

Korean Offset Trade Model in Defense Industry

Hogun Lee, Jaeyoung Lee¹

Abstract. The growth of Korea's defense industry has been initiated by the government and recently export of Korean defense materials increases rapidly. It owes both to offset program against Korean import and to Korea's direct export. Korea has guideline only for offset program against Korean import not for offset program against overseas purchasers. Thus this study give focus to analyzes current Korean defense trade and offset program and to present suggestions and strategies on direct and indirect offset model.

Keywords: defense materials, defense trade, indirect offset, direct offset

1 Introduction

As the economic value of defense materials has drawn attention, the utilization of the defense industry as a new source of economic growth has become an important issue. According to the Ministry of National Defense, defense materials export has risen from a mere US\$ 55 million in 2000 to US\$ 2.35 billion in 2012, which includes such diverse areas as ships, ammunition, aircrafts, individual equipment, and telecommunication equipment.[1].

Korea's export of defense materials can be broadly classified into two categories. The one is the export of military material as an offset against the import of military material. The other is Korea's exports.

With regard to the offset, the GPA (Government Procurement Agreement) of WTO bans this in principle, but the GPA also clearly provides for exemptions with respect to procurement of indispensable materials for national defense purposes. Hence, the WTO allows offset for trade for military purposes.[2]

Given that the substantial amount of Korea's exports are ships and aircrafts to developing countries, Korea needs to develop direct and indirect offset against overseas purchasers. And if target industry for offset is extended from defense industry to the other industrial sectors where Korea has international competitiveness, this will bring about a friendly and sustainable relationship with its trading partners through collaboration as well as more balanced industrial growth.

This paper does not deal with the offset against Korea's import, and present suggestion and guideline on the offset model in case of Korea's export.

¹ Hogun Lee, full professor, Cheongju University
Jae young Lee, Assistant Professor, Cheongju University

2 Analysis of Korea's offset trade

2.1 Defense industry and offset

The Defense industry is in place “to manufacture, repair, process, assemble, experiment with, maintain, reproduce, improve or transform defense materials.”[3] The term ‘Offset’ is also called ‘Industrial Cooperation’ or ‘Industrial Participation’. All have the same meaning and different names are used for different countries. [4] In offset trade, both parties evaluate the technology value on the proposed items.[5]

Offset is divided into Direct Offset and Indirect Offset.

Direct offset is a conditional trade where relevant defense materials for purchase are directly involved. Direct offset accommodates demands from purchasing governments such as local production, technology transfer, maintenance of parts and equipment, purchase of specific military supplies and joint R&D activities.

Indirect offset means a conditional trade that is not directly associated with relevant military material. The purchasing party in indirect offset usually requests suppliers to respond to its strategic demands for industrial cooperation through a transfer of private-sector technology, purchase of its general commodities, participation in the privatization of public corporations, or private investment.

2.2 Trade statistics of defense materials

Exports of defense materials were USD250 million in 2006, but steadily increased to USD1.031 billion in 2008, USD1.19 billion in 2010, and USD2.35 billion in 2012, a 940 % rise over 2006. The main export items formerly were ammunition and parts, but have recently diversified into more value-added, high-tech weapon systems such as ships and aircrafts thanks to increased competitiveness. This is attributed to an increase in the capability of manufacturing Korean T-50 advanced trainers, patrol frigates, and mine sweepers. In 2012, major items were battleships and aircrafts, accounting for 32% and 28% respectively.

Average annual export orders of defense materials through offset trade during the last six years amounted to USD260 million, which is equivalent to 18% of the average annual total defense materials export of 1.144 billion for the same period [6].

3 Identification of industries for offset trade

3.1 Criteria of designation of industries for direct offset trade

Offset trade takes the form of G2G or G2B, in most cases, driven by governments. Even in the G2B, governments of the other party are usually involved. The most

important aspect of offset trade negotiations is that above all, the scale of offset trade deals are large and should reflect the requirements of governments of the relevant parties.

In case of direct offset, purchasers are generally requires corresponding import of or technology transfer of defense materials. It is necessary to investigate the level of defense technology in order to pre-select corresponding import goods. Sometimes purchasers may ask additional procurement of defense materials, repair and maintenance, renewal et.

3.2 Criteria of designation of industries for indirect offset trade

Indirect offset trade, particularly, can be effective when the government supports it with all resources available. The amount of offset trade is measured not in monetary terms but in value equivalent to currency. Thus, offset trade is more suitable for industries producing high value added items.

Based on these points, the important considerations in offset trade negotiations are follows: ① industries where technology transfer is available with support at a national government level or through collaboration between business, ② industries where flexible valuation is possible, ③ industries where the exporting nation has a competitive edge and an advanced level of technology, ④ industries that can be continually promoted with instruments such as international R&D programs, ⑤ sectors that can be linked with ODA program.

4 Tailored Indirect Offset Trade Models

4.1 Sustainable Cooperation through a business model

Development of profitable business models and/or cooperative systems through joint ventures can lead to both profit sharing and technology transfer. A number of developing economies wish to grow their own local businesses because multinational companies dominate their local markets. Accordingly, effective negotiation will be facilitated because of the desire for technology transfers and the development of business models through joint venture.

4.2 Technology transfer through Joint R&D and co-marketing

The Korean government has been supported international cooperation projects on industrial technology. Those projects include international R&D collaboration, European technological cooperation and so on. These projects are largely focused on areas in which the introduction of technology from advanced countries is necessary and on sectors where Korea needs to cooperate with newly industrialized countries.

4.3 ODA linking model

Where importers are developing countries, negotiations may be based on the ODA (Official Development Assistance) facility offered by the Korean government. ODA may be applied to education, health, administration and any areas where the beneficiary hope to attain Millennium Development Goals (MDGs). This will maximize the effect of assistance as well as facilitate negotiation processes relating to offset trade. The ODA is especially effective in indirect offset, and contributes significantly to developing sustainable relationships and extending the range of trade items as well as the implementation of a project.

5 Conclusion

The following suggestions are made to grow Korea's offset trade of defense materials.

- ① Indirect offset needs to be encouraged more than direct offset
- ② Relative laws and regulations should be amended including indirect offset
- ③ Optimized solutions and strategies should be prepared through needs analysis on prospective partner countries
- ④ Scenarios of offset trade needs to be established on selected strategic items.
- ⑤ Facilitating Center for ODA linkage and control is needed.

The most striking feature of Korean offset model may be characterized in two. In Korean place, it is 'full care concept' from master plan establishment, technology transfer, co-R&D, joint-venture and co-marketing by linking direct and indirect offset, R&D program and ODA. In purchasing countries' place, it is securing 'business opportunity creation' in accordance with their policies and strategies.

References

1. Defense Acquisition Program Administration (DAPA), <http://www.dapa.go.kr/>
2. Jang Won-jun (2012), How to promote offset trade to increase exports and support the shared growth of large companies and SMEs, KIET, pp. 22~23.
3. Defense Acquisition Program Act
4. Bell, R., Black, J.,(2010), "Offset and Countertrade 101(Introduction to Offset)", GICC.
5. Jang, W. J., Kim, C. W., Kim, T. Y. and Joung, T. Y.,(2007), "The Defense Offset Valuation Model", DISAM Journal of International Studies, Vol. 5, No. 2. December.
6. DAPA, 「DAPA Annual Statistics Report」, 2011