

Offsets in Defense Trade 1998

EXECUTIVE SUMMARY

This is the third annual report on offsets in defense trade prepared by the Department of Commerce's Bureau of Export Administration (BXA), as required by the 1992 amendments to Section 309 of the Defense Production Act of 1950, as amended. The report includes 1996 offsets data reported by U.S. firms in the last year and combines it with data collected previously from 1993-1995.

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Between 1993 and 1996, 32 U.S. companies entered into 173 new offset agreements with foreign governments valued at \$15.1 billion, with an average completion term of 87 months. The agreements supported \$29.1 billion in defense contracts. Five companies accounted for 78 percent of the value of these new offset agreements and 80 percent of export contract values. The new agreements were concluded with 28 countries. By value, 72 percent of new agreements were concluded with just five countries, and 80 percent with eight countries. The offset agreements, in total, represented 52 percent of the export contract values.

In addition to entering into new offset agreements, U.S. companies also carried out transactions in accordance with agreements reached in previous years. During the four-year period, 34 U.S. companies reported 2,277 individual offset transactions valued at \$9.2 billion, for which they secured offset credits valued at \$10.7 billion. Five companies accounted for 80 percent of the value, and nine companies, for 91 percent. Transactions were completed in 31 countries, with the top five countries accounting for 58 percent of the value. Transactions referenced 150 separate weapon systems (five of these represented 53 percent of the total value). Also, more than 900 offset recipients were identified. The top 10 recipients accounted for 24 percent of the total value of offset transactions.

Seventy-three percent of the transactions' value were subcontracting activity, purchases (counter trade), or technology transfer. Nearly half of the offset transactions were related to transportation equipment (including aircraft and aircraft parts), 16 percent of the transactions were in the electronics and electrical equipment sector, and nine percent in industrial machinery.

For 1993 to 1996, 38 percent of the value of the transactions were direct offsets, 58 percent indirect, and 4 percent unspecified, with significant variation by country. The allocation was often closely linked to the size of the country's indigenous aerospace sector. Generally, countries with established aerospace sectors tended to fulfill offsets with aerospace products; and these were mostly direct. There is also an interesting split between aerospace and non-aerospace product transactions. About two-thirds of all aerospace product transactions (\$3.13 of \$4.96 billion) were direct offsets, and these accounted for 90 percent of total direct offsets. In contrast, non-aerospace products accounted for about 70.4 percent of total indirect offsets (\$3.78 of \$5.38 billion).

Direct offset transactions rose to about 43 percent in 1996, up from the 40 percent recorded last year. This extended to four years the upward trend in direct offsets. The trend reflects very substantial increases in subcontractor activity in the United Kingdom and a very large jump in technology transfers to S. Korea. The large increase in

subcontractor activity was moderated somewhat by a decreases in Israel, Canada, and Australia

Europe has become the central focus of offsets. In the four reporting years, European countries entered into 94 new offset agreements with U.S. firms valued at more than \$10 billion, with an average offset equaling 90 percent of the export contract value. In the last two years of the reporting period, European countries alone accounted for 85 percent of the value of all new offset agreements; the value of European offsets averaged more than 100 percent of the value of the export contracts. The rest of the world, with an average offset agreement equal to only 28 percent of the export contract, accounted for \$5 billion in offsets.

As for the newest data, the value of new offset agreements entered into in 1996 was down sharply from 1995, and well below four-year averages. In 1996, reported new agreements of \$2.27 billion supported \$3 billion in new export contracts. New offset agreements were down over 60 percent from the \$6 billion reported in 1995, and more than 40 percent below the four-year average of \$3.8 billion.

Worldwide, 1996 new offset agreements as a percent of export contract values were 76 percent, compared to 81 percent in 1995. The 1995 and 1996 percentages of offsets to export contract values were the third and fourth highest levels recorded since 1980.

In 1996, a total of 621 offset transactions valued at \$2.86 billion were reported, with a credit value of \$3.07 billion. The 1996 values were the largest for transactions for the four years, and capped off four years of steady increases. The 1996 value was almost 8 percent more than 1995 values, although this was not as dramatic as the 40 percent increase observed between 1994 and 1995.