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DEFENSE SECURITY ASSISTANCE AGENCY
WASHINGTON, D. C. 20301

9 FEB 1979

Mr Duncan has seen copy of this

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Chief, Records & Declass Div, WHS
Date: DEC 23 2014

In reply refer to:
I-20030/79

IRAN

MEMORANDUM FOR THE DEPUTY SECRETARY OF DEFENSE

THROUGH: ASSISTANT SECRETARY OF DEFENSE (ISA)

SUBJECT: Restructuring of the Iranian FMS Program

We are making considerable progress in our efforts to find alternative sources for items of equipment cancelled by Iran. We have issued, or are in process of issuing, instructions to take those diversion actions which can be done within DOD authority. Such instructions include conversion to available FY 1979 DOD financing (e.g., AIM-7F missiles), diverting to other FMS purchasers (e.g., TOW missiles to Korea), cancelling unobligated programs (e.g., AWACS, 98 Phoenix missiles), or terminating at Iranian expense contracts which are not far into the production phase (e.g., AIM-9H missiles, 90 Phoenix missiles).

We have identified five programs which apparently cannot be financed from current DOD resources, but for which contract termination action does not appear to be in the best interest of either the U.S. or Iran. The attached memorandum (Tab A) places the responsibility for developing a DOD position on the disposition of such items into the normal channels used to reach DOD budget decisions.

In this respect we have reviewed with interest Secretary Claytor's memorandum of 8 February 1979 (Tab B) regarding transfer of two CG 993's to DOD financing. We share fully the sense of urgency which he attaches to the developing of an approach to the Office of Management and Budget and to the Congress. I hope that our letter to Fred Wacker and Russ Murray accurately conveys our feeling that time is short and immediate decisions are required. However, we believe that the DOD approach must be made as a "package" approach not only for ships but also for any other items for which we decide to request DOD financing. As indicated in Tab A this could include financing not only for the CG 993's, but also for F-16's and Phoenix, Harpoon, and Standard Missiles.

9 Feb 79

We will continue to work closely with ASD/Comptroller and ASD/PA&E during the process required to reach a DOD position as to the best approach for financing the package.

ERICH F. VON MARBOD
ACTING DIRECTOR
DEFENSE SECURITY ASSISTANCE AGENCY

Sec Def Cont Nr. X-01102

~~Classified by Acting Director, DSAA~~
~~Declassify on 9 February 1985~~

15-M-0322

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DEFENSE SECURITY ASSISTANCE AGENCY
WASHINGTON, D.C. 20301

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9 FEB 1979

In reply refer to:
I-1578/79

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE [Wacker]
COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE [Murray]
PROGRAM ANALYSIS AND EVALUATION

SUBJECT: Restructuring of Iranian FMS Program

With the assistance of your staffs we have issued, or are prepared to issue, instructions which arrange for appropriate disposition of most items terminated from Iranian FMS programs. Disposition involves a variety of diversions to DOD or FMS programs, cancellation of certain programs not yet on contract, and outright termination of certain Iranian contracts for items which could not be diverted to other purchasers. There are five remaining programs, discussed below, for which contract termination action does not appear to be in the best interests of either the U.S. or Iran. The Military Departments will require additional financial authorization to continue such programs. The purpose of this memorandum is to solicit your urgent attention toward developing a DOD recommendation as to the source of such funds. The programs currently are being financed on an interim basis from funds available in the Iranian trust fund. We cannot anticipate continued availability of funds from this source beyond 31 March 1979. If we continue trust fund financing until that time, insufficient funds will be left in the trust fund to pay contract termination costs. We therefore see no alternative to an immediate decision to approach Congress to obtain DOD financing prior to 31 March, other than to initiate immediate termination of the programs at Iranian expense.

Attached is a summary description, based on the best estimates which we have been able to obtain from the Military Departments, of the obligational authority and outlay requirements if DOD assumes the programs. We are providing separately a revised estimate of FMS trust fund receipts and outlays which will indicate to what extent increased DOD outlays would be offset by reduced trust fund outlays.

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~~Declassify on 9 Feb 1985~~

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Following is a discussion of the reasons why we believe each of these programs should be continued under DOD financing:

a. CG 993 Program: Iran has cancelled procurement of two of the four ships in this program. It is likely, though not certain, that Iran may decide to cancel the other two within 30 days. Therefore, any planning with respect to acquiring these ships with USN funds should consider not only the two ships already cancelled but also the eventuality that Navy may have the opportunity to acquire all four. Secretary Claytor's memorandum of 23 January provides a detailed Navy contingency plan for acquiring all four ships, although it does not specify entirely the source of funds which would be used to do so. The advantages to the Navy of acquiring the ships, both in terms of enhanced combat effectiveness and costs savings, are described in Secretary Claytor's memorandum. Based on FY1979 Supplemental Budget estimates, it will be almost $200 million per ship cheaper to acquire the Iranian ships than to initiate similar construction now.

The advantage to Iran is that it would avoid approximately $120 million of termination costs for the two ships ($200 million if all four ships were cancelled), as well as recover into the Iranian trust fund a substantial proportion of its investment in the ships which would be required by the USN. This will make Iranian funds available to finance continuing follow-on support programs for equipment already in its inventories. Continuation of construction also will provide economic advantages to the Pascagoula, Mississippi area, as well as result in decreased costs of future ships which may be constructed in the Pascagoula ship yard.

b. F-16 Program: Iran has cancelled its program for 160 F-16's, of which 55 are now on contract. We have issued stop work orders against the aircraft now on contract, and, of course, have cancelled any plans to procure the additional 105 aircraft. The cost to Iran will be approximately the same whether the contract for 55 aircraft is fully terminated or whether it is continued under USAF financing. However, continuation of the contract under USAF financing would make a major difference on program costs both to the USAF and to other FMS purchasers. The USAF estimates that the impact costs of not producing the 160 Iranian aircraft would be approximately $245 million to USAF, and $45 million to the European Program Group, over the life of the program. The USAF estimates that this cost could be reduced to only about

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$24 million if the USAF can assume the current contract and restructure future production programs. The USAF therefore has recommended that DOD immediately initiate action with the Congress to obtain:

a. Authorization to procure an additional 55 aircraft within FY1979.

b. Authority to fund incrementally its current aircraft buy together with the additional 55 aircraft. That 55 aircraft would be diverted to the USAF, and 55 aircraft would be terminated from the end of the USAF program. The plan would be to fund fully the aircraft in the FY1980 and FY1981 budgets. We leave to your judgment whether the incremental funding concept would be more saleable than a straight forward request for authorization and appropriation by amendment of the FY1979 Supplemental Appropriation request.

It is possible that a decision will be made, during or immediately following SecDef's Mideast trip, to allow early delivery of some or all of the 55 aircraft to Israel. This could obviate the need for USAF financing. However, this possibility is quite problematical, and we should plan toward USAF acquisition of the aircraft.

c. Phoenix Missile Program: Iran has cancelled the 428 AIM 54A missiles currently undelivered. We already have taken action, in coordination with the USN, to terminate long lead time contracts and cancel programs for 188 of these missiles. The USN estimates that the cost of not producing the 188 missiles will be $11 million for FY1979 and an additional $12.5 million for FY1980. Of the remaining 240 missiles, 134 have been produced but not yet shipped to Iran and 106 are in production for delivery between February 1979 and March 1980. The USN estimates that termination of the contract for the 106 missiles now under production would result in an additional $10 million of USN costs due to reduced economies of scale. The Navy position on procuring the 240 Phoenix Missiles has not been totally staffed; preliminary information available indicates that the Navy would wish to acquire the missiles both to meet Navy inventory deficiencies and to avoid further production line disruptions beyond those already caused by the cancellation of the 188 missiles. Estimated value of funds required to procure the 240 missiles is about $113.6 million; this includes the $11 million of increased costs to the USN due to the cancellation of the 188 missiles. If the program for the 240 missiles is terminated at Iranian expense, the Navy still would have unbudgeted costs of approximately $21 million due to reduction of production. The continuation of production will assist in avoiding a production line gap prior to the introduction of the AIM 54C model.

The advantage to Iran of the Navy procuring the 240 missiles is that it would be reimbursed for the value of the 134 missiles produced but not yet shipped, and would avoid termination costs against 106 now under production. The estimated total impact to Iran of full termination approximates $100 million.

The USG also would face a serious legal and political problem if the Navy does not procure the missiles. The current situation in Iran precludes shipment of the missiles because of their high technology. However, since Iran currently has bought and paid for a large quantity of the 240 missiles, the USG would find itself on shaky legal and political ground if it prevents their shipment to Iran.

d. Harpoon Missiles: Iran has cancelled procurement of the 208 undelivered Harpoon Missiles in its program. The USN has indicated that it can use these assets to reduce current fleet shortfalls significantly. The projected shortfall for the current USN program is 130 missiles by the end of 1980 and reaches 500 missiles by the end of 1982. Termination of Iranian procurement would reduce the current Harpoon production program below economical rates, thereby causing additional costs of approximately $35 million to be incurred by the USN and other FMS purchasers for the residual quantities under the FY1977 and 78 Harpoon procurement contracts. The USN would require approximately $106.3 million to procure the missiles, plus $10.6 million for related spare parts. The approximate unit price of $511,000 to procure the missiles from Iran compares favorably with the DOD FY1980 budget price of $535,000.

The advantage to Iran is that it would cost approximately $30 million, in excess of the $60 million it already has spent, to terminate the Harpoon contract. Conversely, if USN assumes the program, approximately $40-50 million could be returned to the trust fund even though Iran would assume the $10.4 million obligation to modify the missiles to Navy configuration.

Some of the Harpoon missiles are now produced and are available for delivery to Iran. Should the program not be transferred to DOD funding, we would face the same political and legal problems, with respect to failure to deliver these high technology items, as were described for the Phoenix Missile program.

e. Standard Missiles: Iran has cancelled a program for 258 Standard Missiles. These missiles have been produced and paid for and are approximately two years old. The USN has proposed to acquire the 258 missiles so as to apply them against a current inventory deficiency which results in insufficient quantities to meet FFG-7 load outs commencing in FY1981. The missiles also would be required for CG 993 shipfills, if the CG 993's are acquired by the USN. These missiles now are in unassembled sections which are not in the current configuration. Two of the eight year service life has expired while the missiles were in CONUS storage. The Navy has proposed to procure these missiles at a depreciated price of $17.9 million (as compared to $23.9 million cost to Iran) with Iran paying a $2 million cost to assemble and update the missiles.

It is our position that the Navy should pay the $23.9 million which covers the full cost to Iran, and also should pay for the missile update and assembly. Payment of these costs would enable the Navy to acquire the missiles for about $100,000 each. It is our understanding that the current procurement price of the missiles is somewhat over $190,000 each. On this basis we believe that it would be equitable for Iran to receive the full price which it has paid, even though the service life of the missile has been depreciated somewhat.

The advantage to Iran is that it would recover the approximate $23.9 million which it already has paid for the missiles.

In addition to the situation described above, we have been advised that the Department of Army intends to initiate a major reprogramming action to acquire 230,000 rounds of 155mm ammunition now being produced for delivery to Iran. Based on prices being paid by Iran, we estimate the value of this potential reprogramming action at $25.5 million. The action would be taken so as to assure a warm production base to allow continued production for the U.S. Army and future FMS purchasers.

In sum, assuming Iran cancels only 2 CG 993's, we have gathered information which indicates that the Department of Defense has the opportunity to acquire first line equipment at a price some $425 million less than current prices. By so doing, DOD also could avoid some $265 million of downstream production costs caused by reduced economies of scale. The latter figure does not include increased downstream shipbuilding costs which would be caused by an increase in yard composite rates from 70% to over 80%, and increase in G&A from 9% to 12%, assuming CG-993 termination. Additionally, DOD financing will minimize production line disruptions as well as effects on local economies.

From our perspective, the avoidance of an estimated $220 million termination costs and the addition of about $295 million which could be returned to the Iranian trust fund would be a major factor in our ability to continue a minimal follow on support program for equipment currently in Iran. Such continuance has the potential for major foreign policy benefits, depending on how the situation evolves in Iran.

I request that your offices develop the recommendation to the Secretary of Defense as to whether, and how, the DOD should request the $1.5 billion needed for DOD to acquire the equipment.

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Date: DEC 23 2014

Ernest Graves

ERNEST GRAVES
LIEUTENANT GENERAL, USA
DIRECTOR
DEFENSE SECURITY ASSISTANCE AGENCY

cc: Under Secretary of Defense
for Research & Engineering

Secretary of the Navy

Secretary of the Air Force

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ESTIMATED DOD BUDGET REQUIREMENTS
TO ACQUIRE SELECTED ITEMS CANCELLED BY IRAN
(VALUES IN MILLIONS OF DOLLARS)

ITEM	ESTIMATED OBLIGATIONAL AUTHORITY REQUIRED	ESTIMATED DOD OUTLAYS FY 1979	FY1980	BEYOND FY1980
55 F-16 Aircraft	$ 535	$ 190	$ 250	$ 95
2 CG-993	692	315 1/	140	237
4 CG-993	1,353	660 2/	275	418
240 Phoenix Missiles ("A" Model)	107.2	75.0	27.2	-
208 Harpoon Missiles	116.9	80.0	30.9	-
258 Standard Missiles	25.9	23.9	2.0	-
230,000 Rounds 15mm Ammo	25.5	20.0	5.5	-

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Office of the Secretary of Defense 5U.S.C. 552
Chief, RDD, ESD, WHS
Date: 23DEC2014 Authority: EO 13526
Declassify: X Deny in Full: ____
Declassify in Part: ____
Reason: ____
MDR: 15 -M- 0322

1/ Includes estimate of a $210 million reimbursement to GOI trust fund to cover GOI investment in two ships being transferred.

2/ Includes estimate of a $450 million reimbursement to GOI trust fund to cover GOI investment in four ships being transferred. Estimate must be refined.

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