

## Trends in Korean Defense Offsets and Policy Implications: Toward Making Korea One of the Four Largest Defense Exporters<sup>1)</sup>

### S U M M A R Y

The South Korean government has been more willing as of late to accommodate demands for export financing and other support from Poland and other major buyers of Korean defense products. But it has at the same time avoided pursuing similar offsets in large import deals with the United States and other countries, for example in the second-phase of the F-35 fighter jets acquisition program, despite being well within its rights to maximize its position in such deals.

Over the five years from 2016 to 2020, South Korea managed to win nearly USD 800 million in offsets against defense contracts, or about 10 percent of what the country used to reap from 2011 to 2015. Reasons for this rapid decline include domestic conflict over whether or not to abolish the legal offset requirement following a 2018 audit by the Board of Audit and Inspection, a reluctance to request offsets against large-scale foreign military sales (FMS) contracts with the US, the absence of a well-established offset banking policy compared to other countries, the lack of a consistent and comprehensive strategy applicable across the government and the military that prioritizes the national interest, and ongoing interdepartmental disputes and infighting regarding the necessity of offsets. Offsets are sought by the governments of nearly 130 countries worldwide as preconditions to purchases of foreign-made weapons. They are growing in importance as avenues of technology transfers and as channels for parts exports, production localization, and the development of maintenance and repair capacities. Türkiye, the Netherlands, Norway, Taiwan, and the United Arab Emirates (UAE) actively pursue offsets against weapons deals, including in their FMS contracts with the United States, and have achieved successes in enhancing the capabilities of their own defense industries, creating jobs and supporting the growth of their own R&D, production, and small and medium enterprises (SMEs) exports. For Korea to achieve its vision of becoming one of the four largest global defense exporters, the Korean government needs to reinforce the status and importance of offsets. Korean lawmakers should ensure that the legal requirement stays in place and actively encourage offsets against FMS contracts with the United States. Moreover, the government needs to tackle resolve existing difficulties in seeking offsets against large-scale FMS and non-competitive contracts by establishing a comprehensive, pan-government offset negotiation strategy and also by adopting an offset banking scheme. Finally, the organization in charge of handling the offset program must be expanded, and the government should redouble efforts to host divisions of leading foreign defense contractors at local governments' defense innovation clusters domestically.<sup>1)</sup>

1) This report is a revised summary of the presentation that the author made at the Defense Offset Roundtable at the National Assembly Research Service (NARS) on May 15, 2023, and of the author's article published in the Sejong Institute's *Uninomic Review* (2023).

## 1. Introduction

Over the past four decades since, South Korea has been an active participant in cross-border trade offsets. A trade offset (or simply an offset) is a negotiating tactic in which an importer demands technology transfers, reverse exports of parts, maintenance capacities, or other such benefits from the exporter as a precondition for purchasing goods. In this case, defense products and weapons systems.<sup>2)</sup> Trade offsets have been pivotal to the development of the Korean defense industry, and Korea has used offsets to obtain membership in various defense development projects such as the program that produced the KAI T-50 Golden Eagle. Offset agreements have also enabled Korea to develop indigenous capacity to produce conventional submarines.

In March 2023, however, the Defense Acquisition Program Administration (DAPA) announced that it would not pursue offsets in the second phase of the Lockheed Martin F-35 Lightning II fighter jet acquisition program.<sup>3)</sup> Following a major audit in 2018 by the Board of Audit and Inspection (BAI), a controversy erupted over whether the legal requirement mandating offsets should be abolished. At the same time, the value of pursuing offsets has come into question, and there is no offset banking policy in place. Elements of the government are divided as to the necessity of offsets.

This report surveys the recent issues surrounding trade offsets in Korea. It also proposes reorienting the overall direction of offset policy to reflect the importance of maintain the competitiveness of Korean industries competitiveness and prioritizing Korea's national interests. The report concludes by describing the implications for policy carried by the results of the analysis.

## 2. Latest trends and shortcomings in offset trade involving the Korean defense industry

### (1) Evolution and milestones of trade offsets for the Korean defense industry

Figure 1 summarizes how the Korean policy on trade offsets has evolved over time. When the policy was first introduced in 1982, a unilateral threshold was applied in offsets must be secured for 50 percent of the value of purchase contracts worth at least USD 1 million. By the late 1980s, the Ministry of National Defense (MND) broadened and diversified the scope of trade offsets to both promote exports of Korean-made products and access key foreign technologies and resources. These offset agreements allowed Korea to participate in contract manufacturing, engineering and production, and testing and evaluation processes. The threshold monetary value to trigger the trade offset requirement in con-

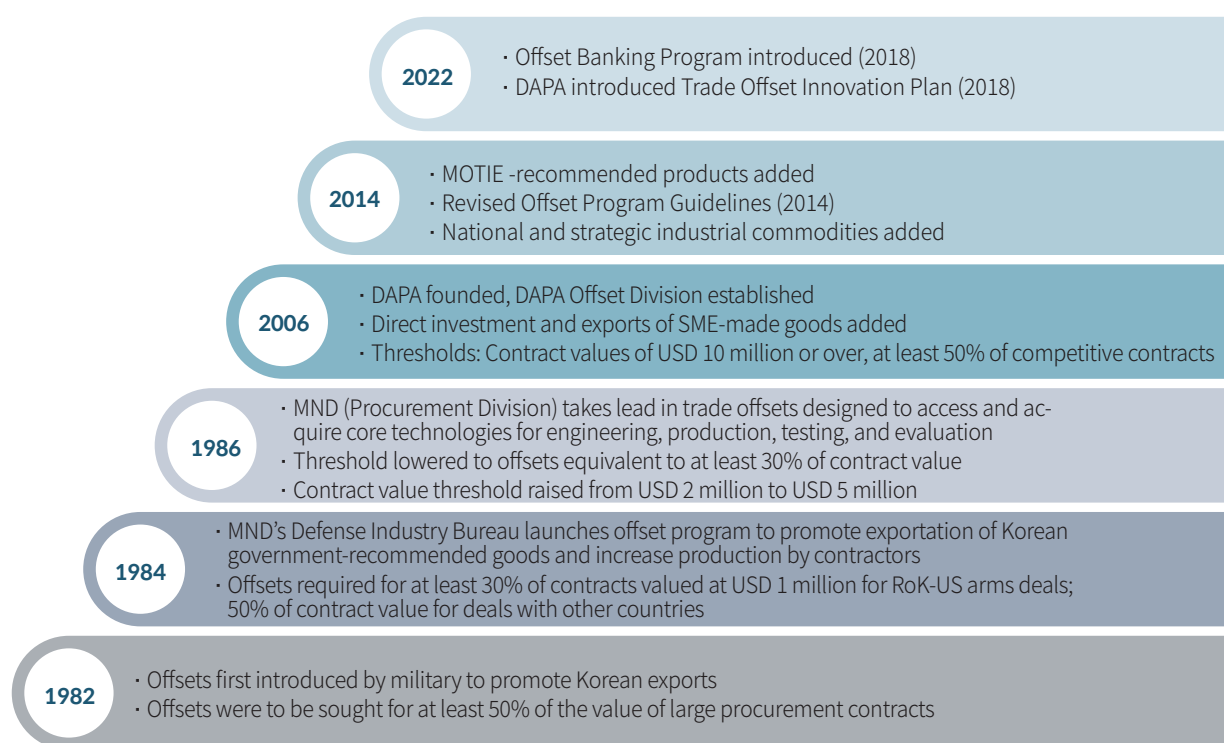
2) Jang Won-Joon and Kim Mi-Jeong (2016), "Latest Issues and Future Tasks for Offset Trade for the Defense Industry," KIET Issue Paper.

3) *News 1* (2023), "Head of DAPA Decides to Import More F-35A Jets, but Sees Little Value in Trade Offsets," March 23.

tracts was subsequently raised to USD 2 million in 1984 and to USD 5 million in 1986. DAPA came into being in 2006 and set the value at USD 10 million. It has remained unchanged since.<sup>4)</sup>

The offset requirement for weapons purchases was lowered from 50 to 30 percent of contract value in 1986, the government began applying different activation triggers to competitive contracts and non-competitive contracts around the same time. As of 2023, the MND is required to seek trade offsets worth 50 percent of competitive contracts valued at least USD 10 million and worth 30 percent of the value of non-competitive contracts, excepting foreign military sales (FMS) deals. The Defense Program Steering Committee (DPSC) reviews trade offset possibilities in FMS deals and other projects and grants selective authorization to projects deemed as serving the national interest.<sup>5)</sup>

**Figure 1. Evolution of Korean Policy on Trade Offsets (1982 to 2022)**



Source: Jang and Kim (2016) (expanded for analysis herein).

As Figure 2 shows, Korea has benefitted from its offset program. Offsets have generated some USD 23.2 billion in value for the defense industry over the last four decades (1983 to 2022). The value of technolo-

4) DAPA (2022), Offset Program Guidelines. Article 4 (Basic Principles): (1) An offset or more shall be sought, in principle, for each project that imports military supplies from abroad for a total value of USD 10 million or more.

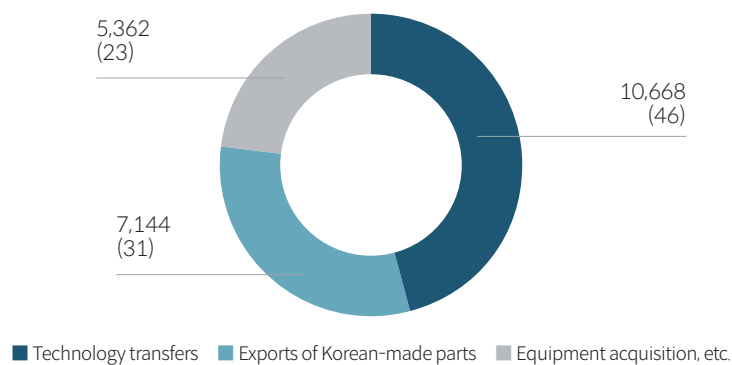
5) DAPA (2022), Offset Program Guidelines. Article 8 (Decision-Making): (1) Seek offsets in principle in accordance with Paragraph (1), Article 4. The head of the Integrated Product Team or the Procurement Planning Division, however...shall obtain the review of the Defense Program Steering Committee first to execute trade projects that are supported by evidence, such as surveys of existing literature, to serve national interests.

gies used to develop native weapons systems accounted for USD 10.67 billion, or 46 percent of the total value of offsets. Other significant sources of value were offsets for parts manufacturing and exports (30.8 percent, or USD 7.14 billion) and equipment acquisition (23.1 percent or USD 5.36 billion).

Since the late 2010s, the value of offsets in defense contracts has plunged. From 2016 to 2020, Korea imported KRW 13.6 trillion worth of weapons systems, but offset these purchases by only KRW 1 trillion (about USD 800 million today). This means that offsets amounted to only seven percent of the total value of weapons imported in that five-year period.<sup>6/7)</sup> In contrast, Korea managed to procure USD 7.99 billion in offsets in the preceding period (2011 to 2015).

**Figure 2. Types of Offset Value (1983 to 2022)**

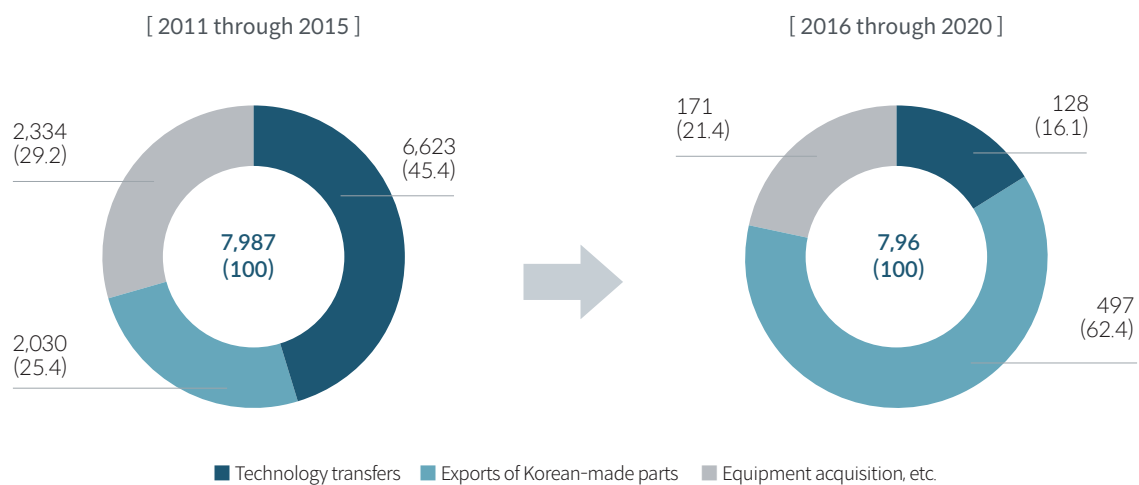
Unit: 1 million USD (%)



Note: Based on DAPA (2011) and DAPA (2023).

**Figure 3. Comparison of Offset Values**

Unit: Million USD (Percentage)



Sources: Newly formulated on the basis of DAPA (2011) and DAPA (2023).

6) *News Today* (2022), "Offset Program for Defense Industry Must Change," April 6.

7) Over the last two years (2021 to 2022), the Korean defense community gained USD 270 million in offset value, making the total for the last seven years (2016 through 2022) USD 1.06 billion. DAPA (2023), "Recent Trends in Offsets and Policy Direction," presentation to the National Assembly Research Service (NARS), May 15.

## (2) Main issues

### 1) Offset abolishment controversy

The foremost issue surrounding trade offsets in Korea is that policymakers are now seeking to abolish the mandatory offset requirement. This runs directly counter to global trends. Ever since the BAI audited the offset program in 2018, DAPA has been pushing for an amendment to the Defense Acquisition Program Act to repeal the clause that requires trade offsets as a matter of law. Article 20 (“Offset Trade”) of the current Act requires the head of DAPA to promote offset trade when purchasing “munitions from abroad.” Those in favor of amending the law seek to insert a proviso into the article so as to allow the head of DAPA to “forgo” offsets and other forms of industrial collaboration where pursuits thereof might be “detrimental” to national security, efficiency, or other related concerns.

DAPA revised its Offset Program Guidelines in March 2020 to make offsets conditional and optional for contracts involving foreign weapons purchasing contracts valued at USD 10 million or more. Under the latest Offset Program Guidelines (December 2022), the government is as a matter of principle to seek offsets for all foreign purchase projects worth USD 10 million or more. However, the head of the Integrated Product Team (IPT) or the Procurement Planning Division may leave the decision up to the DPSC in the event that literature or evidence suggest that offsets would advance the national interest.<sup>8)</sup> The head of DAPA recently announced that current administration would not seek offsets against the second phase of the F-35 fighter program, showing that the government is already treating them as optional, rather than legally required.

**Figure 1. Proposed Amendment to the Defense Acquisition Program Act**

Current	Proposed amendment
<b>Article 20 (Offset Trade)</b> (1) Where the Minister of the Defense Acquisition Program Administration purchases munitions from abroad pursuant to the provisions of Article 19 (1), the promotion of offset trade for a unit project worth more than the amount prescribed by Presidential Decree shall be the principle.	<b>Article 20 (Industrial Collaboration)</b> (1) Where the Minister of the Defense Acquisition Program Administration purchases munitions from abroad pursuant to the provisions of Article 19 (1), the promotion of industrial collaboration for a unit project worth more than the amount prescribed by Presidential Decree shall be the principle. The Minister, however, may elect to forgo the promotion of industrial collaboration where pursuits thereof may be detrimental to national security, efficiency, and other matters of concern prescribed by Presidential Decree.

Source: DAPA (2022), Master Plan (Draft) for Defense Industry Promotion 2023-2027, p. 41.

The majority of defense industry insiders and experts have voiced two principal concerns over DAPA’s move to abolish the offset requirement. The first is that making offsets elective runs contrary to the

8) The “evidence” required in weapons deals may in fact be lacking in the literature, as the government often fails to adequately prepare for offset negotiations, resulting in weak proposals to foreign exporters. There is also the issue of the difficulty of appraising the value of technologies involved.

global trend in which major importers are demanding increasingly more in countertrade. The second is that eliminating offsets would erase any potential future value that Korea could glean through them, in effect undermining national interests.<sup>9)</sup> It has also been pointed out that nearly 130 countries worldwide still actively request offsets despite the costs involved and that Korean defense exporters are eagerly fulfilling offset terms imposed by their foreign buyers.

In February 2023, a group of legislators in the National Assembly (led by Assemblyman Sul Hoon of the Democratic Party) proposed a new bill: the Offset Trade Reinforcement Act. If made law, the bill would require offset trade not only in weapons purchase agreements but also in imports of military supplies through FMS or other contractual mechanisms. The bill aims to support the continued growth of the domestic defense industry and boost the technological advancement of Korean defense products.<sup>10)</sup> But no new laws are on the books yet, and the debate that erupted following the release of the 2018 continues to smolder.

## 2) Radical decline in the value of offsets

As mentioned previously, the value of defense countertrade has cratered in recent years. In the five-year period from 2016 to 2020, Korea purchased over USD 10 billion worth of foreign weapons but demanded just seven percent (about USD 700 million) of that figure in offset trade. This represents a nosedive from the USD 8 billion in offsets secured in the preceding five-year period (2011 to 2015). This is a remarkably low figure in the absolute sense as well, considering that countertrade is legally required to offset at least 50 percent of the value of each competitive contract and at least 30 percent of the value of each non-competitive contract.<sup>11)</sup> The main reason for this is because Korea has been reluctant to seek offsets since 2016, and has in fact foregone them entirely against in some contracts, especially in FMS deals. In contrast, the governments of Türkiye, the Netherlands, Norway, and other countries actively pursue offsets in defense trade. Korea's unwillingness to seek offsets could seriously deprive its domestic defense industry of future opportunities and block off avenues of growth. Offsets could enable the Korean defense industry to access core technologies for cutting-edge combat aircraft, unmanned aerial vehicles, and other defense technologies and processes. Moreover, failing to request offsets denies the industry access to potential channels for exporting Korean weapons systems and parts.

## 3) Reluctance to use offset banking

Korea has also been reluctant to utilize offset banking, which enables weapons exporters to fulfill their

9) In an interview, an offset expert at Global Industrial Cooperation Alliance (GICA) Conference 2023 shared that foreign sellers typically transfer at least part of the cost of the offset by increasing the final sales prices of their weapons. June 2023.

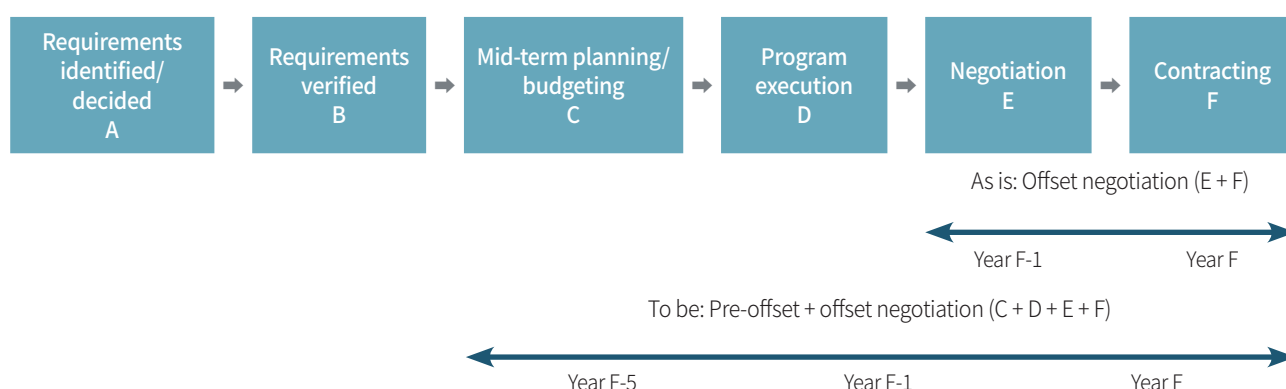
10) Kiho Ilbo (2023), "Assemblyman Sul Hoon Proposes Bill for Offset Trade Reinforcement," February 24.

11) DAPA (2022).

offset obligations to the buyer in advance regardless of the nature of the contract.<sup>12)</sup>

Whereas programs subject to classic offset requirements often must fulfill their contracts within one calendar year, programs with offset banking allow foreign weapons dealers to bank their records with buyers (parts manufacturing, exports, joint R&D, histories etc.) as early as five years prior to the execution of a given FMS contract. This enables weapons exporters to leverage their trade records in future contracts. Turkish, Dutch, Israeli, Taiwanese, and other governments have actively utilized offset banking to access partnership opportunities in international R&D and production, secure necessary quantities of parts, and obtain other core technologies regardless of what weapons they purchase. The Turkish government, for example, relied heavily on offset banking when it implemented defense programs of national importance, including the joint development and production of T-129 attack helicopters and the joint production of T-70 utility helicopters.<sup>13)</sup>

**Figure 4. Offset Banking: Conceptual Diagram**



Source: Jang and Kim (2016).

**Figure 5. Traditional Offsets vs. Offset Banking**

Traditional System	Pre-offsets (offset banking)
<ul style="list-style-type: none"> <li>• Compressed negotiation period (3 to 6 months)</li> <li>• Conditional approval granted only after contract is signed</li> <li>• Foreign sellers unable to propose offsets first</li> <li>• Offsets mostly limited to small unit projects or minor technologies</li> <li>• Offsets proposed from bottom up</li> <li>• Excessive dependency on foreign sellers that are able to designate partner businesses in buyer countries</li> <li>• Lack of efficiency in progress management</li> <li>• Little use of banking/swaps</li> </ul>	<ul style="list-style-type: none"> <li>• Negotiations can occur up to five years in advance</li> <li>• Conditional approval not necessary after given contract is signed</li> <li>• Foreign sellers allowed to propose offsets</li> <li>• Applicable to large-scale projects</li> <li>• Bottom-up and top-down</li> <li>• No reliance on specific foreign sellers</li> <li>• Better efficiency in progress management</li> <li>• Active use of banking/swaps</li> </ul>
Greater efficiency and autonomy concerning offset-related tasks	

12) Jang and Kim (2016).

13) The Turkish government gives pre-approved foreign weapons dealers leeway in fulfilling offset terms by allowing them to use the offsets they have banked in relation to the contract or hand or in an altogether separate contract.



Source: Jang and Kim (2016).

The benefits of offset banking, as summarized in Figure 5, are numerous. The freedom from having to push for offsets not directly related to a specific FMS contract greatly enhances the efficiency of contract implementation. Offset banking also drastically increases the available amount of time for negotiations (from several months to four to five years), enabling policymakers to negotiate and design large-scale joint R&D and other such projects that can significantly enhance the national interest. Finally, offset banking also increases opportunities to foster strategic industries in better alignment with overall national policy objectives, irrespective of individual contracts being handled by IPTs.

Nevertheless, DAPA pursues both offsets on the basis of individual contracts (handled by the respective IPTs) and offset banking (overseen by the Offset Division), effectively nullifying any possible gains that could be gleaned from the latter.<sup>14)</sup> The recognized this problem and replaced the definition of offsets with offset banking in its Master Plan for Defense Industry Promotion 2023-2027 (2022).<sup>15)</sup>

#### 4) Lack of a consistent negotiation strategy

Unlike other major weapons importers, Korea lacks a consistent and integrated strategy for negotiating large-scale and high-value offsets, such as the new T-50 supersonic trainer aircraft, that would serve the national interest. Taiwan for example has set up interdepartmental bodies to devise and implement comprehensive and consistent negotiation strategies and actively promote them.<sup>16)</sup> The Korean government allowed for the introduction of offset banking in 2018, but in actuality the system still only allows offset proposals to move from bottom-up. This is likely because of a dearth of systematic negotiations priorities negotiations and also because of the dominance of defense concerns in offset negotiations. DAPA's Master Plan for Defense Industry Promotion has called for a centralized system for managing offset negotiations in individual contracts to maximize potential gains and effectively serve the national interest.<sup>17)</sup>

### 3. Improving offset practices for the Korean defense industry: Toward making South Korea a leading defense exporter worldwide

#### (1) Maintaining the offset requirement

It is in the country's best interests to uphold the existing legal offset requirement. The Defense Acquisition Program Act should be amended to re-emphasize the obligation to demand offsets in defense

14) *News Today* (2022).

15) DAPA (2022), p. 41.

16) Jang and Kim (2016).

17) DAPA (2022), p. 41.



trade, on par with the efforts of other major weapons importers. Article 8 of the current Offset Program Guidelines on offset decisions should likewise be revised to maintain the offset requirement. As a major weapons exporter to countries like Poland, Egypt, and Norway, South Korea has made every effort to fulfill offsets terms (industrial collaboration) imposed these and other buyer countries. As a buyer of foreign-made weapons itself, Korea should not relinquish its right to demand offsets from its partners, particularly in weapons trades worth billions to trillions of won annually. Whereas other countries are making the most of offsets, strengthening their own defense industries through technology transfers and creating more jobs by demanding localized production, Korea is forgoing offset opportunities in FMS and other such large-scale weapons contracts. This is in direct conflict with the national policy of fostering the Korean defense industry and creating more jobs. The governments and defense agencies of the Netherlands, Türkiye, Taiwan, Norway, the United Arab Emirates (UAE), and Saudi Arabia, for example, actively seek offsets on all major contracts, including those involving FMS with the United States (Table 2).<sup>18)</sup>

**Table 2. Offsets for FMS Contracts**

	Netherlands	Türkiye	Norway	Taiwan	UAE	Saudi Arabia
Offset value per contract	Min. 100%	Min. 70%	Min. 100%	Min. 35%	Min. 60%	Min. 35%
Offsets in US FMS programs?	Yes Yes		Yes	Yes	Yes	Yes
Departments in charge	MEA CMP	SSB	ICA	IDB and Offset Committee	MIEC TDA	GAMI EOC
Legal basis	Guidelines to an industrial benefits and offsets program in the Netherlands	Industrial Participation / Offset (IP/O) Directive	UICA (Umbrella Industrial Cooperation Agreement)	Directions for handling performance of ICP Transaction in excess of preapproved credits	Policy and Guideline on Industrial Collaboration Programme in Government Procurement	n/a

Sources: KIET (2023). GICA Conference interview and presentation. June 2023.

Korea's own experience exporting weapons to Australia, Egypt, and Poland illustrates the growing global demand for offsets in weapons trade deals. The governments of nearly 130 countries still actively seek offsets despite the costs involved. Forgoing these opportunities could deprive the Korean defense community of major opportunities for researching, developing, and exporting key technologies and parts; major defense products including the T-50 trainers and submarines were developed in part thanks to offsets. Abandoning offsets does not serve the national interest. While maintaining the

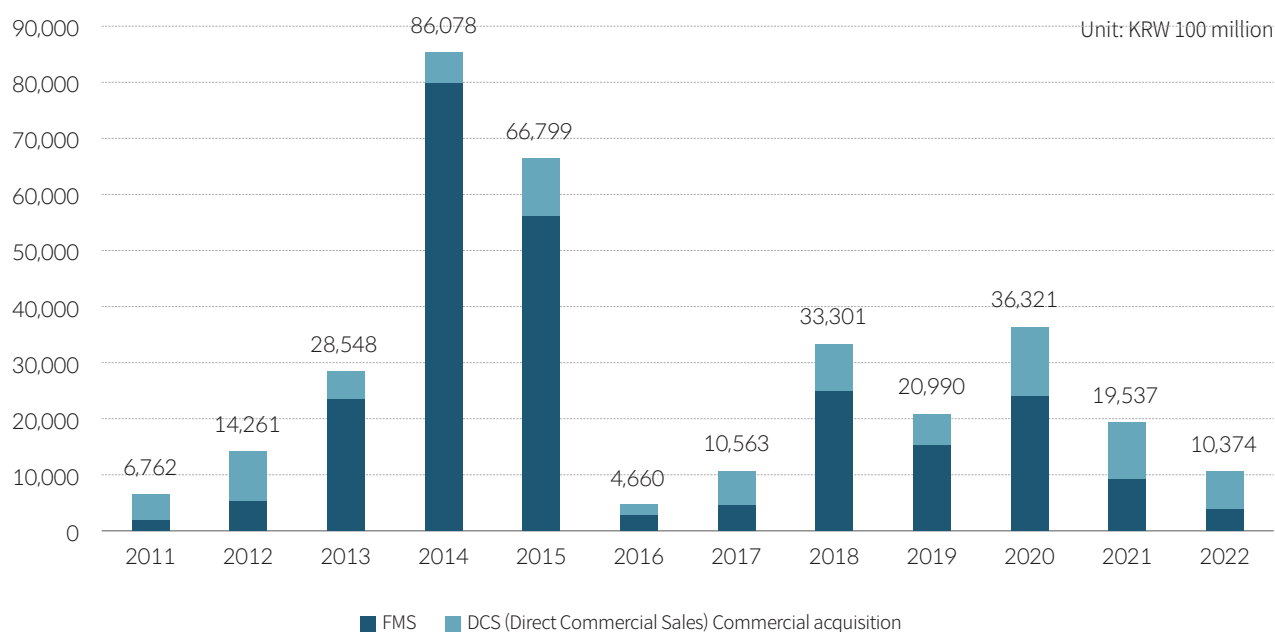
18) KIET (2023). GICA Conference presentation and interview. June 2023.

legally requirement for offsets, the government should additionally encourage offset banking through sufficient negotiations with major weapons exporters such as the United States, and also establish a consistent and comprehensive strategy for ensuring the effectiveness of negotiations.

## (2) Expanding the absolute scale of offsets

In current practice, offsets against FMS contracts are largely considered optional. This is unacceptable, and a reluctance to seek offsets has been the main factor driving the dramatic fall value of defense countertrade in the recent years. FMS contracts accounted for 74 percent, or KRW 25 trillion, of the KRW 33.8 trillion worth of weapons that Korea purchased from the United States from 2011 to 2022.<sup>19)</sup>

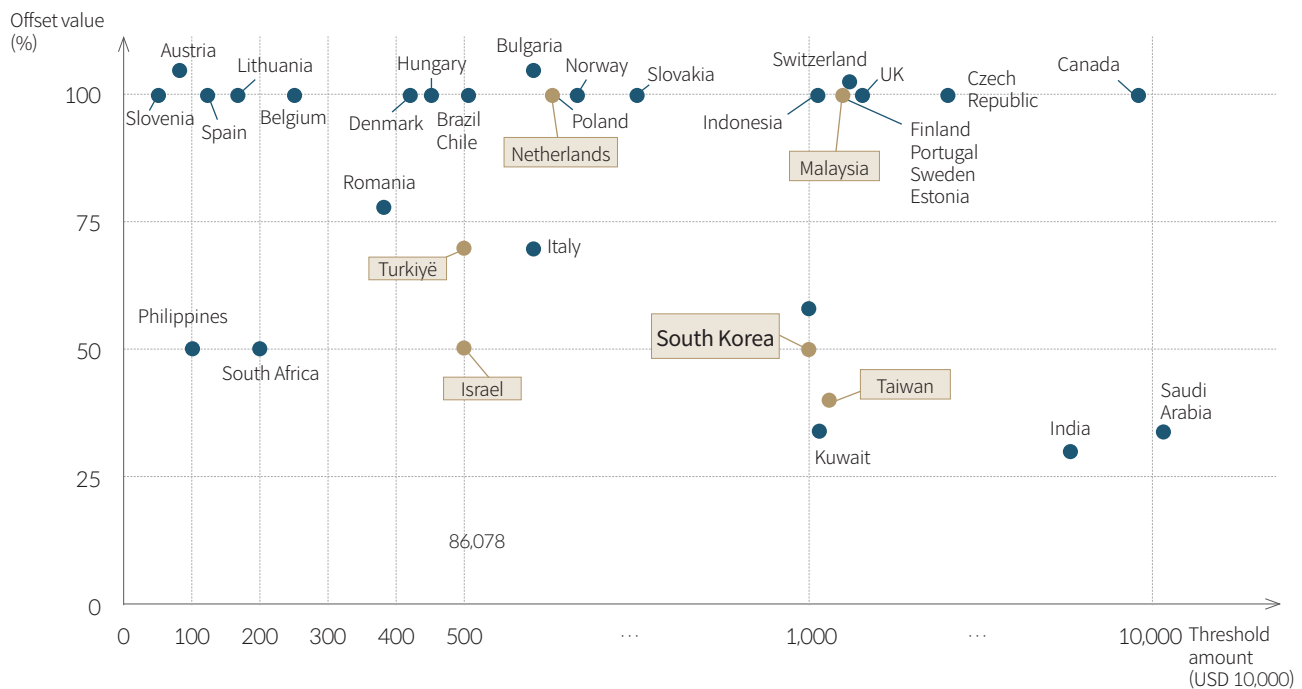
**Figure 6. Weapons Imports from the United States (2011 to 2022)**



Source: DAPA (2023), Defense Industry Statistics Yearbook.

Note: The FMS values represent the values of offers accepted. The commercial acquisition values represent the actual values of contracts entered.

19) DAPA (2021), Defense Industry Statistics Yearbook.

**Figure 7. Offset Value Percentages and Threshold Contract Amounts by Country**

Source: Jang and Kim (2016) (expanded for analysis herein).

Should Korea continue to avoid seeking offsets against FMS contracts with the United States, and specifically in the future acquisitions of F-35 fighter jets and other weapons systems, the country will continue to forego any gains that could otherwise be had. No other country actively avoids seeking offsets in certain contract classes, such as FMS.<sup>20)</sup>

As Figure 7 shows, the majority of countries that actively seek offsets demand countertrade worth 50 up to 100 percent or even more of weapons contracts, regardless of whether or not the contracts in question are FMS deals. Norway, Bulgaria, and other European countries actually look to recoup 100 percent of the money spent foreign-made weapons through offset trade. Turkey has recently raised the required offset value from a minimum of 50 percent to 70 percent, and also raised the threshold contract value against which offsets are to be sought to USD 5 million. With its policy of seeking offsets of 50 percent or more on competitive contracts worth USD 10 million or more, Korea finds itself in the lower-middle ranking among the four-dozen or so countries that actively participate in offset trade worldwide. Korea's policy of not seeking offsets against FMS contracts with the United States, which represents nearly 80 percent of Korea's foreign weapons acquisitions, has been the leading factor behind the decline in the absolute volume of offsets sought by Korea.

DAPA's March 2023 decision to not seek offsets in the second phase of the F-35 acquisition program

20) KIET (2023). GICA Conference presentation and interview. June 2023.

(valued at KRW 4 trillion) will likely set the stage for an attempt to fend off attempts at offsetting similar FMS contracts in the future. DAPA argues that there are 59 programs that will be eligible for offsets in the next two years (2023 to 2024), but these programs include 46 non-competitive contracts, including FMS.<sup>21</sup>) DAPA should abolish the distinction between competitive contracts and non-competitive ones, and expand offsets incrementally by facilitating a transition to offset banking. Amid a shift to offset banking, DAPA should aim to increase offset values to 50 percent to 100 percent of all weapons import contracts, regardless of whether they are competitive or non-competitive. DAPA should also seek offset banking against FMS contracts with the United States under a consistent trade negotiation strategy.

### (3) Transitioning to offset banking

At present, Korea seeks offsets sought in individual contract negotiations. This policy should be abolished and replaced by a universal offset requirement. Active participants in offset trade make the best use of offset banking to their own benefit (Table 3). As offset banking allows the buyer to prioritize higher-priority interests independently of any specific weapons contract, it is gaining increasing popularity in the Netherlands, Turkiyë, Israel, Taiwan, Malaysia, and even here in Korea.

**Table 3. Offset Banking in Other Countries**

	Netherlands	Turkiyë	Israel	Taiwan
Alternative name of policy	Pre-approval	Pre-approval or pre-crediting	Pre-performance off-set/activity	Preapproved credits/ Preliminary approval
Scope of application	Entire range of trade where offsets are applicable	Category-B or C contracts (and certain exceptional Category-A contracts)	Areas of highest concern to national interests (aviation, materials, biotechnology/ medicine, hydro/ renewable energy, etc.)	Entire range of trade where offsets are applicable
Window of negotiation	Up to 10 years leading up to main contract	Typically 2 to 5 years leading up to main contract	Typically 2 to 5 years leading up to main contract	Typically 2 to 5 years leading up to main contract
Pre-authorization required?	Yes (for up to 10 years) (Authorization valid for 5 to 7 years on average))	Yes	Yes	Yes
Offset banking recognized?	Yes	Yes	Yes	Yes
Window of execution	Up to 10 years after main contract	Up to 10 years after offset contract (or up to 2 years after main contract for Category A)	n/a	n/a

Source: Jang and Kim (2016) (expanded for analysis herein).

21) DAPA (2023), Current Status of Programs Eligible for Offsets (2023 to 2024).

**Table 4. DAPA's Policy for Fostering Industrial Collaboration through Offset Banking (2021)**

	Industrial collaboration quotas	Offset banking
Department in charge	IPT responsible for each contract	Offset Division
Scope of offsets	Parts manufacturing for weapons to be imported, exports, joint R&D and production	Indirect parts manufacturing, civilian goods exports, core technology transfers, munitions support, maintenance and repair, munitions exports, aviation MRO, foreign investment, etc.
Contracting	Include main contracts	Memoranda of understanding
Offset value	50% of competitive contracts, 30% of non-competitive contracts	Differs by contract

Source: DAPA (2021), Industrial Collaboration and Itemization Guide, October.

Since adopting the offset banking policy in December 2018, DAPA has placed it on the backburner. It plays a secondary role, supplementing the existing emphasis on seeking offsets in individual contracts. This arrangement is not an efficient use of offset banking. This two-tiered offset system in practice places a significant burden on IPTs, the members of which often lack the necessary expertise to handle weapons contracts and seek offsets at the same time. It also transfers some of the key responsibilities that should be handled by the Offset Division, such as offsets for parts manufacturing, exports, and joint R&D and production, to individual IPTs. As offset banking allows Korea to seek major and high-value deals over relatively long spans of time (four to five years) regardless of the terms and conditions of the main contracts, DAPA should shift its focus to using offset banking to its benefit.

The current administration can help make this possible by first mandating offset banking for all contracts except for those that are currently in progress. It may impose a sunset provision on the practice of seeking offsets against individual contracts. The offset banking program itself should evolve so that it can sufficiently end the practice of seeking offsets against individual contracts. This requires DAPA to make good on its promise to replace the conventional offsets system with offset banking, originally promulgated in its Master Plan for Defense Industry Promotion (2023-2027). Offset banking should be prioritized in deals with major foreign defense contractors, many of which Korea has buying weapons from for decades, such as Boeing and Raytheon. A memorandum of understanding on joint R&D for a new high-tech weapons system with Boeing would be a good start.<sup>22)</sup> The window for executing banked offsets should also be extended to 10 years, up from the current five, depending on the contract, to encourage foreign defense contractors to participate.

22) Yonhap News (2023), April 13.

#### (4) Establishing a comprehensive strategy for offset negotiations

In addition to encouraging offset banking, efforts should also be made to establish a comprehensive strategy for offset negotiations. Such a strategy would ideally guide every department and agency involved in defense trade negotiations toward serving the overall national interest, rather than their own departmental or agency-level interests. An increasing number of countries have already adopted such strategies, often in conjunction with offset banking programs, to maximize the value of large-scale and high-value offsets. Taiwan, for example, keeps and updates an Industrial ICP Priority List each year and publishes it online so that foreign contractors can prepare viable offers to negotiate offsets with Taiwan.<sup>23)</sup> It takes significant investments of time and labor for defense contractors to develop offset proposals that satisfy buyer countries' demands and needs.<sup>24)</sup>

The resulting strategy ought also to support top-down approaches in negotiations, in light of Korea's long-term plans for fostering strategic industries. This is not to say that a strategy should forego the existing bottom-up method, led by DAPA and the Ministry of Industry, Trade, and Energy (MOTIE). Rather the vision should reflect DAPA's negotiation plans and the review of priorities by the Offset Review Committee to serve Korea's best interests. The Defense Industry Promotion Committee (co-chaired by the Ministers of National Defense and of Industry, Trade, and Energy) or the Defense Exports Strategy Review Meeting of the Office of the President should regularly review issues relating to the comprehensive offset negotiation strategy in order to keep it updated and competitive. Efforts should also be made to determine, in advance, high-priority offsets that might inform the larger overall strategy.

In order to ensure that foreign defense contractors understand, review, and base their offers on the Korean government's comprehensive negotiation strategy and identify the nation's top priorities, efforts should be made to increase the number of one-on-one seller-buyer meetings across different departments (DAPA, MOTIE, and the Ministry of SMEs) and organize special forums at large aviation and defense expositions worldwide to explain the Korean offset policy.

#### (5) Reinforcing offset organizational resources and personnel

The personnel and resources at DAPA and MOTIE dedicated to managing offsets needs to be reinforced. DAPA's Offset Division currently has a dozen or so members on staff, but only a very few of them have sufficient offset experience and expertise. There are only one or two officials in all of MOTIE (within the Machinery and Robotics Division) handling offset tasks, with support from the Korea Aerospace Industries Association (KAIA). It is therefore crucial to recruit and hire more outside experts and grant appointed officials tenure in order to enhance the quality of available personnel and resources.

23) <https://www.icpo.org.tw/>.

24) As affirmed in interviews with officials of KIET, Boeing, Raytheon, and elsewhere concerning offsets in 2020.

(6) Hosting R&D and MRO units of foreign defense contractors in defense clusters managed by local governments

Finally, major local governments should be afforded the opportunity to manage and operate offset negotiations on their own. This could be done in part to foster defense clusters that these local governments are developing and managing. Offset banking can and should be used to host R&D labs and MRO centers of foreign defense contractors in these clusters, along with testing and certification arms of Korean defense agencies. In developing strategies for negotiating offsets, DAPA and the Korea Defense Industry Association, along with MOTIE and KAIA should actively consult and cooperate with local governments to help them grow their defense clusters.

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"Trends in Big Tech Companies' Move into the  
Defense Industry and Policy Implications" (2022, co-author)  
"Analysis of the Defense Export Support System and  
Policy Implications: Toward Making Korea  
One of the Four Largest Defense Exporters"  
(2022, co-author)

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