

Chapter 6

Offsets and French Arms Exports

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Offsets can play an important role in securing arms sales and the French experience bears this out. However, offsets have not always been so crucial. Indeed, the importance of offsets really began when the North European NATO countries were looking to order replacement combat aircraft in the mid-1970s. Competition to secure this order was intense and, since then, offsets have grown in popularity with the precise package offered usually being tailored to the requirements of the purchaser. The analysis of offsets is hampered by the absence of precise contract details. However, the need for such an analysis is particularly strong as, in the 1990s, new forms of offset are developing as aggressive exporters, backed by their respective governments, seek sales in an ever shrinking defence market.

6.1 The ‘Contract of the Century’: The Birth of Offsets

In 1974, the replacement of the north European NATO countries’ combat air fleets gave birth to offsets. Belgium, Denmark, Holland, Norway and the Federal Republic of Germany were operating the F-104 Lockheed Starfighter which was becoming obsolete, having had many accidents.¹

The four smaller countries took the decision to select only one supplier for their combined order to minimise the purchase price. The competitors included the Viggen (Sweden), the F-16 from General Dynamics (US) and Dassault’s Mirage F1-M53 (France). The combined total order was to be about 350 aircraft, not including German purchases. The large size of this order, combined with the trans-atlantic rivalry between the potential suppliers, meant that the competition would acquire complex political and economic elements.

Dassault, strongly backed by the French government, offered an attractive offset: 70% of the manufacturing to be locally contracted.² In addition, its price was guaranteed without any further currency adjustment and the maximum inflation rate was to be 7% per year, with any additional inflation being paid for by the French government.

The American package was no less attractive. General Dynamics, bidding with the F-16, estimated that their offset would generate jobs for up to 5000 staff

in Europe. In addition, they agreed to a US\$ payment of only 20% of the price, the balance being accepted in local currency.³ General Dynamics also proposed to erect in Europe a plant for manufacturing the necessary high-technology materials to be used in the aircraft. Furthermore, the USAF proposed to base 200 of the 650 aircraft that they intended to purchase in Europe and to have them maintained by the four European countries.

There were also other offsets not directly linked to the contract proper. These included the promise to examine the possibility of improving European landing rights at US airports and to improve the access of European tankers to oil transportation contracts normally reserved for US shipowners. Other proposals were of a more political nature, and were aimed at turning offsets to the US' advantage. In 1974, the US Congress passed a bill to offset the cost of American soldiers in Europe against the profit from American arms sales to NATO. The implication was that if US arms sales to NATO fell then there was the possibility that American forces in Europe would be cut. This was not attractive to many Europeans.⁴

We shall not further elaborate on this competition⁵ which finally led to the success of the F-16, but it is very interesting to note so many and varied proposals as distinctive evidence of the negotiators' creativity. Finally, this degree of rivalry was to become typical of future competitions and meant that this contract was the first in which offsets played such an important role.

6.2 Common Offsets Practice in French Arms Exports

A Corinthe grapes and green olives market leader? DASSAULT of course ... And MATRA is a great vegetable seller; and THOMSON is an oil products dealer ...⁶

These are some of the more unusual offsets associated with the export of French arms although many more could be listed, such as the French RVI trucks sold for Moroccan jeans.⁷ However, in order to analyse the offsets associated with French exports, it is necessary to define what is meant by the term 'offset'. Barter (the exchange of goods for goods) is not usually considered as a form of offset,⁸ whereas a real offset involves a responsibility shared between the two partners for manufacturing some of the products exported by the contracting seller.⁹

As far as arms contracts are concerned, we shall define offsets in a broad sense, as a system of processes agreed upon by the seller and aimed at:

- either an immediate reduction of the buyer's payment (bartering or simultaneous sales from the buyer)

- or a deferred reduction of his payments by further sales generating counter-payments (deferred counter sales, sub-contracting, employment generation and so on)
- or technology transfers, offsetting part or the whole of the initial contract cost

We shall also include, as a form of offset, any other kind of incentive offered to the buyer (and of which there are many types).

6.2.1 Offsets Leading to an Immediate Reduction in Cash Payment

Experts usually name this offset “financial offset”.¹⁰ It may be a simple barter, or a simultaneous set of counterpurchases, the exact process being disclosed only in the contract which is seldom publicly available. Bartering involves an exchange of products without cash payment. Counterpurchase involves two separate payments, in any order: the arms buyer’s payment coming first, or second to the offset payment by the arms seller. The payment itself may be made through warranted accounts in France, or “trustees’ accounts” opened with British, American or German banks.

These kinds of contracts are often used for French arms exports, of which 75% to 85% involve third world countries usually selling raw materials or oil. With developed countries, the offset usually consists of a counterpurchase of industrial products or services.

6.2.1.1 The Counterpurchase of Raw Materials

This is common practice in Indian arms purchases, and also for their large civil equipment buys. For example, in 1987, when India bought 20 ATR 42 aircraft from the French firm Aerospatiale, there was a requirement to counterpurchase raw materials for 50% of the contract value i.e. FrFr 400 million.¹¹

The same kind of demand had previously been met by GEC-Alsthom. To sign a contract with Cachemire for the erection of a water dam, 20% of the contract value was demanded in counterpurchases i.e. FrFr 720 million.¹² Similarly, Malaysia tried to obtain the counterpurchase of raw materials for a contract involving the purchase of 12 Mirage 2000 fighter aircraft in 1989.¹³ The most important offset involving the diversified counterpurchase of primary products happened when Greece bought 40 Mirage 2000 aircraft¹⁴ worth US\$2.1 billion. This deal will be described further below. On occasions some of the Gulf Countries ask for such non-oil raw material offsets. This was the case with the Saudi Arabian purchase of Mistral missiles in 1989.¹⁵

6.2.1.2 *Oil Supplies*

French armaments exports have also generated important oil offsets. The reason for this is that some of the traditional buyers of French weapons are countries most familiar with such offsets. The four countries producing oil and heavily involved with offsets are Saudi Arabia, Iraq, Iran, and Nigeria. Together, they provide 60% of all oil offsets.¹⁶

Iraq's debt to France for military supplies was increasing in the early 1980s due to the Iran-Iraq war. Part of the payment for this equipment was through direct oil deliveries and, over the period 1983-1985, Total-CFP and ELF Aquitaine lifted about 80000 barrels per day.¹⁷

According to press reports, the negotiations between France and Saudi Arabia concerning the sale of 40 to 50 Mirage 2000 aircraft, worth US\$2.2 to US\$2.7 billion, involved "specially good terms"¹⁸ for oil supplies: Total-CFP and ELF-Aquitaine would have lifted about 70 million barrels of crude oil over a two or three year period.¹⁹ A similar arrangement had already been executed when Saudi Arabia purchased 10 Boeing 747s under a barter scheme involving 34 million barrels over three months.²⁰

More recently, Saudi Arabia has moved away from the provision of crude oil supplies as an offset but this was to make room for petro-chemical offsets, as was shown in their proposal in 1989 for the Mistral missiles negotiation.²¹ In 1984, the French government signed a contract for the supply of 18 Mirage 2000 aircraft (priced at US\$25 million each) to Abu Dhabi. This contract involved the supply of two million tonnes of crude oil as part payment²² and, ultimately, Total-CFP agreed to take delivery of 15 million barrels of crude oil.²³

6.2.1.3 *The Counterpurchase of Industrial Products and Services*

This form of offset is, of course, most frequently associated with arms exports to developed countries. Scandinavian countries have often enforced such clauses in their purchases from France. For example, in 1986 Finland bought the anti-tank weapon Apilas from the French firm Matra-Manurhin worth Fin. MK 290 but the counterpurchase involved an equivalent FrFr 400 million purchase of paper machines.²⁴ In 1992 Finland initiated a competition between American, Swedish and French industries for the supply of its new air force fleet. This competition was very important for Dassault who had received no export order since 1986. As a counterpurchase, the French offered to develop their seaport traffic and sea transportation with Finnish shipowners.

In 1987, Sweden bought 10 Super Puma helicopters (FrFr 400 million) with undisclosed "industrial offsets".²⁵ Three years later, Norway bought Mistral anti-

tank weaponry for FrFr 350 million with a requirement to spend about 75% of this amount on Norwegian industrial products.²⁶

For a long while now Belgium has required offsets when buying French arms, and on some occasions has sought industrial counterpurchases. As early as 1985, and before development had been completed, Belgium committed itself to the purchase of Mistral anti-tank weapons from Matra. This decision involved about 1000 missiles and 150 launchers worth FrFr 560 million²⁷ against a 100% offset, part of which was to be industrial orders placed with Belgian suppliers. The final contract in 1988 was somewhat smaller (714 missiles) but worth FrFr 588 million²⁸ with a detailed offset requirement that balanced various regional interests (analysed further below) and which included a 25% counterpurchase from Belgian suppliers.²⁹ Some less developed countries also seek industrial counterpurchases when purchasing defence equipment. For example, India typically makes such demands when buying arms.³⁰ Part of the offset associated with the Greek purchase of Mirage 2000 aircraft included the purchase Greek industrial products. However, there were difficulties finding Greek industrial products that met the quality standards demanded by French buyers.³¹ Despite these difficulties, the four French corporations responsible for the offset (Dassault-Aviation, Thomson-CSF, SNECMA and Matra) have purchased Greek products and services worth FrFr 350 million, including industrial products, during the two years 1987–1988.

Services, including tourism, play an important role in the Greek offset and the four French contractors contributed about 10% of the offset total in tourist services. The total offset was 60% of the FrFr 7.934 billion contract value, about FrFr 4.8 billion.³² A Franco-Greek tourism company was incorporated under the name of “Vacances Mondiales”, and signed a contract with the four French corporations worth FrFr 550 million to purchase holiday sites, rooms, suites, bungalows and so on.³³ These were then sold to the French public. It is worth noting that these tourism offsets were easier to fulfil than those requiring the purchase of Greek industrial products.

A counterpurchase requirement need not necessarily involve the vendor purchasing goods itself. It might, instead, involve the vendor seeking third parties to buy the goods produced by the purchaser. This is the type of commitment that Dassault made in 1988 when agreeing a 10 year hire-purchase contract for five business aircraft (Falcon 900s) with Australia. The offset involved Dassault helping to find buyers for the Australian second-hand Mirage III aircraft, bought previously from Dassault.³⁴ This agreement worked very well, and the Mirage III were purchased by Pakistan.³⁵ The same trading know-how was also the subject of negotiations in 1991 with Finland: Dassault offered as offset to help to market the Valmet training aircraft.³⁶

Sometimes, the offset products are dual use and this is often the case with civil aircraft. When Brazil decided to purchase 12 Super-Puma helicopters, despite aggressive American competition, the French commitment to consider buying Brasilia Embraer³⁷ civil aircraft was of no small importance.

6.2.2 Offsets Reducing the Purchaser's Foreign Currency Burden

The difference between these and the previously described offsets is that, although they are part of the contract, they are actually executed some time later. They result in a reduction of foreign currency payments or alternatively generate an extra currency contribution to the balance of payments. Two main types of this form of offset can be identified: deferred counter-contracts, often involving the reverse sale of armaments; and the purchase of local manufactures, generating employment in the domestic economy, and made according to the terms of the contract by the seller.

6.2.2.1 *Deferred Counter-contract*

This form of offset consists of a system of “cross arms contracts”, although the actual transfers need not be simultaneous. These counter-contracts need not be restricted to military production, but where they do include civil products these are usually manufactured by a company mainly producing military goods. This is specially the case for aircraft manufacturers. An important point is that the offset may sometimes be a simple “declaration of intent”, without a formal firm commitment to purchase. This was the case when, in 1987, France bought five short take-off CASA 212 aircraft from Spain, as part of an exchange package which was to also involve a Spanish purchase of 18 Super-Puma helicopters from the French firm, Aerospatiale. However, Spain finalised the details of its purchase before the French.³⁸ A similar offset occurred a year later when France bought eight C-235 cargo planes worth FrFr 50 million each, in the hope of selling French equipment to Spain and of encouraging the Spanish to join the Rafale fighter aircraft program.³⁹

Reciprocal purchase deals were also successfully achieved between France and Brazil. In 1988, Brazil, despite substantial US pressure, took the decision to again purchase French helicopters as they did in 1985. Worth a total of US\$248 million, 16 Ecureuils and 36 Dauphins were sold, partly because of the attractive financing package offered by the French, but mainly because French agreed to equip their air force with Brazilian Tucano training aircraft,⁴⁰ manufactured by Embraer. Apart from the revenue, an obvious benefit of this sale for the Brazilians was the confirmation it provided of the aircraft's quality standards. The French purchase effectively provided a label “used by the French air

force” for the Tucano. The first two of the proposed 50 aircraft were ordered in 1991.⁴¹

The same type of cross-contract considerations were present during the negotiations for the French purchase of the US AWACS aircraft. As a *quid pro quo*, France wanted the US to favour the French communications system, named RITA.⁴² For their part, the American side saw the offset as running in the reverse direction, and reminded the French of their earlier decision to re-engine their KC-135 aircraft with the Franco-American CFM-56 engine supplied by General Electric/SNECMA.⁴³

6.2.2.2 *Local Manufacturing Provided by the Seller*

This involves the vendor agreeing to purchase from the buyer parts and components to go into the equipment that is the subject of the contract. This brings closer co-operation between the two countries’ companies than would a straightforward counterpurchase requirement. In some cases, this form of offset may even involve technology transfers, with coproduction or licensing agreements. Publicly available information is often not detailed enough to appreciate the exact size of the local contribution. Sometimes, only the existence of a local manufacturing agreement is known rather than its magnitude. In other instances, maintenance agreements are signed, or components are known to be locally produced, or there is a local assembly line, particularly for aircraft contracts. This form of offset may even go as far as the complete manufacture of the product locally.

Unspecific Local-Contracting:

The local sub-contracting arrangements are sometimes very vague. In 1987, when Sweden purchased ten Super-Puma helicopters, worth FrFr 400 million, little more was mentioned than that “this order includes industrial and technical offset”.⁴⁴ Similarly, in 1992, when Finland finally opted for the US McDonnell Douglas F-18 aircraft, it was only known that 100% of the value of the contract would be offset by the purchase of Finnish goods.⁴⁵ And when the Austrian government purchased several hundred Mistral missiles worth FrFr 730 millions, “more than 100% was offset within a wide range of transport, telecommunication, space and publishing industries” according to the Matra-Hachette declaration.⁴⁶

Sometimes the existence of an offset is reported without any further detail. In 1989, Switzerland took the decision to purchase anti-tank mines HPD F2 from the French firm TRT. This granted offsets worth 74% of the contract value to several Swiss companies including TAVARO (Sion) and MFA (Altdorf).⁴⁷ Similarly, when buying a number of Franco-German Milan weapons worth FrFr

350 million from MBB, Spain sought that two-thirds of the value of this contract should be spent by MBB buying goods from the Spanish firm Santa Barbara.⁴⁸ One year later, Spain again opted for a contract involving several hundred Mistral missiles and 200 launching devices, with a total value of some FrFr 830 million. It was formally agreed that various Spanish companies, such as INISEL, Santa Barbara, OCSA and ENOSA, would co-operate in the production of the equipment.⁴⁹ Thomson-CSF won a competition in the Netherlands for the supply of 14 Crotale missile systems worth FrFr 850 million thanks to co-operation arranged with Fokker and HSA⁵⁰ for the manufacture of the missiles.⁵¹ A year later, the same exporter obtained a Turkish order for 14 radar systems worth FrFr 900 million with an agreement for the involvement of Turkish Company Tefeken in the manufacture of the product.⁵²

Co-production involves a more definite commitment, involving a fairly equal importance of each partner. It was expressly mentioned only in the Belgium contract for the purchase of Mistral weaponry in 1988.⁵³ The co-production arrangement was based on the production of 30,000 missiles, which as of 1994, had not been achieved, despite numerous orders. This clause may possibly generate arguments as a similar one did in 1993 between the US and Taiwan. At the beginning of the year, Taiwan stopped payments associated with the purchase of F-16 aircraft worth about US\$6 billion because of a disagreement concerning the share of production that had been forthcoming to Taiwan. The contract stated that 10% of the employment due to this order would be awarded to Taiwan through technology transfer and local production.⁵⁴

Maintenance Sub-Contracts:

These operations generate employment over several years. They involve high local technical standards, but are less of a commitment than coproduction contracts. Such an agreement was, for instance, signed between the French firm SNECMA and the Greek company HAI⁵⁵ when Greece bought F-1 Mirage aircraft. This agreement involved the local maintenance of the aircraft and the Atar 9K-50 engine which equipped the F-1 in that part of the world.⁵⁶ Similarly, when France purchased US C-130 Hercules cargo planes, the negotiations commenced for 10 to 12 aircraft⁵⁷ with offsets at 60% to 70%.⁵⁸ At the end of the day, the contract covered six Lockheed aircraft, with a 60% offset spread over eight years⁵⁹ with long maintenance contracts to Sogerma, a subsidiary of Aerospatiale, and to Dassault Aviation.⁶⁰

Sub-Contractor Production of Components or Parts:

Components and parts are frequent elements of offsets in the aerospace industry because such items are typically not produced by the prime contractor but are, instead, bought in from subcontractors. When Greece split its order for combat

aircraft between 40 American F-16 fighters and 40 French Mirage 2000, the main purpose was indeed to maximise the volume of orders for components and parts placed with Greek industry.⁶¹ However, this later raised problems. Against Greek criticism of the delay in providing these sub-contracts, the French alleged that Greek manufacturers were finding it difficult to meet the necessary quality standards and needed to improve the quality of their labour forces.⁶²

Similar problems did not arise with the Belgium purchase of the Mistral missile which involved a 100% of offset,⁶³ part of which comprised components for the Mistral system.⁶⁴ Spanish industry is also familiar with undertaking sub-contractor work, co-production or licensed production, with French industry. This explains why the purchase of 18 Super-Puma helicopters resulted in Spanish firms manufacturing several components. The sub-contracts went to CASA, AISA,⁶⁵ Marconi Espanola, Inisel, Sener, Berner, Gutmar, Ceta and Evec.⁶⁶ This FrFr 950 million contract was later disclosed to reveal that of the 18 machines, six will be delivered by Aerospatiale and the remaining 12 locally assembled by CASA. Furthermore, CASA will assemble as an offset 50 further machines to be delivered to other customers, and will manufacture governing wings and transmissions for Super-Pumas, grounding devices for the Gazelle (another helicopter made by Aerospatiale) and, on Gazelles, will fit and maintain Malika turbines.⁶⁷ The last aspect of this offset is particularly important as it involves a close relationship between the Spanish firm CASA and the French Aerospatiale.

A similar agreement could have occurred between France and Canada, should the contract for the purchase of the Leclerc armed vehicle materialise. In the case of a Canadian purchase of the Leclerc, a number of important sub-contracts for major elements of the vehicle were to be placed in Canada.⁶⁸

Local Assembly Agreements:

These agreements may significantly facilitate a sale because they involve know-how transfers. The Super-Puma assembled in Spain, as mentioned above, is a good example of this phenomenon. Such attractive proposals have recently been offered by Dassault-Aviation.⁶⁹ In 1986, the assembly of a second set of 20 Mirage fighter aircraft for Egypt was offered to the Arab Industrial Organisation⁷⁰ together with the assembly of some Super-Puma helicopters. Similarly Dassault, facing intense competition when seeking sales of its Mirage 2000-5 aircraft, has offered large offsets including the local assembly of the aircraft as well as the opportunity to manufacture components and spares.⁷¹

Agreement Leading to Full Licensed Production:

These are the most demanding agreements, technology wise, and they lead to the strongest links between firms in the seller and buyer countries. They obviously improve not only employment but also the level of technical know-how in the

purchaser's economy. And because of the substantial capital which has to be raised both for investment and labour training, this form of offset is typically of a long term nature. The buyer, having invested large amounts of capital, will look for further orders from the seller. The latter, of course, will not be enthusiastic about technology transfers as these have the potential to generate further competition. The seller will also seek to concentrate his interests on co-operation with one particular buyer.

A good example of this kind of link occurred between India and USSR. India sought Russian military supplies but faced a shortage of foreign currency with which to pay for them. Hence India's desire for the Russians to purchase Indian industrial products which, of course, the Russians were happy to accept. Particularly remarkable was the Indian manufacture of T-72 armoured vehicles near Madras, and the production of Mig 27 aircraft in Nasik (by the Hindustan Aeronautics Co).⁷² Because of the reputation of Indian technology in the aircraft industry, in the early 1980s, Dassault attempted to sell 110 Mirage 2000 aircraft which were to be locally manufactured.⁷³

Nevertheless, among French arms exports, local manufacturing remains an exception. One such contract was signed with Egypt, within the framework of a government policy to help to develop this country's military industry, as an offset for the purchase of Sinaï 23-2 anti-aircraft systems⁷⁴ designed by the French firm Thomson-CSF, TBA, Hispano Suiza, and ESD.⁷⁵ This system consists of an armed vehicle and a 23 mm gun with a SATCP weapon, the Sakr Eye, made by the Egyptian government military workshop and the Sakr Company.⁷⁶ A smaller contract was signed with the German Federal Republic in 1988 for the supply of French designed BAP 100 bombs for destruction of landing runways. These were to be manufactured by the Bundesamt für Wehrtechnik und Beschaffung.⁷⁷

6.2.3 Technology Transfers

This is the third kind of industrial and economic transfer. These transfers are not restricted to offsets. There are simple agreements for transferring licences, or know-how, or establishing co-operative ventures, or the co-production of goods for sale to third parties. Examples include Franco-Swedish co-operation;⁷⁸ Franco-Russian negotiations on nuclear weapons' dismantling;⁷⁹ the erection by France of an armaments plant in Thailand;⁸⁰ and the sale by the French firm, Manurhin Equipment, of three workshops producing munitions to Taiwan.⁸¹ However, technology transfers were also involved in a number of offset arrangements that have already been described above, such as local manufacture and assembly. It is also significant that some contracts include explicit technology

transfers and there is evidence that such transfers have been a key factor during the negotiations, particularly where underdeveloped countries are involved. In 1986, when discussing the possibility of the sale of a second batch of Mirage aircraft to Egypt, Dassault offered to build a high-technology composite materials plant, for civil and military purpose.⁸²

A similar offer was made in 1985 when GIAT,⁸³ competing for the contract to supply 155mm guns to India,⁸⁴ offered to transfer the very up-to-date technology of its 155mm AUF1 through a licensing agreement.⁸⁵ Developed countries are also interested in such technology transfers. When considering the purchase of French aircraft in 1991, Finland ascertained that "Dassault had no objection to complete technology transfers, without restrictions even on the most advanced systems".⁸⁶

Some of the contracts that have been actually signed involve developed countries. When ordering 988 Thomson Brandt artillery launchers and 60 mortars in 1988, Switzerland received, as offset, the licence to manufacture these mortars in Swiss government workshops.⁸⁷ And Austria, when buying Mistral weapons in 1993, obtained "a large co-operation and investment program" which is now in progress.⁸⁸

However, less developed countries remain by far the main ones to push for such kinds of offset. Greece had already benefited from an important transfer of technology in 1983⁸⁹ concerning the maintenance and refurbishing of Mirage F-1 engines. This was enlarged some years later with the sale of Mirage 2000 aircraft. During 1987–1988, the four major French companies concerned⁹⁰ provided a total industrial investment worth FrFr 628 million.⁹¹

Egypt, as noted above, has obtained the technology to make locally the missile bought as part of its purchase of the Sinaï 23-2 anti-aircraft system as well as the right to export such products.⁹²

Gulf countries, important customers for French armaments, have required technology transfer offsets with many of their purchases. In 1989, Saudi Arabia initiated negotiations for an offset agreement similar to that signed with both the US⁹³ and the UK. The Saudis require that part of the amount paid to France for armament supplies be invested into industry and high technology projects in their country.⁹⁴ Their aim is not to reduce their currency payment, but to help create factories as a contribution to Saudi Arabia's development. Particularly favoured would be Franco-Saudi joint ventures. These investments should be significant, the aim being that about one-third of the value of the defence contract be reinvested locally.⁹⁵ Offsets of this form and magnitude were requested during the negotiations for the sale of the Mistral missiles and anti-aircraft frigates⁹⁶ and led to a contract for the supply of 3 anti-aircraft ships one year later,

worth FrFr 18 billion. The 35% offset concerned mainly civil and military high technology joint ventures not in the oil industry.⁹⁷

Similarly, the Leclerc tank contract with Abu Dhabi involved a 60% offset “in order, through industry and technology transfers, and also new ventures, to contribute to the Emirates other civil and military projects”.⁹⁸ In order to manage these offsets, GIAT Industries established a permanent office in Abu Dhabi in charge of generating joint ventures with technology transfers, worth a total of FrFr 2 billion within 10 years. This office, named “French Offset Partners”, has already considered 250 non-oil industry projects.⁹⁹

6.3 Other Clauses Being Equivalent to Offsets

The above description has focused on what are usually considered to be the standard forms of offsets. However, many procurement decisions might be influenced by other factors which can also be termed offsets. This category would include favourable financial terms, gift/countergift, and even political decisions. The truth is that, in a buyer's market, the buyer is strong just because he may potentially purchase and it is this strength that is the very source of offsets. Because the seller wants the sales contract, he will meet the buyer's conditions or at least some of them. This has, therefore, nothing to do with discounts, premiums or bonuses designed to enhance the product's marketing. These negotiations lead to a specific contract which will vary from one deal to another. These conditions will not be identical in each sale, nor will there emerge a reference case which serves as the basis for all future deals. Here we are far away from conventional market competition and, for this reason, we now outline some of the forms that these more unconventional offsets might take.

6.3.1 Attractive Finance Packaging

Below we discuss a large variety of financial arrangements which might be attractive to the customer including payment terms, credits or gifts, and price reductions.

6.3.1.1 *Payment Conditions*

These are usually far more liberal than those found in more conventional lines of business. When selling to India, the USSR accepted deferred payments over 10 or even 20 years, with an interest rate of 2% and the possibility of paying in roubles.¹⁰⁰ Using the same factors (long deferred payment and low interest rates) Thomson-CSF won the Turkish order for mobile radar, against particularly strong American competition from General Electric. The total amount, FrFr 900

million, was “payable over even a longer period and at a lower interest-rate” according to sources.¹⁰¹ In 1985, Brasil opted for Aerospatiale Super-Puma helicopters. Interest rates and the availability of deferred payments played an important role in securing the contract.¹⁰² Nevertheless, the competing US firms protested on the basis that the “finance conditions as offered by Sikorski were just as equally attractive”.¹⁰³

6.3.1.2 Credits

It is not unusual for arms sales contracts to include a clause stating that the seller will grant, one way or another, a credit covering part of the purchase amount. This occurred with the Brasilian purchase of Super-Pumas. No details were obtainable in Paris, but the *Financial Times* announced the establishment of a French credit amounting to 185% of the contract value!¹⁰⁴ And three years later, when Brasil took the decision to place a further order for French helicopters,¹⁰⁵ this contract was partly covered by credits provided by French banks.

India, thanks to their aggressive negotiators, obtained low interest rate credits when buying helicopters from France and the UK. With regard to their order for French equipment, FrFr 400 million were granted at a rate of 2.5% over 28 years.¹⁰⁶ In this instance, the finance package proved decisive in winning the competition. The UK had started negotiations with a credit covering two-thirds of the order (at that time for 27 helicopters).¹⁰⁷ But at the end of the day, the 21 Westland W.30, worth FrFr 650 million, had been offered with a 100% credit.¹⁰⁸ France had “offered as a free gift” 8 out of the 27 helicopters.¹⁰⁹ This kind of clause also occurred in the sale of 155mm calibre guns from the Swedish firm Bofors to India. Giat, the French firm, lost the contract because of “specially favourable Swedish credit terms and government subsidies”. More precisely, a gift of FrFr 300 million was budgeted for by the Swedish administration in 1986 together with the provision of a further FrFr 400 million at a very low interest rate.¹¹⁰

It is rather difficult to precisely identify price reductions because they are rarely disclosed and also because in armaments sales the exact price of the contract can be difficult to determine. Nevertheless, in 1987 the French firm Thomson-CSF obtained the Turkish radar contract because it cut the price by half from its initial offer.¹¹¹ Orders from India are also often subject to important price reductions, from 10% to 30%.¹¹² It seems likely that the 40 Mirage 2000 aircraft sold to India in 1985 “have been actually priced at 75% of their initial rate”.¹¹³

These finance clauses are more or less attractive. For instance, Gulf oil producing countries do not rate them as of major importance. The offsets agreed by France and Saudi Arabia in 1990 in the anti-aircraft ships contract is evidence of

this: 35% of the total contract value of FrFr 18 billion is to be invested in joint ventures with a capital contribution of both countries (25% each in bank loans and capital sharing, the balance of 50% being provided by the Saudi government through a 15 year loan at a preferential interest rate).¹¹⁴

6.3.2 “Deception Counterpart” and Gift/Countergift

There may sometimes be only an informal link between different arms contracts. This is usually reported in the media as “deception counterpart” when an unsuccessful supplier on a big contract is awarded by the customer a less important contract to minimise the possible harmful effect on their relationship. As an example, the Swiss ordered 60mm mortar ammunitions worth FrFr 100 million from TBA¹¹⁵ when the F-16 was finally ordered instead of Mirage 2000.¹¹⁶ The same thing seemed to happen when Singapore ordered Dutch patrol aircraft instead of Mirage/Aerospatiale aircraft. Singapore ordered French Exocet missiles to equip these planes.¹¹⁷ When, in 1988, Belgium signed a contract for the supply of Italian helicopters worth FrFr 1.8 billion rather than the French rival model, Belgium alleged that an “advance offset” had been the Mistral missiles order placed with France a few months earlier.¹¹⁸

Offsets can also be retaliatory. In 1992 France opted for the Swedish caterpillar personnel carrier, the Haegglund BV-206, in preference to the Finnish Sisu. It has been alleged that this decision was a consequence of the Finnish refusal to equip their combat airfleet with French Mirage 2000.¹¹⁹ The French decision to purchase eight Spanish cargo planes (the CN-235) has been noted as a friendly gesture, not formally linked to the French Rafale program. However, the undisclosed hope was that Spain would make a reciprocal countergift¹²⁰ in the form of favouring the French program for a new combat aircraft.¹²¹ However, calling this an “offset” is rather an over-statement because nothing was actually formalised in terms of an exchange of contracts or of cross-orders. Certain gifts have been more clearly linked with specific contracts. For instance, following the sale of Mirage 2000 aircraft, Greece complained about the poor performances of the aircraft’s radar and the slow progress made with offsets. The case was solved in 1992 through the provision of a “discreet offset” involving the supply of a free (second hand) Falcon 900 business jet by Dassault Aviation.¹²²

Different parties will take different views as to which transaction is offsetting the one under discussion. The French purchase of the AWACS system was delayed as the French sought US purchases of its equipment. The US mentioned their choice of the Franco-American CFM-56 engine to power their KC-135 aircraft. However, France considered that this purchase was made prior to the commencement of negotiations for the AWACS and could not be considered as an

offset towards the new contract. The offset aimed at by France was an order for the French RITA system.¹²³ Later, the US argued that their purchase of the French BAP anti-runway bombs should also offset the AWACS sale but France persisted, still seeking an order for the RITA system.¹²⁴ Finally, the US ordered the RITA system, but not as formal offset for the AWACS purchase!¹²⁵ The AWACS offset amounted to 130% of the contract, 80% through the purchase of CFM-56 engines and 50% in orders to the French aircraft industry over eight years. Assembly was to be by UTA, and refuelling beams were to be manufactured by Sogerma. Boeing also offered Thomson-CSF and the British firm Plessey the opportunity to bid jointly for the provision of a defence system for Ireland. Boeing suggested that French companies participate in the modernisation of American CH47-D helicopters and act as sub-contractors for the forward edge of the Boeing 747.¹²⁶ On top of all this, Boeing opened an office in Paris to negotiate with 150 potential French suppliers.¹²⁷ Despite the final agreement, it is still difficult to understand what offset what. Did the US offset the purchase of AWACS, or did France offset the sale of CFM-56 engines?¹²⁸ This kind of case illustrates the political side of offset agreements, an aspect which may become pre-eminent.

6.3.3 Political Offsets

These take many kinds and are usually difficult to identify. Nevertheless, a certain number of situations have occurred where offsets have been sought on political rather than economic grounds. The French desire to bring Spain into the Rafale program, led to the purchase of some Spanish Air Cargo CN-235 planes. This decision was clearly of political origin. Of course, there were also economic advantages (i.e. reducing unit R&D costs) but the main objective of this choice was political, as it sought to reduce the size of the consortium devoted to the production of the Rafale's competitor, the EFA2000 (European Fighter Aircraft).

More precisely, some political offsets are sometimes linked to arms contracts, or to their preliminary negotiations. As an example, the first Swiss evaluation of the American and French fighter aircraft in 1988 was largely overshadowed by the American promise to increase Swissair landing rights in the US.¹²⁹ Similarly, France promised to push ahead with the Finnish application for membership of the EU if the Finns purchased the Mirage aircraft rather than its American rival.¹³⁰

The reverse link may also happen, that is where the arms contract is an offset rewarding a political decision. For example, in 1984 France started negotiations concerning possible armament sales to Libya in order to obtain their withdrawal from Tchad.¹³¹ In some cases the political aim could even be to secure a change in domestic policy. When, in the last quarter of 1992, Turkey

opted for an American helicopter rather than the Franco-German Eurocopter Cougar, it assisted the re-election campaign of US President George Bush who could claim responsibility for all the jobs that such an export contract would secure.¹³² Similarly, the regional distribution of the offsets associated with the Belgian purchase of the Mistral missile (53% to Flanders, 39% to Walloon and 8% to Brussels) reflects domestic political considerations.¹³³ Finally, the armament sale may involve offsets to the benefit of third parties who feel aggrieved by the contract. When France sold a number of frigates to Taiwan, Peking, which had unsuccessfully used political pressure to prevent the sale, asked France to provide financial offsets, which were in effect cheap credits.¹³⁴

It is of course no surprise to find political offsets linked to armament sales. These contracts often involve major political decisions, and consequently offsets cannot be restricted to industry matters.

6.4 Offsets Have Become a Basic Element of Armaments Sales Contracts

Not all of the various forms of offset occur with every export sale. The precise nature of the offset will depend on the intensity of the competition for the sale and various purchaser characteristics such as the level of its expertise in aerospace, its degree of industrialisation, its regional policies, and so on. Although offsets vary from one contract to another, this reciprocity has, for the last 15 years, been an essential element in winning any arms exports. It is still true that other elements (such as the equipment's performance, the delivery date, the price and financing arrangements) are of major importance. However, the significant trend is now towards common and disclosed conditions of armament contracts.¹³⁵

It is an acknowledged fact that in most cases offsets can prove decisive in winning a contract. In the competition between France and Italy, to supply Belgium with attack helicopters, counter bidding was intense. The Italians offered offsets worth 73% of the contract while the French firm Aerospatiale went up to 117% offset but only on their own value-added.¹³⁶ The Belgian choice favouring Agusta was explained by "a slightly larger volume of offsets offered by Agusta".¹³⁷ Similarly, Matra obtained the Austrian order for anti-aircraft missiles against Swedish (Bofors) competition, thanks to a more substantial offset package, despite the lower price of the Swedish RBS-70 compared with the French Mistral.¹³⁸ In 1988, Brasil explained their choice of the French Aerospatiale helicopter in preference to the American Sikorsky by the better offsets offered by the Europeans.¹³⁹ The decision of India to share its order for heli-

copters in 1984 between the UK (the initial favourite) and France, was influenced by the French offset proposal, particularly as the initial British offer only included a financial contribution.¹⁴⁰ Of course, other examples could be cited where offsets alone were not sufficient to win a contract. If this was not true, Dassault would not have lost the Finnish order for fighter aircraft, and Eurocopter would not have lost the Turkish helicopter order. Although not sufficient, offsets are necessary to win most arms export contracts.

Offsets are now openly discussed and formally shaped. It has been noted above that Boeing opened an office in Paris to manage the offsets linked to the AWACS contract¹⁴¹ and GIAT-Industries did likewise in Abu Dhabi.¹⁴² To improve the management of its Greek offset programme, Dassault Aviation appointed someone to work full-time on the project.¹⁴³ New national offset organisations have developed in France, and these are not solely dedicated to military contracts. The oldest organisation is AGEKO (Trading Offsets Association) which is a non-profit group offering three main services to members: general information, including access to a data bank; assistance with writing contracts that include an offset; and help finding partners who might be willing to trade products acquired under an offset.¹⁴⁴

The banking industry has also developed its own structures in this field: BFCE¹⁴⁵ is associated with the international trading company SECOPA; Banque de Paris et des Pays-Bas works with the international trading company SCOA; Crédit Lyonnais, in association with an American industrial group, has created GREFICOMEX; and several international trading companies are partly dedicated to offsets. Moreover, some large industrial corporations have developed their own offset networks: Peugeot incorporated FRECOM in 1982; Renault owns SORIMEX; and Thomson receives services from a subsidiary, named SOCOFINANCE.¹⁴⁶

This network system assists the fulfilment of ever-increasing offset demands. For example, Finland went to the point of requesting "prior offsets" in 1992. This required that all potential bidders for the fighter aircraft contract had to fulfil an offset worth 10% of their own bid, irrespective of who ultimately won the contract. This can be regarded as an "entrance fee" which is payable to secure entry to the buyer's list. Defence is a buyer's market and competition is intense for the very few major contracts. The increasing use of offsets over the last 20 years bears witness to this.

For a number of years, the offsets granted by French firms were relatively limited as exporters concentrated on a small number of Gulf states that had very limited industrial infrastructures. Consequently, offsets were far from being the decisive factor that they might otherwise have been, had the purchaser been a developed country or a country attempting to expand its defence industrial base.

(eg India). More recently, French exporters have been looking to south-east Asia, where countries are much more interested in technology transfers and the development of their indigenous capabilities. Hence offsets play a much more significant role in the competitions to supply arms to these countries. Indeed, the view has been expressed that:

The requirement for an offset with all arms exports will soon be unavoidable. In this context of widespread and ever-increasing offset demands, there will be a need to improve communications between the defence industry (which has traditionally been rather isolated) and other large sectors of industrial activity. Particularly for large contracts, the latter might be able to assist arms exporters with their offset programmes such that both sectors benefit from the resulting co-operation.¹⁴⁷

On the import side, offsets typically play a much less important role than that associated with French arms exports. French defence imports increased markedly over the period 1988–91 (partly due to the AWACS programme), but by 1993 had returned to the level seen in the 1970s (about FrFr 4 billion). Although the negotiations for the AWACS offset were rather protracted, the French government is likely to make similar offset demands if it considers buying US-designed equipment in the future. However, the French tend to prefer collaborative European development programmes to off-the-shelf purchases of US equipment and thus there is unlikely to be any marked upsurge in arms imports and associated offsets. The relative infrequency with which France requests offsets has meant that no well defined official policy has emerged, nor is there likely to be any great need for such a development. Negotiations will proceed on a case-by-case basis rather than within any pre-specified framework.

Endnotes

1. The version supplied to the Federal Republic under their own specifications had about 200 accidents out of 600 aircraft, killing 98 pilots. Hence the aircraft acquired the nickname of the ‘widow maker’. See Menant G. in ‘Paris-Match’ No. 1331, 30.11.1974.
2. Worth about 3000 staff employed over a 10 year period. See Gerdan E. “Dossier A comme Arms” edited by Alain Moreau, p. 175–186.
3. Although this did not materialise, it would have been an important new feature in the aircraft business which is always quoted in US\$.
4. “We are small, and as such we badly need protection from the powerful USA” quoted from a Norwegian government spokesman in *Le Monde*, 22.09.1993.

5. We shall not detail many of the other peripheral offsets that are alleged to have occurred, such as “under the table payments, intelligence tips, press leaks, etc”: see Gerdan E., *op cit.*
6. Lenglet F. “Offsetting aircraft against grapes” *Science et vie Economique* No. 57 Jan.1990 p. 60–66.
7. J.P. Hebert “Les ventes d’armes” *Syros Ed.Paris*1988 p. 92.
8. Sauvin T. “La compensation internationale” Thesis Univ. Paris X 1991.
9. Sauvin T. “La compensation,nouveau moyen d’intervention de l’Etat dans les Pays industrialisés” *Cahiers d’Economie mondiale* T.5 No. 1 1992 p. 40.
10. Sauvin T. Thèse citée p. 25.
11. *Le Monde*, 10.03.1987.
12. *Ibidem*.
13. *Le Monde*, 27.02.1989.
14. Greece had taken the decision to share its order between the French Mirage 2000 and the American F-16. *Le Monde*, 16.11.1984.
15. Order of 600 Mistral missiles, each worth FrFr 1 million and the loading device as well. *Le Monde*, 13.06.1989.
16. Sauvin T. Thèse citée p. 206.
17. *Le Monde*, 18.02.1985.
18. *Le Monde*, 19.03.1985.
19. *Le Monde*, 2.03.1985.
20. *Ibidem*.
21. *Le Monde*, 13.06.1989.
22. *Le Monde*, 18.01.1985.
23. *Le Monde*, 2.03.1985.
24. *Le Monde*, 13.06.1986.
25. *Le Monde*, 27.05.1987.
26. *Le Monde*, 2 and 3.09.1990.

27. *Le Monde*, 22.06.1985.
28. *Le Monde*, 09.06.1988.
29. The global offset remained at 100% as originally demanded.
30. *Le Nouvel Economiste*, 19.03.1984.
31. *Le Monde*, 19.03.1988.
32. *Le Monde*, 25.02.1989.
33. *Le Monde*, 01.04.1988.
34. *Le Monde*, 20.12.1988.
35. *Le Monde*, 27.04.1990.
36. *Le Monde*, 13–14.10.1991.
37. *Le Monde*, 03–04.03.1985.
38. *Le Monde*, 22.10.1987.
39. *Le Monde*, 20.10.1988.
40. *Le Monde*, 28.06.1988.
41. *Le Monde*, 04.10.1991.
42. It is surprising that the French newspapers, when reporting the US decision in favour of RITA, did not stress this point.
43. *Le Monde*, 27.03.1985.
44. *Le Monde*, 27.05.1987.
45. *Le Monde*, 08.05.1992.
46. *Les Echos*, 27.01.1993.
47. *Le Monde*, 05.01.1989.
48. *Le Monde*, 11 and 12.02.1990.
49. *Le Monde*, 18.12.1991.
50. Later bought back by Thomson-CSF.
51. *Le Monde*, 12.04.1989.
52. *Le Monde*, 18.01.1990.

53. Le Monde, 09.11.1988.
54. Les Echos, 22.03.1993.
55. Hellenic Aerospace Industry.
56. Le Monde, 09.02.1983.
57. FrFr 120 million each, spares included.
58. Le Monde, 03.10.1987
59. Le Monde, 06 and 07.12.1987.
60. At this time Avions Marcel Dassault-Breguet Aviation AMD-BA.
61. Le Monde, 16.11.1984.
62. Le Monde, 19.03.1988.
63. Le Monde, 22.06.1985.
64. Le Monde, 19.06.1985.
65. Aeronautica Industrial SA.
66. Le Monde, 06 and 07.04.1986.
67. Le Monde, 21.11.1987.
68. Le Monde, 21.06.1989.
69. Who had formerly signed such a contract covering the co-production of Mirage III aircraft for Belgium.
70. Le Monde, 12.12.1986.
71. Le Monde, 03.03.1992.
72. Le Nouvel Economiste, 19.03.1984.
73. Ibidem.
74. Le Monde, 15.01.1988.
75. TBA = Thomson Brandt Armament; ESD = Electronique Serge Dassault formerly Electronique Marcel Dassault, now Dassault Electronique.
76. Le Monde, 01.09.1988.
77. Les Echos, 24.02.1988

78. Le Monde, 14 and 15.06.1992
79. Le Monde, 16.04.1992.
80. Le Monde, 24.03.1990.
81. Les Echos, 17.02.1993 and Le Monde, 18.02.1993
82. Le Monde, 12.12.1986.
83. Now GIAT-Industries.
84. Finally won by the Swedish firm Bofors.
85. Le Monde, 17 and 28.02.1985.
86. Le Monde, 13 and 14.10.1991.
87. Les Echos, 24.02.1988.
88. Les Echos, 27.01.1993.
89. Le Monde, 09.02.1983.
90. Dassault-Aviation, Thomson-CSF, SNECMA, Matra.
91. Le Monde, 25.02.1989.
92. Le Monde, 15.01.1988.
93. Program 'Peace Shield' — La Tribune de l'Expansion — 28.03.1989.
94. Le Monde, 29.03.1989.
95. Le Monde, 31.05.1989.
96. Le Monde, 27.05.1988.
97. Le Monde, 06.06.1990.
98. Les Echos, 15.02.1993 and Le Monde, 16.02.1993.
99. Le Monde, 18.02.1993.
100. Le Monde, 27 and 28.01.1985.
101. Le Monde, 18.01.1990.
102. Le Monde, 03 and 04.03.1985.
103. Le Monde, 08.02.1985.
104. Cf. Hebert J-P, *Les ventes d'armes*, Editions Syros, Paris, 1988, 186 pages (p. 92).

105. 16 Ecureuils and 36 Dauphins worth US\$248 million.
106. *Le Monde*, 27.03.1986.
107. *Le Monde*, 26.12.1985.
108. *Le Monde*, 27.03.1986.
109. *Le Monde*, 27.03.1986.
110. *Le Monde*, 27.03.1986.
111. *Le Monde*, 08.05.1987.
112. *Le Monde*, 27 and 28.01.1985.
113. *Le Monde*, 24.01.1985 cf. Hebert JP (*op.cit*) p. 35.
114. *Le Monde*, 06.06.1990.
115. Thomson Brandt Armament.
116. *Le Monde*, 04.02.1988.
117. *Le Monde*, 06.04.1991.
118. *Le Monde*, 17.12.1988.
119. *Le Monde*, 14 and 15.06.1992.
120. On gifts and countergifts, see Batifoulier P., Cordonnier A. and Zenou Y. "L'emprunt de la théorie économique à la tradition sociologique: le cas du don contre-don" *Revue Economique*, Vol. 43, No. 5, Sept. 1992, Paris.
121. *Le Monde*, 20.10.1988.
122. Aircraft worth US\$20 million. *Le Monde*, 06 and 07.1992.
123. *Le Monde*, 12.11.1984.
124. *Le Monde*, 27.03.1985.
125. France's first option was to purchase three aircraft worth US\$550 million, *Le Monde*, 20.03.1987. France then decided to buy a fourth aircraft for US\$116 million, *Le Monde*, 05.11.1987.
126. *Le Monde*, 16.05.1988.
127. *Le Monde*, 20.03.1987.
128. Hébert J-P, *Stratégie française et industrie d'armement*, FEDN, Paris, 1991, 396 pages (p. 289).

129. Le Monde, 09.03.1988.
130. Le Monde, 03.03.1992.
131. Le Monde, 21.11.1984.
132. Les Echos, 06 and 07.11.1992. The same sources thought that the end of the American presidential election might bring changes to this contract.
133. Le Monde, 09.11.1988.
134. Le Monde, 14.09.1991.
135. The existence of an offset should be taken into account when making statements that armament sales make a substantial net contribution to the foreign exchange balance. This is clearly erroneous, particularly where there is a 100% offset.
136. Le Monde, 27 and 28.11.1988.
137. Le Monde, 10.12.1988.
138. Libération, 29.03.1993.
139. Le Monde, 28.06.1988.
140. Le Nouvel Economiste. 19.03.1984.
141. Le Monde, 20.03.1987.
142. Le Monde, 18.02.1993.
143. Le Monde, 23.03.1988.
144. For further details, see Sauvin (*th.cit*) p. 74 sq.
145. Banque Française du Commerce Extérieur.
146. This 19.9% subsidiary of Thomson is an international trading company dealing in foodstuffs and metals. It has been involved in the Pechiney-Triangle case of disclosing confidential information in Stock Exchange transactions.
147. Berthault D. "Pour une politique d'exportation clairement défini, maîtrisée et audacieuse", L'Armement (NS), No. 43, Juillet-Août 1994, pp. 31-35.