

# Offsets: the UK debate

The Dassault Rafale (main), Boeing F/A Super Hornet (over - top right) and Saab Gripen NG (over - bottom right) - the three primary contenders for the Brazilian fighter competition. Each company has presented formidable industrial co-operation and offset packages.

*An increasingly important facet of the international defence industry is an arrangement that obligates the seller to reinvest (offset) equipment sales proceeds in the purchasing country. In this feature, Ifeyinwa Onugha, Senior Consultant at Offsets 2000, outlines the offset argument in the UK and beyond.*

Increasing global offset obligations (estimated to be in excess of \$70 billion at the time of writing) coupled with protectionist sentiment arising from the recent economic slowdown has raised the profile of offset globally.

2010 will see the completion of two key studies looking at the benefits of the UK's Industrial Participation (IP) policy and analysing whether the original policy, first introduced in 1990, is still 'fit for purpose'. The first, led by the industrial representatives of the United Kingdom Offset Strategy Group (UKOSG), will reflect and compile the views of UK industry; while the second (sponsored by the MOD and led by Professor Ron Matthews from Cranfield University) will use academic and empirical research methods to assess whether the IP policy is meeting the requirements of the Defence Industrial Strategy.

These highly anticipated reports and their key findings will be taken into consideration during the forthcoming Strategic Defence Review process and in the formulation of MOD's future industrial strategy, and will be used as a basis of discussion among key UK government policy makers. The reports come less than a year after the introduction of the European Defence Agency (EDA)'s Code of Conduct on Offsets – a voluntary commitment by participating Member States that has sparked much debate – and only a few months after the release of two MOD policy documents – *The Defence Green Paper, Adaptability and Partnership: Issues for a Strategic Defence Review* (Command Paper Cm 7794) and *The Defence Strategy for Acquisition Reform* (Command Paper Cm 7796).

Though the reports are yet to be finalised and released, the industry view has typically favoured the UK IP policy which aims to “stimulate work and business opportunities for UK companies and secure access to overseas markets by generating long-term partnerships with offshore companies” (UKTI DSO, March 2009). However, this opinion is not necessarily shared by all; some assert that as offset requirements drive up the cost of defence procurements, they should be avoided where possible so as to allow UK government to purchase equipment as cheaply as possible.

As the debate continues, the same EDA offset team who were successful in implementing the Code of Conduct on Offsets have now tasked themselves with highly ambitious plans to create the necessary market conditions and develop a European Defence Technological & Industrial Base (DTIB) in which the use of offsets may gradually be eliminated. It appears that the European Commission is watching these developments closely. The MOD, as a participating member of the EDA's defence industrial and market strategies, will be directly affected by any progression in this

regard and is keeping leading UK industrial representatives up to date through UKOSG.

Without an active and effective IP policy, the UK defence industrial base could potentially suffer a major competitive disadvantage. In a situation where UK companies bidding for foreign programmes must bear the costs (financial, technological, R&D, labour, social) of offsets, but offshore companies bidding into the UK do not, the long-term capacity for UK contractors to compete on the global stage will dwindle. Similarly, if the EDA is successful in its campaign to reduce the prevalence of offsets among its members, but the rest of the world continues to demand industrial/economic compensation, the European defence industrial base will lose competitive ground.

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**“More than 70 countries now request some form of offset or countertrade as part of government defence or security-related procurements”**

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Offset is a growing global phenomenon. More than 70 countries now request some form of offset or countertrade as part of government defence or security-related procurements, and the ability to package and deliver a comprehensive offset programme is fast becoming a discriminating factor in many competitive tenders. To illustrate, at the time of writing, the winner of the \$7 billion Brazilian fighter competition is yet to be announced. However, the manner in which it has been contested, with almost unprecedented promises of technology transfer and indigenous production, serves to demonstrate the prominence of offset and industrial participation in international defence acquisitions.

All three primary contenders – Dassault (Rafale), Saab (Gripen NG) and Boeing (F/A-18 Super Hornet) have presented formidable industrial co-operation packages.

Saab, veterans of offset delivery, are reportedly promising to manufacture 40 per cent of the aircraft in Brazil as well as offering \$12 billion in ongoing industrial co-operation. There is talk of the Swedish Air Force replacing its fleet of

trainer aircraft with Embraer's Super Tucano.

Boeing, whose offering might have otherwise suffered due to restrictive US export controls, have secured the weighty and impressive support of the US Government. In a rare move, US State Department Under Secretary for Arms Control Ellen Tauscher and Pentagon Acquisition and Technology Chief Ashton Carter have explicitly stated that they will allow the transfer of technology to Brazil, going on to imply that the move will be the first step in forging a deeper alliance with the Brazilian defence industry.

In the meantime Dassault, for whom success would herald the first export order of Rafale in its ten years of production, will possibly benefit from warm diplomatic relations between Brazil and France, particularly in the realm of co-production. Indeed, French President Nicolas Sarkozy has reportedly written to Brazilian President Luiz Inacio Lula da Silva promising 'unrestricted access to technology' in support of the Rafale bid.

The importance of offset in the Brazilian fighter competition will be echoed in other countries engaging in similar high-value defence procurements such as India, Norway, Saudi Arabia and so forth. Recognising the escalation of offset and that its members will benefit from access to clear and up-to-date information on offset rules and regulations and the socio-economic environment in target markets, the recently formed UK Aerospace, Defence and Securities industry group, A|D|S, has recently announced the appointment of Offsets 2000 Ltd, a UK consultancy, as A|D|S Offset Advisors.

Reducing the industrial participation requirements for foreign contractors at a time when UK industry is arming itself for increased obligations abroad seems rather incongruous. Going forward, the UK IP policy could have a positive impact on the retention of a strong and competitive domestic defence and security industry allied to increasing support to exports where offset or industrial content is an increasingly important feature of successful business.



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