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DEPARTMENT OF THE TREASURY REPORT
Survey of
OFFSET/COPRODUCTION REQUIREMENTS

Executive Summary

In response to a request from and based on questions initially suggested by the Treasury Department, the Aerospace Industries Association jointly conducted a survey of their members on offset and coproduction commitments made to foreign governments in connection with major export contracts. The objective was to gather data on the nature and extent of offset/coproduction practices.

The information produced by the survey represents a sampling of the companies polled; response to the survey questionnaire was entirely voluntary and many companies did not respond or indicated they had made no offset commitments. Nevertheless, 26 of the largest aerospace and electronic equipment manufacturers in the United States did respond, reporting a total of 143 contracts involving offset commitments signed between January 1, 1975, and the summer of 1981. The total value of these contracts was $15.2 billion.

The nature and value of the offset commitments associated with these contracts varied substantially, and included coproduction, licensed production, subcontracts, foreign investment, technology transfer, and countertrade. Definitions of the various forms of offset are contained in . . . this report. A specific offset value was reported for 130 countries; these offsets amounted, in total, to $9.55 billion.

The great majority of contract value and of offset commitments related to sales of military aircraft. That is, 74 percent of total sales and of total offsets were for military aircraft contracts. Subcontracting, licensed production, civil buys by the U.S. company, defense buys by the company, and coproduction were the most frequently used types of offset.

OECD [Organization for Economic Cooperation and Development] "Medium R&D" countries received the majority of offsets in every major offset category except coproduction and licensed production; in the latter category, OECD Medium and High R&D countries combined received the lion's share.

Canada was by far the chief individual country beneficiary of offset commitments, both in number of contracts (28) and in value ($4.6 billion). Other significant beneficiaries were Japan, "NATO," Sweden, and Israel. A few developing countries were beginning to appear as offset beneficiaries, where the practice had been limited to industrialized countries.

The time periods allotted for fulfilling offset requirements are quite long -- averaging seven and one-half years. Hence the effects of these transactions will continue to be felt for some time. Two-thirds of the responses indicated that U.S. competition for the contract existed, while just over half faced foreign competition -- most often French. About three-fourths indicated that the deal would have been lost if offsets had not been offered.

The U.S. Government played a role in the great majority of the sales -- as approver of the export license, direct seller of equipment via the Foreign Military Sales (FMS) channel, etc. While two-thirds of the respondents thought that multilateral agreements to limit offsets would be advantageous, 75 percent felt that unilateral action by the U.S. Government would be disadvantageous.

Genesis of the Survey

Governments making major purchases of capital goods, such as aircraft, from foreign sources are tending to base their purchase decisions partly on offers of commercial or investment benefits by the supplying firm. These offers can take the form of countertrade, licensed production, subcontracting, direct investment, or other practices designed to "offset" the budgetary or employment "losses" resulting from the foreign purchase.

The use of offsets is especially common in connection with military purchases by the United States' industrialized allies. Critics point out that the purpose of governments in demanding offsets usually is to enhance employment and exports, and to improve the productivity and technical sophistication of local industry. Proponents argue, on the other hand, that the United States has benefited not only through the economic returns from the contracts involved, but also through the additional security provided by the enhanced defense-industrial base of its allies.

A number of well-publicized offset transactions have involved transfer of substantial production activity to the buying country, particularly in high-technology fields such as aircraft and electronics where the United States has been highly competitive. The question arises whether these practices will have adverse effects on future U.S. competitiveness, employment, and trade.

The Treasury Department staff, and some representatives of the U.S. aerospace and electronics industries, have become concerned at the implications of these practices -- the more so as no comprehensive data have existed which would permit an evaluation of their effect. While it appeared that these practices could distort trade and investment flows, no such effects could be documented.

The Aerospace Industries Association and the Electronics Industries Association agreed to conduct a survey of their members to attempt to gather the first set of aggregate data on the subject. Using a line of questioning initially suggested by the Treasury staff, the associations designed the survey questionnaire at Annex A [omitted from this reprint].

The questionnaire defines "offset" and sets out a series of questions which were intended to be as simple as possible to answer, thus encouraging response (which returned for each single contract involving offset). The results were to be aggregated, yielding overall data while preserving business confidentiality regarding any particular transaction. While an attempt was made to include questions dealing with technology transfer and employment effects of offset, these questions ultimately were judged too difficult to answer in an initial survey of this kind, and were dropped.

The questionnaire has two parts. Part A is composed of questions on the export contract and the associated offset obligation. Part B was designed to elicit background information on the responding firm, as well as to invite comment on the policy issues raised by the questionnaire.

The Survey

Introduction: The term "offset" was very broadly defined in this survey. Because the impact of a particular offset on the U.S. economy is dependent not only on its size, but also on certain of its key characteristics, any analysis of data in the area must include the examination of such characteristics, including:

- -- the country receiving the offset
- -- the type of offset
- -- the relative value of the offset
- -- the product or products involved
- -- other offset characteristics

In addition, an evaluation of the offset must take account of the content in which it was offered, including, for example, the foreign competition faced by U.S. manufacturers and the role played by the U.S. Government.

Definitions of Offset: Though the terms of the offset on individual contracts may vary substantially and a contract may call for more than one kind of offset, offsets can generally be grouped into the following types:

- -- coproduction
- -- direct licensed production
- -- subcontract production
- -- overseas investment
- -- technology transfer
- -- countertrade

The definitions of these terms used in this survey follow:

A. Coproduction: Overseas production based upon government-to-government agreement that permits a foreign government or producer to acquire the technical information and know-how to manufacture all or part of an item of U.S. equipment. It includes government-to-government licensed production. It excludes licensed production based upon direct commercial arrangements by U.S. manufacturers.

B. Direct Licensed Production: Overseas production of all or part of an item of U.S. equipment based upon transfer of technical information and know-how under direct commercial arrangements between a U.S. manufacturer and a foreign government or producer.

C. Subcontractor Production: Overseas production of a part or an item of U.S. equipment. The subcontract does not involve license of technical information or know-how, and is usually a direct commercial arrangement between the U.S. manufacturer and a foreign producer.

D. Overseas Investment: Investment arising from the offset agreement, taking the form of capital invested to establish or expand a subsidiary or joint venture in the foreign country.

E. Technology Transfer (other than licensed production and coproduction): Transfer of technology that occurs as a result of an offset agreement and that may take the form of:

E.1 Research and development conducted abroad.
E.2 Technology assistance provided to the subsidiary or joint venture of Overseas Investment (see D above).
E.3 Other activities under direct commercial arrangement between the U.S. manufacturer and a foreign entity.

F. Countertrade: Purchase of goods and services from the buyer country as a condition of the offset agreement, excluding purchases under codes A, B, and C above. These purchases may be made by the U.S. Government, the U.S. contractor, the contractor's suppliers, or by third parties with whom the contractor acts as middleman. The purchase may involve products for defense or civil use.

Countertrade subtypes:

F.1 Defense purchases by U.S. Government.
F.2 Civil purchases by U.S. Government.
F.3 Defense purchases by the company.
F.4 Civil purchases by the company.
F.5 Defense purchases by suppliers or subcontractors.
F.6 Civil purchases by suppliers or subcontractors.
F.7 Defense purchases by third parties arranged by a company.
F.8 Civil purchases by third parties arranged by a company.

Coproduction and licensed production are commonly grouped by industry because of their similarity. Therefore, they have been combined in the following analysis. Likewise, the subtypes of technology transfer and countertrade, respectively, have been aggregated.

These types of offsets differ in several crucial ways. First, while coproduction, licensed production, technology transfer, and in

some cases foreign investment, explicitly entail the imparting of know-how to the recipient, subcontracting and countertrade may not. Therefore, the latter two are perhaps less likely to encourage the technological advancement of the recipient. (All offsets undeniably benefit the recipient in generalized economic ways, and the contracts with which they are associated benefit the seller, but the transfer of technology may have specific longer term effects for buyer and seller.)

Methodology: The total offset values shown in this report contain some imprecision, since some commitments were given as "best efforts," "N/A," "best efforts up to 25%," etc. Where a "best efforts" target figure was given, as in the latter example, that figure was used in calculating the offset total. If no figure was given ("N/A" or "best efforts" without a target figure) then nothing was added to the offset total. In all, 13 of the 143 responses failed to specify the offset amount. In this sense the offset figures produced by the survey may be slightly understated. In at least one case, a range of offset obligation of 75-125 percent was specified; for purposes of calculating total offsets, and midpoint was used in such instances.

Where specific figures were given, there were wide variations in the size of individual offset obligations. For example, at one extreme were several small contracts in the $2-3 million range for which offsets were listed as "best efforts" only. At the other extreme were several very large contracts for which offset obligations were in the 100-135 percent range. There was no statistical correlation between the size of contracts and the size of the offset obligation: one contract in the $300-400 million range, for example, involved $5 million in offset, while several relatively small ones called for 100 percent offset.

Evaluation of the Survey: The strengths of the survey are that the twenty-six responding firms included most of the largest and most diversified manufacturers in the fields of aerospace and electronics. The information provided is, at this time, the only aggregate data extant on the subject. The survey yielded potentially useful results, such as:

-- the value of contracts containing offset obligations and, where possible, the associated offset value for contracts signed during the period 1975-1981;

-- a rough sectoral breakdown;

-- countries most frequently employing offset requirements;

-- relative frequency of use of the various forms of offset;

-- the role of the U.S. Government in offset transactions; and

-- industry views on possible action by the U.S. Government.

The survey's greatest weakness is that the questionnaire did not specify whether dollar figures were to be in current or constant dollars. A post-survey telephone poll of several respondents chosen at random showed that both were used. Nor were respondents asked to specify the date of signing of contracts, or the date on which the contract's provisions became final -- which might have permitted some comparisons of whether, and how, offset commitments have changed over the period of the survey. No questions were included on the employment effects of offset, nor on levels of technology embodied in the sale and offset commitments, since it was felt such questions would have been difficult to answer and would have discouraged response. Finally, the survey did not yield data adequate to permit a judgment as to the effect of offsets on subcontractors.

The survey cannot be considered conclusive. It does indicate that the offset phenomenon is of considerable magnitude in certain sectors and certain countries, and that further investigation and data collection could be useful.

Overall Results: Twenty-six companies reported a total of 143 contracts,* with a face value of $15.2 billion, signed since 1975 involving offset obligations. Of these, 120 contracts (84 percent) valued at $14.2 billion were in the military sector. Specific offset values were reported for 130 contracts; these offsets totaled $9.55 billion, of which $8.94 billion (94 percent) were related to military contracts. See Table 1.

Table 1

TOTAL SALES AND OFFSETS

	Total		Military		Civil	
	No./$	%	No./$	%	No./$	%
Number of Contracts	143	100	120	84	23	16
Total Contract Value ($ billions)	15.16	100	14.24	92	0.92	6
Offset Commitments ($ billions)*	9.55	100	8.94	94	0.61	6

*Based on 130 contracts which specified numeric offset values rather than "best efforts" or other nonspecific requirements

* Partial responses were received on another 24 contracts, but these data were not usable.

Recipient Countries, by R&D Standing: In order to examine the survey responses with respect to recipient countries without compromising the confidentiality of data on individual contracts, the following categories were used:

-- OECD High R&D Countries
-- OECD Medium R&D Countries
-- OECD Low R&D Countries
-- Other Countries
-- NATO
-- Unknown

The countries in each set are named in Table 2. The first three categories are based on a system developed by the Organization for Economic Cooperation and Development (OECD) to describe countries by their relative expenditures in Research and Development (R&D).* (Note that the OECD categorization includes countries that do not appear in this list because they were not cited as offset recipients in this survey.) Nations that do not appear in the OECD scheme are in the "Other Countries" category. By and large these are less developed countries. "NATO" refers to contracts with the North Atlantic Treaty Organization as a whole. Those responses that did not specify a recipient country are listed as "Unknown."

Table 2

Recipient Countries by Category 1/

OECD High R&D	OECD Medium R&D	OECD Low R&D	Other Countries
France	Australia	Denmark	Brazil
West Germany	Belgium	Finland	Greece
Japan	Canada	Norway	Israel
United Kingdom	Italy	Netherlands and Denmark 2/	Pakistan
	Netherlands	Portugal	Korea
	Sweden	Spain	
	Switzerland		

1/ See text for further discussion.

2/ Where these two countries were mentioned together in a response, they were grouped in the "Low R&D" category for purposes of this report.

* OECD Newsletter, Science Resources, Summer 1980.

Differing political and economic factors create functional distinctions among these categories. For instance, a nation without advanced technology but with the basic industries to support such technology may gain substantially from technology transfer. Countries with existing industry but lower labor rates may be able to act as subcontractors to U.S. manufacturers at an advantageous (to the U.S. manufacturer) price.

Table 3 shows the proportions of all contracts, and of total offset obligations, by country category. About 75 percent of all offset requirements reported were in the OECD High and Medium R&D nations, and in NATO. Much of the total reported in the OECD High R&D category is accounted for by Japan (see Table 6). The figures for the OECD Medium R&D category -- by far the largest in terms of contracts as well as offset obligations -- are strongly influenced by Canadian contracts (see subsequent discussion).

Table 3

Relative Value of Reported Contracts and Offsets by Recipient Country Groups

Category	Percent of All Reported Contracts	Percent of All Reported Offsets
OECD High R&D	15.3	15.4
OECD Medium R&D	49.0	59.1
OECD Low R&D	4.6	2.9
Other Nations	8.6	3.2
NATO	11.0	10.9
Unknown	11.4	9.3

Table 4 shows the value of the reported contracts and offsets by country category.

Types of Offset: Many of the contracts called for more than one type of offset. Table 5 shows the reported incidence of each of the various types, for military and civil contracts together and for military contracts alone. The number of contracts shown in the table adds to well over 100 percent since most responses mentioned more than one type of offset.

There was no basis on which to allocate dollar values to licensed production, subcontracting, or the other types of offset, when more than one type was mentioned in a single questionnaire. It was believed that any attempt to elicit such detailed information in the questionnaire almost certainly would have discouraged response because of the substantial amount of extra work required to disaggregate the contracts. On the other hand, summation of the total dollar value of contracts in which each of the various types of

Table 4

Value of Reported Contracts and Offsets
by Recipient Country Group

Category	Value of All Reported Contracts	Value of All Reported Offsets*
OECD High R&D	2,313.4	1,478.4
OECD Medium R&D	7,437.0	5,666.2
OECD Low R&D	701.0	199.9
Other Nations	1,662.1	307.9
Unknown	1,735.5	893.2
TOTAL	15,164.4	9,585.9

*Offset figures are not as precise as suggested by this table, since a number of offset commitments were given as "best efforts" or as a range of dollar values. See text.

Table 5

Number of Contracts and Percent of Contracts Requireing Various Types of Offset

Type of Offset	Military and Civil (136 Valid Responses) Contracts No.	%	Military Only (117 Valid Responses) Contracts No.	%
Coproduction	28	20.6	27	23.1
Direct Licensed Production	41	30.1	40	34.2
Subcontract Production	86	63.2	75	64.1
Overseas Investment	9	6.6	9	7.7
Technology Transfer-R&D Abroad	5	3.7	5	4.3
Technology Transfer-Technical Assistance	12	8.8	12	10.3
Technology Transfer-Other	5	3.7	5	4.3
Countertrade-Defense Buys by USG	5	3.7	5	4.3
Countertrade-Civil Buys by USG	7	5.1	6	5.1
Countertrade-Defense Buys by Company	36	26.5	36	30.8
Countertrade-Civil Buys by Company	48	35.3	39	33.3
Countertrade-Defense Buys by Suppliers	16	11.8	16	13.7
Countertrade-Civil Buys by Suppliers	16	11.8	14	12.0
Countertrade-Defense Buys by Third Parties	16	11.8	16	13.7
Countertrade-Civil Buys by Third Parties	15	11.0	12	10.3

offset was mentioned would have resulted in large-scale double counting.

The responses show that subcontracting was by far the most frequently mentioned single type of offset, with countertrade, licensed production, and coproduction also frequently mentioned. However, Table 5 does not provide a comprehensive measure of the relative frequency of the various major offset categories -- countertrade, coproduction and licensed production, etc. For that purpose an index was constructed from the data in Table 5, grouping the offset types in that table in five major categories. With a base of 100, the following index numbers show the relative frequency of use of the five categories:

--	Coproduction and licensed production:	20.0
--	Subcontract production:	24.9
--	Foreign Investment:	2.6
--	Technology Transfer (all types):	6.4
--	Countertrade (all types):	46.1

Figure 1 shows the division of the major offset categories by major country category. The OECD "Medium R&D" category -- including Canada, Australia, Switzerland, etc. -- received the largest share of offset in each major offset grouping (see the five smaller diagrams in Figure 1). Its preponderance is particularly marked in countertrade, foreign investment, and technology transfer. The incidence of coproduction, licensed production, and subcontracting seen in "Other Countries" is slightly higher than might have been expected, due mostly to contracts with Israel.

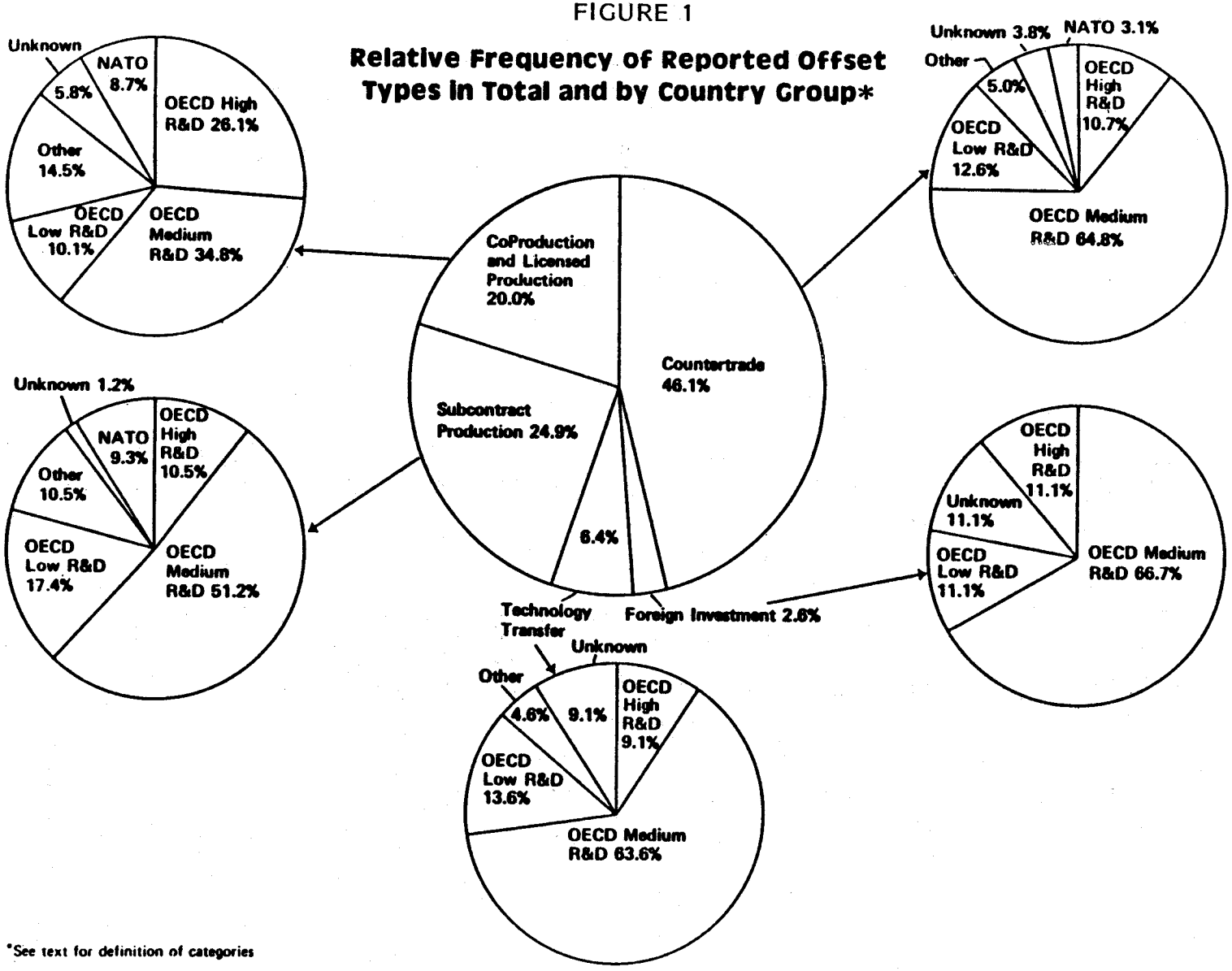
Individual Recipient Countries: Contracts were identified by the intended use of the product, military or civilian. Table 6 shows the value of the military and civilian offsets reported, by recipient country. In terms both of number of contracts and of value, Canada accounted for by far the largest share: 28 contracts (15 military) with offset commitments of over $4.6 billion (of which nearly $4.3 billion were military offsets). In terms of number of contracts, Australia was in second place with 13 and Israel and the Netherlands in third, with 12 each. In terms of dollar value, Japan was easily in second place with over $1.1 billion in total offsets, while Sweden ranked third with nearly $318 million. "NATO" also ranked high in terms of offset value; country breakdowns were not provided. Also of interest in Table 6 is the fact that developing countries -- Brazil, Korea, and Pakistan -- appear as recipients of offsets.

Product Categories: Survey responses identified contracts by program name. The AIA research staff then grouped responses by three-digit Standard Industrial Classification (SIC) number into four product categories:

- -- aircraft (including engines, since listing engines separately would have identified individual companies or transactions in some cases);
- -- missiles;
- -- electronics and instruments;
- -- unidentifiable, or non-aerospace (such as vehicles).

FIGURE 1

Relative Frequency of Reported Offset Types in Total and by Country Group*



*See text for definition of categories

Table 6

VALUE OF OFFSETS BY COUNTRY AND USE

Country & Use		$ Thousands	Number of Contracts
Australia:	Total	88,819	13
	Commercial	21,800	2
	Military	67,019	11
Belgium:	Total	240,220	5
	Commercial	45,000	1
	Military	195,220	4
Brazil:	Total	3,500	1
	Commercial	3,500	1
Canada:	Total	4,627,671	28
	Commercial	368,721	13
	Military	4,258,950	15
Denmark:	Total	30,614	7
	Military	30,614	7
Finland:	Total	2,243	2
	Military	2,243	2
France:	Total	26,250	2
	Commercial	26,250	2
West Germany:	Total	189,107	7
	Commercial	51,165	1
	Military	137,942	6
Greece:	Total	910	1
	Military	910	1
Israel:	Total	262,250	12
	Military	262,250	12
Italy:	Total	51,500	2
	Commercial	33,000	1
	Military	18,500	1
Japan:	Total	1,142,978	8
	Military	1,142,978	8
Netherlands:	Total	194,208	11
	Military	194,208	11
Netherlands & Denmark	Total	18,500	1
	Military	18,500	1
Norway:	Total	51,200	5
	Military	51,200	5
NATO:	Total	1,040,345	5
	Military	1,040,345	5
Pakistan:	Total	4,700	1
	Military	4,700	1
Portugal:	Total	65,000	1
	Commercial	65,000	1
Spain:	Total	32,400	5
	Military	32,400	5
Sweden:	Total	317,800	3
	Military	317,800	3
Switzerland:	Total	146,000	2
	Military	146,000	2
United Kingdom:	Total	120,000	2
	Military	120,000	2
Korea:	Total	5,000	1
	Military	5,000	1
Unknown:	Total	893,200	5
	Military	893,200	5

Table 7 shows the division of contracts and offsets by product category. For all contracts as well as for military contracts alone, aircraft accounted for 74 percent of the sales and offset obligations. Missiles and electronics accounted for much smaller proportions of total contract value and offset. Offsets in the period 1975-1981, thus were overwhelmingly associated with sales of aircraft, especially military aircraft.

Other Offset Characteristics: Table 8, describing some characteristics of offset, shows that both number of months for fulfilling contracts and number of months for meeting offset requirements were quite large, as would be expected in transactions which tend to involve military aircraft. The average period for fulfilling offset requirements associated with military contracts was ninety months, or seven and one-half years; the "mode," or most frequently cited period of time, for contracts in which a time period was specified was sixty months. The time periods indicate that the consequences of offset agreements will be felt for some years to come.

Two-thirds of all responses summarized in Table 8 indicated they faced U.S. competition for the contract, while just over half reported foreign competition. Although it is not summarized in Table 8 since responses on this point were not complete, the foreign competition most often was of French origin, followed by the U.K., Germany, and Italy. Three-fourths of the responses indicated that the firm would not have won the bid without offset provisions.

Table 7

APPROXIMATE SECTORAL BREAKDOWN OF OFFSETS

	Total			Military			Civil		
	No. of Contracts	% of Contract Value	% of Offset Value	No. of Contracts	% of Contract Value	% of Offset Value	No. of Contracts	% of Contract Value	% of Offset Value
Aircraft	69	74.4	74.3	49	73.5	74.3	20	87.2	74.8
Missiles	29	12.7	16.9	29	13.5	17.5	--	--	--
Electronics/ Instruments	33	7.7	4.6	30	7.4	3.9	3	12.8	25.2
Unidentifiable	12	5.3	4.2	12	5.6	4.3	0	--	--
TOTAL	143	100.1	100.0	120	100.0	100.0	23	100.0	100.0

Table 8

SOME CHARACTERISTICS OF OFFSETS

		Total	Military
Number of Months for Contract Deliveries 1/	Mean	51	53
	Mode 2/		24
	Range		3-276
Number of Months to Meet Offset 3/	Mean		90
	Mode		60
	Range		12-234
% of Contracts Facing U.S. Competition		67%	62%
% of Contracts Facing Foreign Competition		53%	54%

1/ For a base of 120 contracts.
2/ Most frequently cited number of months.
3/ For a base of 64 contracts which specified a time period for meeting the offset obligation.

Perceived Consequences: Table 9 shows the consequences of offsets involving technology transfer or foreign investment (66 contracts total, 44 military) in the opinion of the responding firms. Figures shown are the number and percent of respondents foreseeing stronger foreign competition, etc., as a result of the offset transaction. The figures cannot be added, again because many responses mentioned more than one consequence and addition would have involved double counting.

Table 9

Consequences 2/	TOTAL 1/ Number of Contracts	TOTAL 1/ Percent of Contracts	MILITARY Number of Contracts	MILITARY Percent of Contracts
New Competition	23	25	28	52
Stronger Foreign Competition	25	35	25	57
Loss of Future Sales	23	38	23	52
Other Consequences (See Annex)	16	24	16	37
No Consequences	19	30	17	39

1/ Base = 66 Contracts with Foreign Investment or Technology Transfer, or which 44 were in the Military sector.

2/ Percentages do not add to 100 since a number of contracts mentioned more than one likely consequence.

The data on which Table 9 is based included questions on the proportion of total offsets which were either (a) passed on to the responding firm by a prime contractor, or (b) passed on by the responding firm to a subcontractor. Of the responses for military contracts only, 35, or 29 percent, indicated that some portion of the offset obligation had been passed on to the company by prime contractors, with a total value of $1 billion passed on. Conversely, 13 responses indicated that they had passed on to their suppliers and subcontractors a portion of their offset obligation, amounting altogether to $2.1 billion. While these figures do not suggest that offset practices in 1975-1981 had a severe effect on subcontractors in the aggregate, the data cannot be regarded as complete and great care should be used in drawing conclusions on this point.

Annex B summarizes some comments by responding firms on the possible effects of offset, and their opinions as to what action (if any) should be taken by the United States Government.

The Role of the U.S. Government: Currently, the U.S. Government plays a number of roles in offsets or offset/contract negotiations including:

-- Seller -- Foreign Military Sales (FMS)
-- Active Negotiator
-- Observer of Negotiations
-- Approver of Export License
-- Purchaser of Foreign Products

Table 10 shows the number of contracts and the percent of contracts in which each role was mentioned. Because some contracts mentioned more than one U.S. Government role the percentages add to more than 100. To avoid significant double counting, the relative frequency (percent of responses) of each role was calculated. Figure 2 depicts the relative frequency of U.S. Government roles and the distribution among country categories.

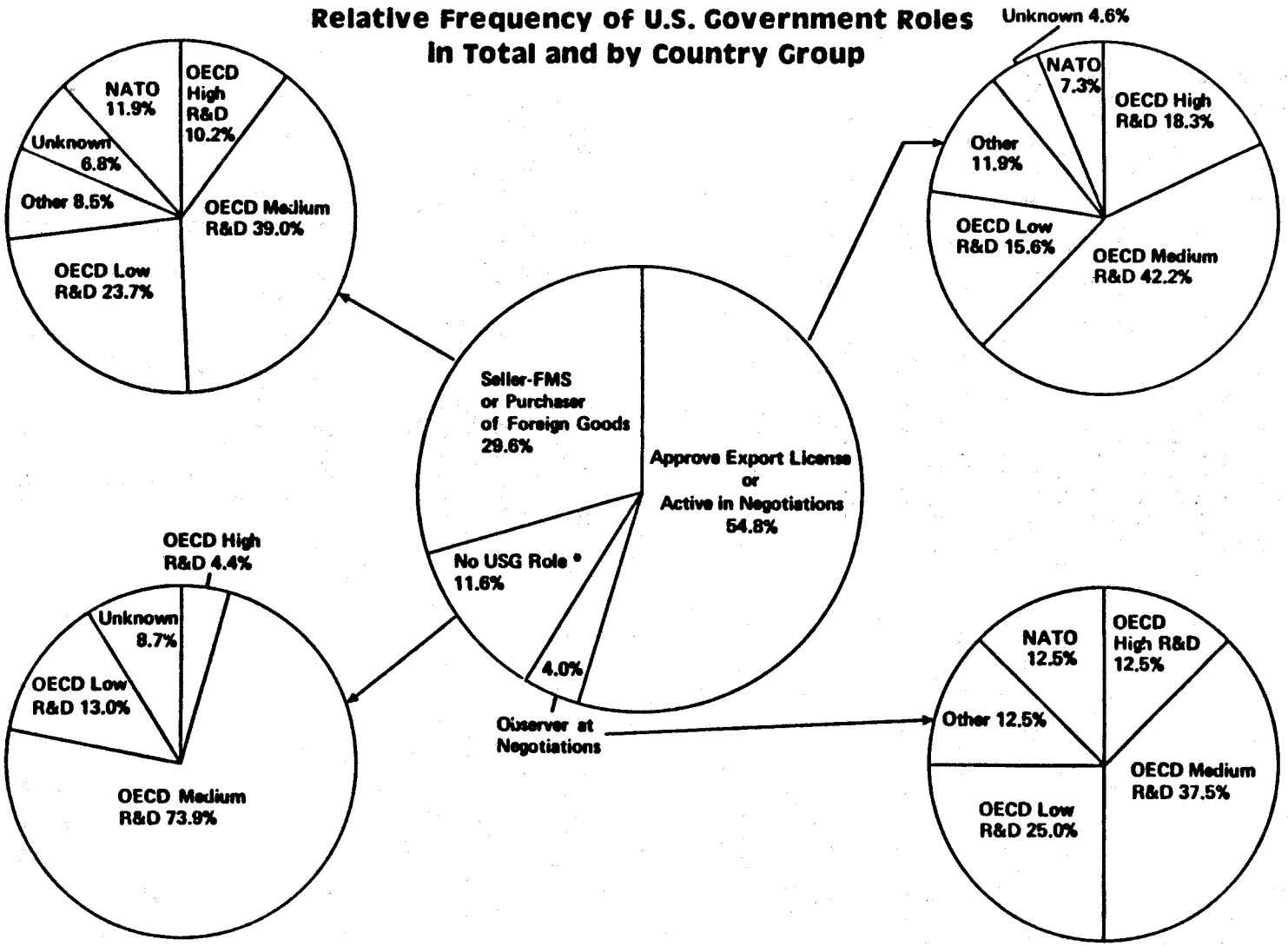
Table 10

U.S. GOVERNMENT'S ROLE IN OFFSET/COPRODUCTION TRANSACTIONS 1/

	Military & Civilian Contracts		Military Only Contracts	
	No.	%	No.	%
No USG Role	23	16.1	8	6.7
USG as Seller-FMS	48	33.6	48	40.3
USG Active in Negotiations	21	14.7	21	17.6
USG Observer at Negotiations	8	5.6	8	6.7
USG Approver of Export License	88	61.5	79	66.4
USG Purchaser of Foreign Products	11	7.7	11	9.2

1/ Number and percent of contracts in which each role is mentioned. Percentages do not add to 100 because a number of contracts mentioned more than one U.S. Government role.

FIGURE 2



*These transactions are largely on commercial contracts

Table 10 and Figure 2 (center diagram) indicate that the U.S. Government exercised considerable influence over these offset contracts, whether as approver of export licenses, seller via the FMS channel, direct negotiator, etc. Table 10 shows that the U.S. Government played no role of any kind in only 23 of the 143 contracts reported in the survey. Only eight of those contracts were in the military sector; put another way, about two-thirds of the contracts in which the U.S. Government played no role were non-military contracts. Just over three-quarters of contracts in which the U.S. Government played no role involved OECD High and Medium R&D nations as buyers.

With regard to the contracts in which the U.S. Government played a role, a plurality involved OECD Medium R&D nations; see the four smaller diagrams in Figure 2. For the two most common forms of U.S. Government participation -- FMS Seller/Purchaser, and Negotiator/Approver of Export License -- the Medium and High R&D countries accounted for over half of all contracts, with the Low R&D countries also accounting for a significant share.

The respondents were queried as to whether they felt it would be advantageous or disadvantageous to their companies to have future offset offerings and/or requests limited to multilateral agreement among nations. The same question was asked in reference to unilateral action by the U.S. Government. Finally, respondents were asked if their company would be in favor of or opposed to a U.S. Government policy of demanding credits for its purchases abroad with these credits to be applied toward reducing the offset requirements imposed on U.S. industry.

Table 11 shows the response to these three questions. While a majority (67 percent) of companies would find offset limitations advantageous if imposed by multilateral agreement, an even larger portion (75 percent) feel such action taken unilaterally would be disadvantageous.

Table 11

Company Views on Potential Government Action (Percent)

Action	Would Find Advantageous	Would Find Disadvantageous	No Response
Offset Limitation by Multilateral Agreement	67	19	14
Offset Limitation by Unilateral Action	8	75	17

	In Favor of	Opposed to	No Response
USG Purchase Credit for Offset Reduction	70	17	13

ANNEX A

Editor's Note: Annex A, "A.I.A. - E.I.A. Offset Survey Respondent Information Form" withdrawn, but rest of report completely verbatim.

ANNEX B

Summary of Industry Views on the Consequences of Current Offset Practices and Potential Government Actions

Consequences of Current Offset Practices

In addition to providing information on each contract with offset requirements, each company was asked to describe its views regarding the positive and negative consequences of current offset practices. Eighteen firms responded, citing economic consequences related to the contracts or programs themselves and to the world-wide economic situation as well as political ramifications and defense impact. Industry views on offset practices vary substantially, but most companies cited both positive and negative consequences. (In total, negative responses outnumbered positive ones.)

The following paragraphs summarize the subjective responses of the companies. An attempt has been made to present all views reported and, therefore, some opinions are contradictory. The number in parentheses indicates the number of responses or firms that indicated a particular consequence.

Economic Consequences to the Contract, Program, or Firm

Positive: The most frequently cited positive impact at the micro level was that offsets made possible some procurements that would not otherwise occur. Offsets were said to provide a competitive edge in a sale or to allow the contractor a very flexible marketing tool. Offsets also were thought to encourage countries to purchase products they otherwise might not buy to get important side benefits. One company felt low percentage offsets (10 percent) are manageable while still offering the sales advantage. In total, six firms indicated increased sales.

The additional sales made by offsets were considered beneficial in that they add to the business base and expand the influence of the firm.

Another frequently cited positive benefit was the development of alternate foreign sources (3). One company reported that they found a "good, low-cost" new source.

Negative: One company reported that current offset practices sometimes preclude bidding or getting business. More frequently (5), firms indicated there are increased costs associated with offset commitments. Comments ranged from "no monetary value to the manufacturer," to "runs up total costs, forces uneconomic procurements," to "most U.S. manufacturers raise prices to cover additional costs."

Four companies indicated increased cost associated with locating and selecting foreign sources. Five responses indicated other inefficiencies associated with foreign sources. Government-designated suppliers, or those facing little competition, were thought to provide parts or subassemblies at higher cost, which at times unfairly influences the competing prime bidder's cost. The distance of the supplier can also affect the delivery of the final product.

Distance, language, and time disadvantages leading to increased administrative, accounting, and management costs were described in six responses.

Finally, one firm indicated that indirect offset demands -- apparently meaning those involving products other than those covered by the contract at hand -- are unworkable, while direct offset -- confined to the current contract -- are acceptable.

Economic Consequences to the United States and World Markets

Positive: While the number of "positive" responses in this category was small (5), they were all different. As described earlier, offsets were said to generate sales that would not ordinarily occur; in the broader context, offset practices place the U.S. manufacturer in a position to compete with foreign producers.

Offsets were thought by some to reduce the cost of U.S. procurements and enhance the balance of trade. For less developed countries, this could mean improving trade and obtaining new technology with a smaller than otherwise trade deficit.

One company indicated that current offset practices form the basis for international partnerships.

Negative: The most frequently (9) perceived negative consequence of current offset practices was that they often involve technology transfer which potentially provides assistance to foreign

competition. One company indicated that they require U.S. industrial commitment to a foreign base.

More general economic consequences were also cited; namely, the reduced net gold flow to the United States or the outward flow of dollars. Four responses suggested reduced employment levels or reduced net increases in the jobs in the United States. One company believes that offset requirements have grown to such an extent that they distort trade significantly.

Three responses indicated loss of future sales or business; one of these specified future sales of spare parts.

One also thought current offset practices to be uneconomic in that they force companies to set up excess production capacity worldwide and reduce the economic benefit of increased production quantities and rates to both buyer and seller. Finally, one firm suggested that offsets are being used between developed countries to force acceptance of noncompetitive products.

Political Consequences

Positive: The use of offsets was thought to give evidence of U.S. Government friendship and support. Further, they often make foreign procurements politically feasible or more attractive to the foreign buyer.

Negative: Current offset practices were thought to have become, unfortunately, politically rather than economically motivated. The free market was perceived to be a better, more efficient mechanism for balancing trade.

It is believed that the U.S. Government continues to encourage foreign offset demands even though such demands are becoming increasingly stringent. One company indicated that current offset practices violate bilateral MOUs.

Another company indicated that offsets were not in the long-term economic best interest of even the buyer. This company suggested that improved marketing by the foreign country could have the same effect except for the political appeal of having part of the weapons system cost returned to the local economy.

Defense Consequences

Positive: Current offset practices were believed to improve or modernize the defense industries of allied or coproducing nations (2). Less developed nations can upgrade defense capability with smaller trade deficits than would ordinarily be expected. Further, these practices enhance standardization and interoperability and assure U.S. Government weapon sales control.

Negative: Offsets were also perceived to have negative consequences for allied defenses in that they can focus competition on

factors other than the most suitable weapon. In addition, because the selection can be unduly influenced by the offset rather than the weapon's cost and effectiveness, the allied nation at times receives less defense per dollar than it would without offsets.

One firm indicated that technology transfer associated with offsets compromised our technical superiority with respect to national security and defense.

Recommendations on U.S. Government Policy

The companies were also asked to describe their views on what policies the U.S. Government should adopt regarding offsets. Eighteen responses to this question were received and, again, many contradictory opinions were voiced.

No or Limited Government Action

Four firms of the 18 would like to see no government involvement, or as little as possible. One stated that U.S. firms should decide whether or not to pursue export business based on its own merits or risks. Where limited involvement was indicated, U.S. Government action was considered desirable to ensure equity or enforce present regulations regarding technology transfer to Communist bloc countries.

Another firm indicated that arbitrary limits on coproduction should not be established.

Bilateral/Multilateral Agreements

Half of the firms that responded (9) believed that the Government should negotiate multilateral or bilateral agreements to "clearly define" or "limit" offset practices in order to assure competition and guard against restraint of trade. The firms explicitly excluded the possibility of unilateral action. Several of the responses emphasized the lack of benefit of such agreements to the buyer nations and, thus, the need to negotiate them among seller nations.

The U.S. Government should adopt a policy that discourages offsets, yet does not leave U.S. manufacturers open to unfair competition due to lack of U.S. Government support (3).

It was suggested that multilateral agreements include a system of "transferable credit" where every export essentially earns "credit," a negotiable instrument, to be used by the importer to fulfill his own offset obligation or to transfer to another defense contractor who might have an offset obligation to the exporting country. Such credits would encourage trade with cooperating nations. This credit is being proposed by certain bankers and trading companies.

Policy without Multilateral Agreements

As indicated above, unilateral agreements were generally thought to be unacceptable. However, even without multilateral agreements, the Government should establish a policy of discouraging offset requests using government/industry cooperation and political, diplomatic and economic influence on a case-by-case basis (5). One firm advocated that the U.S. Government demand credit for its own foreign purchases. Another company suggested that reduced offset requests would lead to tighter control over U.S.-developed technology and thus allow a liberalized technology transfer policy.

Technology Transfer

Three firms indicated support for the current control on exportable technology, including both design and manufacturing technologies.

DoD Policy

In general, comments received were more critical of the current practice of establishing MOAs or MOUs without prior consultation with industry than they were in any other area. Five firms indicated that this practice is unacceptable and that the U.S. Government should set up a mechanism to correct this problem.

Four respondents believed that FMS contracts or other contracts financed through the U.S. Government should be free of offset requirements or that the U.S. Government should provide assistance in meeting the offset or pay the extra costs. Other companies believe that the foreign government should pay the premiums involved, including tooling, facilities, training, etc., regardless of whether or not the equipment is sold directly through the Government. It is believed that the foreign second source must be competitive with U.S. schedules and quality. Finally, one firm suggested that no more than half of U.S.-developed systems should be produced outside the United States.

Government Data Collection

Two respondents recommended that the U.S. Government should establish a method and office for collecting data on all U.S. Government purchasing and financing actions in each country to be used in negotiating offset credits.

Government Support of Industry

Several companies indicate that increased support (for both FMS and direct sales) of industry by the U.S. Government is warranted. Suggestions for support activities include:

1. provide data on available U.S. Government offsets;
2. provide information on the offset "posture" of the customer;

3. provide active in-country support for offset purchasing through U.S. commercial attaches;
4. provide matrix of companies available for similar work;
5. encourage foreign country product fair;
6. provide direct support to primes in sale.

Further, it was suggested that the U.S. Government should allow, if indicated, some degree of cooperation between U.S. contractors.

U.S. Government Policy in the Absence of Foreign Competition

Two of the eighteen respondents suggested that where no foreign competition is involved, the U.S. Government should establish or limit the required offset and thus eliminate the amount (not type) of offset as a factor in the competition.

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