

FOR: ALLAN MENDELOWITZ

ARTHUR P. ISMAY

1169 Chain Bridge Road McLean, Virginia 22101
Tel: 1-703-790-7805 Fax: 1-703-790-8890 E-mail:

SUMMARY

As President of Ismay International, LLC and as a professional consultant he develops international business, industrial cooperation and countertrade. He has performed both line management and staff leadership of more than 90 multi-million dollar international development and trade programs that totaled over U.S. \$1 billion and involved 30 countries. He has planned, developed and negotiated numerous international projects that achieved profitable results. He is skilled in risk analysis, problem solving and international networking. He is educated in business, finance, international banking and engineering.

PROFESSIONAL ACCOMPLISHMENTS

As Vice President (and earlier as Director) of Rockwell International Trading company (a wholly owned subsidiary of Rockwell International Corporation), he planned, developed and managed industrial cooperation, offset and countertrade that supported international sales for all Rockwell subsidiaries and divisions. He streamlined internal procedures and policies in order to reduce costs, negotiated with foreign government agencies and private commercial companies, and represented Rockwell at meetings on offset with U.S. government agencies. He has been a member of the Board of Directors of both the American Countertrade Association, and the Defense Industry Offset Association.

Earlier, as Director of Countertrade for Sears World Trade (a wholly owned subsidiary of Sears Roebuck & Company), he developed and managed international trade between companies in Morocco and the U.S. Prior to joining Sears World Trade, he developed and managed export trading and specialized trade financing in Guatemala, Congo, Cameroon and Iran for Gateway International Company (a small privately held trading company).

MILITARY ACCOMPLISHMENTS

As a Naval Officer, Mr. Ismay served on various surface ships and military staffs. He commissioned and commanded in Vietnam a Coastal Squadron of 100 Swift boats, 150 officers and 800 sailors; commanded the Presidential Yacht Sequoia; commissioned and commanded a coastal minesweeper. His awards include the Bronze Star and the Legion of Merit.

EDUCATION

MBA, finance, University of Hawaii
MS, business, University of Rochester
BS, engineering, U.S. Naval Academy

Law, 1.5 years, George Washington University
Banking, 1 year, Chase Manhattan Bank
Electrical Engineering, 2 years, Union College

ISMAY INTERNATIONAL, L.L.C.
1169 Chain Bridge Road McLean, Virginia 22101-2215
Tel: 1-703-790-7805 Fax: 1-703-790-8890 E-mail:

Testimony of

Arthur P. Ismay

Ismay International, L.L.C.

Before the

U.S. Trade Deficit Review Commission

Kansas City Federal Reserve Bank

Kansas City, Missouri

April 26, 2000

Canadian Industrial and Regional Benefits Program (IRB)

Introduction

Mr. Chairman and Members of the U.S. Trade Deficit Review Commission, I am pleased to present highlights of the Canadian Industrial and Regional Benefits Program.

Definitions

To begin, I will describe terminology that is unique to both the IRB program and to offsets. Industrial and Regional Benefits is the Canadian Government's terminology for its offsets program which aims to achieve industrial benefits and distribute a portion of those benefits to the lesser industrialized regions and small businesses in Canada. In a broad sense, the word offsets (or offset) refers to reciprocal economic benefits that result from compensatory trade arrangements. However, a U.S. interagency group has developed the following relatively narrow definition which is normally used in U.S. government documents. *Offsets are industrial compensation practices required as a condition of purchase in either government-to-government or commercial sales of defense articles and/or defense services as specified in the International Traffic in Arms Regulations.*

Background

The background for understanding Canada's IRB program starts with the long standing political military relationship between Canada and the United States. The Government of Canada knows that the United States will join in defending Canada against foreign threats. Therefore, Canada requires only small size military forces and small size defense companies relative to those in the United States and the United Kingdom.

Canadian Procurement Policy

Next, a few comments on Canadian Procurement Policy are appropriate because Canadian federal procurements provide a lever for Canada's IRB program. This is particularly significant to U.S. defense contractors because Canada relies on foreign defense companies for procurement of military aircraft, submarines and other major defense equipment.

The Canadian agency with overall responsibility for government procurements is the Department of Public Works and Government Services.

It requires that all bids meet government standards. When a contract value is C\$ 2 million or more, procurement preference is given to bids containing IRB commitments. When a contract value is C\$ 100 million or more, IRB commitments must equal at least 100% of the contract value. IRB bids and proposals are clearly important factors in evaluating bids and selecting procurement sources along with technical, price and delivery considerations.

In all Canadian defense procurements Canadian firms are given preference over foreign bidders. Canadian firms acting as either authorized agents or prime contractors for foreign subcontractors are given next preference. This system encourages foreign firms to establish joint ventures as well as production facilities in Canada. Lowest preference is given to foreign firms that have neither an affiliate relationship with a Canadian firm nor a production facility in Canada.

The Canadian federal procurement process involves several agencies in addition to the Canadian Department of Public Works and Government Services. For example, the Canadian Department of Supply and Services manages Canadian federal procurement announcements. The Canadian Department of Industry, Science and Technology evaluates all IRB proposals along with regional agencies that provide comments. The Department of Foreign Affairs and International Trade approves contracts based on foreign relations and expenditure policy. The Canadian Cabinet, through its Committee on Foreign & Defence Policy, is the ultimate authority on major procurements.

IRB Policy and Activities

Shifting from comments on Canadian federal procurement policy to comments on IRB policy and activities, I have previously noted that Canada uses federal procurements as a lever to achieve IRB benefits.

Under a federal offset policy that started in 1975, Industry Canada administers Canada's IRB program. Industry Canada is an organization that is jointly governed by the Minister of Industry, the Secretary of State and the Parliamentary Secretary to Industry Canada. In addition to administering the IRB program, Industry Canada promotes Canadian business, develops Canadian industrial sectors, and encourages Canadian scientific research.

IRB activities include, but are not limited to: technology transfers; joint ventures; business alliances; investments; product mandates, manufacturing licenses; marketing agreements; development of industrial regions; work for small businesses; access to international markets; and creation of sustainable jobs. All IRB activities, regardless of type or description, are governed by the following three overriding requirements.

1. They must be clearly caused by a prime contractor or subcontractor as a direct result of the relevant federal procurement process.
2. They must be new industrial or regional development projects of at least 3 years duration.
3. They must be completed within a specified time frame and prior to final performance or deliverables scheduled under terms of the procurement contract.

IRB Bids and Agreements

IRB bids and proposals must contain extensive details and documents in order to enable a comprehensive review and produce a favorable evaluation by the Canadian Department of Industry, Science and Technology.

During a period of 5 years (1993 through 1997) IRB agreements supported 14 sales contracts for American defense contractors. These sales contracts aggregated US\$ 277 million and were supported by related IRB agreements totaling US\$ 221 million equal to 80% of those sales.

U.S. Government Offset Activities

Now, shifting focus to the U.S. Government, I will briefly describe two ongoing U.S. activities that are related to offsets.

1. Offset Reports: In 1984, an amendment to the Defense Production Act of 1950 required annual reports on the impact of offsets on U.S. defense preparedness, industrial competitiveness, employment and trade. The agency that is currently responsible for collecting offset data and submitting annual reports to Congress is the Bureau of Export Administration in the Department of Commerce.
2. Bilateral Offset Discussions: In accordance with a 1992 amendment to the Defense Production Act, an Interagency Offset Steering Committee has been conducting a series of discussions with U.S. allies on defense

offsets. The Committee is chaired by a Department of Defense representative and includes representatives from the Department of Commerce, the Department of State, the Department of Labor, and the U.S. Trade Representative. The Committee plans to hold discussions with each country that has a Memorandum of Understanding (MOU) with the U.S. on reciprocal defense procurement. The 21 MOU countries are: Australia, Austria, Belgium, Canada, Denmark, Egypt, Finland, France, Germany, Greece, Israel, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey and the United Kingdom.

Additional Comments

As a former Rockwell employee with both corporate and line responsibilities for over 70 offset programs, I would like to conclude by sharing the following personal observations.

1. Although a U.S. interagency group has narrowly defined offset as arising from a required condition for selling defense articles or services, defense contractors will also proffer offsets when deemed necessary to gain acceptance in important markets. In these situations offsets promote sales opportunities.
2. Although U.S. defense contractors would welcome universal restrictions and elimination of all offset requirements, they usually agree to provide offsets when required as a condition of bidding and selling. In these situations offsets simply support sales opportunities.
3. American defense contractors, the Defense Industry Offset Association and the Aerospace Industry Association have consistently stated that the U.S. Government should refrain from negotiating bilateral agreements that restrict or eliminate offsets. The reason is that bilateral offset agreements would presumably not affect all foreign competitors equally and, therefore, bilateral offset agreements would very likely result in the loss of international defense sales to foreign competitors.
4. In addition to winning sales, offsets can result in other benefits such as (a) finding a better subcontractor with lower prices or (b) teaming with a foreign company that will market products on behalf of the U.S. defense contractor. Reporters often overlook benefits such as those.

Mr. Chairman, I thank you for this opportunity to introduce Canada's IRB program, and I look forward to a subsequent discussion.