



# **Policy on Industrial Participation in Defence Contracts**

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# POLICY ON INDUSTRIAL PARTICIPATION IN DEFENCE CONTRACTS

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## ***INTRODUCTION***

The purpose of this document is to inform as exhaustive as possible about the aspect of the industrial benefit related to military orders and the importance of the mechanism of industrial benefit linked to purchases of military equipment, in general for the Belgian economy and in particular for the Belgian industry.

Indeed, apart from the need to meet the operational requirements of our MOD and to respect the budgetary constraints of this department, the equipment of the armed forces can contribute to maintain the technological and industrial base, due to the highly technological nature and the important financial volume involved in defence orders. Among other things, this contributes to maintain our national security and explains why the majority of industrialised nations insist that their national industries participate in these contracts.

The great nations have a strong and advanced industry and have a high need for military materiel, often enabling themselves to develop military equipment. However, small countries have neither the need nor the means to develop large-scale projects and have therefore set up various systems to permit their economy to profit from such abroad procurements. It concerns the system of industrial benefit also known under different acronyms: “economic return”, ”juste retour”, ”offset”, ”industrial benefit”, ”industrial participation” and “buy back”.

Before detailing the policy followed in Belgium since the 1950s and comparing them to those in other industrialised nations, it is worth enumerating some features of the international defence market.

## **1. INTERNATIONAL SITUATION**

The defence industry has a certain number of specific features that have notably led most industrialised nations to adopt measures enabling their national economy to benefit from military equipment procurement contracts notified by their government.

The procedures are very different between countries depending on the objectives of industrial policies, and are notably influenced by national defence policies, national legislation on public procurement contracts, defence equipment budgets, funding allocated to R&D and industrial and technological capacity.

The specific features of the defence sector have been analysed by a working group within the European Union (POLARM) and form part of a document approved by the Council of the European Union. The following points taken from the document are worth noting<sup>1</sup>:

*“The specific characteristics of the armaments sector, which have been acknowledged since the foundation of the Community, are taken into account by the provisions of Article 223 of the Treaty.”*

*“The defence-related industry is a strategic industry, the products of which can be crucial to national defence. Unlike in other industries, where economic considerations are the determining factor, security and defence policy, to varying degrees, also dictates national armaments policy. Political, strategic and security considerations accordingly come into play in determining the conditions within which the industry operates and the demand for its products.”*

*“90% of the production of EU defence equipment is concentrated in some Member States: France, UK, Germany, Italy and Sweden.”*

*“In addition, the quality-price relationship is not the sole criterion which determines procurement policy. Offset (compensation), including industrial co-operation agreements, as well as strategic political, economic and security considerations can also be a factor.”*

The POLARM working group carried out a comparative study of national policies on defence equipment procurement and it was noted that many European countries, in particular the greatest one, take care, first of all, of the maintain of their industrial and technological defence base (ITDB). This has resulted in a protectionism of the market, in different ways of supporting “national champions”, in the launching of armament programmes on a national basis and in multinational cooperation generally occurring between great nations.

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<sup>1</sup> Report to the Committee of Permanent Representatives dated 25/11/96

The opening of the market at the publication of calls for tender in accordance with procedures established by the Western European Armament Group (WEAG) has not had any noticeable effect; in most cases contracts are won by national companies<sup>2</sup>.

*"En 1996/97, en Grande-Bretagne, 730 contrats de matériel militaire sont passés par le système du GAEO, dont 56 % avec appel d'offre ouvert et 46 % sur une base restreinte. Dans le premier cas, 96 % ont été attribués à des fournisseurs nationaux et, dans le second, 93 %. Les contrats nationaux couvrent ainsi 95 % de la totalité des contrats passés".*

*"En France, sur la même période, 99 contrats sont passés par le GAEO, dont 27 avec appel d'offre concurrentiel. Tous ont été remportés par des fournisseurs nationaux".*

*"En Italie, sur les 341 contrats passés par le GAEO, 74 % l'ont été sur une base restreinte et 26 % sur base concurrentielle. Dans le premier cas, 86 % des contrats ont été attribués à des fournisseurs nationaux et 14 % à des fournisseurs européens ou américains. Dans le second cas, 68 % des contrats ont bénéficié à des entreprises nationales et 32 % à des entreprises étrangères".*

*"De plus, on estime qu'une entreprise étrangère est invitée une fois sur dix à participer à un appel d'offre, meilleur moyen de mesurer l'ouverture effective des marchés, pour une couverture d'environ 1/5 de la valeur des contrats".*

According to a comparative study in 1995 (<sup>3</sup>) between the six main European countries (France, the United Kingdom, Germany, Italy, Spain and Sweden) looking at the extent to which the market was opened, France appears to be the most closed country for the import of military materiel with an import/production ratio of less than 5%, whereas Spain appears to be the most open (with a ratio of more than 30%).

Contract procedures permit some countries to favour their national industry. One such example is Italy where local military products are preferred ahead of foreign products provided that the price difference is less than 15%.

The context described above explains why countries that do not produce major weapon systems set up mechanisms of industrial benefit, enabling their companies to be benefited by foreign procurements made by their armed forces, whether in direct or in indirect way. NATO countries that regularly use these mechanisms are among others Belgium, Canada, Denmark, Spain, Greece, Norway, the Netherlands, Portugal and Turkey.

The big European countries producing military equipment, although they have not always established a procedure for the systematic application of industrial return, they reserve themselves also the possibility of negotiating in certain cases and this is the reason why offset is frequently asked for the purchases made abroad.

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<sup>2</sup> MEZZADRI, Sandra, 2000, "L'ouverture des marchés de défense: enjeux et modalités", Institut d'études de sécurité - U.E.O.

<sup>3</sup> SERFATI, Claude, 1996, "Les industries Européennes d'Armement", La documentation française Paris.

In this respect, it is interesting to look into the 1998 American Congress report<sup>4</sup> on offsets requested by European countries to American companies (Europe and Offsets):

*"Why is Europe so dominant in offsets? Part of the answer is that European countries, among them our NATO allies, have long been the major purchasers of the newest and often most expensive weapons systems available from the United States. In addition, Europe has a large overall defence market and requirement for sophisticated weapon systems. Offsets also have a historic basis in this trade, and they seem to have a momentum of their own. Moreover, most European nations demand particularly high levels of offsets relative to the value of the imported weapon system. This is a common practice among more advanced economies. Offsets can make good political sense by redirecting what would otherwise be large international outflows back into the domestic economy. In so doing, they may also promote technology transfer, supplement defence infrastructure, or provide commercial business opportunities. Almost all European (and other) countries have adopted formalised offset policies".*

Also the report 2007 to the American Congress<sup>5</sup>:

*"During 1993-2006, U.S. firms reported entering into 313 offset agreements with European countries with a total value of \$39.5 billion. The value of these offset agreements ranged from just under \$2 million to a little more than \$6 billion in offset demands, and averaged \$103.1million per agreement. The average offset agreement with a European country had a term of just less than 85 months.*

*Many European governments require a minimum of 100 percent offsets on purchases of foreign defense systems. Of the 313 offset agreements with Europe during the 14-year period, 206 (65.8 percent) had offset percentages of 100 percent. Another 27 agreements specified offset percentages of more than 100 percent, including two for which the offset percentage was at least 200 percent. In sum, 74.4 percent (by number) of offset agreements with Europe featured offset percentages of 100 percent or more during the period of 1993-2006."*

In this way, offsets are a widespread practice and are not only requested by small countries.

It must be emphasised that companies from small countries are sometimes obliged to propose offsets when they introduce a tender in a foreign country. Doing so, Belgian companies were obliged to propose offsets for contracts in Germany (which considers offsets as a "sale argument"), Italy, the United Kingdom, the Netherlands, Norway and Denmark. In this field, they generally ask for support from the FPS Economy.

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<sup>4</sup> US Department of Commerce, 1998, "Offsets in Defense Trade", "Third Annual Report to Congress Conducted Under Section 309 of the Defense Production Act", Washington D.C.

<sup>5</sup> US Department of Commerce, 2007, "Offsets in Defense Trade", "Twelfth Annual Report to Congress Conducted Under Section 309 of the Defense Production Act", Washington D.C.

The protectionist measures taken by Member States of the European Union in the frame of defence policy have their origin in article 296 of the Treaty of Amsterdam, which stipulates that:

*“...any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes”.*

The different attempts made to open the European defence market remain without result till now, and the issue is recently a topic of a debate at European level. A premature, unilateral decision by Belgium to abandon the offsets lever, could be detrimental to its industrial interests.

## **2. SITUATION IN BELGIUM**

### **2.1. National procurement programmes**

#### **2.1.1. Introduction**

In Belgium, the system of industrial benefit was set up in the 1950s following a decision by the Council of Ministers that created a special department in the FPS Economy (former Ministry of Economy).

The basic principle was, in the negotiated procedure and in the invitation to tender, to award the contract to the company having made the most advantageous offer according to criteria set out in the Request for Proposal (RfP). One of these criteria concerned the industrial benefit.

Over the years, the system was established in an empirical way, and apart from the general rules on public procurement contracts and administrative memos on industrial benefit, there was no specific legal text on the matter.

The new regulations for public procurement contracts (law dated 24 December 1993) filled up this gap and established the framework and the procedures to be followed in contracts containing industrial benefit.

In this context, the Royal Decree of 6 February 1997, modified by the R.D. of 6 December 2001, specifies how article 3, § 3 of the law dated 24 December 1993 is to be applied and establishes certain rules to be followed for the procurement of military equipment covered by Article 296 of the Treaty establishing the European Community. The provisions of this Decree are based on the work of the Parliamentary Investigation Commission on military procurements. This Commission recommended in particular more transparency in the criteria and procedures for awarding contracts.

It is worth pointing out that according to these Royal Decrees, industrial benefit can strengthen the economic or technological potential of the country. The report to the King for the R.D. dated 6/2/1997 stipulates that (article 2), which can be translated as follow:

*"They can relate to the direct execution of the concerned contract, or relate to supplies or services that are not linked to the execution of the contract. As an example, the contracting authority can take into account the technological knowledge acquired by a Belgian company as a result of taking part in executing the contract –*

*whether as a partner in a joint venture or as a subcontractor or supplier – and this, at any stage of the execution. Apart from this direct offset, indirect offset could also be taken into consideration, for example, purchasing or development proposals not directly linked to the execution of the contract but enabling the Belgian industry to maintain, increase or develop its technological capacities.*

*This especially means that priority must be given to involving Belgian industry where possible in the very early stages of the development and production process, as this will offer the best guarantee in terms of transferring technology and innovation. As regards industrial participation, there is a need to encourage national development, joint production and industrial cooperation. For orders placed in a foreign country,, it is advisable to opt for the best possible combination of the different categories of industrial benefit".*

### **2.1.2. Definitions of the different categories of industrial benefit**

#### **a) Direct participation**

*Participation by Belgian industry in the supply and the services that are covered by the contract concluded with the MOD, and that are destined for the Belgian needs only.*

Features of direct participation:

- it offers our national industry an opportunity to take part in the realisation of the order, and to carry out (partially) the assembly and the final assembly, acquiring in this way sufficient knowledge about the equipment in order to possibly insure the logistic support at a later stage;
- it can include technology transfers with possible use by our industry in other fields, as well military as civil ones;
- the work to be carried out in Belgium is well defined in terms of quantity, quality and value, and can be kept track of;
- the work will be carried out immediately, while it begins at the start of the programme.

## **b) Offset (general points)**

In the economic clauses of Belgian contracts, offset is defined as follows:

*Order for equipment and/or services placed by a foreign client at a Belgian company.*

*This order shall comply with each of the following four conditions:*

- *Causality aspect (compensatory character): It concerns an order for which it could be supposed that, without the economic obligations of this contract, would be normally placed within a foreign company;*
- *Technology aspect: the order will concern equipment and/or services of an advanced technological level and realised in Belgium making use of high qualified labour;*
- *Newness aspect: the order must create unambiguously a new or additional business flow;*
- *Export aspect: the final destination of the order is not situated in Belgium.*

### **Semi-direct offset**

*Offset relative to equipment and/or services identical to those covered by the contract concluded with the MOD or very similar and intended for the same applications.*

The technological level of semi-direct offset orders is at least equal to, if not higher than that of direct participation, but the concretisation depends on sales to third parties.

These orders can offer the advantage of being relative to larger production series and can afford our industry to amortise the fixed costs in a more beneficial way.

Semi-direct offsets therefore allow to constitute a supplement to the direct participation and to balance the related imperfections inherent to production series that are possibly too small.

## **Indirect offset**

*Offset relative to equipment and/or services other than those covered by the contract concluded with the MOD.*

Indirect offset can offer several major advantages:

- although they were initiated by firms of the military sector, these orders are often in other industrial sectors; in accordance with the Parliamentary Investigation Commission on military procurements, the technological level of indirect offset is strictly audited;
- moreover the orders as such, technology transfers and internships for young engineers are also accepted as offset, which again highlights the technological aspect;
- in some cases, they can encourage production diversification and thus offer opportunities to open new markets; as a result, they can become a lever for stimulating our exports.

Nevertheless, there are some less positive points:

- the compensatory character of these indirect offset orders or the causality link with the defence order can not always be clearly proved, because maybe these orders would have been placed in any case in Belgium;
- most of the time these orders are situated in the field of traditional commercial trade.

To be complete, it must be mentioned that the use of indirect offset could possibly be contested, because article 296 § 1. b. of the Treaty of Amsterdam stipulates that “... *such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes*”. However, the FPS Economy starts from the principle that a Belgian company that wishes to obtain offset orders must be competitive (provided that there is a "level playing field"). Moreover, Belgium does not even impose any obligation.

In the field of offset, there is a difference between new business and additional business, which are defined as follows:

New business flow:

- Business flow between a foreign client and a Belgian company relative to equipment and/or services that were not supplied previously by Belgian industry in the context of its business flow with this client;

- Orders of equipment and/or services placed by a foreign client within a Belgian company, relative to equipment and/or services that have made an evolution thanks to:
  - either a meaningful technological development;
  - or the use of a new technology for production;
  - or a meaningful investment in production tooling in the Belgian company.

Additional business flow:

- Increase of an already existing business flow with a Belgian company, concerning well-defined equipment and/or services.

**2.1.3. Belgian legislation relating to industrial benefit (Royal Decree dated 6/2/97, amended by R.D. dated 6/12/2001)**

The key points of this legislation applicable on procurements made by the MOD directly at the manufacturer, can be summarised as follows:

Firstly, every contract into which an industrial benefit clause can be added, must be sent to the Council of Ministers, as well at the stage of prior approval to start the procurement procedure, as at the stage of the awarding decision.

Depending on the procurement procedure proposed, the law stipulates certain thresholds for the estimated value of the contract above which it is possible to ask for industrial benefit from the tenderers.

The legislator's intention has been that the choice of Defence materiel must depend in the first place on the MOD and that the industrial benefit play a role in awarding the contract, only when the MOD cannot indicate a clear preference for a specific equipment.

The tenderer is invited to make up his global offer in such a way that, in his opinion, it is the most interesting.

Accordingly, he could decide not to introduce an economic offer. On the other hand, when he decides to introduce an economic offer, the possible nonconformity of this offer does not influence its offer for the MOD. Furthermore, in the same idea, the industrial benefit proposed can play a role in awarding the contract only if the MOD's assessment of the offers shows comparable offers. This means that in the ranking made by the MOD, there are offers with scores falling within a 10% margin in report to the score of the first ranked offer.

The threshold amounts, above which industrial benefit can be asked, differ according to the type of procedure. The amounts are as follows:

- 11 MEUR for public procurement contracts relating to supplies or services awarded after an invitation to tender.
- 2,7 MEUR for public procurement contracts relating to supplies awarded through a restricted invitation to tender or a negotiated procedure with publication.
- 2,2 MEUR for public procurement contracts for services awarded through a restricted invitation to tender or a negotiated procedure with publication.
- 1,1 MEUR for public procurement contracts for supplies awarded through a negotiated procedure without publication.

For practical reasons and with the experience that valuable industrial benefit for relatively small procurements can be obtained only in exceptional cases, in principle no industrial benefit is asked for contracts below 2,5 MEUR.

The R.D. does NOT exclude on beforehand to include industrial benefit in the case of a sole source procurement or in the case of an FMS-sale (ref. F-16 programme)

In any case, for a procurement exceeding the above mentioned thresholds, the Council of Ministers has to decide if industrial benefit will be asked for this purchase and in this event decides which weighting factor will be applied for the economic part in the evaluation of the offers. In accordance with the R.D., the economic criterion cannot exceed 15% relative to the total set of awarding criteria.

Furthermore, the Council of Ministers decides on the level of contractual penalties imposed on the contractor in case of non-fulfilment of the committed economic obligations; according to the R.D., the penalty will be at least 10% of the amount of the non-realised industrial benefit.

The principle applied by the Administration and which forms the basis for setting the weighting factor of the economic criteria, is that it must depend on the expected importance of the industrial benefit for each specific contract, taking into account several factors, including of course the technological level, the possible direct participation, the industrial valorisation outside of the programme itself. For this reason, this weighting factor is different for each file but limited to 15% in accordance with the R.D..

The law also aims to separate the evaluation of the industrial benefit, carried out by the FPS Economy, the competent authority for IB matters, from the other aspects of the offer, which are evaluated by the MOD.

The R.D. stipulates that, the offers for industrial benefit, introduced in separate and sealed envelopes, are sent directly and unopened by the MOD to the FPS Economy.

If the MOD considers that offers are non-compliant, the FPS Economy is informed about this and the corresponding economic offer is no longer taken into consideration.

Furthermore, the legislation stipulates that the MOD and the FPS Economy fix by common agreement the date until which clarifications, in the case of an invitation to tender, and modifications, in the case of a negotiated procedure, can be brought to the offers. In other words, both Departments must conclude discussions with the tenderers at the same time.

As from this date, the FPS Economy can establish a weighted and motivated ranking for the industrial benefit proposals. The results of this evaluation are taken into account when awarding the contract, insofar as the evaluation made by the MOD shows that there are comparable offers. This means that in the ranking made by the MOD, there are offers with scores falling within a 10% margin in report to the score of the first ranked offer.

The Minister of Economy must, within thirty days of receiving the confirmation on the comparable offers, send his economic ranking to his colleague of Defence.

The MOD adds up the evaluations and sends the Council of Ministers an overall weighted ranking on the financial, technical, operational and economic aspects of the competing offers.

This evaluation method also implies that the FPS Economy establishes the criteria to be taken into account, as well as their relative weight, and fixes the calculation method for awarding points to the industrial benefit offers.

In a concern of objectivity, all these elements are fixed before the opening of the offers and the following evaluation criteria are listed in the Request for Proposal.

The volumes of economic benefit in the different categories constitute the “main criteria”; each of these criteria receives a weighting factor that may be different from one contract to the other, depending on the estimated opportunities for the Belgian industry. In general, the following hierarchy is used:

- Direct participation
- Semi-direct offset:
  - New business flow
  - Additional business flow
- Indirect offset:
  - New business flow
  - Additional business flow

The following weighting factors (sub- criteria) are added to these main criteria, in descending order of importance:

- Research and development of the system or sub-system of the defence contract, in the Belgian industry;
- Technological level of industrial benefit proposals;
- Guarantees introduced for the realisation of the industrial benefit obligations (agreements signed with the Belgian industry);
- Causal relation of the offset proposals;
- Degree of reality of the economic offer and of the tenderer (credibility of the economic offer and of the tenderer, financial situation of the tenderer, precision of the content of the economic offer...);
- Execution period for the fulfilment of the industrial benefit.

As mentioned above, the attention is drawn to the fact that the tenderer is not obliged to submit an economic tender.

For the evaluation, if the tenderer decides not to introduce an economic offer or if his economic offer does not comply with the requirements enumerated in the offset part of the RfP, he will receive a quotation equal to zero for the criterion "industrial benefit".

If the tenderer decides to submit an economic offer, he is free to choose the global volume of economic benefit.

Nevertheless, a government’s directive of March 2005 aims to encourage a global volume of 80%, following modalities mentioned in the RfP.

On the other hand and only for evaluation purposes, an economic offer proposing more than 100%, shall be limited to 100%.

The tenderer is responsible for composing his offers, by combining the different categories of industrial benefit in such a way that, from the tenderer’s point of view, are the most beneficial for the Belgian industry, and taking into account the above mentioned elements.

The industrial benefit obligations are included in the economic clause that forms an integral part of the procurement contract of the MOD, while for the large contracts, the economic clause also mentions the regional distribution of the industrial benefit to which the tenderer is committed. This economic clause is finalised before the evaluation of the economic part and is binding for the tenderer winning the contract.

Other principles:

- Also following the government's directive, the tenderer is asked to propose a well balanced regional distribution between the 3 regions of the country;
- Multipliers can be applied for new business created by a transfer of technology and for internships;
- Clearing can be granted if there is an agreement between the responsible authorities of the 2 countries;
- A bank guarantee of 10% must be laid down to cover eventually the unfulfilled part of the industrial benefit;
- Banking of industrial benefit is not allowed (in order to put the competitors for a future programme on equal footing);

During the execution of the contract, the contractor is requested to introduce to the FPS Economy all potential offset for prior approval (before placing the order) and must justify his proposals with regard to the acceptability criteria included in the contract. The aim is to examine the technological level, determine the Belgian added value as well as the compensatory character of the potential order, and more generally, verify the compliance of the proposal with the contractual criteria. This investigation begins already from the receipt of the industrial benefit proposal from the contractor, to enable the Minister to take a decision on the acceptability of the proposal.

Concerning the audit, the industrial benefit proposals are verified within the Belgian companies by specialised services of the FPS Economy (Directorate General Control and Mediation).

Every six months, the FPS Economy reports on the fulfilment of the economic commitments in order to adapt the bank guarantee laid down by the contractor to cover the eventual penalty in case of non-fulfilled industrial benefit.

**2.1.4. Agreement relative to the procedure between the Minister of the Economy and the Minister of Defence concerning the common treatment of certain public procurements contracts by the MOD in accordance with the R.D. dated 6 February 1997.**

The Minister of Economy and the Minister of Defence have signed in August 1998, an agreement setting out the consultation procedures concerning the exchange of information between the two Departments, the preparation of recommendations for the Council of Ministers at the prior approval stage (DAP) in order to start the procedure, the progress in the procurement procedure, the evaluation of the offers and finally the follow-up of the signed contract. This agreement has been amended several times. (A Government decision says that the FPS Economy must be informed in time about the future military procurement contracts.)

The most recent version is dated December 9, 2005, but is in update now.

**2.1.5. The Council for Industrial Benefit**

In execution of article 5 of the R.D. dated 6 February 1997 and in accordance with the Ministerial Decree of 18 July 1997, the Minister of the Economy set up a “Council for Industrial Benefit ”. The aim of this Council is to give recommendations to be followed in the industrial benefit policy. These guidelines are communicated on initiative of the Council or on request of the Minister. The Council is composed of representatives from the Central Economic Council, the Economic and Social Council of the Brussels-Capital Region, the Social and Economic Council of Flanders, the Social and Economic Council of Wallonia and the FPS Economy.

In a spirit of transparency, the FPS Economy regularly informs the Parliament (parliamentary Commission on the military purchases) on the activities of this Council and more particularly on the situation of the industrial benefit programs.

## **2.2. International programmes**

### **2.2.1. Possibilities for cooperation**

#### **a) International cooperation from the Research and Development stage (R&D)**

Under this formula, the industry in each participating country has an opportunity to participate in the R&D phase, the most interesting phase from the technological point of view. When developing the prototype, every partner is in principle responsible for a complete part of the developed equipment, which normally facilitates the workshare in the acquisition phase.

Until now, this formula has only been used in exceptional cases, as it involves several conditions, in particular harmonisation of the needs of different armed forces, not only in terms of the technical-operational aspects, but also in terms of the procurement schedules, the budget allocation for R&D and the possibility to conclude commitments for the purchase of materiel that will be produced much later.

Finally, it is not always easy for a small country to let itself recognise as a full partner in a cooperation project involving several large countries.

#### **b) Integrated production or co-production on an international level**

If it appears to be impossible to participate in a programme right from the R&D stage, it is nevertheless worth trying to involve our industry in the industrialisation and the production of jointly purchased equipment.

This possibility enables participating countries to share the total production volume in accordance with the regulations set out in the international Memorandum of Understanding (MoU); these regulations generally take into account the respective needs of the different countries and the competitiveness of the companies.

In this way, the industry from each of these countries has the opportunity to manufacture parts in economically profitable quantities in the interest of the industrial partners and the buyers.

The ideal base principle is the sole source production for the needs of all the countries purchasing the material throughout the duration of the programme. Nevertheless, one often deviates from this principle, and for supply security reasons, several production sources are set up.

Belgium has taken part in different projects including the F-16 programme, which has been one of the biggest.

Currently, the Belgian MOD participates in the AWACS program and also in the A400M project.

Another possibility coming up is the NATO-program AGS (Alliance Ground Surveillance).

### **2.2.2. Belgian legislation related to international cooperation (RD of 29 April 2001)**

Purchases made in the frame of an international cooperation programme, are based on article 3, §4, of the law dated 24 December 1993:

The law dated 12 August 2000 on social, budgetary and other provisions has added a new article 3, § 4 into the law dated 24 December 1993 and stipulates that the following are not subject to the application of the present law: *“public procurement contracts for supplies and services to which article 296 § 1, b of the Treaty establishing the European Community applies, placed by the Minister or by the authorised authority for this, in the frame of an international cooperation where the majority of the partners are Member States of the European Union or the North Atlantic Treaty Organisation. The King establishes the control methods applicable to these contracts”*.

According to certain established thresholds, the Royal Decree relating to the execution of these legal provisions (RD dated 29/04/2001) stipulates that the concerned public procurements must be approved by the Council of Ministers before starting any procedure of international cooperation.

The Council of Ministers verifies the applicability of Art. 296 and decides on the opportunity of the choice for an international cooperation, taking into account notably the operational, technical, financial and industrial advantages resulting from it. The opportunities in all these areas of cooperation must be fully utilized.

The approval by the Council of Ministers is also required for the terms and conditions of the international cooperation, before the signature of the cooperation agreement. This approval takes into account the aforementioned evaluation factors (advantages).

According to this R.D., the Minister of the Economy who has co-signed this R.D. and being in charge of the economic aspects, must give his opinion on the industrial advantages linked to the proposed international cooperation.

### **2.2.3. Future developments**

#### **a) OCCAR**

Due to the Belgian participation in the A400M, Belgium has become a member of OCCAR (**O**rganisation **C**onjointe de **C**oopération en matière d'**A**rmement). The setting up of this organisation and its executive rules are fixed in a Memorandum Of Understanding (MOU) signed by all the participating countries.

The MOU includes several principles relating to the industrial workshare between the different participating countries. The aim of OCCAR is to obtain a “*juste retour*” on several procurement programmes and on a long-term basis, rather than on a programme-by-programme basis. Nevertheless, in a first stage the objective is that each country receives at least 66% of its costshare as industrial return, for each programme or even for each sub-programme. Furthermore, across all the programmes, the aim is to deviate less than 4% from the 100% target. If these terms are not met, the Board of Supervisors (the highest management committee within OCCAR) may take all corrective actions to rectify the situation.

Until now, the FPS Economy has not been implied in the industrial management of the OCCAR programs, but takes initiatives to fulfil its role in this field.

#### **b) European Defence Agency (EDA)**

On July 9, 2004, the Council of the European Union has decided to set up a European Defence Agency.

The aim of EDA is to strengthen the European Defence market and industry, particularly by a harmonisation, as well in the field of the needs as in the field of the regulations. The final goal is to give each company of each participating country the opportunity to participate in military procurement programmes. In this way, EDA has taken various initiatives, in particular the redaction of a "Code of Conduct" which should be applied by all the participating countries, but on a voluntary basis. In this "Code of Conduct", the concepts of "Security of Supply", "Security of Information" and "Offsets" are included.

Other initiatives were already worked out, such as the “Code Best Practice in the Supply Chain” (CoBPSC) and the "EBB" (Electronic Bulletin Board) which is a tool for the publication of invitations to tender in the field of defence, in particular contract opportunities with the government (EBB1) and contract opportunities on industrial level (EBB2).

The EDA entrusted the Swedish "Defence Research Agency" FOI with a "Study on the effects of offsets on the Development of a European Defence Industry and Market" (July 2007).

The FPS Economy can hardly subscribe to the conclusions of this study, for various reasons; the most important of them are:

- For Belgium, the statistics mentioned and the values of exportation/importation are far from being correct.
- In the study, the European countries are divided into 4 Groups; as a result the very specific Belgian situation has been completely lost;
- The study starts from the hypothesis that offsets are economically inefficient, but the antithesis has not been elaborated and the positive aspects are not mentioned and are in any case definitely insufficiently developed and analyzed (e.g. technology transfers).

The purpose of another initiative is taken in the field of the EDTIB ("European Defence Technological and Industrial Base") and aims to reinforce the DTIB in order to support the present and future defence capability requirements of the Armed Forces of the EDA participating Member States. This strong EDTIB is considered as a fundamental mean of its Security and Defence Policy.

This strategy is elaborate in Roadmaps.

The aim is to arrive, in the future, to a larger harmonisation and cooperation in the field of the operational requirements, the acquisition policies, for instance, the integration of the industry at an early stage into the operational requirements definition process, a rational approach to the "Juste Retour" principle and the use of a standard contractual framework for cooperative programmes.

However, as far for Belgium, the standardisation can and may not lead to "de facto" monopolies.

Indeed, it must be underlined that the Belgian defence industry is characterized by SMEs and niche industries and only covers a limited part of the wide defence equipment spectrum which is the case for the big nations.

Although the MOD is responsible for the negotiations with EDA, the FPS Economy is in principle involved in the preparation of the Belgian positions in areas for which it is competent. So the FPS Economy is actively collaborating in the evaluation of the economic aspects and the elaboration of the related measures.

c) **European Commission**

The European Commission wishes to increase the competitiveness of the European defence industry and to counter the fragmentation of the market in order to endeavour to a larger transparency in the purchase procedures.

End 2007, a draft of a new Directive (*“on the coordination of procedures for the award of certain public works contracts, public supply contracts and public service contracts in the fields of defence and security”*) is presented, which would fix general conditions for the purchase procedures of military and security material and which must lead to a level playing field for the European defence industry.

Art. 296. that allows a derogation from the normal European competition rules, would remain applicable under this Directive. The EU wants to narrow the field of application, which was widely interpreted by many Member States (e.g. textile procured by the MOD, was considered by some countries as essential for the security of the country).

Belgium agrees in principle but underlines that Europe does not live on an island (US protectionism: Buy American act, Small business act..., requirements from e.g. South-American countries and from far east countries concerning offsets) and that the European industries may not come, in an unfavourable position;

Large European countries (FR, GE, ...) might then no longer invoke these measures (and in particular the application of Art. 296) to protect their defence industry to the prejudice of the industries from the smaller countries.

The Belgian industry may not come into an unfavourable position with regard to the industries from the new EU-member states which have a too large interpretation of the directives.

These matters are followed closely by agents within the Commission for public procurements, the chancellery of the prime Minister, the MOD, the FPS Economy and the federal police force.

### **3. INDUSTRIAL BENEFIT POLICIES IN OTHER COUNTRIES**

Belgium is not the only country using an industrial benefit policy for large military procurements. The majority of the other Western countries also demand some form of industrial benefit. This Chapter aims to provide an overview of the offset policies in these countries, based on published information.

#### **3.1. Canada**

##### **Offset policy**

**Legal basis:** “Industrial and Regional Benefits Policy for major Crown procurements (IRB)” / “Politique des retombées industrielles et régionales (RIR)” (1986, amended 1994).

**Objectives:** The IRB requires that the prime contractors make sub-contracts and investments in the high-tech sectors of the Canadian economy. This aims to enable

- (a) long-term industrial development;
- (b) regional development;
- (c) small business development.

**Threshold value:** Purchases exceeding the threshold of 100 MCAD (72 MEUR) are automatically subject to an economic evaluation. Purchases between 2 and 100 MCAD (1,5 and 72 MEUR) may also be subject to a similar evaluation.

##### **Procurement procedure:**

Industry Canada (the Ministry of Industry), Regional Agencies, Provincial Governments, and Industry Associations help bidders identify industry partners across Canada prior to bid submission. Canadian Companies need to make sure they have made contact with the Bidders prior to the release of the RfP.

The specific IRB requirements are included in the RfP and also in a model contract with the IRB terms and conditions.

Bidders usually have 3 months to respond on a RfP. As part of their bid, each bidder is required to submit their plans for involving Canadian companies, in particular how they will involve the different regions, SMEs (Small & Medium Enterprises) and specific transactions (when required, aboriginal business). No requirement for regional distribution is imposed.

For those procurements which have IRB requirements, there are three parts to the government’s evaluation:

- a technical evaluation carried out by the Department of National Defence;
- a financial evaluation carried out by Public Works and Government Services Canada (PWGSC);

- The IRB evaluation is conducted by “Industry Canada” in consultation with representatives from regional development agencies, assessing the quality, the quantity and the likelihood that they will be carried out. Industry Canada is responsible for regional economic development, investment, and innovation/research and development.
- During the IRB evaluation, the bidders’ proposals are classified on a pass/fail system.

In descending order the evaluation criteria are:

- Operational requirements, competition, fairness and accessibility.
- Long-term industrial and regional development.
- Other national objectives.

**Offset agreement:** The successful Bidder will be invited by the Government of Canada to enter into contract negotiations. If negotiations are successful, the Bidder will be asked to sign a formal contract with the federal government. The IRB portion of the Bidder's proposal will be embodied into the formal contract.

**Responsible authority:** The “Aerospace and Automotive” division of “Industry Canada”, managed by the Minister of Industry and assisted by the regional offices for economic development agencies: “Western Economic Diversification”, “Atlantic Canada Opportunities Agency”, “Canada Economic Development for Quebec Regions”.

### **Offset requirements**

**Minimum requirements:**

100% of the bid price.

In general, 60% of bidders proposal will need to include identified transactions.

- Benefits must be brought about due to IRB obligation to Canada (Causality).
- Benefits must be completed within the contract period (begins after release of the RFP and ends with final delivery)
- Only Canadian Content of work is counted (Canadian Content Value).
- Must be NEW work in Canada (Incrementality).
- Benefits must be high tech and sustainable in nature (same level of technology as the platform being procured by the Government)

**Direct/Indirect:**

Either through direct or indirect IRB Transactions are acceptable.

"Direct" IRB Transactions are those business activities that are associated with the actual production or support of the goods and services being bid on.

"Indirect" IRB Transactions are contractual business activities that are not associated with the goods and services being bid on, but contribute significant economic value to Canada.

Canada encourages direct offsets. However, depending on the goods and services being purchased, it may be more appropriate for Bidders to propose high quality indirect activities in business areas unrelated to the equipment/service being purchased.

Each contract has its own mix of direct and indirect IRB requirements, depending on the overall procurement strategy and what makes good business sense to the prime contractor.

**Sectors:** The IRB can be exercised in the military or civil industry provided that it relates to high technology sectors and focuses on regional and SME development.

**Business activities:** The emphasis is placed on long-term development of export markets. The activities must be the direct consequence from the main contract (causality) and concern new or additional business flows (incrementality).

**Execution**

**Term:** In general, the time period for execution begins with the RfP and ends with the completion of the main contract. The exact time period for each procurement will be clearly specified in the RfP.

**Multipliers:** Multipliers are only permitted on IRB Transactions involving cash contribution inputs to Canadian university(ies) for work related to the commercialisation of university research or the establishment of university Chairs, and, for cash contributions to venture capital funds specialising in small business development. The maximum multiplier available is 5.

**Monitoring:** IRB officials review and verify these annual progress reports, to confirm that the activity claimed in the report was indeed achieved. IRB officials also need to confirm the Canadian Content Value being claimed for the transaction.

**Swaps:** Clearing of obligations between a company having obligations in Canada and a Canadian company having obligations overseas is possible if the contractors have made first of all efforts by themselves to respect their own obligations in the two countries.

**Banking:** It is impossible to transfer an overflow of realised offset credits to other projects of enterprises.

**Guarantee/penalty:** If an obligation is not fulfilled, the authorities retain at least 10% of it on the purchase payment. A penalty - normally 10% in case of non-fulfilment of the offset agreement - is fixed in the contract. If tenderers propose a higher penalty, their tenders receive a better evaluation.

## **3.2. Denmark**

### **Offset policy**

**Legal basis:** “Executive Order on Industrial Cooperation in connection with Procurement of Defence Equipment” No 264 and “Circular on Industrial Cooperation in connection with Procurement of Defence Equipment” No 26 (13 April 2005).

**Objectives:** To enhance Danish defence-related enterprises' technological level, market access and cooperation with foreign suppliers of defence material.

### **Threshold value:**

- 25 MDKK or 3,3 MEUR for an Industrial Cooperation Contract type 1 (ICC1);
- 100 MDKK or 13,2 MEUR for an Industrial Cooperation Contract type 2 (ICC2);
- With respect to acquisitions between 5 and 25 MDKK (670 KEUR and 3,3 MEUR), the foreign supplier is required to sign an Industrial Cooperation Contract type 3 (ICC3), according to which the supplier commits to perform to enter into an ICC provided that the total procurement from the same supplier for the Danish Armed Forces exceed 25 MDKK over a period of 5 years.

**Offset agreement:** Conditional ICC signed with each potential foreign supplier during the initial bidding period, 30 days prior to signing the final contract with the relevant Danish Material Command. Offset commitment comes into force once the contract has been awarded.

**Responsible authority:** The selection procedure for the main contract is entirely under the responsibility of the Ministry of Defence. The “Danish Enterprise and Construction Authority” (DECA) of the Ministry of Economic and Business Affairs is responsible for signing and follow-up the ICC.

### **Offset requirements**

**Minimum requirements:** 100%. For large contracts (ICC1), it is necessary to sign already contracts with Danish companies for a total value of 30% during the first 4 years after notification of the main contract. If the achievement within the first 4 years reaches 30%, the obligor will be rewarded with a discount on the 100% IC obligation. If there is an overachievement of the 30% within the first 4 years the total obligation is further reduced.

A product purchased under the ICC must be of Danish origin (i.e. not more than 40% foreign content).

**Direct/Indirect:** The two categories are acceptable.

**Sectors:** Only offsets in defence related products, technologies or services.

**Business activities:**

- New and additional business flows resulting from the awarding of a defence contract;
- Technology transfers.

**Execution**

**Term:** Defined in the ICC.

**Multipliers:** The DECA may approve the application of a multiplier higher than 1, provided the foreign supplier contributes to technology transfer, R&D cooperation, investments or the like that enhance the prospects of Danish defence related enterprises with regard to technological development, cooperation or growth. However, multipliers cannot be used to meet the requirement of 30% of the contract value within 4 years (relating to ICC1).

**Monitoring:** Once a year, the foreign supplier is required to submit a report to the DECA regarding the fulfilment of the contract (concluded contracts + invoiced purchases). For all supplies exceeding 1 MDKK (135 KEUR), the DECA will ask the Danish enterprise for confirmation. The DECA may also carry out random checks. Supplier's obligation will subsequently be written down by the approved amount.

**Clearing & Swaps:** The DECA may enter into an agreement to swap a Danish enterprise's obligation regarding industrial cooperation in another country with foreign suppliers' similar obligations in Denmark. A precondition of this agreement is that the wish to swap obligations is based on an undertaking in writing by both the managing directors of the Danish enterprise and the involved foreign supplier and the authorities of both countries.

**Banking:** A foreign supplier may request a Banking Agreement. The objective is that contracts concluded with Danish defence-related enterprises are to be applied to the fulfilment of an envisaged, future ICC's. Offset contracts may be placed during a 2 years period prior to the signature of the main contract (pre-offset).

**Guarantee/penalty:** The bank guarantee must be issued no later than 3 years after the contract has been concluded with the Danish Armed Forces. The bank guarantee is to be issued for the amount that at this point might constitute the shortfall with respect to the 30% obligation (after 4 years for ICC1).

If a bank guarantee is paid out, the funds will be spent on the administration of ICC's and the establishment of cooperation between foreign suppliers and Danish defence-related enterprises. Furthermore, the funds will be spent on initiatives to foster research and R&D activities with a view to meeting future demand for defence material among the Danish Armed Forces.

In case of breach of an ICC, the foreign supplier may be excluded from concluding any new contracts with the Danish Armed Forces until the outstanding obligations have been fulfilled. The names of suppliers that have been excluded from concluding contracts with the Danish Armed Forces may be made public on the website of the DECA.

**Closed and current contracts:** In June 2005, 35 foreign companies had offset obligations in Denmark for a total value of 1000 MEUR. New ICC-agreements are now totalling 260 MUSD/year. This amount is expected to increase in the coming years due to planned procurements by the Danish MOD.

### **3.3. Finland**

#### **Offset policy**

**Legal basis:** There is no legal framework, but there are “Guidelines on Industrial Participation (IP)” (2002; last edition August 2006).

**Objectives:** The principal aim of industrial participation is to help the Finnish defence industry to get the necessary maintenance, overhaul and development capacity of the purchased military systems. Secondly, IP aims at promoting the Finnish small and medium-sized industry, transfer of new technology to Finland and cooperation between Finnish and foreign companies.

**Threshold value:** IP is normally required when the value of the procurement exceeds 10 MEUR. In special cases, the Finnish MOD may decide that IP is not required.

**Procurement procedure:** Industrial participation is a precondition set by the Finnish Parliament for large foreign military procurements. The MOD requires not only that the bidders commit themselves to perform the IP obligation(s), but also that they present a plan and a provisional list of IP transactions. Especially the direct IP package should be agreed upon in advance, before the final award of contracts. The impact of IP (evaluation criteria, weight) is mentioned in the RfQ.

**Offset agreement:** An Industrial Participation (IP) agreement is signed simultaneously with the procurement contract.

**Responsible authority:** The Finnish Ministry of Defence is responsible for negotiating the IP agreement. After the IP agreement has been concluded, the Ministry of Employment and the Economy (TEM) is responsible for its administration. The Finnish Committee on Industrial Participation (CIP) was set up for this purpose within this Ministry. In addition to the TEM representatives, the Committee has representatives from the MOD and from the Ministry for Foreign Affairs. The secretariat of the CIP is in charge of the preparation of IP matters.

#### **Offset requirements**

**Minimum requirements:** 100% of the total and adjusted contract price(taking into account price revisions, amendments and options).

**Direct/Indirect:** The MOD fixes the volume of the direct participation. Direct industrial participation (Category N° 1 below) transactions are normally agreed with the purchasing authority in advance.

Proposals for indirect offset do not have to be presented on beforehand. An indirect IP transaction can be qualified provided that the Contractor is instrumental in creating the transaction, if it benefits significantly the Finnish economic interests, if it is at least of similar high technical level as the procured equipment, and if it can be classified in one of the 5 categories listed below.

**Sectors:** Defence related industry, IT, biotechnology and other advanced industrial sectors.

**Business activities:** The IP Contractors are expected to direct their IP activities into these areas with emphasis on the first two categories.

1. Manufacturing of parts, assembly, testing etc. of the purchased equipment, as well as getting the necessary knowledge for the maintenance and further development of the equipment;
2. Other defence-related work, and supply of sophisticated technology to the Finnish defence-related industry;
3. Promoting the internationalisation and exports of the Finnish small and medium-sized industry;
4. Transferring new technology to Finnish industry, or other significant cooperation between Finnish and foreign companies;
5. With the consent of the Finnish CIP, new exports of high-technology products or other important international products of the Finnish industry can exceptionally be accepted for IP.

### **Execution**

**Term:** Generally, the same period as the delivery time for the purchased material.

**Multipliers:** The CIP may apply multipliers for indirect IP:

- the export of Finnish defence materiel (from 1 to 3);
- exports by a Finnish SME (from 1 to 3);
- other export transactions (from 0,3 to 1).

Technology transfers, marketing assistance and other possible transactions are evaluated case by case by the Committee. No multipliers are applied in these cases.

**Monitoring:** The Contractor shall submit all requests to the Committee. The Contractor can also ask for a prior approval from the Committee on the eligibility of a future IP project and the multiplier applicable to it. The Committee will make its best efforts to reply to all requests within eight weeks of the reception of the request. A precondition for the decision is that the Finnish company benefiting from the activity has provided the verification requested by the Committee.

Transactions from category (1) are taken into account for their total value.

Other transactions are normally accepted at the full value of the Finnish content. However the Committee may take into account only a part of the amount. This value can be agreed upon in advance between the Contractor and the Committee.

**Banking:** Foreign companies that are participating in a competition for a military procurement or that have otherwise a potential project, can sign an agreement with the CIP for a pre-contractual IP in the form of a Record of Understanding (RoU). The signing of an ROU has also to be accepted by the Finnish Ministry of Defence. The credits on a pre-contractual IP account can be used to discharge any obligation that the contractor gets during the validity of the credits. The existence of a pre-contractual IP or an RoU may not have any effect on the selection made by the Ministry of Defence. An overflow of offset can be transferred during a period of 5 years.

**Guarantee/penalty:** In principle, no guarantee is requested, although this can be fixed in the contract and may vary between 3 and 5% of the non-executed part. The penalty consists of exclusion from future procurement programmes up until all obligations are met. There are plans to strengthen the penalty system.

**Closed and current contracts:** At the beginning of 2004, there were 20 outstanding IP agreements with more than 30 offset obligors. At the beginning of 2008, an amount of more than 1000 MEUR open offset obligations is still to be fulfilled within variable fulfilment periods (up to 2017).

### **3.4. Greece**

#### **Offset policy**

##### **Legal basis:**

- Presidential Decree 284 from 1989.
- Defence Procurement Law (7/02/2007).

##### **Objectives:**

The support of the local defence industry and the development of business activities in Greece, which contribute to the upgrading of the country's technology and production infrastructure in the defence industry.

**Threshold value:** in principle 10 MEUR.

General Directorate of Defence Armament and Investment (GDDAI) can specify a lower threshold.

**Procurement procedure:** The tenderer has to describe really in detail in his offer his economic proposals and to transfer it in a separate envelop. The economic evaluation is carried out, based on the following criteria:

1. Offset percentage (quantity);
2. Content of the offset programs (quality);
3. Term of execution of the offset program (the shorter, the better).

The Domestic Industrial Participation (DIP) will not be evaluated if:

- The DIP rate < DIP rate fixed in the RFP;
- The planned projects with local industry are not detailed;
- The penalty clauses and the letter of guarantee are not accepted by the tenderer.

**Offset agreement:** Offset shall be concluded together with the main supply contract.

##### **Responsible authority:**

The GDDAI, a division of the MOD, is responsible for the design and implementation of decisions concerning Military Projects and Armaments Contracts for main and secondary Armament projects, Contracts, Offset programs, Quality Assurance as well as Armament Investment and Technological Research.

### **Offset requirements**

- The requested DIP-rate is mentioned in the RFP. This DIP denotes the value of the program which must be signed to the local industry, as a percentage of the procurement value. This DIP is fixed by the GDDIA for each procurement and is function of the GAV (Greek Added Value) of each offset proposal;
  - The GAV must be min 35%;
  - The tenderer must submit an implementation schedule;
  - The offer must contain signed contracts with local industries.

And

- Totally separate there is a request for Offset: Minimum 100% of the foreign currency part.

Both requests are cumulative.

The way to calculate the GAV is quiet complicated. This calculation method takes into consideration between others the direct and indirect labour, materiel, the profitability, size and revenues of the company.

The contractors have to make this calculation in order to determine how much GAV is in their proposal.

**Sectors:** Military sector.

### **Business activities:**

The offset must be built up as follows:

- 10% investments by the foreign company (min 51% of the shares, to be hold during at least 5 years);
- 40% sole source, licensed production, subcontracting;
- 20% purchase of Greek industrial products of which 12% must be the development of new Greek products;
- 20% Grant of capital equipment (free of charge) to state-owned defence industries;
- 10%
  - “social benefits” for the Greek armed forces (non defence related; indirect);
  - Marketing assistance.

### **Execution**

Projects that are mentioned in the offer may not be replaced during execution.

**Term:** In principle, the same execution period as for the purchasing contract.  
At least 60% of the obligation must be fulfilled at the half-time period.  
An additional term can only be accorded if 80% is fulfilled at the end of the normal term.

**Multipliers:** Wide range of possibilities but all the multipliers are fixed now:  
Examples:

- sole source multiplier: factor 10
- licensed production: factor 6
- subcontracting, software transfer: factor 2
- grant of capital equipment: multiplier: factor 8
- social benefits: multiplier: factor 8.
- marketing assistance: multiplier: factor 6

**Banking:** Pre-offset or surplus offsets from previous programs may be used.

**Guarantee/penalty:**

In the new offset regulations (2007) the penalties are increased.

Two categories of penalties:

- penalty for late implementation: 1,5% per month of delay;
- for not fulfilled offset: 10% on the non fulfilled part.

There are penalties both for missing the GAV and for missing the DIP.

**Closed and current contracts:**

Between 1993 and 2006 more than 100 offset programs have been signed for more than 15000 MEUR offset credit.

## **3.5. Hungary**

### **Offset policy**

**Legal basis:** Governmental decree n° 228/2004.

#### **Objectives:**

The integration of SME's, foreign investment, job creation, regional development, training and technology transfer.

The priorities are: technological development, innovation, R&D, creation of competence centres, of regional logistic and service centres.

**Threshold:** 1000 MHUF ( $\pm$  4 MEUR)

**Procurement procedure:** Not specified.

**Offset agreement:** The supply contract, as well as the offset agreement, is only valid from the signature of both documents.

**Responsible authority:** "Offset Coordination Office" within the Ministry of the Economy and Transport (MOET).

### **Offset requirements**

**Minimum requirements:** 100% of the imported value, with at least 30% of the contract value in the form of investments. In practice, this percentage can be as high as 180% of the imported value.

**Direct/indirect:** Both categories are acceptable.

**Sectors:** Priority areas:

- IT and telecommunications;
- Biotechnology, environmental technology and renewable energy;
- Electronics and nanotechnology;
- Defence industry and "dual use" applications.

**Business activities:** All activities contributing to achieving the Hungarian National Development Plan:

- Transfer of technology and know-how;
- Investments;
- New product sales or new customers;
- Marketing assistance resulting in access to foreign markets;
- Human resources development;
- Infrastructure development;
- Enhanced competitiveness.

## **Execution**

**Term:** Fixed in the contract, including the interim evaluation phases.

### **Multipliers:**

- 1,5: for investments in certain priority sectors. This factor is increased with 0,5 for investments in certain target regions.
- 1,4: for the sale of certain priority goods and services.
- 3 to 5: for projects relating to other priority sectors.

**Monitoring:** This is carried out by the “Offset Coordination Office”.

**Banking:** For pre-contractual activities an offset credit may be accepted. The amount that can be banked in the case where the tenderer’s offer is not chosen needs to be agreed upon before the award of the contract.

**Guarantee/penalty:** The level of the guarantee is fixed in the RfP. It is currently 6% of the contract value and the amount will be adjusted according to the fulfilment of the offset.

## **3.6. Italy**

### **Offset policy**

**Legal basis:** No codified offset policy. All aspects of this policy are outlined by the Ministry of Defence on a case-by-case basis.

**Objectives:** The main objective is to provide export opportunities for Italian defence companies.

**Threshold:** in principle 5 MEUR (unless bilateral MoU exists) but not in every case offset is requested. On the other hand offset is also often required for contracts less than 5 MEUR if the Italian industry has similar obligations in the country of the contractor.

**Procurement procedure:** The procedure is fixed on a case-by-case basis by the Ministry of Defence, which always consults with the “Finmeccanica Working Group”, but the MOD is sole responsible for making decisions.

**Responsible authority:** The National Armament Directorate of the MOD.

### **Offset requirements**

**Minimum requirements:** The percentage is a matter of negotiation with a maximum of 100% of the contract value. However a higher percentage is required if the contractor’s country also applies this method to Italian companies.

**Direct/indirect:** Both categories are acceptable. Direct offsets are preferred and required when there is a strong requirement for the Italian industry to ensure the logistic support of the acquired product.

**Sectors:** Military.

### **Execution**

**Term:** On a case-by-case basis.

**Multipliers:** On a case-by-case basis. The value depends on the technology and its availability in Italy. The maximum multiplier is 3 when it concerns new technology that can immediately be implemented.

**Banking, transfer:** Transfer of realised percentages is possible between different obligations/contracts with the same contractor running at the same time.

**Guarantee/penalty:** The offset agreements mention a maximum penalty of 10%. However, in practice this is never or nearly never applied.

## **3.7. The Netherlands**

### **Offset policy**

**Legal basis:** Offset Guidelines (Oct. 2005).

**Objectives:** The offset policy forms an integral part of the industrial policy of the Ministry of Economic Affairs.

The general objective of this policy is to contribute to the industrial base of the Netherlands through technological advancement, thereby broadening its technological capabilities, improving its level of quality, expanding its markets and enhancing employment within the Netherlands.

The first objective is to promote competitive participation of the Netherlands industry and service sector in the development, production and procurement of materiel and services on the (inter)national defence market.

**Threshold:** 5 MEUR.

**Procurement procedure:** Foreign companies submit their offset proposals to the Ministry of Economic Affairs that negotiates with potential suppliers and must result in a signed offset agreement, prior to the signature of the procurement contract. Therefore the Directorate-General of the MOD in charge of the procurement (DGPM) takes care of the coordination with other Ministries (Finance and in particular Economic Affairs).

The offset agreement is signed on the basis of a sufficient level of activities listed in the offset proposal. Realised or firm offset orders equivalent to a certain percentage of the procurement (usually 30-40%) must be part of the proposal.

**Offset agreement:** Before awarding the main contract, a separate contract is drawn up between the Ministry of Economic Affairs and the potential suppliers of the main contract. In an attachment to the offset agreement, the potential suppliers have to detail and to rank their offset proposals in 5 levels of firmness corresponding to their probability of realisation.

**Responsible authority:** Ministry of Economic Affairs > Directorate-General for Enterprise & Innovation > Industry Department > Commissariat Military Production (CMP).

## **Offset requirements**

**Minimum requirements:** 100%. Nevertheless it is possible for a foreign supplier to agree to a predefined percentage of military compensation programmes with Netherlands defence industry. When this predefined percentage is reached within the agreed timeframe, the foreign supplier will receive a waiver for a part of the remaining obligation.

An offset agreement is required for each order of defence equipment in the amount of - or exceeding - 5 MEUR which is (mainly) produced and delivered by a foreign supplier.

A minimum 20% involvement of Small and Medium Sized Enterprises (SME's with max. 100 employees) is required.

10% is required as a goal for involvement of the Netherlands institutes and industry in R&D-programs and technology cooperation.

**Direct/indirect:** Both categories are considered, but there is a preference for direct offset. Indirect offset has to meet the following conditions: it must relate to new business flows or increasing existing business flows, concern Netherlands origin activities, have a causality link with the offset obligations and be of an equivalent technological level as the concerned purchased defence equipment in the main contract.

**Sectors:** Both military and civil products en (technical) services are taken into consideration.

### **Business activities:**

Higher involvement of Netherlands' defence related industry;  
Stimulation of programmes with SME's and innovative enterprises;  
Stimulation of knowledge-transfer programmes and investments;  
Training on the job and trainees.

## **Execution**

**Term:** The time limit for execution is set out in the offset agreement and depends on the value of the obligation as well as the delivery schedule for the main contract, with a maximum of 10 years. The average performance period is 5 to 7 years. Furthermore, a milestone for 50% fulfilment is mentioned in the agreement.

**Multipliers:** To benefit from a multiplier, the foreign supplier must obtain prior approval from the Ministry of Economic Affairs.

The multipliers are as follows:

- Civil R&D: up to 3;
- If an exceptional contribution is made to the Netherlands defence industrial base through involvement of the industry right from the development phase and its selection as single supplier (single source) or preferred supplier of certain sub-assemblies for the global market, The multiplier can go up to 5;
- For defence-related R&D programmes with Dutch knowledge institutes, the multiplier can go up to 10;
- Knowledge transfer: it needs to be demonstrated that the technology is currently unavailable and opens up new markets;
- Marketing and sales support, particularly in the North American market;
- Investments in venture capital supporting Dutch high technology start-ups: multiplier up to 10 depending on the risk;
- Innovative technology orders not linked to the defence industry (the multiplier depends on the new technology, the R&D, the creation of new business relationships...).

**Monitoring:** As soon as the main contract is concluded, the foreign company can start to claim offset proposals to the Ministry of Economic Affairs, which accepts or rejects them based on information given by the Dutch concerned company and by the foreign ordering company (usually based on a questionnaire).

Any company with offset obligations is also obliged to send a progress report once or twice a year. Every year the Minister of Economic Affairs sends the status of the realisation of the offset obligations to the Parliament.

Offset credits are based on NL added value.

**Swaps:** The Netherlands are favourable to clearing of offset obligations (“*mutual abatements*”).

**Banking:** possible for defence activities; can be used within a maximum of 3 years.

**Guarantee/penalty:** No bank-guarantee is required. If the obligation at the first milestone (50%) is not met, the obligation is increased by 15% of the unrealised part. If the obligation is not met at the final date, the obligation is increased by 30% of the unfulfilled part.

The parties will agree upon a reasonable extension of the execution period so that the supplier can meet his remaining (increased) obligations.

**Closed and current contracts:**

At the end of 2004, 90 agreements were in progress for a total offset value of 4000 MEUR of which almost a half was realised at that time:

- 40% in the defence industry; 60% in other sectors;
- 30% consisted of direct offset against 70% for indirect;
- About a quarter was for SME's.

At the begin of 2007, 81 agreements were in progress for a total offset value of 3600 MEUR of which almost a half was realised at that time.

## **3.8. Norway**

### **Offset policy**

**Legal basis:** “Provisions Concerning Procurements for the Armed Forces” (BAF) which is part of the “Service Regulations for the Armed Forces. These Directives were modified several times. The most recent modifications were enumerated in a “White Paper” (no.38 2007).

This new offset regulation is expected to come into force in March 2008.

In the text below, these modifications are already integrated.

### **Objectives:**

The new “White Paper” increases its emphasis on offset agreements.

Offsets are considered as industrial opportunities that counterbalance Norwegian defence orders placed abroad. Norwegian Offsets are intended to contribute to maintain and strengthen the expertise, the capacity and market potential of the Norwegian defence industry and to support the export activities of Norwegian defence industry.

For national procurements there is a strategy to emphasize the early dialogue between Defence and Industry and early industry participation in the development of the defence projects.

Offsets are considered to contribute greatly to maintaining and developing competencies in Norwegian industry.

**Threshold:** 50 MNOK (6,7 MEUR).

### **Procurement procedure:**

The quality of the industrial cooperation agreements (ICA’s) are part of the evaluation criteria for the procurement. Also previous performances are also taken into consideration.

The main contract will not be signed before the ICA has been negotiated and signed.

**Offset agreement:** The ICA must be valid for the main contract and for all the follow-on contracts like upgrades and maintenance contracts.

**Responsible authority:** The Ministry of Defence (Department of Finance and Management) is responsible for the economic offsets. Beside this an advisory group reports to the Ministry of Defence. This organism is presided by the MOD and is composed of representatives from the Ministry of Industry and Trade, the “Norwegian Defence Research Establishment” (FFI) and the Norwegian defence industry.

## **Offset requirements**

**Minimum requirements:** At least 100% of the purchase price. The content produced in Norway is taken as the basis. If the Norwegian content is higher than 80%, the total value (100%) will be counted as offset.

On the contrary if it is lower than 20%, nothing is counted.

### **Direct/indirect:**

The following categories are considered:

Category I: strategic projects that are considered important to the armed forces, the national security and to the Norwegian industry (typical requirement: 50% in this category);

Category II: non-strategic defence or security related projects;

Category III: “dual-use” military or non-defence related projects, that may become important to the armed forces in the future. The volume in this category must be limited to 25%.

### **Sectors:**

The following areas have been established to focus on:

1. Information and communication technology;
2. System integration and architecture
3. Missile technology and autonomous weapon and sensor systems
4. Underwater technology and sonar systems;
5. Simulation technology
6. Weapon and missile propulsion technology, ammunition and military explosives
7. Material technology
8. Maritime technology.

## **Execution**

**Term:** The execution period of the ICA can be negotiated and a number of milestones must be fixed.

**Multipliers:** From 0,1 to 5

- Technology co-operation: factor 1 to 5
- R&D co-operation: max 5
- Investments: max 5
- Technology transfer: max 2,5;
- Marketing assistance: factor 0,1 to 2;

A bonus multiplier for implication of SME's (x1,1) and Small enterprises (x1,2) is envisaged.

**Monitoring:** Once the agreements are signed, the “Norwegian Defence Logistics Organisation” (FLO – NDLO of the MOD) is responsible for monitoring them. The contractor is requested to send an annual report.

**Swaps:** Clean swaps between countries on a bilateral basis will be positively considered.

**Banking:** When an obligation is fulfilled, the Ministry of Defence decides whether or not it is in its interest to grant a “banking facility” (max 40%, valid during 5 years).

**Guarantee/penalty:** In principle, the minimum penalty is 10% by means of a bank guaranty. All penalties for non-fulfilment are mandatory but NOT liquidating.

**Closed and current contracts:**

During the period of 2001-2005, offset agreements were made for a total amount of 7700 MNOK, nearly 1000 MEUR.

The accumulated amount of the offset obligations totals at the end of 2007 an amount of 13000 MNOK to be realized before the end of 2017.

### **3.9. Austria**

#### **Offset policy**

**Legal basis:** Special regulations for military procurements are stipulated in the “Bundesvergabegesetz” (law relating to public procurement contracts), part I, chapter 3, § 12, Par. 1, Z3, but no directives have been published.

#### **Objectives:**

Reconciliation of the defence imported goods through predominantly technologically equivalent civilian exports, direct investments and R & D

The main aim is to enhance the attraction of the technological and innovative aspect of the Austrian economy.

In concrete terms, this means: technology transfer, investments in development and quality, setting up companies and direct investments in Austria, improving of the business climate, regional distribution, continuity and durability of relations with suppliers, opening up of new markets for existing companies and products and the involvement of Austrian SMEs.

Further on is the job creation and job protection important, as well as the long term aspect of the collaboration.

**Threshold:** This is fixed by the Ministry of Defence on 726 KEUR (10 MATS).

**Procurement procedure:** Tenderers state in writing the volume of offset that they propose and the amount of the guarantee that they agree to pay if they do not fulfil their commitments. These aspects are negotiated.

The result of the offset evaluation can flow (does not have however) into decision making of the MOD (BMLV), primarily with equivalent military offers.

**Offset agreement:** For each purchase, an offset agreement (*Gegengeschäftsvereinbarung*) is signed between the contractor and the Federal Ministry of Economic Affairs and Labour and is negotiated on a case-by-case basis.

**Responsible authority:** Federal Ministry of Economic Affairs and Labour (BMWA) >Federal Service for Public Procurement Contracts (*Bundesbeschaffung*).

#### **Offset requirements**

**Minimum requirements:** 100% of the contract value. This percentage is generally exceeded during the tender phase. 200% is not unusual (even 240% in case of the Eurofighter program).

A regional distribution is important, notably when it involves employment opportunities.

The causality, here called instrumentality, must be proven.

**Direct/indirect:** No preference is specified. Both categories are accepted.

**Sectors:** Key sectors:

aerospace, automobile industry, ICT, wood technology, life sciences (biotechnology, genetics medicine), environmental technology, military technology, machinery and plastics industry. They must be high technology projects. There is no precise definition of the “high technology” concept, however the following areas are mentioned as examples: micro and nanotechnology, mobility and traffic (automobile technology, tunnel building...), new materials, environment and energy.

**Business activities:** Sub-contracting, direct investments, applied R&D, product development, research cooperation and technology transfer.

**Execution**

**Term:** Is normally the same as the delivery-period in the main contract. It can be longer than for the main contract if the offset amount is substantial. For instance for the Eurofighter program (4000 MEUR over 15 years).

Intermediate stages will be fixed.

**Reporting:**

The contractor is obliged to report on a half-yearly basis.

The contractor must establish at his own costs a cooperation office in Austria, which must remain operational during the entire duration of this agreement.

A pre-approval is needed from BMWA prior to making the relevant offset order.

R&D and investments will be evaluated on a case by case basis

Third parties may participate in the fulfilment of the offset obligation, but only with the prior approval of the BMWA.

**Multipliers:** Up until 2004, no multiplier had been granted, however it was possible to negotiate on specific projects. In the meantime, a not official table has been drafted for the multipliers.

Multipliers are granted to projects whose start-up is complex or expensive.

Based on negotiations, multipliers from 3 to 9 are also used for some investments in R&D projects.

However, no multiplier is awarded to SME projects or activities in specific regions.

**Banking:**

Normally no pre-offset is accepted. In some cases, pre-offset can be granted for activities taking place before the signature of the main contract. It is valid for 5 years.

This does not mean that it will automatically be accepted for a future contract having no link with the original order.

**Guarantee/penalty:** The level of the penalty is negotiated, normally between 3 and 7% of the unfulfilled value. Some contracts stipulate a penalty as high as 12%.

**Closed and current contracts:**

Since 1978, 169 offset agreements have been signed. The total amount of obligations is 6000 MEUR, while the corresponding purchases amount to only 3500 MEUR. 3800 MEUR of offset have been accepted. Obligations included in outstanding contracts amount to 4300 MEUR.

## **3.10. Poland**

### **Offset Policy**

**Legal basis:** “Act of 10 September 1999 on certain compensation contracts concluded in connection with supply contracts for the needs of national defence and security” (*Official Journal* 1999 No. 80, item 903 - Offset Law); “Regulation of the Council of Ministers of 2 July 2002, concerning the detailed principles for verifying and approving offset commitments of a foreign supplier of armaments or military equipment towards the value of the offset agreement” (*Official Journal* 2002 No. 100, item 907 “Offset Regulation”).

The act has been amended in December 2006 (published with other most recent amendments in May 2007).

**Objectives:** Offset agreements must ensure the participation of foreign suppliers in the restructuring and development of the Polish economy. The primary objectives are:

- Development of Polish industry, especially with regard to the Polish defence industry;
- Gaining access to new export markets for Polish industry or increasing current export potential;
- Transfer of new technologies and improvements in organisation;
- Development of research work, development of Polish universities and R&D centres;
- Creation of new jobs, in particular in regions affected by high unemployment.
- Retaining jobs in the defence sector;
- Development of knowledge - based economy.

**Threshold value:** Min 5 MEUR for the same foreign supplier in a 3 year period (included spare parts).

### **Procurement procedure:**

Contract with offset are not limited to the MOD; also procurement of “military” equipment for the Ministry of Internal Affairs are subjected to this practice.

The Ministry of the Economy (ME) communicates to the awarding entity the guidelines for the offset offer, the evaluation criteria, the expected time for evaluating the offset offer and for negotiating the offset agreement, and the weight of offset in the total evaluation.

When bidding on public procurement contracts, foreign suppliers must submit at the same time offset proposals conform to the Polish law. They need to introduce their offer directly to the ME. The ME evaluates the offset offers and transfers the results of the offset evaluation to the awarding entity in order to integrate them in the total evaluation.

Based on the result of the final ranking the ME starts negotiations with the bidder chosen by the awarding entity. During these negotiations the initial offer can not be reduced.

The subject of the negotiation is:

- the value of offset agreement;
- the content of offset commitments;
- the value of offset multipliers;
- the time period for execution of the offset commitments.

The ME informs ASAP the awarding entity about the end of the negotiations.

If ever it seems that it is not possible to reach an agreement on the offset arrangement, the company is excluded and the negotiations continue with the company ranked as second in the final evaluation.

Should there be at least one offer without an offset obligation (obviously in the case of a Polish tenderer) the first evaluation is made by the awarding entity without taking to account the offset aspect. If this evaluation gives a ranking with a first place for the tenderer without offset obligation, then normally the contract is awarded without offsets.

If on the other hand, if in such a case the first ranked in the evaluation of the awarding entity is a foreign company with offset obligations, the negotiations with the ME start, in the same way as above, in order to conclude an offset agreement.

If the offer does not meet the requirements defined in the guidelines, the ME may permit to the foreign supplier to complete his offset offer.

In any case the main contract will not be signed as long as the offset agreement is not signed.

**Offset agreement:** Means an agreement executed by and between the State Treasury and the foreign supplier, specifying, in particular, the value, the subject and the schedule of performance of offset commitments.

A special procedure exists for an amendment or if the delivery contract is changed. In that case the ME decides about a possible change in the offset agreement.

**Responsible authority:** Offset proposals and progress reports are examined by the Committee for Offset Agreements, a section within the Ministry of the Economy, in which other ministries are also represented. The Ministry of the Economy is the competent authority for signing offset agreements.

## **Offset requirements**

The offset offer is prepared in the Polish language; it must contain:

- Info about the legal form of the foreign company;
- Financial balances of the last 3 years (selection/exclusion criterion);
- Performances in the field of offsets;
- The value of the proposed offset;
- Time schedule for the performance of the offset;
- Offset agreements with the Polish industry (selection/exclusion criterion)

**Minimum requirements:** at least 100% of the contract amount (“Not be lower than an equivalent of the delivery specified in the contract”).

**Direct/indirect:** Both categories are accepted.

The value of direct offset commitments shall not be lower than half of the total value of the offset obligations. Direct offset is valorised higher than indirect offset (through multipliers).

### **Sectors:**

- Defence;
- Information Technology et Telecommunication;
- Optoelectronics;
- Space;
- Biotechnology;
- Nanotechnology;
- Power generation, including renewable sources of energy;
- Environmental protection.

## **Execution**

**Term:** The minister competent for economic affairs shall define the execution period for the offsets; however, this period cannot exceed ten years.

**Multipliers:** (Amendment to the regulations dated May 2007)

A large scale of multipliers are possible:

- For Direct the range is from 1 to 2;
- For Indirect from 0,5 to 1,5;
- In cases specially justified by the interests of the economy or by reasons of security and defence of the State, the offset multipliers ranging from 2,0 – 5,0 may be applied.

**Monitoring:** The foreign contractor is required to submit to the ME semi-annual and annual reports on the fulfilment of offset obligations. The Ministry may request information and make audits within Polish companies that have received orders. To be considered as offset, the foreign part may not exceed 80%. When the foreign part is less than 20%, the full amount of the offset order is accepted but when it is higher than 20%, only the Polish part is considered.

**Banking:** Non-military equipment may be accepted as offset provided that the orders are placed by the contractor not earlier than 36 months prior to the introduction of the economic offer.

**Guarantee/penalty:**

The penalty clause is stipulated each time in the offset agreement.

The Minister of the Economy may on behalf of the Treasury require from the foreign company a guarantee that must be formalised not later than the date of the signature of the offset agreement.

Instead of the payment of this penalty, the contractor may propose a number of concrete offset proposals but in any case No extension of the performance period will be accorded. The total value of these concrete, late offset proposals “is equal to the value of unperformed offset commitments or in case of inadequate performance is equal to the value used to calculate indemnity fees.” This stipulation gives to understand that the once heavily debated penalty system of 100%, is still in place.

**Closed and current contracts:**

As of 1 January 2005, 7 offset agreements were running for a total value of 8000 MUS\$.

## **3.11. Portugal**

### **Offset policy**

**Legal basis:** Law on Military Procurement (LPM). Directives published in “*Diário da República*” no.164 of 16 July 2002. Decree published on 7/08/2006.

**Objectives:** Major defence orders must at least be fully compensated in order to strengthen the position of Portuguese industry. The objectives are to support technological development of the national military and civil industries and to provide industry with the opportunity to actively participate in international industrial structures.

**Threshold value:** 10 MEUR.

**Procurement procedure:** Bids are evaluated on the basis of a weighted sum of the proposed offsets.

The following aspects are taken into account:

- The global value of the offsets that are offered;
- The distribution of this global value between the 3 Groups (see below);
- Technological interest, degree of economic innovation and economic impact of each proposal;
- The value of each proposal and the way of calculation, including the Portuguese added value (VAN);
- Business plan presented by the beneficiary company;
- Execution period and a planning including milestones;
- Identification of the concerned Portuguese companies;
- The degree of the commitment with the Portuguese beneficiaries (agreements).

For evaluation purposes the offset projects are grouped in the following categories:

- Foreign direct investment;
- Technology transfer that improves the competitive capabilities of Portuguese industry;
- Partnerships with Portuguese companies aiming to insert the Portuguese companies in a sustainable way in the global market;
- Partnerships leading to R&D capabilities;
- Export of goods and services;

**Offset agreement:** The offset agreement is negotiated and signed at the same time as the procurement contract.

30% of the proposals must be perfectly defined. The remainder will be given during the execution.

**Responsible authority:** The “Comissão Permanente de Contrapartidas” (CPC; constitution 2006), which includes representatives from the MOD and the Ministry of Economy and Innovation (MEI) is responsible to define and to put in effect the offset programs. The CPC is supported by a Technical Cabinet (GT) and a consultative council wherein the Armed Forces and the Industry are represented.

### **Offset requirements**

**Minimum requirements:** at least 100% of the contract value.

**Direct/indirect:**

- Group I: Direct Offset (15% subcontracting);
- Group II: Indirect Offset in the Defence Sector;
- Group III: Indirect not linked to the Defence Sector.

one-third of offsets should go to groups I and II.

**Business activities:**

- Direct participation of Portuguese industry;
- New exports. For existing commercial relationships, the value used is the average value of the export realised by the Portuguese beneficiary taken over the best two of the previous three years;
- Technology transfer;
- Establishment of consortiums to develop new systems through joint ventures.

### **Execution**

**Term:** Obligations must be fulfilled within the payment period specified in the procurement contract.

**Multipliers:** These multipliers are fixed between 1 and 5 depending on the category of the offset project.

- For the special projects with special economic-social interest, the factor should be at least 3;
- For projects related to defence industries, not less than 2;
- For a project that will support the maintenance during life cycle of the equipment, will be at least 2,5.

**Monitoring:** The “*Comissão Permanente de Contrapartidas*” (CPC) and the ICEP (government agency Investments, Trade and Tourism) are responsible for the follow up of the offset programme.

**Banking:** Accepted offsets may be transferred if they reach at least 1 MEUR. These are valid for a maximum of 5 years after the approval by the CPC.

**Guarantee/penalty:** A bank guarantee of 15% of the total offset obligation is required.

Penalties are as follows:

1% per month on delayed planned projects until a maximum of 15% of the total value of the project;

An extension of the execution period can be given according to the following modalities:

- Increase of the obligations by 10% if the extension is less than 1 year;
- Increase of the obligations by 15% if the extension is longer than 1 year but less than 2 years;
- Increase of the obligations by 20% if the extension is longer than 2 years;

The contractor which does not fulfil his obligations is put on a black list.

The calculated penalties can also be deducted from the payments to the prime contractor.

## **3.12. Spain**

### **Offset policy**

**Legal basis:** No published regulations, but only an internal directive.

**Objectives:** To guarantee the highest degree of national supply in advanced systems to the Armed Forces, the policy seeks to compensate the weakness of the Defence industrial network and also the endemic lack of technology in Spain, by using as catalyst the investments in Defence equipment that were needed for the modernisation of the Armed Forces. Offsets are considered as marketing and development tools.

- Its main objectives are: The acquisition of technology, directly or indirectly related to the acquired systems;
- The recognition of the Spanish industry as a supplier of goods and services by foreign companies and organisations;
- The procurement of technology and documentation not only for the Spanish industry but also for the Armed Forces, in order to carry out the maintenance, modifications and updating of the weapon systems;
- Training in both, operational and industrial Defence-related aspects as well as in areas of civil application;
- Providing the Spanish industry with production opportunities leading to job creation;
- The improvement of quality assurance techniques and projects management;
- Reduction of the deficit in the balance of payments, either by the increase of Spanish exports or by substituting imports by local production.
- Consolidation of strategic industrial sectors;
- Obtaining auto- sufficiency in the maintenance and the support during the lifecycle of the acquired systems;
- Establishment of the bases to enter the external markets by national industries.

**Threshold value:** Not specified.

**Procurement procedure:** The Industrial Cooperation Agreement (ICA) is to be taken into consideration in the evaluation process. The contract can not be awarded if the ICA has not been previously set up. An ICA has to be negotiated and signed prior to the acquisition to any foreign company.

The joint negotiation of the prices and the ICA contribute towards the optimization.

**Offset agreement:** The Ministry of Defence requires the establishment of such an ICA associated to any foreign material acquisition, directly acquired, or through a subcontract offered by a Spanish prime contractor company. Time limits and conditions of execution are stipulated in the agreement.

All the foreign companies which either as prime contractor or as subcontractor of a national prime contractor or as potential suppliers in the case "Foreign Military Sales" (FMS), choose to tender, must sign an ICA before the notification. Only the ICA signed with the finally selected company will enter into force.

**Responsible authority:** The agreements are signed between the company and the “*Dirección de Armamento y Material*” (DGAM of the MOD), which is responsible for this matter. The DGAM tasks the Industrial Cooperation Agency of Spain (“*Gerencia de Cooperación Industrial*”, ISDEFE = “*Ingeniería de Sistemas para la Defensa de España*”) with the negotiation of the Industrial cooperation agreements and the follow-up of it. Doing so, the ISDEFE has a supporting role and has to report to the DGAM. ISDEFE is a public company and chaired by the Secretary of State for Defence. It also cooperates closely with the Ministry of Science and Technology.

### **Offset requirements**

**Minimum requirements:** Fixed by contract. Aim is 100%. Only Spanish added-value is taken into consideration.

**Direct/indirect:** Varies from one contract to the other. Both categories are possible but direct offsets are preferred. Generally, at least 60% must be direct offset.

**Sectors:** Spain prefers offsets in the defence sector. Offset in non defense related activities have to be agreed on a case by case basis. The more, in this latter case, a higher volume of offset is required.

**Business activities:** Direct purchases, cooperation agreements, licenses in the field of sensitive technologies and advanced military technologies, military staff training, and establishment of centres of excellence to ensure development of the transferred knowledge.

### **Execution**

**Term:** Fixed by contract, generally the same period as the main contract.

**Multipliers:** Officially there are no multipliers. Nevertheless, the amount accepted for some projects may be higher than the corresponding invoiced amount ((equivalent to multipliers between 2 and 5).

**Monitoring:** The ISDEFE reports to the Ministry of Defence.

**Guarantee/penalty:** The execution is contractually split up into fixed periods (annual or biannual). If at end of an execution period there is still a deficit, the obligation is increased by 10% of the non-realised portion. The final penalty negotiated and fixed in the contract (generally between 5 and 10%). A deficit at the end of the execution period leads to a penalty in form of liquidated damages payable to the public treasury.

Penalties are applied when all other options have been exhausted.

**Closed and current contracts:**

Since offset policy took off in 1984, 302 industrial cooperation and offset agreements have been signed; 129 of them are still active (situation end 2005). At that moment 7506 MEUR had been credited, of which 6727 MEUR flew to private Spanish companies and 779 MEUR to the armed forces. A total of 900 Spanish companies have been involved through 160 foreign companies with offset obligations.

### **3.13. Czech Republic**

#### **Offset policy**

**Legal basis:** Resolution 9 of January 2005 regarding a “Directive for the implementation of Industrial Cooperation Programmes (IC-programmes).

#### **Objective:**

- the process of transfers of advanced technologies and know-how for the benefit of the Czech Republic;
- opening of new export markets, exports of new commodities or a marked increase of existing exports of the Czech products; in all the cases listed above, emphasis should be placed particularly on high added value products and services;
- strengthening of the Czech economy by transfers of capital in the form of direct foreign investments, with an emphasis on improving the competitive ability of advanced industrial sectors and services;
- initiating positive changes in employment levels, especially in selected regions of the Czech Republic;
- the development of new research and development capacities and capabilities,
- increasing the potential of the tertiary sector;
- the development of environmental technologies;
- further economic cooperation projects, which will bring provable and quantifiable benefits and contribute to improving the competitive ability of the Czech economy;
- the development of human resources;
- the development of small and medium-sized businesses in the Czech Republic.

#### **Threshold value:**

500 MCZK (17 MEUR) for foreign main contractors; 250 MCZK (8,5 MEUR) for foreign subcontractors of domestic contractors.

#### **Procurement procedure:**

The requirement for an IC program is an indispensable condition for taking part in a public tender.

The National Armament Directorate of the Ministry of Defence negotiates military procurement contracts. Offset is not a criterion in awarding public procurement contracts.

**Offset agreement:** Negotiations concerning IC programs only take off once the foreign supplier has been selected.

**Responsible authority:** An interdepartmental offset Commission with representatives from the Ministry of Industry & Trade (4 members, including the chairman) the Ministry of Defence (2 members), the Ministry of Interior (2 members) and 1 representative of each of the other ministries. This Commission coordinates the preparations, discussions, negotiations, evaluation and audit of offset programmes.

The Commission approves the offset transactions. This Commission is submitted to the Ministry of Industry & Trade.

## **Offset requirements**

**Minimum requirements:** 100% of the contract value.

### **Direct/indirect:**

Both categories are acceptable.

At least 20% of the contract value must be performed as direct offset.

**Sectors:** Defence and “non-traditional” sectors.

**Business activities:** See Objectives

## **Execution**

**Term:** The guidelines stipulate an execution period that shall not exceed 10 years, that starts at the signature of the contract. The interdepartmental Commission can allow longer execution periods for large contracts.

**Multipliers:** No multipliers are given.

**Banking:** The Czech authorities encourage realising Offset before the notification of the contract; this can be counted to fulfil the effective obligation. If the public contract is not awarded to the tenderer, the realised offset can be transferred to another contract within a period of 10 years. If, in a programme, there is an overflow of realised offset, this can also be transferred to a future programme.

**Guarantee/penalty:** Penalties vary between 5% and 10% of the unfulfilled obligations, depending on the result of the negotiations. There will be also a back to back arrangement, in which payments made under the main contract shall be tied to the performance of the IC-programme.

### **Closed and current contracts:**

In May 2005, 4 programmes with a total value of 25000 MCZK (850 MEUR) were running.

### **3.14. Turkey**

#### **Offset policy**

**Legal basis:** “Industrial Participation/Offset (IP/O) Directive” (February 2007).

#### **Objectives:**

Continued promotion and enhancement of the Turkish defense industry through qualitative offset programs.

Offsets are considered as:

- A key opening the doors to high technology, know-how and exports;
- Effective means in launching investments in the defence industry and in other industry branches that requires high technology while developing a technological infrastructure that contributes to an increase in local employment.
- Means to create a local defence industry base that does not rely on sources abroad for every product.
- Means to reduce the foreign currency based payments as a result of defence deals with foreign companies.
- Means for the establishment of long-term cooperation between Turkish and foreign defence industry companies.

The aim is to increase

- the proportion of defence systems produced locally from 25% to 50% by 2010;
- the exports of defence products and services from 200-300 KUSD to 1MUSD per year by 2011.

**Threshold value:** 10 MUSD.

**Procurement procedure:** Tenderer presents his proposals in a file separated from the rest of the offer. This file contains an offset commitment for each category (defined further on) and each year. The evaluation value of the proposal is calculated based on the specific categories and the periods during which the execution takes place.

**Offset agreement:** Signed at the same time as the main contract.

**Responsible authority:** Undersecretariat for Defence Industries (SSM) of the Turkish Ministry of National Defence.

#### **Offset requirements**

- Prospective contractors will be required to guarantee work share, technology transfer and/or strategic partnership with eligible Turkish companies;
- Applicable Law and Language of the IP/O Agreement (Turkish);
- Causality is required for offset projects.

**Minimum requirements:** 50% of the contract value. Only the Turkish added value is accepted. If the Turkish added value of the exported product is higher than 50%, the total invoiced amount is counted.

**Direct/Indirect:** Only direct offset is accepted, but the definition of “direct” has been broadened: all military offsets are accepted.

Categories:

1. Category A:

Local Content: the works to be given to Turkish industry within the scope of the Procurement Agreement;

2. Category B:

The export of defence, aeronautics and aerospace goods and services;

3. Category C:

In defence, aeronautics and aerospace industry and/or other fields requiring high technology;

- Technological cooperation;
- New and/or expanded investment;
- R&D activities.

In the evaluation of the proposals, Categories A and B have a weighting factor 1; Category C has a weighting factor of 0,4.

Transfer of credits between categories is possible but NOT outgoing from C to the other categories. On the other hand transfer of credits to category C can be honoured with a multiplier of 2.

With regard to technological cooperation, R&D and linked to this, training in the defence or high-tech industries, the credit value will be estimated by SSM. These activities have to be performed free of charge.

### **Execution**

**Term:** Generally, the execution period is the same as for the procurement contract. The Undersecretariat for Defence Industries (SSM) may however allow an extension of maximum two years after the termination of the initial execution period.

**Multipliers:** These vary between 1 and 5.

For the following area the maximum multipliers are:

- Platforms: 4
- Systems: 3
- Software: 3
- Subsystems: 2
- Part-components: 1

A factor of 1 is added to these multipliers if:

- The exports are realized by SME's;
- The R&D of the product is realized in Turkey;
- The production in Turkey is really new.

The multipliers accorded for category A are higher than for categories B and C.

**Monitoring:** For each offset proposal, contractors must ask a prior approval from the SSM before starting the activities. Transactions executed out without such a prior approval are not accepted as offset.

Investments can be approved following the prior approval procedure and with the condition that the Eligible Party does not transfer this investment to third parties for at least 5 years.

Temporary credits can be requested by the contractor.

**Swaps:** Swaps can be evaluated by SSM

**Banking:**

Pre-offset or transfers may be granted in the following cases:

- Regarding projects realised during the bidding phase, the realisation of activities in one or more of the mentioned categories, can be taken into account as offset for the company which has won the contract. (validity: 5 years after the acceptance of the pre-offset credit);
- In case the offset realisation exceeds the total offset commitment before the end of the execution period, the overflow of realised offsets can be used for potential future offset commitments (validity: 5 years after the date of crediting);
- In the case the offset in Category B realized after the effective period of the IP/O Agreement by the companies which fulfilled their obligations, can be counted towards their existing or future IP/O commitments. (validity: 5 years after the acceptance of the pre-compensation credit);
- The realisations in Category B realized via exports to new markets can be counted to their potential IP/O commitments (validity: 5 years after the date of crediting).

Banking of excess offset credit can, under certain conditions, be transferred to another eligible company.

**Guarantee/penalty:** A bank guarantee of 6 % of the total commitment, to cover the potential penalty must be laid down before the signature of the offset agreement.

The format and the content of the bank guarantee is imposed by SSM.

The Contractor is evaluated at the end of each intermediate Program Period (milestone).

To fulfil the non-realised part the contractor receives an additional period of 6 month with a penalty at a rate of 1%/month (= 6% max).

The same procedure is repeated at each milestone but commitments already subjected to penalty are no more subjected during the next period. Only in the case that the escalation principle is applicable the non-realized commitment from an earlier period is added to the following period.

The payment of the penalty does NOT relieve the contractor of their offset obligation. If at the end of the last period there exist unfulfilled offset obligation for which there can not be found a solution in short term, the remaining obligation is added to contractor's other existing or future obligations.

The Contractor shall submit Annual Reports stating the status of his realisations. In case the reports are not submitted on time, the Contractor should pay 5 KUSD.

**Closed and current contracts:**

Since 1985: an amount of 6100 MUSD of offset has been committed trough 63 offset agreements;

Begin 2007: 3300 MUSD has been fulfilled, the remaining 2800 MUSD waits to be fulfilled. 20 out of 60 offset programs have been successfully completed.

43 offset programs are still effective.

Before the new Directive 2007, 53% of the realisations were direct, 47% indirect offset.

Almost 70 % of exports realized by the leading Turkish defence companies are realized through offsets.

## **3.15. United Kingdom**

### **Offset policy**

**Legal basis:** Defence Industrial Policy (DIP), 2003, reviewed in the light of the Defence Industrial Strategy (DIS)

**Objectives:** The United Kingdom operates an Industrial Participation (IP) policy which aims to encourage successful offshore companies to offer UK companies the opportunity to bid for defence work. IP proposals are invited from foreign companies bidding either as prime contractors or as subcontractors to a UK prime contractor. The aim is to help position UK companies in supply chains.

**Threshold value:** 10 MGBP (15 MEUR). The threshold has been set at 50 MGBP for French and German companies (75 MEUR), in conformity with bilateral agreements (“reciprocal waiver agreements”).

**Procurement procedure:** Foreign companies are invited to annex industrial participation (IP) proposals to their bid. Proposals are evaluated focussing on quality, quantity, risk associated with the proposal, the potential export of the equipment and the past performance in previous IP programmes with the Ministry of Defence. The evaluation is then transferred to the “Industrial Participation Unit”(DESO) and forms a criterion of the decision making process.

**Offset agreement:** During the bidding phase, the MOD negotiates industrial participation agreements with foreign firms (so called Letters of Agreement, LoAs), that sets out the basic rules for the fulfilment of any eventual IP obligation. Once the contract is notified, the LoA of the successful bidder is activated.

**Responsible authority:** The “Defence Export Services Organisation (DESO)”, within the British Ministry of Defence. In April 2008 the DESO’s work will be splitted between the UK MOD and the newly formed Defence & Security Group within the UK Trade and Investment (UKT&I) department. Under the new policy UKT&I will be charged with the defence trade promotion.

### **Offset requirements**

#### **Minimum requirements:**

Bidders decide amount of IP and who to work with.

The proposals must concern defence work of equivalent quality.

It is important that IP proposals provide a clear picture of the capabilities that will be created or sustained in the UK.

The obligations can be increased during execution of the program depending on the changing circumstances and if in an amendment in the contract the foreign part would raise.

**Direct/indirect:** Direct as well as indirect IP are acceptable.

Direct means directly related to the supply to the MOD UK.

Indirect means defence work with UK companies on third party sales of the system and other defence programmes.

**Sectors:**

The following proposals are eligible:

- Contracts for the development or production of defence equipment, supply of defence services and materials, or contracts in the field of defence research and development if such contracts result in new business for UK defence companies;
- Transfer of technology and/or technology improvements to UK companies in defence areas;
- Contracts for defence research & development. IP credit will be considered in relation to the extent that the UK company is able to use the intellectual property rights derived from the research for its own purposes;
- Marketing assistance may be considered for IP credit provided it is free of charge and results in the UK company concerned winning third party orders.

**Execution**

**Term:** The same time-frame as for the procurement contract.

**Multipliers:** No multipliers have been established.

**Monitoring:** The DESO monitors the fulfilment of industrial participation. The foreign contractor must submit biannual reports, in a fixed form, listing the IP activities implemented for which IP credit is claimed. Before implementation, projects regarding technology transfers, R&D agreements, and marketing assistance have to be discussed with the DESO in order to be recognised as IP. The DESO requires that British companies confirm the reported business activities.

IP credit is awarded on the basis of the replies received from the UK companies judged against the eligibility requirements.

**Swaps:** There is no specific policy but the UK is willing to consider that the IP obligations that foreign companies have in the UK may be exchanged with the obligations that British companies would have in other countries, by means of an agreement between the responsible authorities in the two countries. In the past abatements have been carried out with Israel, Italy, the Netherlands, South Africa, Switzerland and Canada. Government offset authorities have lead role in this process.

**Banking:** Current IP linked initially to a specific contract are not eligible for transfer to other IP obligations. Nevertheless, the MOD is prepared to grant pre-offset credits to foreign companies actively pursuing a specific future MOD programme and wishing to accumulate IP-credit in advance of the selection announcement for that future programme, or which have an over-achieved IP on a existing IP programme. These IP credits remain valid for 5 years and can only be used to cover 50% of the new obligation.

**Guarantee/penalty:** While LoA's are not legally binding, the DESO takes the past performance/underachievement into account during the acquisition phase for future tenders.

**Closed and current contracts:**

In 2003, 300 British companies won contracts for a total of 600 MGBP (900 MEUR) through the IP system.

Mid 2004 the total IP value was nearly 4900 MGBP (7200 MEUR).

At that moment the outstanding IP value was nearly 1730 MGBP (2540 MEUR).

## **3.16. Sweden**

### **Offset policy**

**Legal basis:** Act on Public Procurement; Industrial Participation Programme (31 March 1999).

**Objectives:** Industrial participation (IP) is considered as “an instrument for Sweden’s defence and security policy to secure the Armed Forces demand for industrial capacity and competence in the defence material area”.

The 3 main objectives are:

- to secure the participation of the Swedish defence industry in manufacturing and to gain know-how on subsystems (direct IP);
- to increase the export efforts of the Swedish defence-related industry and the supply of sophisticated technology to the defence-related industry and research agencies (indirect related IP);
- to promote internationalisation and exports of Swedish defence industry and research agencies (indirect related IP).

**Threshold value:** 100 MSEK (10 MEUR).

**Procurement procedure:** IP agreements must be defined and quantified before procurement contracts are awarded. Among other requirements established in the RfQ (Request for Quotation), IP is one of the criteria used to evaluate and select the supplier. A fixed percentage must be concretised by signed orders before the signature of the main contract.

**Responsible authority:** Sweden’s Defence Materiel Administration (FMV) is a independent civil authority reporting directly to the government and is responsible for administration and monitoring. In addition, an IP Reference Group, with representatives of the FMV, the Swedish Armed Forces (FM) and the Swedish Research and Defence Agency (FOI), issues general policy recommendation on IP’s and handles individual cases. Representatives from the Swedish defence industries (SOFF) will be invited to participate in this reference group on a regular basis.

### **Offset requirements**

**Minimum requirements:** Minimum 100% of the contract value. Sweden neither requires offset from nations that don’t do it themselves. In practice however this has few implications, because (nearly) all countries require offset in some form.

**Direct/indirect:** Both categories are acceptable.

**Sectors:** Since 2004, only defence-related industries have been involved.

Priority sectors: electronic warfare technology; advanced signature; aerospace technology; information technology; “command, communication and control”; electronic warfare, man/machine interaction, under water technology; weapon technology and ballistic protection; unmanned vehicle technology, e.g. UAV; modelling and simulation; signature adaptation and camouflage; use of FMV test facilities.

Equipment and services of low technological level outside the above-mentioned sectors are not considered unless they are in alignment with the main objective of the IP policy. High-tech equipment and services (R&D, engineering, etc.) from other sectors may be considered if the technological level exceeds this of the main contract. Traditional exports or increased business flow of existing relations are not eligible.

**Business activities:** Co-production (direct participation), maintenance contracts or subsequent modifications of the procured systems or subsystems, technology transfers in certain areas (indirect participation).

### **Execution**

**Term:** IP obligations must generally be fulfilled within the execution period of the main contract. Exemptions may be made for long-term contractual cooperation. In most cases, there are two intermediate milestones at which an established percentage of the total obligation must be fulfilled (after 1/3 and 2/3 of total period).

**Multipliers:** In principle no multipliers are applied. Multipliers may, however, be granted for indirect R&D projects in Sweden (maximum multiplier = 3 and limited to 10% of the value of the main contract).

**Monitoring:** Each year, the supplier submits a report to the FMV in order to be credited for a part of its offset obligation. This administration monitors the IP agreements and conducts financial audits. This monitoring and assessment data are then analysed by the Reference Group.

**Swaps:** Up to 15% of the total obligation may be exchanged between foreign obligations in Sweden and Swedish obligations abroad, but solely in the case of new business opportunities.

**Banking:** IP activities realised between the date of the RFQ and the signature of the procurement contract may be banked to be used within this procurement contract. On the contrary, the overachieved part of the realised IP in the main contract, can, as a general rule, not be transferred to other IP contracts. However, when the IP commitment has been fulfilled, the overachieved IP credits may be granted and formalised in a separate agreement. This excess credit must be utilised within 3 years.

**Guarantee/penalty:** There are 5% penalties at each milestone and at the end of the execution period, each time on the non-fulfilled part of the obligations.

## **3.17. Switzerland**

### **Offset policy**

**Legal basis:** “Principles of the Federal Council regarding the Armament Policy of the DDPS” (dated 29 November 2002).

**Objectives:** Offsets are considered as a means to ensure the Swiss industrial independence. This can be realised through the acquisition of know-how. The presence of foreign expertise lowers the dependence from abroad. It must also tend to open foreign markets to the Swiss industry and strengthen its position in these markets. Offsets are an important political argument since major defence contracts must be approved by referendum.

**Threshold value:** 20 MCHF (13 MEUR)

**Responsible authority:** Armasuisse (the former Defence Procurement Agency; now Procurement and Technology Center), a section of the Federal Department of Defence, Civil Protection and Sports (VBS - DDPS).

### **Offset requirements**

**Minimum requirements:** 100%.

There is no longer a requirement for a regional distribution.

**Direct/indirect:** When direct participation is impossible or seems to be an inadequate solution, indirect offset is allowed in order to complete the IP bid.

Defense acquisitions with a large direct participation content enhance the political acceptance of defense expenditures.

**Sectors:** Military and civil sectors.

### **Business activities:**

**Direct:** complete or partial manufacturing under license, coproduction, subcontracting, joint ventures and other forms of cooperation. During the evaluation of a project, the opportunity for direct participation is evaluated on the basis of aspects such as national security and competitiveness within the concerned Swiss industry.

**Indirect:** The Swiss Defence industry is too small to absorb all the offset. So the offset is not limited to defence sector.

The following criteria apply to indirect IP:

- Support to the Swiss exporting industry to the penetration of new markets or to the consolidation of its market position;
- Competitiveness of Swiss products is a prior and indispensable condition;
- Swiss industry itself must be interested in the potential orders; the industry must make its own effort to realize offset transactions;
- Technology transfer;
- Cooperation with Swiss universities.

Consumer and agriculture products, consultancy, banking services, tourism and insurance services are NOT eligible as IP.

### **Execution**

**Term:** The offset obligations must be fulfilled within the 3 years after the execution of the main contract.

**Multipliers:** vary from 1 to 1,5; very exceptional 2 (local content > 51% can sometimes be counted as 100%).

**Monitoring:** To receive credits, foreign contractors are required to present for each proposal a written attestation by the Swiss company proving that the order was really placed and that it fulfils the applicable criteria. Armasuisse and the representatives of Swissmem (Swissmem unites the Swiss engineering, electrical and metal industry and associated technology-oriented sectors) are responsible for auditing and decide on eligibility of the proposals.

**Guarantee/penalty:** Penalties, applicable in case of non-fulfilment of the offsets, have recently been introduced.

### **3.18. Other countries with offset policy**

#### **Europe**

Bulgaria  
Estonia  
Croatia  
Latvia (being prepared)  
Lithuania  
Romania  
Slovakia  
Slovenia

#### **South-East Asia and Oceania**

Australia  
Brunei  
Philippines  
India  
Malaysia  
Singapore  
Taiwan  
Thailand  
New Zealand  
South Korea

#### **Middle East and Africa**

Israel  
Kuwait  
Libya  
Saudi Arabia  
United Arab Emirates  
South Africa

#### **America**

Brazil  
Chile  
Colombia

### **3.19. Conclusion**

Most of the Western countries demand some form of offsets linked to military procurements. The used terminology varies: “Industrial and Regional Benefits” (Canada), “Industrial Cooperation” (Denmark, Spain), “Industrial Participation” (Finland, Greece, , Sweden, Switzerland and the United Kingdom), “Offsets”/Compensations (other countries in this document). Other countries that have their own strong defence industry use alternative methods for supporting their defence sector, e.g. in the USA (“Buy American Act”), France, Germany,..., and for this reason are not included in this document.

In Norway, Switzerland, the United Kingdom and the Mediterranean countries, the Ministry of Defence is responsible for the economic aspects of defence orders. In the other examined countries, the Ministry of Economic Affairs or Trade lines out the offset policy, eventually in close cooperation with the MOD.

The objectives are first and foremost economic ones, however in some countries, the strategic factors also play a role (Turkey, Israel...). For Eastern Europe countries, the offsets are considered as an important means for restructuring their ageing industry and for integrating them into the world economy. In general, the procedures are established on a legal basis and in a more or less detailed manner. Large countries like Italy and Spain are exceptions to the extent that they rather apply an informal offset policy.

The threshold of military contracts for which offsets are requested is in the majority of cases between 4 and 10 MEUR.

Most of the countries in this study fix an offsets level of 100% of the procurement contract with the MOD. But some of them such as Turkey ask for a lower volume, while in other countries the offsets volume linked to some contracts can even be higher than 100% (Portugal, Austria, ...).

The offsets activities can go from the production of subassemblies by and the coproduction with local companies, the transfers of technology, to the training or to the export promotion. Also direct investments (Greece, Hungary, Austria and Czech Republic), investments in venture capital (Canada and the Netherlands) and even financial contributions to universities (Canada, Poland and Switzerland) can be considered. For some of these activities multipliers can be granted.

Although most of the countries prefer direct offsets, a combination of direct and indirect offsets can also be accepted. The definition of Direct and indirect offsets varies from one country to the other. Most of the countries having an offsets tradition mainly involve the industrial benefit in the defence sector or in “dual-use”.

When this is not possible, due to the fact that these sectors are not present on the local market, also orders in other sectors for products of equivalent technological level can be considered. For this latter option in indirect offsets the east European countries handle sometimes a wider definition.

According to our study, industrial benefit could play a role in the evaluation of the global offer in most of the countries. A report from the American authorities<sup>6</sup> goes in the same direction. The weight or the importance of the economic benefit in the global evaluation is not systematically figured in the applied principles. For the countries which publish this information, the weighting factor is mentioned case by case in each RFP. For some countries, the economic commitment is an obligation which constitutes a determining selection criterion.

The offset obligation is fixed in the main contract with the MOD or in a separate agreement between the authorities and the foreign supplier. There are two procedures. The offsets commitments are fixed with each potential supplier before the defence contract is awarded. After the contract is awarded, the offset commitments of the selected supplier enter into force. In other countries, the offset agreement is signed only after the contract has been awarded.

Generally, penalties are imposed in case of unfulfilled offset obligations (a penalty corresponding to a fraction normally 10% of the non-executed part.) Some countries draw up a black list of companies that have not met their offset commitments or take this into account for future procurements.

This comparison and derived conclusions are snapshots and are subjected to changes.

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<sup>6</sup> US Department of Commerce, 2005, “Offsets in Defense Trade”, “Ninth Study Conducted Under Section 309 of the Defense Production Act of 1950”, Washington D.C.

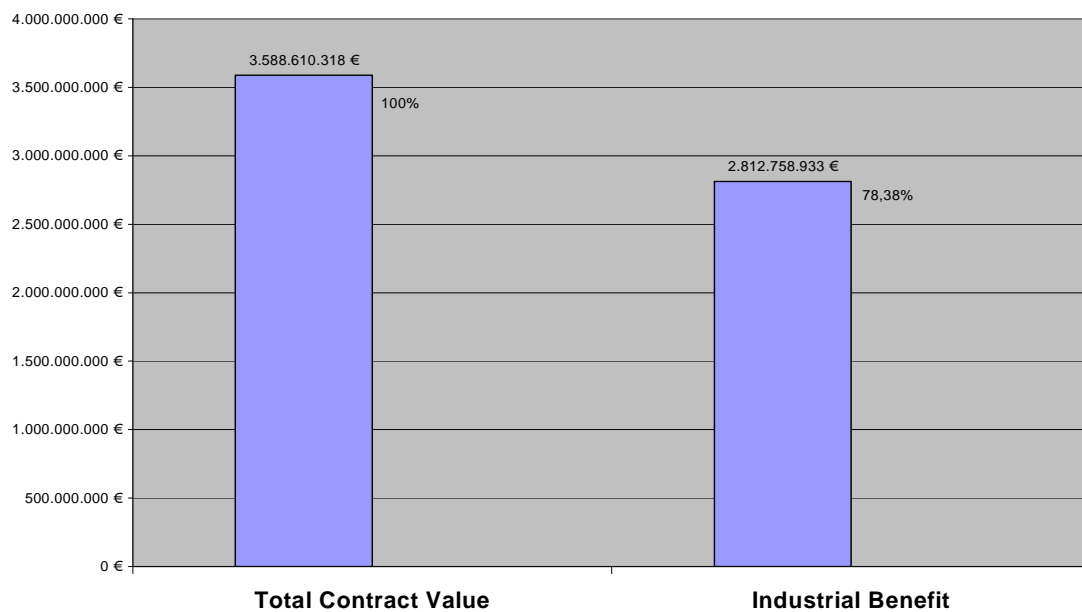
## 4. SOME STATISTICS FOR BELGIUM

Remarks:

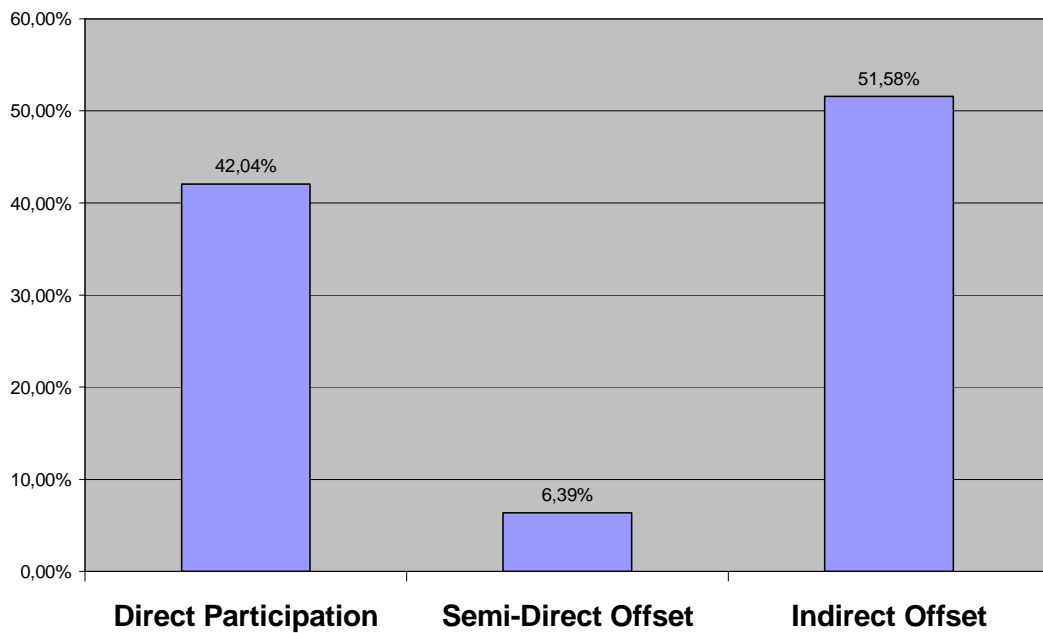
The impact of the considerable investments by the BE MOD in the period 2004-2006 is not yet really visible because in fact, these programmes are for the moment still in a start up phase or in a beginning stage and it must be underlined that the approval of the IB is done on the basis of invoices.

### **4.1. Global Overview**

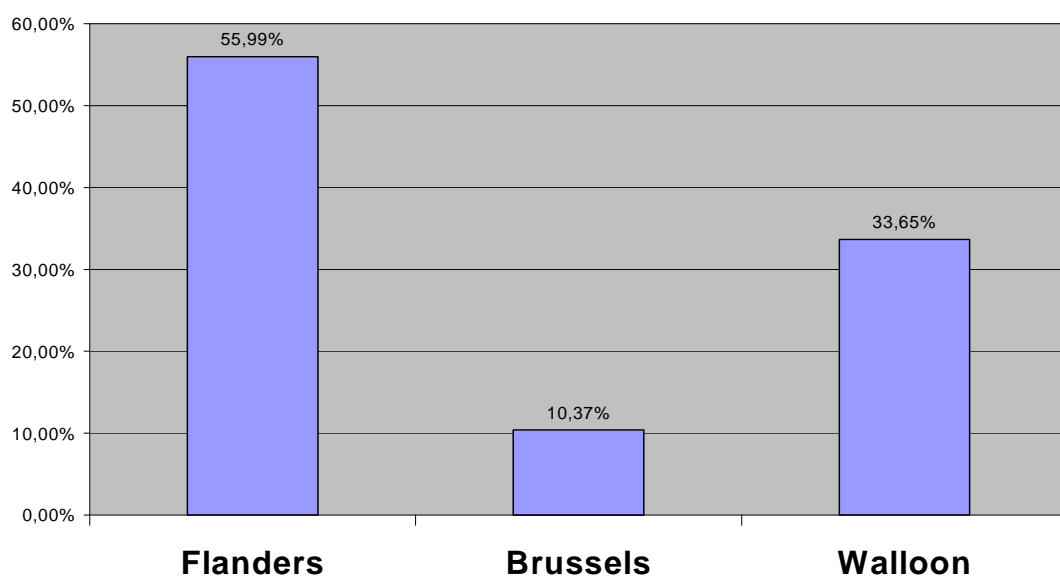
*( based on the important programs since 1983)*



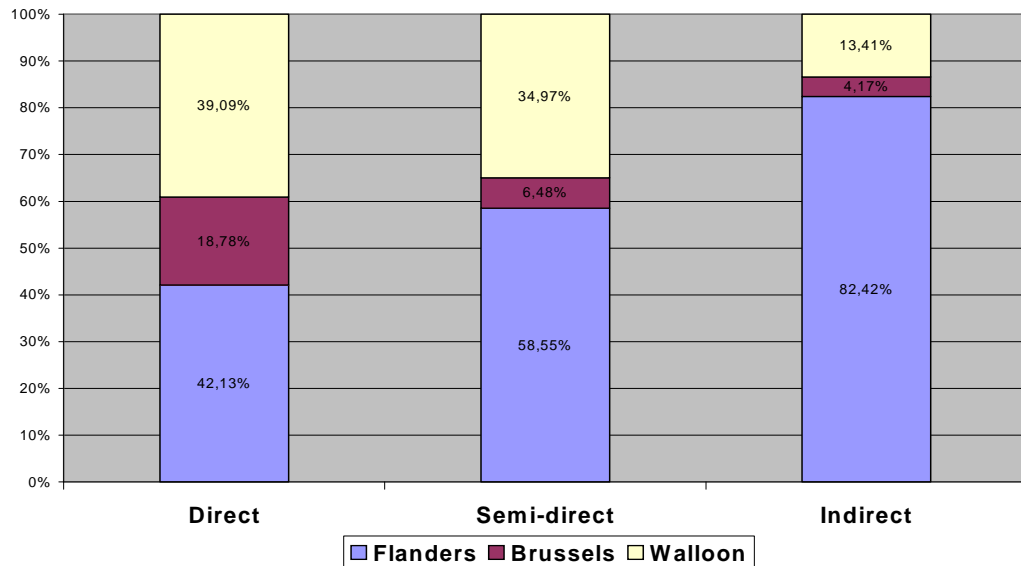
## **4.2. Distribution Industrial Benefit in categories** *( based on the important programs since 1983)*



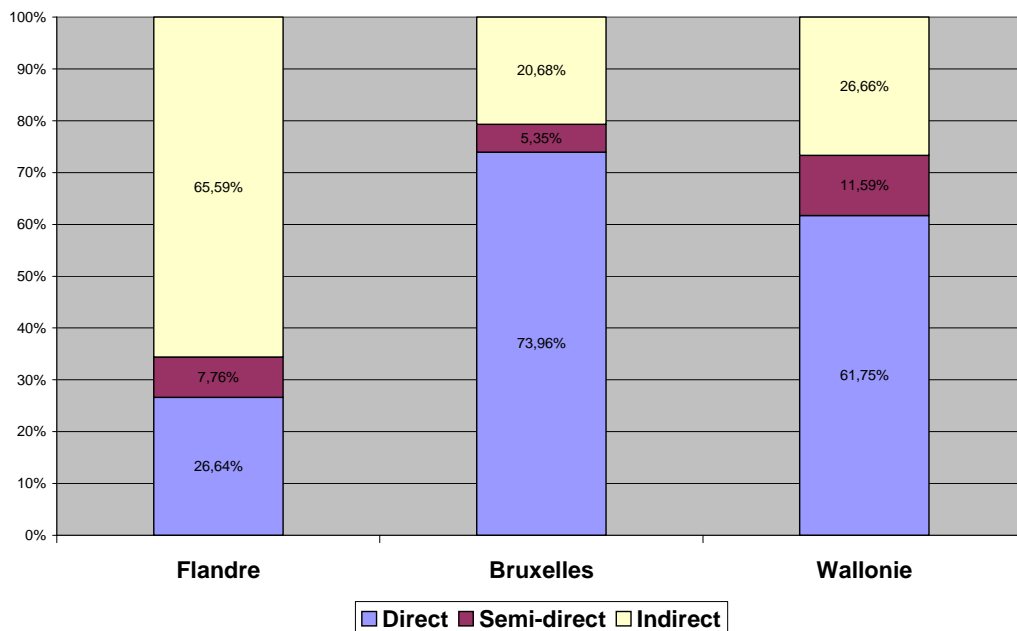
## **4.3. Regional distribution Industrial Benefit** *( based on the important programs since 1983)*



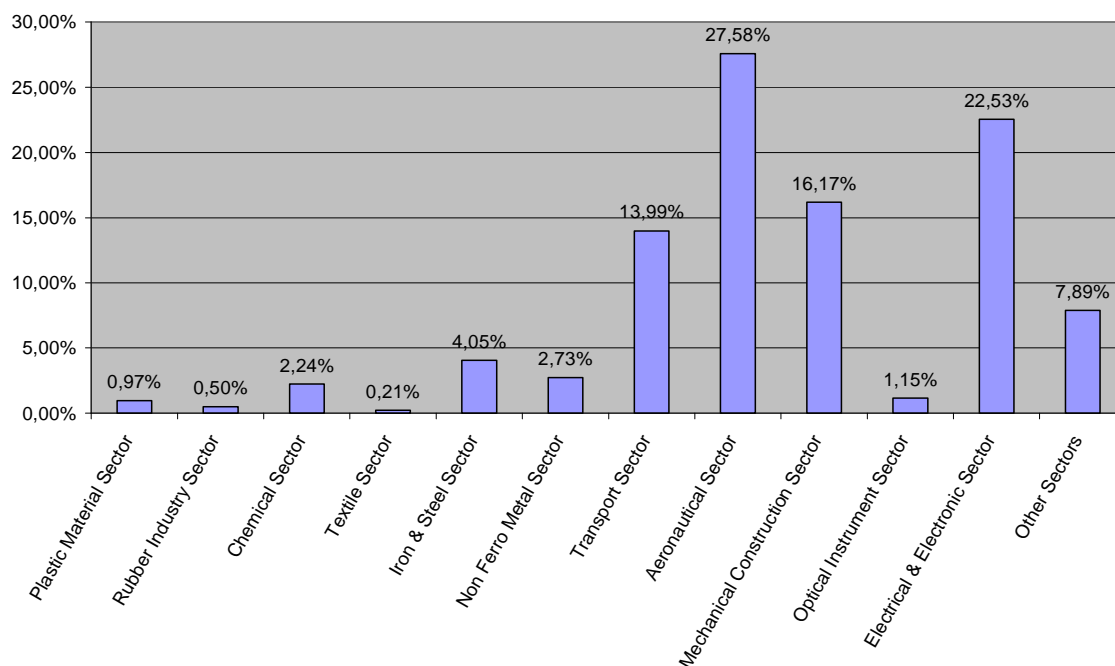
#### **4.4. Regional distribution of Industrial Benefit in categories** *( based on the important programs since 1985)*



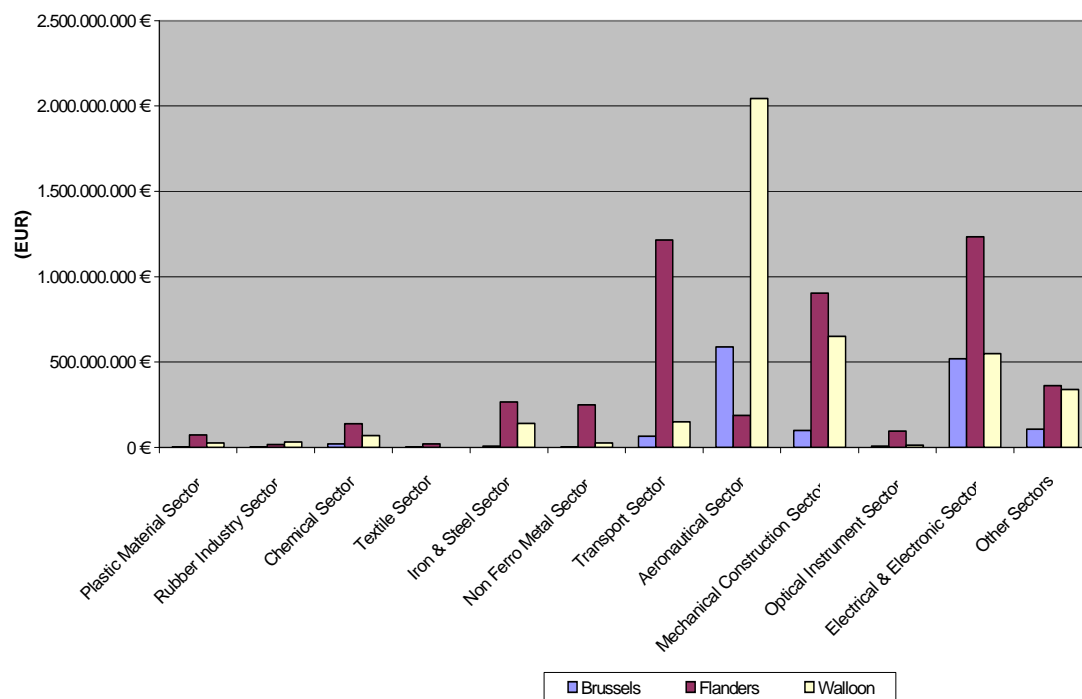
#### **4.5. Distribution in Categories of Industrial Benefit for each region** *( based on the important programs since 1985)*



#### **4.6. Distribution Industrial Benefit as per industrial sector since 1970**

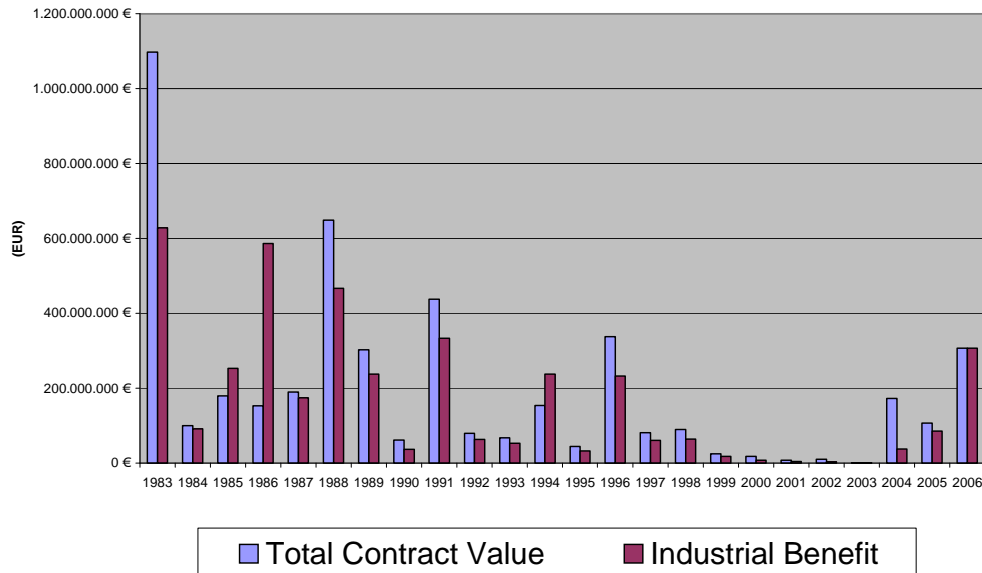


#### **4.7. Regional distribution of IB per industrial sector (In accepted Belgian added value; since 1970)**



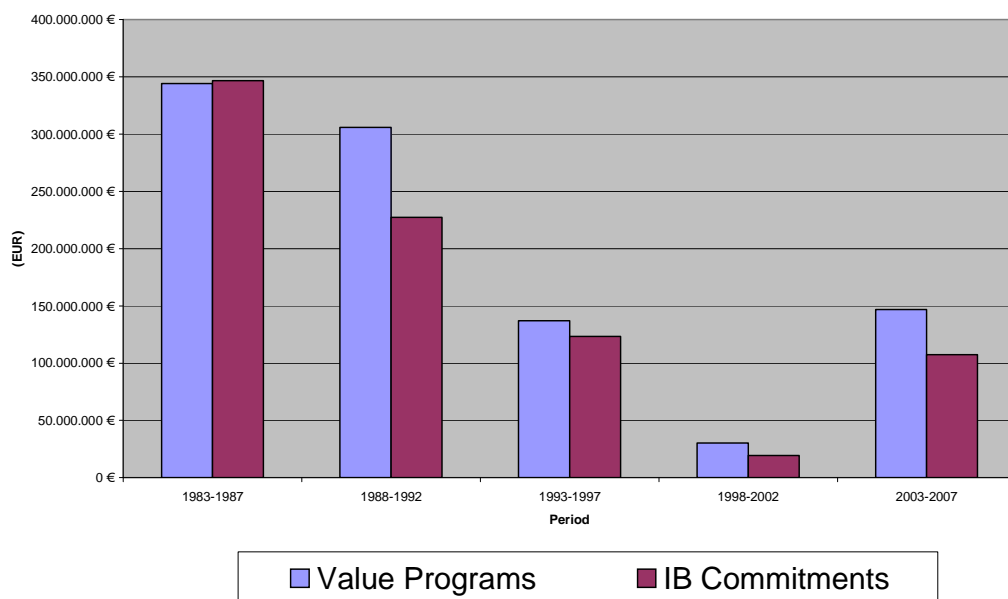
## **4.8. Evolution Value Defense Programs - Economic Commitments**

*(only programmes WITH IB)*



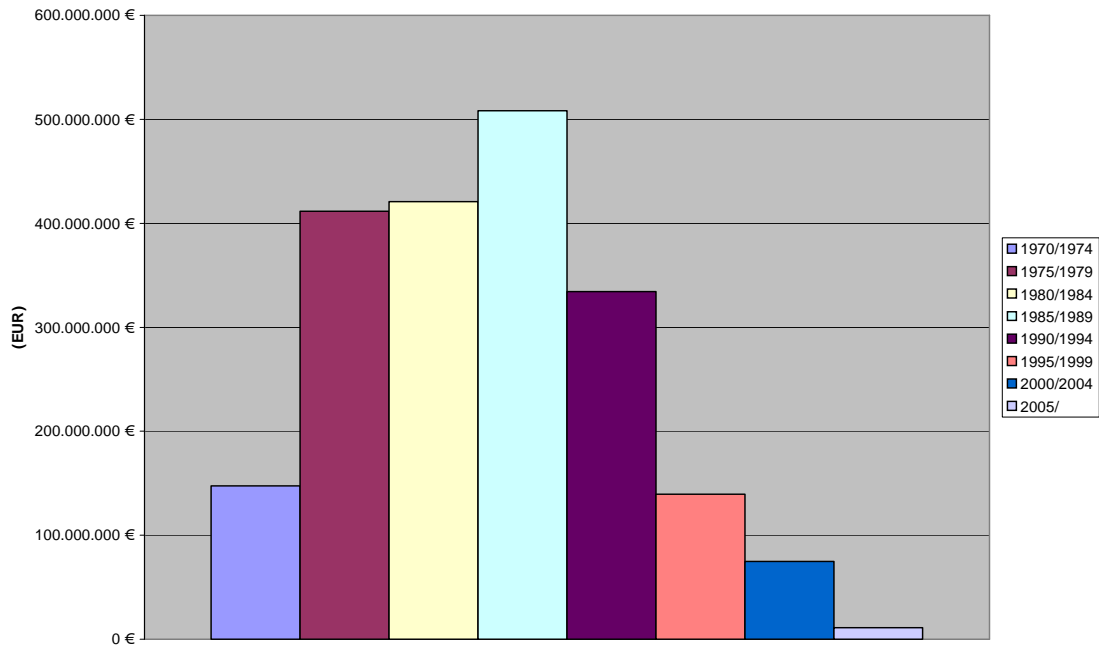
## **4.9. Evolution Value Defense Programs - Economic Commitments**

*(only programmes WITH IB; averages over 5 year)*



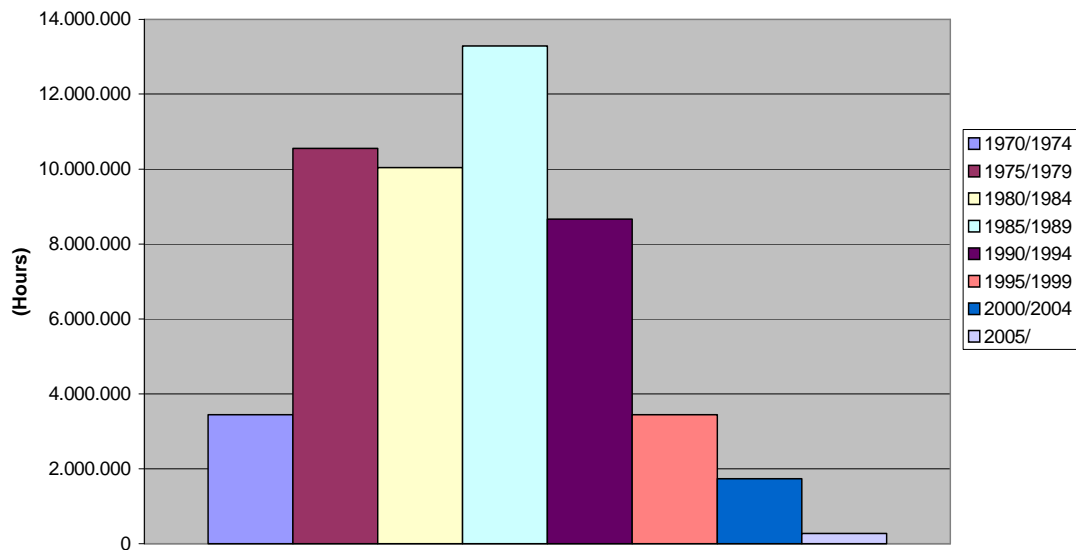
## **4.10. Evolution Industrial Benefit (Realised)**

*(Averages over 5 years, 1970-2007)*



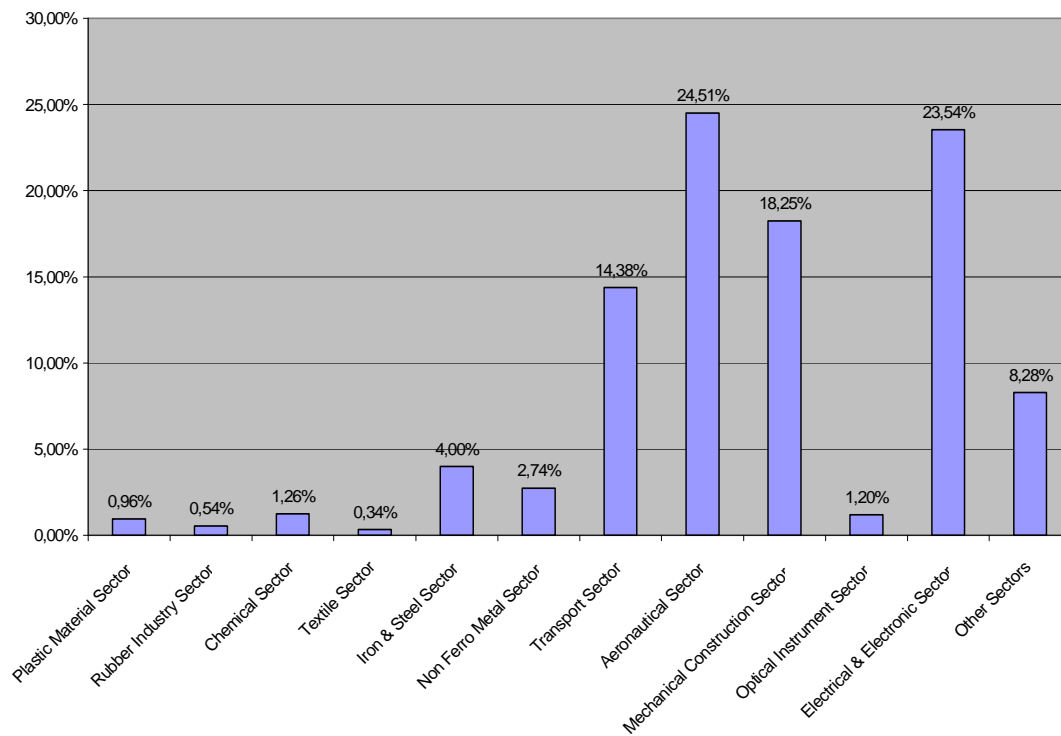
## **4.11. Evolution employment linked to Industrial Benefit**

*(working hours; averages over 5 years; 1970-2007)*



## **4.12. Distribution employment linked to IB per industrial sector**

*(in % of the total number of working hours; 1970-2007)*



## **5. ADVANTAGES AND DISADVANTAGES OF INDUSTRIAL BENEFIT**

The industrial benefit system has always been controversial and will probably always be so. The following aims to provide an objective description of the phenomenon.

### **5.1. Disadvantages**

#### **1. Additional costs linked to offset**

Industrial benefit requirements in military contracts are a departure from the free market principle. Since other criteria than cost and quality are taken into account, the cost of the acquired equipment might be higher. Few studies have been able to quantify scientifically this possible overcost. In a study on the Scandinavian offset policy, overcosts for Finland have been estimated at 10 to 15%<sup>7</sup>. Other studies only take into account the following costs linked to industrial benefit: negotiating costs, the setting up of new production lines, training and technology transfer costs, administrative costs, The Finnish “National Audit Agency” reported an overcost of 3 to 6% for the Finnish programme F/A-18 Hornet (1999)<sup>8</sup>. Other authors mention an increase due to the enumerated costs of 7 to 10% of the contract value<sup>9</sup>.

As far as Belgium is concerned, some authors even mention an overcost, due to industrial benefit, of 20 to 30% for the procurement of armament systems<sup>10</sup>. As these statements can hardly be proven objectively, it is clear that these figures percentages are largely exaggerated. There is no scientific proof that offsets might lead to such an overcost. Studies made at different times by different superior officers at the Royal Military School about military procurements have never proven such overcosts. In 1993, the Ministers of Defence and of Economy ordered a study from the Central Council of Economy. This study was conducted by four independent university teams and was unable to scientifically prove that such overcosts were inherent to industrial benefit. Furthermore, the defence market is not necessarily a completely free market. The final contract price depends on the competitors, not only on the costs.

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<sup>7</sup> Hagelin, Björn, 2004, “Nordic offset policies: changes and challenges”, in: Brauer, J. and Dunne, J. (Eds), 2004, “Arms Trade and Economic Development”, Routledge, London, p. 143.

<sup>8</sup> Brauer, J. and Dunne, J. (Eds), 2004, “Arms Trade and Economic Development”, Routledge, London, p. 160.

<sup>9</sup> Markusen, A., 2004, “Arms trade as illiberal trade”, in: Brauer, J. and Dunne, J. (Eds), 2004, “Arms Trade and Economic Development”, Routledge, London, p. 71.

<sup>10</sup> Struys, W., 2002,, “Offsets in small countries: Between Scylla and Charybdis?”, ECAAR Conference on Offsets and Economic Development, 25-27 September, Cape Town.

Moreover, if we might assume that there was indeed a overcosts of 15 to 30%, this would mean that in the CUP CMT programme (modernisation of mine hunters in the Dutch and Belgian Navy), carried out through a contract between the Dutch Navy and a foreign (German) contractor, and, following an advise from the Belgian Ministry of Defence, requesting for offsets only for the Dutch industry over the entire programme, then the Belgian Ministry of Defence would contribute to the overcost due to offset orders in the Dutch industry for the part that in fact had to return legitimately to the Belgian industry. This dubious situation was at that time reported by the Minister of the Economy to the Council of Ministers, but apparently in vain.

A study conducted in the Netherlands by an independent consultancy office (PriceWaterhouseCoopers)<sup>11</sup> assessed the possible overcost at less than 3% based on “facts and figures”, without taking into account of the multiplied positive impact of offset orders. These conclusions are confirmed by a Belgian study<sup>12</sup> indicating that for Belgium, a country in a similar situation, any overcosts are much closer to 3% than to 30%.

Furthermore, Belgium does not impose any industrial benefit obligation to foreign tenderers. The proposed industrial benefit only plays a role in awarding the contract if the evaluation of the offers concerning the military requirements and the price made by the MOD results in so called “comparable” offers<sup>13</sup>. The tenderer which obtains a high score in the economic assessment with a high overcost, will have certainly a bad ranking in the financial assessment of the MOD, where the price of the procurement is an important evaluation criterion.

Whatever the case, from a purely practical point of view, we can not deny the fact that some overcosts are possible in some cases, however it is a highly exaggerated to pretend that these are in the range of 20 to 30%. Furthermore, we should look not only at the costs, but also at the benefits of the system. These might justify a slight overcost.

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<sup>11</sup> PWC Consulting, 2002, “Kosten/baten-analyse van het Nederlands compensatiebeleid”, The Hague.

<sup>12</sup> BISCOP, Sven, 2002, “The ‘Hardware’ of the European Security and Defence Policy. Defence procurement and the defence industry in Belgium and the smaller European countries. Consultancy assignment for the Belgian Defence and Security Industry Group (BDIG)”, presented to the Industrial Compensation Council on 6 February 2003.

<sup>13</sup> This means that in the ranking made by the MOD, there are offers with scores falling within a 10% margin in report to the score of the first ranked offer.

## **2. Offsets are an obstacle to competition**

This is probably a (justifiable) argument for countries where all sorts of severe conditions are imposed in terms of offset. In Belgium however, **not any** condition is imposed to foreign tenderers, and the more, they are not even obliged to introduce an economic offer. Furthermore, **not any obligation nor restriction** is imposed on the overall volume of the industrial benefit, **nor** on the distribution into categories, **nor** on the regional distribution of industrial benefit, nor on the recipient of the offset (SME, industrial sectors). So it is hard to pretend that it constitutes a barrier to competition, especially when we look at other (European) countries where various restrictive measures are in force.

## **3. Offsets are a “short-term solution”**

This statement can indeed sometimes hold water, but the aim of the FPS Economy has always been, if possible, not to limit the offset to a “one shot” operation, but rather to tend to long-term business relationships. This is the reason why, for example the execution period for offset is not limited to that of the Defence contract. Longer periods are accepted to realise the industrial benefit, so that long-term cooperation can be fully developed (for example through framework contracts). This is confirmed by different success stories in Belgium.

## **4. Offsets (mainly indirect) are by nature of a lower technological level.**

It should be pointed out that in the economic clauses of purchasing contracts, the FPS Economy strictly applies the recommendations of the Parliamentary Investigation Commission on military procurements. These recommendations are included in the aforementioned Royal Decrees. It is stated that the offset must “preferably be of a high technological nature”. In the economic evaluation by the Belgian responsible authority (FPS Economy), high technology offset is higher appreciated. Also during the execution phase, the FPS Economy strictly monitors the high technology aspect.

## **5. The causality link of (indirect) offsets cannot often be proved.**

Using all means available, the Administration attempts to verify the causality link of an order. If the contractor cannot prove this link, the proposed order is rejected.

However it must be granted that it is often difficult to verify this aspect.

## **5.2. Advantages**

*From a list of examples (limited but not exhaustive), a number of advantages of the system can be illustrated:*

### **1. Offsets often result into long-term trade relations.**

We need only to list some illustrative examples of contracts with offset commitments, where some of them have been signed more than 25 years ago, which are contractually completely closed, but where the Belgian companies still receive orders:

- THALES BELGIUM - RAYTHEON (in the frame of the SEASPARROW programme)
- BARCO - RACAL
- RECTICEL – MERCEDES
- SABCA LIMBURG – DASA
- COMPOSITTRAILER – LOCKHEED MARTIN
- BARCO – HONEYWELL

In this list, the F-16 programme should certainly not be forgotten; today, almost 30 years after signing the agreement protocol, Belgian companies are still receiving important orders for F-16 components.

### **2. Offsets create opportunities to penetrate foreign markets.**

The international defence market lacks openness. Without references and the more without national references, it is very difficult to be considered as an equal player in other countries. The position of Belgian companies on the international market has been strengthened by orders resulting from offsets obligations linked to procurements by the Belgian MOD.

The involvement in the F-16 programme has enabled for example TECHSPACE AERO to produce spare parts, not only for European Airforces but also for the USAF.

It has for instance enabled SABCA, even in competition with the OEM (the Original Equipment Manufacturer), LOCKHEED MARTIN, to sell wings to Norway and to update planes for Portugal and Venezuela. The contract signed by BATS with the Belgian army for the supply of radar equipment has also enabled this company to win a competition in the Netherlands.

### **3. Offsets tend to benefits in the civil sector**

If the F-16 programme had not included commitments for co-production within the Belgian industry, the aeronautics sector would highly probably no longer exist in Belgium. Furthermore, through the know-how acquired in this programme, the concerned companies have been able to successfully take part in the production of civil aircraft (AIRBUS, etc.) and in aerospace programmes (ARIANE).

### **4. Offsets could be a lever for Belgian companies.**

Offsets can help Belgian companies to diversify and offer an opportunity to be introduced to big companies. In this way, through the TRIGAT programme, NEXANS succeeded in convincing MDBA of its capabilities and became a subcontractor of this company. In the same way, offsets enabled SABCA to enter into the aerospace industry, while BARCO, through offset obligations due by SAGEM, evaluated from being a producer of pure monitors to being a producer of console systems, a field in which it has become a world leader.

### **5. Offsets have enabled Belgian companies to improve their competition level.**

In the “fully competitive” AWACS programme, THALES BELGIUM is the only non-American company to have been able to win 2 of the 20 "work packages". In the F-16 MLU programme, the companies SABCA, SONACA, NEXANS and THALES BELGIUM have won several orders in a competitive environment. BARCO is the “Sole Source” for all the needs of HONEYWELL for the C-130 CDU. BARCO wins orders from the French army, even in competition with THALES FRANCE.

### **6. Indirect benefits are not negligible:**

- Employment

The above mentioned Dutch study by PWC calculated that a direct participation of approximately 126 KEUR in turnover, provides work for one person over a year; while for indirect offsets, this figure is 158 KEUR.<sup>14</sup>

- Strengthening the knowledge level of industry

The knowledge acquired thanks to offsets, relates to product and production technology and to internships, and results in the development/improvement of civil and probably military products, the improvement of the efficiency and the quality of the production and of the professionalism in the organisation of the company.

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<sup>14</sup> PWC Consulting, 2002, “Kosten/baten-analyse van het Nederlands compensatiebeleid”, The Hague.

- Strengthening the industry's market position

Marketing and export support received thanks to offsets tends to strengthen commercial contacts, obtaining good results and references in the military field, penetrating new markets, financial support to winning international orders and support for creating facilities in other countries.

- Additional revenues for the country

It is clear that the industrial benefit system has positive effects on the revenues of the country. Not only an important volume of employment is created, with inherent positive effects, but also extra benefits are made by the companies leading to additional revenues for the country.