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CANADA IN HIGH SPIRITS OVER DUAL FOCUS OF LOCKHEED BENEFITS

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The Canadian government's contract with Lockheed Martin for the supply of seventeen C-130J Hercules aircraft, worth about $1.4bn, imposes on Lockheed two very different sets of obligations.

In addition to granting Canadian defence contractors hundreds of millions of dollars' worth of parts and maintenance work, Lockheed has also accepted a 100 percent Industrial and Regional Benefits requirement in compliance with Canada's IRB policy.

The Ministry of Public Works and Government Services (PWGS) had been demanding that Lockheed spend 75 percent of the long-term support contract in Canada, a level that Lockheed has now accepted. How Canadian companies will supply the support services has yet to be decided, but PWGS Minister Michael Fortier said: "Under the in-service support portion, the contractor will be required to spend in Canada 75 percent of the total cost in direct industrial regional benefits — well above the 60-percent ratio negotiated by the previous government for purchases of this magnitude."

The **Canadian Association of Defence and Security Industries** (CADSI) expressed satisfaction at the package. Tim Page, CADSI's President, said that the acquisition would provide an important opportunity "to nurture and develop domestic industrial capabilities and competencies in economic, military and trade areas of strategic national importance to Canada."

Page also remarked that the contract with Lockheed will provide "meaningful, value-added engineering work for Canadian defence and aerospace companies for the next twenty years."

Except for program oversight, final design authority, initial spare parts and quality assurance, Canadian industry expects all other work to be performed in Canada by existing defence and aerospace contractors. Canadian industry will have access to all intellectual property, including the technical data needed to perform its in-support service (ISS) functions for the life of the fleet.

Jacques Gagnon, spokesman for Michael Fortier, verified that the 75 percent Maintenance Repair and Overhaul (MRO) package is additional to the 100 percent IRB requirement.

"[The] 75 percent will not be credited against the 100 percent requirement. It is a separate obligation. The 100 percent is for the $1.4bn of IRB commercial activities to Canadian companies," Gagnon told CTO.

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Speaking of the MRO requirement, we were told: “Previous governments demanded that they be at a much lower level. This acquisition, although the exact total dollar value required over the 20 years for maintenance is not in the public domain… the government has asked that [the percentage] be increased to 75 percent to increase the amount of work by companies specialising in the maintenance of military or commercial aircraft. So that is a real gain for the Canadian economy.”

The IRB benefits must be distributed to:

1. the “Atlantic Region,” consisting of the provinces of Newfoundland and Labrador, Prince Edward Island, New Brunswick and Nova Scotia (where the floor limit for benefits is 10 percent);
2. the “Quebec Region,” consisting of the province of Quebec (15 percent);
3. the “Northern Ontario Region,” consisting of the province of Ontario north of the southern limits of Nipissing and Parry Sound districts (15 percent); and
4. the “Western Region” consisting of the provinces of Manitoba, Alberta, Saskatchewan, and British Colombia (15 percent).

Canada’s Shopping List:

Canada has eight major military procurements now underway to help rebuild the country’s armed forces. PWGS is responsible for the purchase of these goods and services on behalf of the Department of National Defence (DND). They consist of (in USD):

1. Tactical airlift (C-130J Hercules) valued at $1.4bn and assigned to Lockheed Martin;
2. Strategic airlift (C-17 Globemasters) valued at $869m. Contracts with Boeing and Pratt & Whitney were signed in February 2007. Requirements are 100 percent of total contract value in IRB: 50 percent of work in aerospace and defence sectors; 30 percent of work in key technologies; 15 percent of work with SME involvement.
3. Medium- to heavy-lift helicopters (Chinooks). Canada will issue an RfP to Boeing by the spring of 2008 and is expected to award the contract in winter 2008. IRB requirement is 100 percent of contract value.
4. Medium-size truck fleet and associated logistics equipment. RfP closes in April 2008. IRB requirement is 100 percent of contract value.
5. Joint support ship project. The government is purchasing the ships through a competitive three-phase procurement process. IRB requirement is 100 percent of contract value. Project definition proposals are due now. Bidders are SNC Lavalin and Thyssen Krupp Marine.
6. Tank replacement project. IRB requirement is 100 percent of contract value.
7. Arctic offshore patrol ships. IRB requirement is 100 percent of contract value.
8. Operational training system provider. The RfP is expected to be issued to CAE Inc. in early 2008. IRB requirement is 100 percent of contract value.

Lockheed will decide which Canadian companies qualify for contracts. Work may not be limited to the C-130Js but could include supplies for other projects. Lockheed has apparently already identified contractors for $842m, or 60 percent, of the $1.4bn in industrial benefits the company is obliged to fulfil. Reports suggest that 50 percent of the obligations must be in the aerospace and defence sector, 30 percent in nine specified key technologies, and a minimum of 15 percent in SMEs.

The Canadian government will establish an industry-government consultative body to make certain that the scope of the work assigned meets the government’s commitments to Canadian defence contractors.

Allocation of contracts to the provinces:

Lockheed has allocated contracts to Quebec worth $240m with regard to the Hercules aircraft; Boeing has allocated contracts to the region worth $420m in connection with the purchase of four Globemasters.

Atlantic Canada aerospace companies will receive about $242m from Lockheed for work linked to the Hercules, and Boeing will allocate $52m in contracts and investments in the region. The beneficiaries include **IMP Aerospace, Wiebel Aerospace, Dalhousie University**, **Memorial University** and the **University of New Brunswick**. Atlantic Canada has the smallest aerospace sector of any province and is anxious to promote itself to the defence industry.

Boeing has provided contracts worth more than $157m to companies in Canada’s Western provinces with regard to the order for four C-17 Globemaster IIIs, a company statement said. Mark Kronenberg, Boeing Integrated Defence Systems Vice President for International Business Development, said that Boeing was “well on track” for meeting the IRB policy.

“Boeing will match every dollar spent by the Canadian government in acquiring its C-17 fleet by partnering with and issuing contracts to companies in Canada,” said Kronenberg. “This will result in long-term, high-value jobs for Canadians and will further embed Boeing as a long-term partner with Canadian industry, particularly with our partners here in the West."

Boeing has so far identified more than 66 percent of its total Globemaster obligations, a company statement claimed. The remaining 34 percent will be located over the next three years. Boeing has also agreed to a collateral agreement that provides further industry benefits worth $750m over 20 years for the in-service support of the C-17 fleet.

Meanwhile, the four provinces competing for the regional benefits are showing an unusual degree of composure. Typically the prime contractor is subjected to intense public lobbying and squabbling, though Ontario's *Globe and Mail* was quick to break ranks. The newspaper grumbled that Quebec will receive the largest slice of benefits and accused the Industry Minister, Jim Prentice, of flying from coast-to-prairie touting the regional benefits arising from the decision to spend billions on new US-built aircraft from Lockheed and Boeing. In an acid aside the newspaper commented: "On Monday it was Montreal. Tuesday, Halifax. Wednesday, Winnipeg. Thursday, Toronto. Or, if you prefer, $660m, $294m, $341m and another $341m."

The newspaper's drift became clearer with a sardonic note that "the spin doctors pointed out that there's another $550m to come and Quebec will have a crack at some or all of it. So, Quebec's overall share of Lockheed contracts should be closer to its 55 per cent share of Canada's $20bn aerospace industry. If your reaction to all of this is, who cares?, you'd be best advised to avoid a career in military procurement, industrial policy or political strategy."

OFFSETS

CZECH REPUBLIC: PATRIA OFFERS TO UNDERTAKE STEYR'S OFFSET PLEDGES

Finland's **Patria** is prepared both to supply armoured personnel carriers (APCs) to the Czech military and to undertake the offset programmes that were part of the original contract with **Steyr**, said Filip Rybin, Patria's representative in the Czech Republic.

"To smooth the economic impact of the cancellation of the contract with the original supplier we are prepared to offer to most Czech sub-suppliers cooperation on the scale that was agreed within the offset programme," Rybin said.

Patria's Vice-President, Wulf Hessulf, offered to deliver the first 30 APCs within three to four months.

Originally, the Czech military was to receive 199 Pandur APCs from the Austria's Steyr for more than 20bn korunas ($1.15bn). The Czech government withdrew from the deal at the close of 2007, citing Steyr's failure to fulfil the commitments ensuing from the contract. Patria had complained to the Czech antitrust authorities about the outcome of the tender. The authorities declined to deal with the complaint. Patria appealed the verdict to the European Commission but withdrew its appeal last March.

POLAND: AUDIT TEAM TO EXAMINE F-16 OFFSETS

Poland's Supreme Board of Inspection (NIK) is to investigate the completion of the offset obligations connected to the purchase of F-16 fighters. A brief statement to the Polish media referred to the legal obligation for every purchase of foreign defence equipment to be balanced by domestic purchases intended to compensate for the purchase.

GREEK EQUATION WILL REGULATE EVALUATION PROCEDURE

An equation to be used for the evaluation of the best Greek Industrial Participation (GIP), Greek Added Value (GAV), financing terms, life cycle cost, and offset benefits tendered by prime contractors has been submitted by the Greek MoD for approval by Parliament.

Parliamentary approval would result in a legislative amendment to Article 56 of Law 3433 regulating the procurement of defence materiel for the Hellenic Armed Forces. The Law came into force in February 2006.

A Greek defence analyst commented that, if approved, the equation would clarify some grey areas in the competitive process. However, the analyst, who asked for anonymity, said: "It's very difficult to launch an international competition because there are some fatal flaws in the [original] concept. For the government it improves the legal framework and will affect positively the procurement process. For industry the basic flaws in the legal framework have not changed."

Purists may take pleasure in the following:

$$BP = C1*RP + C2*GIP + C3*GAV + C4*OB + C5*PC + C6*LCC$$

Where C1, C2, C3, C4, C5, C6 are the weight factors of the criteria.

The rates for the factors are:
-Reflective price: 0,5
-GIP: 0,1
-GAV: 0,1
-OB: 0,1
-Procurement Cost: 0,1
-Life Cycle Cost: 0,1

Specifically parameters like the Reflective Price (RP), the Greek Industrial Participation (GIP), the Greek Added Value (GAV), the Offset Benefits (OB), the Procurement Cost (PC) and the Life Cycle Cost (LCC) are taken into consideration.

OFFSET TRAINING PROGRAM GOING GLOBAL AFTER LONDON DEBUT

A professional offset training program is to be initiated in the UK, then go on the road on international engagements. The program is managed by **Offsets 2000**, a company established by Roger Bulgin to provide specialist support to companies involved with offset.

Bulgin is the offset advisor to the UK's **Defence Manufacturers Association** (DMA). The program, we are told, has the support of the **Chartered Institute of Marketing**.

The first training program, which is open to everyone, is titled 'Offsets for Success.' The program will open in London on 26th March, 2008. The objective, Bulgin said, is to increase the awareness of offset among business managers. These may not necessarily be people involved in offset on a day-to-day basis, but managers of export companies or executives involved in marketing, finance, etc.

The full-day program will address both defence and non-defence sectors, and will look at issues such as bid preparation, planning, the implementation of offset projects, and at some of the commercial and financial issues that arise as a result of the obligations. Bulgin will use actual examples and case studies.

"The idea is to present a cross section of countries with different polices with differences in approach," he said. Bulgin said he has recently been involved with offset projects in Norway, Korea, Kuwait, and Romania.

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S. KOREAN STEALTH FIGHTER IN THE BALANCE OVER LOW ESTIMATE OF ECONOMIC BENEFITS

South Korea is likely to scrap an ambitious project to build its own version of a stealth fighter as the project has been assessed as non-viable economically and technically, military sources told the *Korea Times*. The **Korea Development Institute** (KDI) has concluded that the so-called KF-X program would not be affordable.

The KF-X development would cost at least $10bn but bring about only $3bn in economic benefits, making the economics of the aircraft unsustainable.

Defence Program Acquisition Agency (DAPA) officials, however, said debates on the fate of the program are still under way. Korea would acquire key aircraft technology through joint research and development with foreign partners, officials note.

Last November, the state-funded **Agency for Defence Development** (ADD) unveiled a plan to develop the KF-X fighter in partnership with Western aircraft makers. The agency said it wanted foreign firms to foot 30 percent of development costs. Several foreign defence firms such as **Lockheed Martin**, **Boeing**, **General Electric**, **Saab**, and **Safran** were studying the feasibility of the KF-X, focusing on possible technology transfer and the potential market for the aircraft, according to ADD officials.

Core technology, including aircraft system integration, avionics, fly-by-wire systems and stealth capabilities, would be obtained from partner companies via offsets or domestic research and development, the ADD officials said.

"To be honest, it is very difficult to predict the fate of the KF-X program as there are lots of question marks as to the level of technology, gestation period, development costs and so on," Lee Ju-hyung, a researcher at the state-run **Korea Institute for Defence Analyses' Centre for Weapon System Studies**, told the *Korea Times*. "I just want to remind you that the foremost purpose of the program is acquiring state-of-the-art aircraft technology through joint research and co-operation with foreign countries," he said.

BOEING PROMISES SAUDI FURTHER EDUCATIONAL AND INDUSTRIAL BENEFITS

Boeing's defence division chief has called for further investment in Saudi Arabia. "The Boeing Company is committed to the continued industrial growth and development of Saudi Arabia through its educational and industry partnerships that encourage innovation and competitiveness," Boeing Integrated Defence Systems President and CEO, Jim Albaugh, told the 2008 Global Competitiveness Forum in Riyadh.

Saudi Arabia has asked for the supply of 900 Joint Direct Attack Munition (JDAM) tail kits and associated munitions and bomb components with an estimated cost of $123m. Boeing would be the prime contractor if Congress approves the sale, which is part of a broader $20bn arms package for Saudi Arabia and other Gulf states announced by Secretary of State Condoleezza Rice and Defence Secretary Robert Gates in August 2007.

"In May 2007, Boeing Chairman Jim McNerney and [Saudi Arabian General Investment Authority Governor Amr] Dabbagh signed an agreement to jointly grow the aerospace sector in the Kingdom of Saudi Arabia," a Boeing statement said.

The statement reviewed the role Boeing has played in establishing companies in Saudi Arabia as a result of offset commitments, and referred to its industrial partnership through **Alsalam Aircraft Co**. Alsalam was established by a Boeing-led consortium and a group of local investors and companies in 1988 as a maintenance, repair and overhaul facility for Saudi Arabia and the region.

Alsalam, which reports to Boeing International Support Systems, has apparently grown into a profitable company with approximately 2,800 employees, 75 percent of whom are Saudi nationals.

BRAZIL SECURES FRENCH TECHNOLOGY, OFFERS FRANCE 'JUNGLE WARFARE TRAINING'

"Any defence-related agreement that may eventually be signed with France must include the transfer of technology," said Jose Ramos, Brazil's Defence Ministry spokesman following the visit to Paris of Defence Minister Nelson Jobim in January. During the visit, the two countries signed a Strategic Alliance Agreement intended to help Brazil build a submarine hull and associated weaponry.

Brazil is seeking to obtain military technology from France that could help it become the first country in Latin America to have a nuclear submarine, the Defence Ministry said. Ramos remarked that while Brazil has nuclear reactors and fuel enrichment capacity, the country has not had the technology to build a nuclear submarine. He declined to confirm a report in the *Folha de S. Paulo* newspaper that Brazil would buy the submarine for $600m.

Jobim declared: "We want to build a Brazilian nuclear submarine. And the partnership with France is definite, because it is the only country that is willing to transfer technology." The armed forces already knows how to make the nuclear fuel, he said.

Ramos added that Brazil wants to establish a strategic partnership with France to transfer technology, and noted that France is interested in Brazilian know-how on jungle warfare and "the use of electronic equipment in the humidity of tropical rain forests."

Roberto Mangabeira Unger, Secretary for Long-Term Planning, and Júlio Soares de Moura Neto, Commander-in-Chief of the Navy, had accompanied Jose Ramos to a meeting with Jean Poimboeuf, President of the French state-owned naval defence group **DCNS**.

Brazil is understood also to be interested in acquiring Cougar helicopters and up to 36 fifth-generation Rafale fighter planes.

NEW DANISH REGULATIONS COME INTO FORCE

Denmark's new industrial cooperation regulations have been signed off by the Minister of Economic and

Business Affairs. Executives at the **Danish Enterprise and Construction Authority** (DECA), after a long and anxious wait, will be calmed at last. The regulations took effect from February 1st, 2008. We present a review of the main requirements.

As predicted by in CTO Issue 1, dated 14th January, 2008, DECA has opened up the projects that obligors may use to discharge their obligations to civil aerospace and dual use. Multipliers have been capped at 10. Indeed, the regulations make this position unambiguous by noting that multipliers above 10 "will not be approved."

Specifically, foreign contractors now may discharge their industrial co-operation obligations through:

1) defence-related products, technologies, or services;
2) products, technologies and services securing infrastructure and other public security tasks naturally related to defence materiel technologies; and
3) products, technologies, or services for use in civil aerospace and space naturally related to defence materiel technology.

In the interpretation of defence-related products, technologies, and services the following points will be considered significant. When:

- it is a direct part of a product requiring industrial co-operation when procured by the Danish Armed Forces;
- it is used for manufacturing or processing of a product that would require industrial co-operation;
- it is adjusted to special military specifications;
- it has a specific function in relation to the military assignment;
- it concerns development of defence-related products;
- it requires a Danish export or production licence because the product is covered by the EU's weapons list, the EU's dual-use list or the Danish laws on Weapons or War Materiel.

For defence supplies worth more than DKK 100m ($20m) Denmark requires that at least 30 percent of the obligation be contracted with local companies within four years. The reward process remains unchanged: over-fulfilment will bring a corresponding reduction in the total obligation. If a supplier, for example, has concluded contracts with Danish companies for 40 percent within four years, the total obligation will be reduced from 100 percent to 90 percent. Signing of contracts for 65 percent of a total obligation within four years corresponds to a 100 percent discharge of the obligation. Multipliers cannot be used in combination with rewards for over-fulfilment under the 30 per cent requirement.

The penalty for non-compliance with the 30 percent rule is forfeiture of the entire shortfall by way of bank guarantee. This does not release the foreign supplier from the obligation to fulfil the remaining 70 percent of the industrial cooperation contract (ICC).

An escape clause allows foreign suppliers to gain offset credits by placing orders with Danish companies in a prequalification phase two years prior to contract with the Danish Armed Forces. Multipliers will qualify for pre-performance offsets.

As before, there are separate ICC contracts, according to the value of the supply contract. For procurements exceeding DKK 100m the foreign supplier must sign an ICC One. ICCs Two and Three are for smaller contracts that escape the 30 percent IC requirements applied to an ICC One.

For procurements in the DKK 25m-100m range and between DKK 5m-25m the foreign supplier must sign an ICC Two or ICC Three respectively. If supplementary purchases bring a supplier into the ICC One threshold, contractors must then sign a new ICC One.

A foreign supplier has to sign an ICC with DECA at least 30 days prior to contracting with the Danish Armed Forces. A foreign supplier that fails to do so — or which fails to fulfil its ICC obligations — will be blacklisted and publicly named.

An Advisory Board for Industrial Cooperation, chaired by DECA, shall be consulted on matters of principle and in evaluating projects involving multipliers above 3.

Credit banking is valid for five years though banked credits cannot be applied to fulfil the first 30 percent of the ICC.

Multipliers will not normally be awarded for marketing assistance. Transfer of technology or know-how can be credited with multipliers up to 10. The multiplier related to transfer of machinery or equipment is dependent on the uniqueness of the transfer and its availability on the market. Usually a multiplier above 5 will not be approved in connection with the transfer of machinery or equipment.

PAKISTAN COMMENCES FIGHTER PRODUCTION WITH CHINA

The **Pakistan Aeronautical Complex** has begun formal production of the JF-17 fighter aircraft in collaboration with China. Pakistan plans to commence commercial export of the fighter within three years.

JF-17s were initially imported in fully assembled form from China, but now are to be produced in-country. The agreement with China reportedly calls for 50 to 60 per cent of airframes and 70 to 80 per cent of avionics to be manufactured in Pakistan in the next few years.

Domestic reports suggest six to eight JF-17s would be fully assembled locally, and after final flight testing would be formally inducted into the Air Force this year.

BOT

LIBERIA ADOPTS BOT TO RESOLVE MISSING INFRASTRUCTURE

Liberia, slowly recovering from years of civil war, is to promote the concept of Build, Operate and Transfer (BOT) to encourage foreign investment in much-needed basic infrastructure projects. The capital remains without mains electricity and running water.

Liberian President Ellen Johnson Sirleaf told Parliament that 2007 witnessed a significant increase in the number of investors seeking initiatives through the National Investment Commission.

Viable entities suited to BOT are the **Liberia Petroleum Refining Co.** and the **National Port Authority**. The country is now talking to private Chinese investors about the possibility of building an Economic Free Zone in Buchanan, as Liberia has been selected as one of three African countries for this activity.

The Buchanan Renewable Energies project, with support from a Canadian investment fund is well on the way with an investment of $10m in the processing of old rubber trees for export and for a potential energy source at home. Over 2,000 jobs are expected to result from these National Investment Commission initiatives.

KUWAITI FRAMEWORK TO ENCOURAGE BOT

The Kuwaiti Parliament has passed a law governing BOT contracts. An *Economist Intelligence Unit* report comments that it had become increasingly difficult to implement BOT in recent years owing to corruption allegations.

Now that an agreed framework is in place, the report says, the Cabinet's Economic Committee will begin discussing new BOT projects, among them the provision of storage areas for **Kuwait Ports Authority** on reclaimed land at Shuwaikh Port, the development of liquefaction terminals and associated industrial facilities at Sabhan, and the institution of a free zone and storage area at Shuaiba.

COUNTERTRADE

"MALAYSIA MUST RESORT TO BARTER TO PRESERVE ITS FOOD SUPPLIES"

A Malaysian academic, Mohd Peter Davis, has called for the country to resort to government-to-government barter trading to secure its imports of corn and wheat, without which, he asserts, the population of 27 million will face starvation. Malaysia can barter its palm oil with countries like India and China in return for wheat and corn, he suggested.

Malaysia's Deputy Prime Minister, Datuk Seri Najib Razak has already announced that a National Price Council would be established "to create a national stockpile of essential goods and commodities as a safeguard against the impact of rising prices."

Davis, a lecturer at the **Universiti Putra Malaysia**, formerly known as the Agricultural University of Malaysia, writing in Malaysia's English language newspaper the *New Straits Times*, said he believes that because the world's stock markets face uncertainties and national economies are beginning to suffer hyperinflation, the Malaysian government has to move smartly "to minimise the impact of rising prices on the people's cost of living and purchasing power."

With producing countries banning exports of wheat and corn, there is an urgent need for Malaysia to abandon the normal monetary channels, he said.

ETHIOPIA TO EVADE SANCTIONS BY SUPPLYING GRAIN FOR SUDANESE OIL

The Ethiopian government has agreed to resume oil imports from Sudan under countertrade terms.

Sudan has been supplying 80 percent of Ethiopia's annual consumption of benzene (120,000 metric tonnes) on credit for the past five years. However, sanctions imposed last May on Sudan by the US government disturbed the agreement. The **Commercial Bank of Ethiopia** (CBE) could not therefore transfer dollars to the **Sudan Petroleum Corporation** through **Citibank** for the oil it procured on credit.

The Ethiopian government then proposed a countertrade deal involving the supply of agricultural products, but the two parties were unable at first to reach consensus on the value and volume of grains. With the mediation of Saudi Arabia the two countries have now agreed countertrade terms together with payments in currencies other than dollars. The agreement will be renewed annually.

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