

Saudi Offset Program: A Golden Opportunity

By

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Arab News, Monday Oct 30, 2006

The Saudi Economic Offset Program can be a powerful tool for domestic investments, for those seeking to enter the lucrative Saudi and regional markets. The Offset Program has been in existence since 1984, when Saudi Arabia was the first country in the GCC to set up such a program. To date though, despite some commendable efforts by some of the governments involved, notably Britain, as well as the energetic initiatives of the Saudi Arabian Government Investment Authority (SAGIA), few Saudi businesses are aware of the existence of the program or its benefits. The recent Saudi government agreement to purchase Eurofighter jets from the U.K. should add further impetus to this program.

Offset Programs are considered a special type of foreign direct investment (FDI) and transfer of technology. Offset programs can be classified as “*direct*” or “*indirect*” offsets. Direct offsets are those by which the purchasing country joins the selling country to supplement elements of the underlying purchased product through co-production, technology licenses and other supply arrangements. Indirect offset means the selling nation agrees to assist the importing country in its general development and investment strategy, unrelated to the principal contract item.

Saudi Arabia has opted for the indirect offset approach, as did the other GCC countries such as the UAE and Kuwait that followed with their own offset agreements. The Saudi offset program started with the Peace Shield programs with the U.S.A., the *Al Sawary* Program with France, and the larger *Al Yamamah* program with British Aerospace. The Saudi Economic Offset Program, as it became known, hoped that the offset mechanism would generate many benefits to the Kingdom. These would be in the areas of industrial development and economic diversification, spurred on by the inflow of new technologies in sectors such as aviation engineering, electronics, computer and information technology, as well as utilizing the Kingdom’s mineral resource base.

Other benefits would help with strategic self-sufficiency in crucial military or civilian sectors, such as defense systems, aircraft repair and modification. Employment of Saudis and human resource development was also a priority. Finally it was hoped that a successful offset program would act as a major “drawing power” to attract other international companies to the Kingdom as a viable center for investment.

The results to date, again with the exception of the more energetic efforts of BAe systems, have been somewhat disappointing in terms of actual projects launched, measured against the magnitude of potential available resources for investment. Official reasons put forward for the lack of progress is one of identifying “good” investment opportunities, or that foreign partners have been unable to obtain reliable local market data on potential local partners. In the past some complained about the multiple level of foreign, corporate and government administration they must deal with.

These arguments might have had some merit in the past. Since 2000, the Saudi Government has come a long way towards establishing a foreign investment – friendly organization to smooth bureaucratic hurdles by providing offset advice through a “one-stop” administration under SAGIA. This helped to streamline the application processes for possible projects. The energy of SAGIA is beginning to pay some dividends, as currently the Offset Program is screening through 35 or so project ideas for possible implementation. The international “road-shows” by SAGIA, as well as closer co-ordination with the regional Chambers of Commerce and Industry, is also helping to educate Saudi and foreign businessmen on possible opportunities under the program.

In terms of areas of interest, Offset is now concentrating on priority sectors for the Kingdom such as petrochemicals, high-tech education and healthcare services. Health management could become the next focus of the Offset Program, through specialist medical colleges and nursing schools, *nano*-technology research centers and the production of specialist medical equipment.

Offset financing is available for both Saudi and foreign partners, to reduce the upfront investment risks. Loans up to \$10 million per project are available on a seven-year term basis. The Saudi Industrial Development Fund (SIDF) can also provide up to 50% of a total project financing on concessionary terms. To add to this, local bank financing has been pioneered by SABB-Saudi British Bank – in conjunction with BAe systems, to provide further financing for the project on long-term loan rates. British Aerospace is also willing to provide up to 6.5% of the total equity financing through its own soft financing loan program, after due evaluation of the project’s feasibility.

The administration of the Offset Program is still evolving to ensure that it becomes “investor-friendly”, and opens up to a wider segment of Saudi business. With the exception of a few key Saudi family industrial groupings, a majority of the smaller businesses who could benefit from the program are either unfamiliar with or are unaware of the offset’s existence. One reason was that the Economic Offset Office operates as part of the Saudi Ministry of Defense and Aviation, which seems to create psychological barriers to potential investors. The fact that SAGIA is actively sponsoring the Offset Program has opened up Offset to a wider international and domestic audience.

The short-comings of the Offset Program in the past was due more to institutional, administrative and marketing constraints, rather than to financial or technological restrictions as evidenced by the number of successful non-defense related offset ventures pursued, especially by the U.K. Offset Program. With the involvement of SAGIA, and the greater awareness of the program’s potential by those running it at the Ministry of Defense, the Offset Program is a real winner for Saudi and foreign joint venture businesses.

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