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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

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BAHRAIN

Technical report: Economic Offset/Import Compensation in the Bahrain context*

Prepared for the Government of Bahrain
by the United Nations Industrial Development Organization
acting as executing agency for
the United Nations Development Programme

Based on the work of N. Afeiche,
Expert in technology transfer
cum investment contracting procedures
(offset arrangements)

Backstopping Officer: V. Gregor
Institutional Infrastructure Branch

United Nations Industrial Development Organization
Vienna

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*This document has not been edited.

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ABSTRACT

The main purpose of the activity, which lasted three weeks, was to assist the Ministry of Development and Industry in assessing the viability of developing offset programmes for Bahrain.

In the course of the mission, the duties laid out in the job description were reviewed and modified to:

a) detailing the concept of Economic Offset;
b) making a comparison of the practices followed in different countries keeping in mind the absence of international standard or code of practice;
c) analysing and detailing the prerequisites or steps to be taken in Bahrain preparatory to the introduction of "Economic Offsets".

Using training materials specially prepared for the exercise, the consultant held in-depth discussions with a pre-selected group of officials from relevant Government Ministries and state bodies in Bahrain towards the attainment of the aforementioned objectives.

The consultant recommends that a committee be entrusted with the work of further assessing the advantages of the Economic Offset over other similar options. Should the Government decide to carry out the system in Bahrain, the consultant further recommends the following:

1. Clarification and analysis of the determining factors such as: elements of risk carried by the offset demand; economic situation and applicable laws of importer's countries; capabilities, needs and difficulties of local companies which could qualify as subcontractors or associates in the offset deal;

2. Clear definition of the goals to be achieved through offset demands, and the prioritization of such;

3. Greater level of product identification;

4. Technical survey of the aluminum industry, which shows very great potential;

5. Preparation of the documents on the following subjects to facilitate the formulation of acceptable proposals by the Contractor/supplier:

    a. Marketing and technical information

b. Law on foreign investments

c. list of the potential local manufacturers eligible for subcontracting;

6. Assessment and further improvement of the foreign investment incentives;

7. Creation of an Authority specialised in Offset Programmes to serve as interlocutor for Suppliers.

FIRST PART

Review of Different Forms of Countertrade in order to determine which transactions are "eligible" as forms of compensation

1. BARTER

Definition:

Direct, simultaneous exchange of merchandise of equivalent value giving rise to no financial payment or transfer of funds and covered by a single contract.

Comments: Barter agreements usually cover one-off deals rather than long-term arrangements. Each party to such transaction must want what the other party offers. Since this simultaneous double coincidence is difficult to achieve, pure Barter transactions have a limited use in the modern world business community. A number of more sophisticated types of "reciprocal trade" have been developed as a result. The most common form is that of Countertrade.

2. COUNTERTRADE

Countertrade covers different types of transactions which can be "eligible" entirely or partly as forms of compensation that the "contractor" (international supplier) under the Supply Contract can or must, undertake in exchange for the Importer/Government's commitment to award such contractor said Supply Contract, such a commitment being conditional on the above transaction.

a. Counterpurchase

Definition:

A transaction whereby the "contractor" undertakes to purchase or arrange for the purchase of products from the Government/Importer's country, of a value equal to an agreed percentage of the main Supply Contract. Such transactions usually involve the signature of two separate contracts - the main Supply Contract and the Counterpurchase Contract - upon which separate payment is due for separate deliveries.

Determining Factors in Counterpurchase

° technical specification and range of products eligible for compensation

° compensation quota (percentage of Supply Contract value that is subject to compensation

° prices of compensation products

° companies eligible to receive orders for compensation products

° duration of obligation and execution schedule

° non-performance penalties

° the right to sell on to third countries

° the right to have third parties execute Counterpurchase obligations

b. Buyback

Definition:

Buyback involves a commitment on the part of the contractor to purchase or Buyback compensation products up to a percentage of the products that are manufactured using the industrial plant supplied under the main Supply Contract, i.e. Buyback can be regarded as a compromise between Counterpurchase and Industrial Co-operation.

Differences between Buyback and Counterpurchase

- In Buyback, compensation products are directly related to the goods or services imported under the Supply Contract. In Counterpurcahse the products are not manufactured using the plant supplied by the Contractor.

- Buyback is usually made on large scale, medium and long-term projects such as the sale of turn-key factories, mining equipment or any other project where technology transfer is a vital element of the deal.

Advantages of Buyback

- For the "Importer Government"

    - self-financing partly of the installation, and thus the possibility of overrunning import budget allocation;

    - acquisition of modern technology;

    - foreign distribution handled by the equipment supplier (the Contractor).

° <u>For the Contractor</u>

- possibility of carrying out a project which is not budgeted for;

- low-price products present commercial advantages, provided that the Contractor can dispose of these products easily.

c. <u>Industrial Co-operation and Joint Production</u>

<u>Definition</u>:

Compensation transaction linked to the main Supply Contract (or Export deal) and involving joint activities and responsibilities in <u>manufacture</u> and/or <u>marketing</u> of the product.

- End users of the product may be one or both of the two parties, or else a third country.

<u>Main Features</u>:

The simplest way of describing Industrial Co-operation would be to draw distinctions between this form of Countertrade and other forms.

<u>Differences between Co-operation and other forms of Countertrade</u>

° Co-operation implies joint responsibility for the execution of a specific programme. Work is divided between the trading partners.

° Co-operation does not exist in any one set form. It can be applied to a wide range of industrial or commercial activities.

- Co-operation can incorporate Counterpurchase or Buyback agreements but only within the broader framework of reciprocal obligations leading to the signing of separate contracts respectively.

- The compensatory or off-sets value of Co-operation contracts is usually very high. This value represents the volume of reciprocal trade to take place over a number of years, and has a technological element that is often essential to execute the contract.

Different Forms of Co-operation

Industrial Co-operation

Depending on the goals which can include:

- For the Importer/Government:

  - improvement of balance of trade

  - access to new technology

  - increased employment

  - autonomy of operation and maintenance of imported plant

  - development of a specific local industry, etc.

- For the Exporter/Contractor:

  - increased exports

  - access to competitively priced goods and labour

Industrial Co-operation gives rise to a wide range of <u>transactions</u> including:

- Transfer of licences.
- Supply of factories and production lines.
- Subcontractor production.
- Transfer of Technology.
- Co-production or the founding of joint-owned production companies.

"Industrial Co-operation" as a form of Countertrade (or "Compensated Co-operation") can also be extended to:

<u>Commercial Co-operation</u>

Commercial Co-operation is designed to faciltate the sale of products coming from the Importer/Government's country, whether they are manufactured under a Co-production agreement or simply by local factories. The goal is to ensure that the Importer/Government has outlets for all or part of the merchandise he produces with imported plant. The commitments made constitute a sort of guarantee.

3. <u>OFF-SETS</u>

Usually applied only to Defence, Aerospace and High-Technology contracts. Off-sets is an umbrella term for reciprocal trade transactions of various types, involving a situation where manufacturing capacity is shifted to another country (the Importer/Government's country) as a means of achieving sales.

Remark: It should be pointed out here, that the term Off-set is being used now in a broader sense than its original use limited to Defence, Aerospace and High-Tech contracts. It is used in the wide sense of "Import Compensation" demanded by the Importer/Government for the considerable "Imports/Purchases" of foreign equipment under the main Supply Contract.

Nevertheless the countries which are using this term "Off-sets Programme" such as Australia, Korea, Saudi Arabia, etc., are still applying such programmes mostly on the purchase of products of high added value such as Defence, Aerospace and High-Tech Contracts.

IT SHOULD BE POINTED OUT THAT THERE ARE NO GENERAL, INTERNATIONAL "NORMS", "POLICIES" AND "REQUIREMENTS" ATTACHED TO OR APPLICABLE TO "DESIGNING" OR "STIPULATING" OFF-SET REQUIREMENTS OR PROGRAMMES, NOR CAN A "TRAINING PROGRAMME" BE SET UP ON THE "THEORY AND PRACTICE" OF DESIGNING AND IMPLEMENTING OFF-SET PROGRAMMES, because of the very nature of such "arrangements" or requirements which does not fall within the written laws of international trade as practiced between fully industrialised countries of the West. Although Countertrade has become "institutionalised", even outside the Eastern bloc, it still remains an arrangement "tailored" to a special need, i.e. designed case by case, according to the aims and overall goals of the country.

Such goals have therefore to be clearly and lengthily defined in a long-term "Development Plan", which can be made part (as attachment) of the Off-set Programme.

In order to be able to make any recommendation in this respect (for suitable administrative structures and policies), we shall review the different elements or concepts that usually constitute a specific Off-set Programme, point out their characteristics in Part Two and outline, in Part Three, how such concepts have been used in practice by certain countries, e.g. Australia, Korea and Saudi Arabia.

PART TWO

The "value" of compensation Obligation or Commitment defined in the Off-set Agreement is generally calculated by applying a "Compensation Quota/Percentage" to the "Compensation Base".

1. Compensation Base or Purchases Subject to Off-set

   This figure refers to all or part of the value of the main Supply Contract, and is used as the basis for all calculations related to the amount of compensation due, i.e. the "Off-set Obligation".

   The Contractor/Exporter usually tries to negotiate it as low as possible. A distinction is usually drawn between items invoiced as part of the main Supply Contract, which are subject to compensation and those items not subject to compensation, or for which the amount of compensation is negotiable.

   For example:

   - Main Supply: the main piece of equipment, i.e. production equipment such as -

     Plant (process) equipment
     Mechanical equipment
     Electrical equipment
     Instrumentation and controls
     Process conveying and transport
     Other plant and machinery

- Secondary Supply: the supply of ancillary goods and services

  The Contractor will then try to split up the Supply Contract into several separate contracts in order to invoice main supply and secondary supply separately, as in some "Importer" countries, Off-set Obligations are statutory on Supply Contracts worth more than a given amount. This way, Contractors can avoid, reaching this threshold.

- Local Share: the local share which is the part of the Supply Contract carried out in the Importer's country involving participation in the manufacturing process or the provision of services, is usually excluded from the calculation of the "Compensation Base".

- Technology Transfer and Related Services: the value of technology transfer carried out as part of Countertrade/Off-set deals is deducted from the "Compensation Base" as its "eligibility" as a "compensatory" or Off-setting Activity is usually established and accounted for as compensation as it will be seen later.

2. Compensation Quota/Percentages

It is the rate applied to the "Compensation Base" which defines the amount of the Off-set Obligation/Commitment.

Quotas vary greatly from one country to the next (from 5% to more than 100%) and it is very often impossible to know the exact rate that will be applied to a particular Supply Contract.

Since there are no international standards or codes of practice, Compensation Quotas are to a large extent subject to negotiation.

After reviewing the different forms of Countertrade and their characteristics the following transactions are usually considered "eligible" as forms of compensation (i.e. as having by nature, entirely or partly an Off-sets value):

- Counterpurchase
- Buyback
- Subcontracts (Subcontractor Production)
- Investment

If these transactions are not undertaken entirely as compensation/Off-set, the parts of the transactions which do come under that heading must be specified, as must the methods of valuation of the transactions or of their eligible components.

Introductory Remarks:

1. We have seen in Part One above that, among the different forms of Countertrade, Counterpurchase and Buyback could be qualified as relatively simple transactions both involving an obligation, undertaken by the Contractor/Exporter to purchase:

   a. local goods and/or commodities from the Importer/Government's country in the case of Counterpurchase,

   b. the "products" manufactured at the production facility created or transferred by the Contractor under the main Supply Contract in the case of Buyback.

2. But when and where "compensation" at industrial level is involved as in "Industrial Co-operation", such compensation is in practice more usually performed within more complex transactions, mainly Subcontractor Production and/or Investment.

3. Split Compensation

It should also be pointed out that the types of Compensation/Off-set transactions analysed here are not mutually exclusive: they can co-exist within the Off-sets obligation applied to a single "Supply Contract".

For instance, orders placed as part of a Counterpurchase commitment can quite easily be awarded to Subcontractors in the Importer's country which have been selected by the Contractor/Exporter himself; conversely, compensation in the form of Subcontracts can often be complemented by Counterpurchase of other products, if the required amount of compensation cannot be achieved through Subcontracting alone. Also, a Contractor who has been unable to fulfil its Counterpurchase obligations can, in certain cases, "Invest" the amounts due as penalty in the creation of a marketing company for the Importer country's products.

In the light of the above remarks, we shall say a few words about the above mentioned "eligible" transactions with more emphasis on Subcontracts and Investments with regard to their complexity:

- Counterpurchase

Counterpurchase obligations imposed on Exporters/Contractors usually do not list those (eligible) products which he will be allowed to order in view of fulfilling his Compensatory/Off-sets commitment.

Usually:

a) Multi-product Counterpurchase transactions undertaken in free market economies revolve around a range of products defined by reference to the "sectors" of the economy or "fields of activity" which are "eligible" to receive compensation orders.

b) Single Product Counterpurchase

Counterpurchase obligations limited to a single product usually involve Countertrade with raw material producing countries in periods when the markets are shrinking or the prices falling, or in cases where the raw material in question is not in line with world market standards. Producer countries demand compensation in an effort to safeguard outlets for their resources.

- Buyback

The principle of Buyback, as we have seen, is a commitment on the part of the Exporter to buyback a proportion of the output of the production line he has set up under the main Supply Contract.

Here the "eligibility" of the type of Compensation/Off-sets involved is not open to negotiation.

Remark: It may be useful to examine the possibility of setting up intermediary ("stand-by") compensation arrangements in the form of Counterpurchase commitments to help finance (if necessary) the Importer's currency requirements between the effective date of the Supply Contract and the moment the production unit becomes operational.

- Subcontractor Production

Demands for compensation involving industrial production by local subcontractors (in the Importer's country) are usually made on all important deals.

Subcontracts can cover the manufacture of parts of the equipment supplied under the main "Supply Contract" or of other items intended wholly or partially for re-exportation.

A subcontract can make it possible for countries to acquire advanced technology and support for embryonic or unprofitable industries.

Difficulties

More than any other form of Countertrade Subcontractor Production used as means of compensation presupposes fairly precise knowledge of the industrial capacity of the beneficiary country, in terms of the productivity and technical know-how of the individual companies with which Subcontracts will be signed. Incomplete or erroneous assessment of this capacity may lead to non-performance of part of the compensation requirements (which are the responsibility of the Exporter/Contractor) and delays or problems in the execution of the main Supply Contract.

Subcontracts involving the transfer of production capacity must be planned beforehand.

Eligibility of Items in Subcontractor Production Agreements

In contrast with most Counterpurchase and Buyback agreements, the value of industrial Subcontracts awarded to the Importer's country is not usually deducted in full from the total Offset Commitment of the Contractor/Exporter. The Offset Commitment Agreement specifies the "eligibility" of the different items making up the total order value of the Subcontract and their "valuation".

This value consists of the Subcontractor's selling price plus his profit margin, i.e.

- Labour costs: are eligible since employment of local labour forces is one of the prime goals of Countertrade.

- Procurement by the local Subcontractor of goods and services required for the execution of his orders. The eligibility of such items depends on their country of origin: local supply is eligible, while items supplied by foreign industries (or by the Exporter/Contractor himself) are not eligible and should not be deducted from the total Compensation/Off-set commitment.

Ancillary Supply from the Importer's Country

Industrial outfitting carried out by local companies in preparation for Subcontractor production can also be made eligible.

Transfers made by the Exporter/Contractor

These transfers may entail: training programmes, hiring of technical staff, production of documents and manuals, and technical assistance, for which the Exporter does not invoice the Subcontractor directly (unde the main Supply Contract), but which are essential for the execution of the orders subcontracted.

All these items can be considered as transfers of technology to the Importer's country, and their eligibility is usually accepted as having off-setting value.

- Investment

It is rare in Off-sets Programmes to specify that all Off-sets activities will take the form of Investment by the Exporter/Contractor aimed at establishing or expanding industrial (or commercial) companies, subsidiaries or joint ventures in the Importer's country.

Note: We shall see later, that this is the only form of Compensatio../Off-set activity accepted and applied in the Saudi Arabian Off-sets Programme.

However, when this type of transaction exists, it is considered a form of compensation.

It is obvious that Counterpurchase, Buyback and Subcontractor Production will be facilitated if parties to the Countertrade contract (i.e. Compensation/Offset Agreement) make capital available for the express purpose of fulfilling these obligations.

The eligibility of the Investment, and the extent to which it will be discounted from the compensation commitment (i.e. Off-sets Obligation), usually 100% of the value of the Investment (made by the Exporter/Contractor) will be deducted from the Off-sets Obligation due.

The long-term advantages to the Importer's country could bring the Exporter/Contractor to argue, sometimes, that a "co-efficient of increase" should be applied to the Off-setting Value of the Investment, in the light of the permanent nature of such investment.

PART THREE - COMPARISON OF THE PRACTICES RE ECONOMIC OFFSET IN DIFFERENT COUNTRIES

GENERAL	AUSTRALIA	SAUDI ARABIA
1. Compensation Base All or part of the value of Supply Contract see: Part Two (p.II) paragraph 1	2. Purchases Subject to Offsets Purchases of overseas-sourced goods and services either: a) single orders placed overseas or b) cumulative orders to an overseas supplier in a single financial year c) where: ° the duty free price of the purchase or the accumulated purchases exceeds A$2.5m. ° and the "imported content" exceeds 30% of said price	2. Economic Offset Programme Scope Amount of the Supply Contract i.e. "Any major contract for the supply of equipment and services according to each Contractor's share of the Supply Contract"
2. Compensation Quota from 5% to over 100% Rate applied to the Compensation Base which defines the amount of the Offset Obligation/ Commitment	2. Level of Offsets Obligation The general requirement is: 30% of the "Imported Content" if such "Imported Content" exceeds 30% of the price of the Supply Contract Calculation of the Offset Obligation The value of Obligation = Value of Imported Content x % level required i.e. 30%	2. A percentage applied to the amount of the Supply Contract determines the Contractor's Offset Commitment Does this imply that the whole amount of Supply Contract is considered as "Imported Content" The Economic Offset Commitment i.e. Total amount of investment = 35% of the amount of Supply Contract

GENERAL

3. Types of Compensation

The Countertrade Contract (separate from the main Supply Contract) which will secure and govern Offsets Obligations shall define in addition to the amount or level of Offset Obligation the type or form of transactions "eligible" and their "eligible" components, i.e. the nature of activities "eligible" for compensation.

These Transactions could be: Counterpurchase
Buyback
Subcontracts
Investment

covering all kinds of activities from the most simple: Purchase of goods to the most complex: Transfer of Technology and related activities. Said transactions could be also combined as split compensation (p.13-18)

AUSTRALIA

3. Types of Offsets Activities

Here the Countertrade Contract or Deed shall include, in addition to the nature (long-term arrangement Individual Contract by Contract Arrangement) and level of the Offsets Obligation incurred by the Overseas Supplier/Contractor

° a clear description of the Offsets Activities that can be proposed by the Supplier/ Contractor to discharge his Offset Obligation.

The types of Activities "eligible" are listed in the Offsets Programme without exclusion of any form of transaction indicating in detail the eligible items under each main Activity and the method of Valuation thereof. Said list covers:

a - Transfer of Technology
b - Training
c - Research & Development
d - Purchases of Australian products and services for Export
e - Overseas Marketing
f - Joint Venture
g - Venture Capital Investment

SAUDI ARABIA

3. Economic Offset Programme Joint Venture Characteristics

Here also there is a Countertrade Contract called "Economic Offset Programme Commitment Agreement. A contract setting out the obligations and understandings of the Contractor and the Government with respect to the Economic Offset Programme. This Agreement is based on an Initial Proposal of Offset Programme Design to be submitted by Contractor before entering into a Supply Contract. Such programme must include a Joint Venture (50/50%) on a Specific Project. Here, the only form of transaction admitted to discharge the Contractor's Obligation under the Offset Agreement is the Joint Venture implying an investment by the Contractor up to 50% of the Project or Activity to be carried out as Offset.

The Contractor will receive an Economic Offset Programme Credit against its Economic Offset Commitment through his:

- equity contributions by the Contractor group, which can include cash and non-monetary contributions (capitalised licences, trademarks, etc.)

- a percentage of each Joint Venture's medium and long term financing equal to the position of the Contractor Group in Join Venture.
- a percentage of retained earnings of the Joint Venture equivalent to the ownership position of Contractor.

Cash equity investment to be made by the Contractor has to be = 20% of its Offset Programme Commitment (i.e. 20% x 35% of amount of Supply Contract)

The "eligible" types of Activities are:

° Transfer of High-Tech while capitalising on the country's major resources
° High-Tech manufacturing or productionm techniques using automated processes
° Contribute to Management and technological training
° Enhance self-sufficiency

GENERAL	AUSTRALIA	SAUDI ARABIA
5. <u>Valuation Method</u> should be indicated in the Countertrade Contract	5. A valuation method of the Offsets Activities agreed between the Offsets Authority and the overseas Supplier/Contractor is to be defined in the Contract or Deed. Here, precise valuation principles have been given along with the eligibility criteria of each type of Activity listed in the Offset Programme.	5. Here, an "Evaluation Method" is foreseen in the Offset Programme, but only general guidelines are given such as: ° level of commitment as judged by the overall quality of the Proposal ° the profitability prospects of the proposed Joint Venture (marketability of J.V. products) ° extent to which proposed technology remain current with the state of the art of the industry in question ° the extent to which technology and skills will be transferred.
6. <u>Execution Schedule</u> to be negotiated	<u>Schedule for Discharging the Offsets Obligation</u> Offsets will start within one year from the date of contract signing and are to be completed within 3 (three) years of that date	<u>Implementation Schedule</u> Each Economic Offset Programme shall be completed within 10 (ten) years of the effective date of the effective date of the Supply Contract Other features of the Saudi "<u>Economic Offset Guidelines</u>" are the following: - Detailed characteristics of the Joint Venture requirements: its capitalisation, management, ownership, etc. - Description of Procedure of Programme submission and Review with timing schedules

- Initial Proposal is to be submitted by the Contractor and shall include projects for one or more Joint Venture(s) representing at least 50% of the Contractor's Offset Commitment:
  - ° detailed description of Joint Venture activity and location
  - ° review of the markets for the output of each Joint Venture
  - ° review of all essential technical aspects
- Feasibility Study, etc.
- A list of Saudi Arabian Government investment incentives of benefit to Joint Ventures
- Attachments such as:
  1. Extracts from relevant Development Plans
  2. Marketing and Technical information
  3. Laws, decrees and resolutions such as:
     - Foreign Capital Investment Law
     - Law for the Protection and Encouragement of National Industries
  4. Companies' Law on Joint Ventures
  5. List of Products, Processes and Systems "eligible" for Offset Activities
  6. Outline of a Feasibility Study

PART FOUR

RECOMMENDATIONS

General Remarks

The Contractor/Exporter's general approach tc Offset demands by the Importer/Government is that: Offsets Commitments imply certain commercial or industrial transactions which, while enabling him to win the Supply contract, are not of any direct interest to him. On the contrary, such transactions are considered by the Contractor as involving additional expenditure, (i.e. extra cost) which must be covered by his profit margin, and therefore, he will try to assess such extra cost and integrate it into his selling price of equipment under the Supply Contract.

This assessment will be made on the basis of certain factors such as:

- What are the elements of risk carried by the Offset demand? These elements will be determined on a case by case basis.

- Economic situation and applicable laws of Importer's country, such as: Economic Plan, banking system, financial institutions, etc. Which local laws (particularly in banking) are applicable to financing loans, etc?

- Analysis of the needs and difficulties of local companies which are liable to become subcontractors or associates in the Offset deal, their technical, commercial and management capabilities, etc.

With the view of minimising such extra costs and obtaining, under the best conditions, an Offset Agreement with the potential Contractor/Supplier, the above determining factors should be analysed and clarified by Bahraini authorities themselves.

The following recommendations are therefore made:

1. Clear definition of the goals to be achieved through Offset demands.

   - General goals in the case of designing a general Offset Programme such as:

     ° correct balance of trade (decrease of Imports Expenditure);

     ° access to new technology;

     ° create local employment;

     ° contribute to management and technological training;

     ° enhance self-sufficiency of local industries.

2. Greater level of Product Identification should be achieved.

   - Clear and precise definition of the "eligible" projects in different sectors and identification of eligible products covered by said projects (characteristics and technical specifications, state of existing technology and of what downstream products are requested to achieve).

3. Set up the priorities among the goals.

   - <u>For example</u>: If it is the priority to enhance self-sufficiency in a specific local industry such as Aluminium, this implies access to higher technology, and management and technological training of local personnel, the following steps should be taken in order to be able to prepare an adequate demand for Offset Commitment from the potential Contractor:

a. A Technical Survey by a specialist in the aluminium industry to identify further downstream aluminium products and define the profiles.

Such specialist should -

- make a realistic precise assessment of the actual level and capacity of the existing industries and the line of products actually manufactured, i.e.

  - assess the level of present technology;

  - assess the difficulties faced by the manufacturers and what is needed to improve their level and competitiveness.

- define input requirements.

b. Assess Local Human Resources -

- level c^c their qualifications;

- exact training requirements, re technical field, number of peeple.

c. Market Study - actual and if possible, potential markets -

- local;

- regional (GCC);

- international.

d. Macro Economic Study and Pre-Feasibility Study re economic viability of the project.

e. Analysis of Potential Suppliers from the point of view of -

- their technical activities;

- their commitments re marketing:

  - their own similar line of finished and semi finished products;

  - and of the other producers of same products which they assist;

  in order to figure out how far they would be prepared to go in transferring future technical development, or would they tend to withhold information and be reluctant to have Bahrain as a competitor in marketing the same line of products?

4. In order to enable the Contractor/supplier to make an acceptable proposal of Offset Programme for a product or products selected as eligible by the Government, the following documents should be made ready:

   a. Marketing and Technical information required.

   b. Law on Foreign Investments.

   c. If Bahrain wishes to request Offset in the form of local subcontractor production, list of the potential local manufacturers "eligible" for subcontracting.

   d. Examine the different forms of Offset transactions and try to make a preliminary selection according to the needs and structure of present industry and goals to be achieved.

   Example: Envisage requiring the Joint Venture form, define its characteristics (capitalisation, management, ownership, location, responsibilities).

5. Incentives

a. Assess the actual incentives.

b. Compare them to those of competitive neighbouring countries and enhance Bahrain's competitiveness in this respect, for manufacturing purposes to encourage foreign investment:

- Electricity charges should not be higher than in other GCC countries.

- Soft loans - such incentive should also be harmonised with other GCC countries, such as Saudi Arabia.

- Reduce bureaucracy in setting up a business. Establish a "one stop" industrial approval system, operated outside public service.

- Industrial Estates and infrastructure should be made available at low cost. In general low cost utilities.

- Tariff exemption on imported equipment and materials.

6. Creation of an Authority specialised in Offset Programmes that would be equipped with specialists, so that the Supplier would have an appropriate interlocutor to deal with in negotiating and implementing its Offset Commitment and to establish a clear and simplified procedure in this respect.

IMPORT COMPENSATION/OFFSET

RECIPROCAL/COUNTER TRADE

- BARTER
- COUNTER PURCHASE
  (PURCHASE OF PRODUCTS ETC. BY EXPORTER FROM IMPORTING COUNTRY)
- BUY-BACK
  PURCHASE BUYS A % OF PRODUCTION FROM EQUIPMENT SUPPLIED)
- SUB-CONTRACT /TECHNOLOGY TRANSFER
- INVESTMENT /JOINT VENTUR

<u>Major steps to conclude an Offset Agreement</u>

1- Importing country to list areas for counter trade and indicate priority.

2- Negotiate and agree on counter trade options. This could be one or a combination of the above methods.

3- Negotiate and agree on the quantum of the compensation base or the portion or the total contract amount on which the offset quota percentage will be applied.

4- Negotiate and agree on the offset percentage or quotas. Quotas vary greatly from one country to the other (from 5% to over 100%). As there are no international standards or codes of practice, quota is determined by negotiations.

5- Conclude detailed offset agreement with protection clause for non-performance.

GLOSSARY

BASIC DEFINITIONS

Contractor/Exporter

The "international equipment supplier" i.e. the prime contractor (and its associated sub-contractors) who is supplying the goods and/or services imported by the Government under the main contract, i.e. Supply Contract. The term "contractor" or "exporter" separately or jointly shall refer to the same concept.

Importer/Government

The Government of the State (of Bahrain) or its representative, that imports goods and/or services under the main contract, i.e. the Supply Contract.

Supply Contract

Term used to designate the main contract, i.e. the major contract for the purchase of both civilian and/or military foreign equipment made by the Government to differentiate it from the countertrade contract.

Offset Obligation/Commitment

The total amount of the commitment (to be undertaken through certain types of transactions) required - by the Importer - of the Contractor/Exporter attempting to participate in major contracts for the supply of equipment and services, i.e. the main "Supply Contract".

Compensation/Offset

These terms shall be used equally and in their wide sense as "import compensation" demanded by the State against the amount of purchases/imports of foreign equipment.

Eligible (Projects, Activities or Transactions)

Such projects, activities or transactions that are admitted by the Importer and that may be undertaken by the Exporter in order to discharge its Obligation under the Offset Agreement.

ECONOMIC OFFSET/IMPORT COMPENSATION

Final Discussion

Record note prepared by Mr. Ravishanker of the final discussion in meeting held at the Ministry of Development and Industry on 7 August 1989 at 08.30 am.

Present:	UNIDO	Ms. Nadia Afeiche
	MODI	Mr. Sager Shaheen (part time)
		Mrs. Fatima Al Hassan (part time)
		Mr. Tareq Kooheji
		Mr. Faisal Chehab
		Mr. N. Ravishanker (Adviser to the Ministry)

1. Ms. Afeiche referred to her draft report circulated (in 4 parts, to which this document is attached) by explaining the nature and purpose of the agreement, the practices followed by certain countries and the preparatory work to be carried out if the system is to be introduced in Bahrain.

2. Ms. Afeiche stated that:

   a. There were no international standards or codes of practice applicable to Offset agreements and that the system varied in different countries.

   b. Exporters usually view Offsets as a burden and try to indirectly recover the cost from the importer.

3. It was noted that:

   a. A detailed listing by the Government of the importing country, the areas eligible for Offset agreements and the policy on the quantum of Offset that would be required in relation to the contract value/import component of contract together with a write up on the procedure for starting new industries, incentives available and other information of interest to investors, would facilitate better understanding for both the exporter and importer.

      Recommendations in this respect are made in Part Four of the Report.

   b. Negotiations play a crucial role in concluding a fair and mutually acceptable Offset Agreement.

4. It was recommended that a committee should be entrusted with the work of studying and evolving guidelines to

introduce in Bahrain the practice of entering into Offset Agreements for the benefit of industrial development and import substitution.

5. It was suggested by Mr. Kooheji that in the immediate short term efforts should be made to obtain the benefits of Offset against some of the major projects proposed.

6. The meeting concluded with a vote of thanks to Ms. Afeiche for her efforts and co-operation.