

Statement of

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**Before the
Senate Armed Services Committee**

on

**Lease of Boeing KC-767
Air Refueling Tanker Aircraft**

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Thank you, Mr. Chairman and members of the Committee. I am pleased to be here today to discuss OMB's role in reviewing the Air Force's planned lease of Boeing KC-767A refueling aircraft. Although I was not at OMB at the time the decision to proceed with the tanker lease was made, I will make a brief statement describing OMB's role in that process and I will be happy to answer any questions you may have.

As with all lease proposals, OMB reviewed the terms of the lease as they were developed by the Air Force. OMB's role in such transactions is to ensure that our fighting men and women have the resources they need, while maintaining fiscal discipline to protect the taxpayer. Both the Secretary of the Air Force and the Office of the Secretary of Defense convincingly argued that a modernized tanker fleet, made available on an expedited basis, was and remains essential to ensure that our military is adequately supported in the war on terrorism and other critical missions.

The facts supporting the military necessity for the lease are discussed at length in the Air Force's report to Congress on the lease proposal of July 10, 2003, and in Secretary Roche's testimony before you today. I will not repeat those facts in detail, but simply highlight the Air Force's strong conviction about the urgent need to recapitalize the aging tanker fleet. The arguments in support of the need for new tankers may also have informed the debate in Congress at the time Section 8159 of the FY 2002 Defense Appropriations Act was enacted. In Section 8159, Congress expressly authorized the Air Force to lease Boeing 767 aircraft.

Shortly thereafter, the Air Force proposed a tanker lease that was extensively reviewed both by OMB and within the Department of Defense. OMB's unflagging focus during nearly two years of review and negotiation was to ensure that the Air Force

entered into the most advantageous deal possible under the circumstances. The tanker lease proposal was not without its challenges: the Air Force presented an exceedingly complex lease proposal that raised many unique issues. During the review process, and pursuant to its long-standing institutional responsibilities, OMB posed a number of questions regarding the need for this aircraft; the business case supporting a lease proposal; and the aircraft price.

Of all these issues, from OMB's perspective, ensuring that the price represented the best value for the taxpayer was paramount. As a result, OMB was aggressive in working to hold down costs while preserving capabilities. Early on, OMB was concerned that the initial price of the tanker aircraft was too high, and believed that, through negotiation with Boeing, the Air Force should and could reduce the price. By the time negotiations were concluded, the aircraft price had dropped from an early estimate of \$150 million to a final price of \$131 million. Reducing the price per plane by \$20 million achieved \$2 billion in savings for the taxpayer.

The Committee has requested that I address the decisions to proceed with a lease instead of a purchase and to classify the lease as an operating lease. Both of these issues were challenging, involving subjective judgments on difficult analytical questions. Under our Circular A-94, OMB requires a lease vs. purchase analysis from any agency proposing a lease, and the results are an important part of our decisionmaking process. OMB worked closely over many months with the Air Force to understand its business case supporting the lease proposal, and the give and take of these discussions resulted in significant improvements to the Air Force's model. While OMB and the Air Force agreed that leasing, in present value terms, is a higher cost option than purchase, the

magnitude of the difference varies depending on certain assumptions. The Air Force estimates that the net present value of the lease proposal is \$150 million more than a purchase. However, the Air Force's Report to Congress also states that the difference between the net present value of lease and purchase could be as high as \$1.9 billion, depending on a variety of complex assumptions. The Administration decided to approve the lease understanding this range of financial costs in order to satisfy an important military requirement in the post-September 11 world: leasing these aircraft will result in delivery of 60 new 767 tanker aircraft by 2009. There is no question that without a substantial reallocation of resources that would have a negative impact on other programs critical to national security, direct purchase would take much longer to acquire the same number of aircraft.

Determining whether the proposed lease qualifies as an "operating lease" under OMB Circular A-11 also raised difficult analytical questions. Of necessity, the assessment of whether or not a lease is an operating lease under Circular A-11 is based on estimates and assumptions that can be subject to honest disagreement. Some of the A-11 criteria contained considerable ambiguity. As a result, capable and impartial analysts applying those criteria to the same information may reach different conclusions about whether a lease is a capital lease or an operating one, especially when the proposal is right at the margin. In light of the Air Force's conviction that these planes are needed to meet an urgent military need, and in light of clear Congressional intent to support a lease, as expressed in legislation, OMB believed it appropriate to resolve ambiguities in favor of classifying this transaction as an operating lease.

Throughout its review process, OMB repeatedly questioned numerous aspects of the deal in order to press the Air Force to complete the best possible deal for the taxpayers. In addition to helping the Air Force to negotiate the price down, OMB, together with the Office of the Secretary of Defense, also raised concerns about other aspects of the contract, including operational restrictions and the lack of adequate liability protection. As a result, the Air Force went back to the negotiating table, and improved these contractual provisions to the benefit of the military and the taxpayers.

OMB believes that the lease proposal satisfies Congress' intent in enacting the legislation authorizing this lease, and represents the best possible lease under the circumstances. Over the next few months, we will work with the Department to ensure that the funds required for the lease are included in the Air Force's FY 2005 budget and their future plans.

Thank you, Mr. Chairman, for the opportunity to testify on this important issue. I would be happy to answer any questions you and the Members of the Committee may have.