customers, what they are really saying is that FMS sales do not represent good value for money. FMS transactions take longer than they should and they cost more than they should. FMS transactions do not represent the optimum sales channel, nor do they lead to fair and reasonable prices. It’s not the contractors’ fault: it’s the DoD’s fault. When using the FMS program, DoD expects its foreign partners to pay for the privilege of slowing down weapon system delivery. And DoD is profiting from the situation.

DSCA describes this situation as “building a stronger relationship with the U.S. Government.”

How much profit is DoD making on these transactions? GAO reported “Our analysis indicates that even if the administrative fee rate were reduced to as low as 2.9 percent and administrative expenditures were to increase 15 percent above expected growth, the administrative account balance would likely remain sufficient to pay for projected expenditures while maintaining a reserve balance through at least fiscal year 2024.”

GAO says the excess balance (profit) generated by the excessively high administrative fees could be used to pay for additional expenditures. Sure. That is certainly one possibility.

Or perhaps the U.S. Government could build stronger relationships with its international partners *by refunding the excess costs*—costs that it was prohibited by contract terms and conditions from collecting—back to the entities that overpaid in the first place.

You think that might generate some goodwill? We certainly do.

Meanwhile, DSCA and DoD continue to charge international customers the excessively high transaction fees that add costs while admittedly slowing down the entire process.