The Importance and Role of Offsets within International Economic Exchanges

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Abstract
Over time offsets have been defined differently. In essence, defense offsets and those in civil commerce, are offset a buyer seek to a seller for the purchase of goods and/or services. Offset demand for defense showed an upward trend since 1950. It took a further scale in 1980 and since has grown all. Two decades ago, the offset was practiced by around 20 countries, currently being adopted in more than 130 countries. Subsequent changes in the policy of offsets in defense from procurement procedures in 2006, 2008, 2009, different countries have included provisions for bank credit, delimitation of defense products and reduce licensing requirements. Procedures for defense procurement in 2011 are making a significant jump from the preceding provisions of direct offsets by including dual use - civil aerospace and security features for home launching the indirect offsets in a limited way.

1. Compensation in International Trade
1.1. Compensation - general concepts
Compensation is based on the traditional notion of barter which is based on the exchange of goods for goods, commercial practice that emerged thousands of years ago and began to disappear with the emergence of currency and units of account. Therefore, to eliminate the need for currency in international trade appeared compensation which is a cancel operation consisting of one by another trade flows reversed.
Trade compensation Association defines compensation as "a commercial transaction in which the seller undertakes to make some purchases in the state of his client, transfer service or any other exchange transactions, a sale is not achieved only by this condition".

Facts which caused some countries to promote or explicitly demanded compensation practice in their bilateral trade relations were lack of resources, other than their primary ones, or the difficulty in trading international products whose quality is not accordance with international standards. To take into account the specific situation of each country and the multiplication countries favoring more or less open this kind of exchange, assemblies began to be increasingly complex.

International trade activity, has adapted to markets consumer goods and raw materials, developing for many years, as corresponding to global needs. This work was inserted into the clearing operations and serves as a regulator or as an interface for raw materials markets (coffee, cocoa, corn etc.).

1.2. Compensation origins, the reasons for its development and possible factors that may interfere
Related exchanges occurred during the contemporary period with the development of bilateral agreements. Compensation was practiced in Eastern countries in industrial cooperation.
The reasons that made compensation practices intensify and become the preserve of at least 140 countries of the world were: failure of the international monetary system ’70s, the two oil crises, the economic crisis of the 80s and indebtedness of developing states.
If this phenomenon was often criticized by economic organizations (IMF, World Bank, WTO, OECD), we can see that most states in which compensation practice is frequently, use this way because is the only way that can participate in international trade. The reasons enhancing compensation practices cannot be limited to payment difficulties, they sometimes corresponding to development policies.
The most common arguments used to justify the use of compensation are:
• Compensation partial remedy commodity.
Compensation has the advantage of an independent commercial operation against the cost of LIBOR reference type (London Interbank Offered Rate) and EURIBOR (Euro Interbank Offered Rate). An increase of one point of these costs has immediate impact on the debt of a developing country.

Compensation is imposed as a payment technique and appears as a complement or substitute to the reduced export credit, itself linked to increase risk countries.

However, some countries such as Mali, Comoros and Guinea-Bissau have no facilities to finance imports and cannot use compensation because of lack of raw materials for the exchange.

The compensation may be the only way to save a difficult situation from a wars crisis or economic degradation. Compensation becomes a guarantee of maintaining trade relations.

Compensation can be the way to correct distortions due to exchange inadequate penalties.

Compensation practices may allow practices of selling below cost (dumping) or masking export subsidies.

In the case of states with planned economy or the states with oil economy, compensation can become a privileged instrument of economic development. States with planned economies were able to assure a flow for the poor quality production or over-farming, while the second ones you were able to maintain the level of imports and economic development policy, despite the repetitive oil crisis.

The exporter cannot ignore this phenomenon, in sight of all the evidence and the intensification of these practices, as this technique is passing mandatory funding for access to some markets. Knowledge of compensation mechanisms can be put as a commercial and financial advantage compared to other competitors. In a trade negotiation that would be blocked by financial issues, the exporter will be able to offer compensation, subject to be evaluated before the financial consequences.

Compensation operations can serve private agreements between companies or public exchange agreements between states. This type of operation is requiring the intervention of companies (and / or states) seller and buyer, banks, international trade companies specialized in compensation and the international negotiators.

In industrialized countries that practice compensation they either have a specialized autonomous structure or resorted to the service of compensation companies. In fact, large industrial groups have developed specialized independent compensation structures; they often have a representation in main capitals. Structures were often originally designed to meet the needs of internal group but due business professionalism it brought ancillary businesses. These structures act as international trading companies.

1.3. Forms of compensation
There are four big categories of compensation:

- Sales Compensation;
- Industrial Compensation;
- Compensation focused on buying;
- Financial compensation.

2. Offset Operations in International Monetary Relations

2.1. Offset - general concepts
The Offset is a form of industrial compensation through which an importing country is participating itself in the production of merchandise that will purchase afterwards and induces franchise operations, co-production operations and technology transfer. Offset arrangements are considered unconventional forms counterparty transactions involving significant state participation.

According to the "Agreement on Public Procurement" in the World Trade Organization, the offset is an agreement in which a foreign buyer, usually a government requires the contractor to agree to purchase a number of components from subcontractors within the country buyer or to perform other requirements of the private acquisition company from the firms within that State, in order to help the country in selling its products.

Offset is an Anglo-Saxon term that denotes all compensation means that allows the seller to get high-tech materials. Originally offset was limited to the national defense sector market, but in recent years it knows an impressive growth which leads to his presence today also in civil sectors, particularly transport and communications. This phenomenon of the development of offset is due to the increased number of dual technologies that enable their application in both civil and military branches. Sellers are often the same for the civil buyer as well as the military buyer. But the real cause of the explosion of the offset is, of course, the demand for technology.

Offset operation has the following characteristics:

- Commitments are made at intergovernmental level or with an important participation of governments.
- Operations refers to high value contracts, that are to be implemented in the medium and long term;
- Combines elements of the counterparty, such as compensation benefits, connecting import to export, with elements of cooperation activities like interdependence between benefits and objectives;
They are frequently met in relations between developed and developing countries;

- It is a tool for importing countries to develop their production capacity, raising the competitiveness of domestic supply and export promotion.

Offset arrangements have a number of advantages for important partner as:

- Currencies economy.
- Import of technology and equipment as well ensuring its operation.
- Global market access for their products at lower costs.
- Quality products made of advanced material, which benefits from the opening of international markets with a low cost advantage from production.
- Using local labor and trained personnel.

For the exporter the key benefits are:

- Possibility to relocate part of its production under favorable cost (cheap labor and access to material resources).
- Maintain and increase its international market position.
- Exploitation of less advanced technologies.
- R & D funding by selling old technology that has already been cushioned.

Arrangements offset have also disadvantages. The exporter will encounter difficulties in:

- Financial evolution of products manufactured in the country of implementation.
- Financial management and technique is cumbersome, this type of compensation is reserved, most commonly for large industrial groups.

Disadvantages related to these arrangements:

- Long lasting of operations.
- Difficulty managing these complex contractual assemblies.
- Payment and financing issues.

In complex arrangements of great value, offsets are usually made from exporter by large industrial groups, and from the importer by government agencies or governments.

### 2.2. Offset forms

Offsets are defined as a number of industrial and commercial compensation practices a necessary condition of purchase of goods and services for defense. Offset can have different forms:

- Co - production in the importer's country based on an agreement on a government to government that allows a government manufacturer to obtain technical information to manufacture all or part of an important article of defense.
- Licensed production - production in the importer country for defense articles based on technological information transfer through a direct commercial agreement between the exporter and the government of a country or an manufacturer.
- Production subcontracts - production in the importer's country part or component of a product defense. Subcontract does not necessarily imply licenses or technical information but is usually a direct commercial agreement between exporting and importing company.
- Foreign investments - investments resulting from the offset agreement, in the form of capital investment to establish or expand a subsidiary or a joint venture in the importer's country.
- Technology transfer - occurs due to a compensation agreement which may take the form of research and development conducted in the importer's country technical assistance offered by subsidiary or joint venture in the importer's country or other activities of a direct commercial agreement between exporting firms and importing countries.

#### 2.3. Directly offset

Directly offset is the buyer's participation in the manufacture of goods sold and implemented in local co-operation, maintenance agreements and technology transfer (assignment of patents, licenses, personnel training and so on). Directly offset can be assimilated and semi-direct.

In the direct offset the vendor approves co-production for specific components of its products or obtains related services within the purchasing nation. Specific components or services must be directly related to deliveries under the contract. It talks about a semi-direct offset when participation doesn't concerns the sales of the good, but another good range of vendor or services related to the object. The purpose of this type of offset is technology acquisition by the buyer to the seller, with the intention of developing a know-how that is interested.

Direct offsets are usually used by governments of the importing country as a mean to develop strategic industries. They could help boost employment in a particular geographical area or as a method of improving the balance of payments.

Directly offset arrangement is more profitable to make a purchase technology than through a conventional market transaction. Direct offset transactions are assuring a good quality product, so this type of arrangement reduces the risk of importer passing it also to the exporter. Therefore, direct offset transactions serves as a reliable signal of quality, in case of asymmetric information between the exporter and importer, and is a rational response to market imperfections that restrict the sharing of technology.
2.4. Indirect Offset

Most of the industrialists who sell technology prefer indirect offset. This term means all forms of compensation related to the sale of property belonging to high technology, except directly offset obligations. These arrangements imply an indirect association of firms from the importing country, meaning that the exporter country buys goods and services not related to the objective/equipment exported. In this case it is actually counterpart operations (compensation and parallel operations).

Tie between direct and indirect offset is negotiated or stipulated in the "guidelines"- offset regulations adopted by some countries (Kuwait, UAE, Australia and so on). Not all countries have framed the offsets in the “guidelines”. Thus, European Union, United States and Canada, although practice offset, officially they do not recognize it, mainly because of GATT.

The offset it shows up as a correction tool for conjuncture and economic development for countries that practice it. For the exporter who sells in these countries is a constraint, a further condition of the sale to be in negotiations to integrate business and production strategy right (relocation, technology transfer). In essence, it aims to reduce cash outflows requiring the exporter to purchase goods and services produced in the importing country to install manufacturing facilities in this country or to use locally produced ingredients.

One of the techniques developed to solve the difficulties of achieving indirect offset are purchases and investment recovery. This lies in identifying, before signing contracts, the companies that purchase or investment projects in the country and eligible sectors.

3. Conclusions

Offset contracts management is a complicated task. These contracts require close monitoring and support mechanisms to achieve the desired objectives, regarding the industrial base mobilization and acquisition of basic skills for domestic production and support services.

In addition to industry demand for indirect offsets under defense procurement regulations, which will require stricter monitoring of contracts offset, there is now some evidence that there may be mandatory offset requirements in general procurement for "Civil offsets " which uses counter measures to allows access to sophisticated technology, investment and joint ventures.

The fact that - for decades, the number of countries wishing to benefit from increased offset indicates that the results were positive from the offset contracts.

World countries need more technology transfer, higher percentages of offset and higher local requirements for offsets for foreign military purchases. In addition, countries that previously did not require offsets use it now as a simple matter of politics. Offset strategies of many countries focus on business and offset long-term contracts. This change emphasizes that these countries use offsets as a tool for achieving the objectives of industrial strategies.

Types of offset projects sought by buyer countries depend on their offset program goals, which in turn are governed by the needs of industrial and economic development. Companies take a wide range of activities to meet requirements for offsets. Defense industries of developed countries use offsets to help companies focus on their defense work. Developed countries with defense industries, pursuing of defense-related offsets also want high technology transfer. Less industrialized countries with economies often follow indirect offsets as a way to encourage investment and create viable commercial business.

Views on the impact of offsets on the U.S. economy and specific industries are divided. Measuring the impact of offsets on the economy and on specific industries as defense is difficult without reliable data.

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