

9

Nordic offset policies: changes and challenges

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Introduction

This chapter compares the origin and content of offset policies in the four Nordic countries Denmark, Finland, Norway, and Sweden. By policies are meant formal government and/or agency guidelines that explain the reasons and conditions for demanding offsets in connection with military acquisitions. All of the Nordic countries have experiences as arms importers—in the case of Finland from both the Soviet Union and western countries—as arms exporters (although that experience varies greatly), and as partners in international arms cooperation. This chapter describes their policies, if any, in these three roles.

Evolution of Nordic offset policies

The idea behind offsets is to compensate (or offset) the cost of importing weapon systems. As the Nordic countries began to use such arrangements at different dates they also defined somewhat different policies. The earliest Nordic examples were in the form of countertrade or work share/cost share arrangements during the 1960s and involved Finland and Denmark.¹ During the 1980s, offsets were demanded also by Norway and Sweden. Access to foreign markets and/or to receive foreign technology became central objectives. The first important case in Norway was the order of six type-210 submarines from Germany in 1982. Sweden's largest indigenous military project, the Gripen combat aircraft, was to save money as compared to the prior-generation combat aircraft, the Viggen. One option was to purchase subsystems and components from abroad rather than to develop them in Sweden. The costs for those imports were to be compensated for by the foreign suppliers.²

These examples illustrate that offset arrangements could mean different things, and that they were generally used in connection with larger acquisitions. Still, the early offset policies of all the Nordic countries are considered flexible when compared with the policies of larger arms producing countries (Ahlström, 1992a; Ahlström, 1992b).

The actual codification of Nordic national offset policies do not, with the exception of Sweden, date back to those early years. Sweden's first offset guidelines were presented in a Ministry for Defense document in 1983 and updated in 1999 (see table 9.1).

Table 9.1: Year of published offset policies, guidelines, and revisions

Denmark	1996
Finland	(1977), 1991, 1998, 2001, 2002
Nonvay	1999
Sweden	1983, 1999, 2002

Denmark's offset policy was formalized into an official document in 1996. In connection with Finland's acquisition of British Hawk aircraft in 1977 the Finnish Parliament decided that offsets were a precondition for a purchase. An intra-governmental Finnish Offset Committee was established, but formal policy guidelines were not published until 1991. The rules were then slightly revised in 1998, 2001, and 2002. Until 1999 the policy in Norway was a short Ministry for Defense statement passed by Parliament. In 1999 formal offset guidelines were published by the defense ministry, and a Strategic Advisory Group for Industrial Co-operation and Offset (SAGICO) was established.³

The presentation and comparison in this chapter make use of available policy documents and guidelines, published summaries, and personal communication.⁴ Not every aspect of national policy can be formally defined in official documents, and many aspects of implementation have been left open for negotiation on a case-by-case basis, but by 1999 all Nordic countries had published offset policies. Having evolved especially during the 1990s, the policies more clearly specified what governments want (or do not want) as buyers and how they set out to achieve their objectives.⁵

A comparison of Nordic countries as arms importers

All the Nordic countries have defined minimum values for when 100 percent offsets are to be requested (table 9.2). Finland and Sweden have roughly the same minimum values, while Denmark has defined the lowest limit. These limits broadly reflect the size and capacity of their respective domestic defense industrial base. By international comparisons, all are relatively small. The smaller the national defense industrial base, the more difficult to implement large military offset agreements. In Norway, if there is at least 80 percent foreign participation in a military project, it is credited as a 100 percent offset. Among the Nordic countries, small size has become a problem for Denmark in particular. This problem was reflected in its 1996 policy which defined not only minimum values but also stated that above DKr100 million (\$12.7 million, at average 2002 market exchange rates at current prices) only 30+ percent offsets would be demanded. Otherwise, it was feared, offset implementation by Danish industry would be too complicated.

In June 2002 Danish offset obligations with 33 foreign suppliers amounted to eight billion DKr (\$1 billion) to be completed before 2010. More than 50 percent of these obligations were with EH Industries Ltd. and Lockheed Martin Aeronautical Systems. Military offset obligations were expected to increase further as a result of additional

major acquisitions, including new combat aircraft, submarines, transport helicopters, aircraft surveillance equipment, battle tank communication systems, and naval radar systems. With an offset policy specifying that offset obligations should be implemented within eight years there was a risk that over time obligations would

Table 9.2: Limits for demanding 100 percent offsets

Denmark

25–100 m. DKr (US\$m. 3.2–12.7)

Entire time period

Finland

50m. FIM (US\$7.9m.) 1991–2001

10 m. € (US\$ 9.4m.) since 2002

Nonvay

50m. NOK (US\$6.3m.) until 2001

75 m. NOK (US\$9.4m.) since 2001

Sweden

75 m. SEK (US\$7.7m.) 1983–1999

100m. SEK (US\$10.3m.) since 1999

become impossible to fulfill. Consequently, in August 2002, the National Agency for Enterprise suggested to create a venture fund with foreign supplier capital. This would be used as a catalyst to expand Denmark's military production. Foreign suppliers would be given the opportunity to pay into the fund—about five percent of the offset amount was mentioned—and receive a multiplier benefit, although multipliers have as a rule not been accepted in Denmark. The foreign suppliers who would pay into the fund would also receive a return on their investment.⁶ In May 2003, based on the recommendation by a special Task Force study, government decided against pursuing the idea at this time (Etablering, 2003).

Offset priorities are similar in all four countries. The overriding aims are to support indigenous military companies by sustaining domestic military-industrial capabilities, technological skills, employment more generally, and to generate new business activities. Still, actual administration differs. Although the Ministry for Defense is involved in one way or another in all four countries—it is the formal buyer of military equipment—ministries involved with trade and industry seem equally important. For example, in Denmark the Agency for Trade and Industry—which is part of the Ministry of Business and Industry—prepares the Industrial Cooperation Agreements (ICA). In Finland, the Ministry for Trade and Industry defines industrial participation guidelines and is responsible for reviewing offset fulfillment. In Denmark and Sweden it is the defense acquisition agency that is involved in the actual offset specifications. In Finland, the

Finnish Offset Committee has that role, and in Norway the aforementioned SAGICO seems to have a similar role.

One of the main reasons for policy revision was to increase the military-technological content of offsets through direct and indirect technology transfers. In Finland, technology transfers in indirect offsets were introduced in the 1991 policy. Preferred offsets today involve more participation of domestic industry in the development and/or manufacture of the purchased equipment in order to sustain or develop skills and to learn how to maintain and support the equipment during its lifetime. Support of small and medium-sized enterprises (SMEs) is also an important offset objective in both Denmark and Finland.

Although Norway's policy document includes a list of prioritized technology areas to be counted as indirect offsets, Sweden seems to have the strongest technology focus, partly because of the armed forces' Research and Technology (R&T) policy (Swedish Armed Forces Strategy, 1997; 2002). In Sweden, decisions about whether the procurement of a particular technology, or parts thereof, should be defined as a direct or indirect offset in a tender document must be taken in consultation with the armed forces.⁷

Another important reason for offset revision was to make policy more specific and detailed. This was the result of, first, more competition in the international arms market (which in the 1990s had made it a buyers' market), and, second, increasing national, especially industrial, awareness of market demands. Offsets are not just a political add-on to make any specific contract more appealing; instead, together with credits and favorable loan guarantees they have become a competitive tool. Sweden's 1999 policy and the 2002 acquisition guidelines (Guidelines, 2002) illustrate this by

linking industrial participation directly with defined defense technological areas; not, as a rule, accepting multipliers or offset banking;⁸ and only accepting swaps between Swedish and foreign offset obligations of up to 15 percent of total obligations.

In general, the use of multipliers, especially with high coefficients, has been reduced. The 1991 Finnish guidelines could give technology transfers a multiplier coefficient as high as 20, while for investments leading to new industrial production it could be as low as 0.5. According to the revised Finnish 2001 rules, technology transfers and investments are evaluated on a case-by-case basis by the Finnish Offsets Committee. In Denmark, unless there are substantial technological benefits involved, multipliers are not accepted. Industry is required to bid competitively on any offset contract. Still, there are exceptions. Finland's 2002 rules state that in specific cases concerning technology transfers or marketing projects, a fixed part of the cost may be borne by the Finnish parties. In Denmark, technology transfers may be credited in proportion to the investment if a Danish company can exploit it and if it is free of charge. Sweden's defense acquisition agency (*Försvarets Materielverk*, FMV) may accept multipliers in indirectly related R&D activities, but only with a maximum coefficient of three. The highest possible multiplier coefficient accepted by the Norwegian government is five, and must involve R&D projects placed in Norway, R&D technology transfers to a Norwegian company, or investments resulting in new commercial activities. The lowest offset multiplier coefficients in Norway are offered for the acquisition of partly finished products (0.2 to

1.0) and marketing assistance (0.1 to 2.0). Marketing assistance is, moreover, only accepted as offset if it leads to sales within two years.

All Nordic countries accept offset banking, i.e., the use of offset credits that a foreign supplier has earned before a new defense acquisition contract is signed (in Norway, this is called “conditional offsets”). Sweden accepts such credits but again the use is restricted. If a foreign supplier to Sweden has exceeded its obligation when a contract is fulfilled, these excess credits cannot as a rule be transferred to a new contract. When exceptions are made, such credits must be used within three years. If a foreign company that has entered into conditional offsets in Norway does not win a new delivery contract, the credits may be used by other suppliers in that country within two years. The Danish policy is most explicit, stating that banked credits will be extended for two years, may not be transferred to a third party, and will only be allowed to satisfy up to 50 percent of obligations under new cooperation agreements.

No buyer wants compensations to drag out for a long time. Preferably, fulfillment should not take longer than the time agreed to fulfill the military order. Norway’s policy stipulates that offset obligations must be fulfilled “by the delivery of the procurement contract.” Still, in their policies, Denmark and Finland have formulated time limits for the implementation of offset agreements: in Denmark between 3 and 8 years and in Finland between 3 and 10 years, at least according to its 1991 guidelines. In the revised Finnish IP guidelines no such time limit is mentioned, as is also the case in Sweden. With an emphasis on long-term technology offsets and IP, it is actually very difficult—or may even be counterproductive—to specify time limits. This is also acknowledged in Norway for offsets involving long-term contractual cooperation.

Offset requirements are generally to be defined before a delivery contract is concluded. Moreover, they should be implemented according to the agreement. If not, all the Nordic countries retain the right to punish a foreign supplier. The Finnish and Swedish policies accept direct economic sanctions. The Norwegian policy states that the authorities in such cases “...will withhold payment corresponding to 10 percent of the contract figure... If the offset obligations are not met within two years after the expiry of the agreement, the withheld sum will be forfeited.” Denmark takes a somewhat different position. The threat of economic sanction is not used since it is acknowledged that it increases the price of the imported product. Instead, Denmark blacklists a supplier from receiving new contracts until the obligations have been fulfilled.

How important are offsets for the procurement outcome? Can an acquisition decision be based on offset benefits rather than on other considerations? Basically no. Norway’s policy states that conditional offsets will not influence the acquisition decision. The Swedish guidelines are explicit in that the “...purchaser’s choice of supplier must not be influenced by any offsets on offer unless and until it has been established that the prospective suppliers’ products or systems meet the purchaser’s requirements.” Even without such explicit references it is understandable that neither offset offers nor the existence of offset agreements should be allowed to affect the procurement decision so that the decision-process is focused on military requirements.

As from the 1980s offset arrangements have come to include not only compensations to take place *in* the buyer’s country but also *from* the buyer’s country. Increasing the volume of exports as well as finding new export markets have become important aspects of offsets. Both military and civilian exports have a high priority in Finland’s military IP

policy, especially for SMEs. As in Finland, Sweden's defense acquisition agency guidelines are explicit about export expectations, especially from indirect IP commitments. Links between offsets that lead to domestic coproduction and follow-on exports are also important. For example, as a result of the selection of NH-90 transport helicopters by Finland, Norway, and Sweden, industry in these countries are involved in NH-90 production also for non-Nordic customers.⁹ Transnational military-industrial relations are increasingly relevant for all Nordic countries as well as for their future position in European military production.

A comparison of Nordic countries as arms exporters and as international arms cooperation partners

No Nordic country has formulated an explicit military export offset policy. In 2002, the Association of Swedish Defense Industries (ASDI) attempted to do just that by making the point that Swedish military companies should accept their own import offset policy also as exporters. But this did not remain in the association's final IP policy document (Policy for Offset, 2003). Still, large military exports from Nordic countries, such as the Saab-B AE Systems Gripen sales, involve recipient offsets. The supplier may also, as an offset benefit, help the recipient to export its own military products to other customers. For instance, as part of their offer to sell 24 Gripen aircraft to the Czech Republic, BAE agreed in December 2001 to attempt to find buyers for 36 L-159 light combat/trainer aircraft being produced for but no longer wanted by the Czech Republic.¹⁰

As exports and international cooperation have become increasingly important aspects of Nordic defense industrial policies, arranging offsets with foreign buyers will be important to secure Nordic export contracts. With countries with which closer military relations have developed, special offset arrangements may be negotiated.¹¹ The historical and political relations among the Nordic countries, the changing security situation in Europe during the early 1990s, and the shared need to reduce acquisition costs resulted in the signing of a Nordic Armaments Cooperation (NORDAC) framework agreement in 1994, in essence an attempt to establish a common Nordic arms market Objectives include more effective use of Nordic defense industrial resources and increased use of common acquisitions. In November 2000 the countries signed another agreement to further the economic, technological, and industrial advantages from military cooperation, and in June 2001 they signed an agreement concerning support for industrial cooperation in the defense materiel area. Of special interest is that the parties agreed to refrain from requiring industrial compensation for the procurement of products from each other, if not prevented to do so by other rules and regulations, and that intra-Nordic arms trade information is to be compiled in annual compensation accounts. Every five years an evaluation report on the compensation balance is to be drawn up (Agreement, 2001, section 4).

Changes and challenges

While there has been supplier criticism of offsets as a distortion of otherwise competitive arms markets, offsets have simultaneously been regarded as necessary to compete for contracts. The 2001 status report by the US Presidential Commission on Offsets in International Trade downgraded the overall negative effect of offsets in US military trade when valued against the benefits (US Presidential Commission, 2001). This conclusion is likely to reduce the effect of offset critics in both the USA and other countries and to direct the debate toward policies that reduce the most negative consequences of offsets. Such developments are already visible from the revisions of Nordic offset policies. But the policies and their changes also point to challenges both for the use of offsets as such and for the participation by the Nordic countries in wider European military-industrial undertakings.

Policy versus reality

It is clear that the Nordic countries have learned from and been influenced by other, including each others', policies. As buyers they try to get as much out of offsets as possible. Over time, this resulted in a shift in the basic Nordic offset policy: from indirect civilian offsets to direct and indirect military offsets. There has been a move away from mixed industrial, regional, and other civilian aims toward military gains, mainly through direct IP and technology transfers. Factors used for calculating offset values have been adapted and principles developed to punish suppliers that do not implement agreed offsets. But it is important to remember that while policy formulates objectives and guidelines, the companies involved can still accept arrangements that stretch the implementation of the policy if deemed rewarding.

Nordic policies are somewhat ambivalent about offsets. On the one hand, offsets will continue to be demanded for large military acquisitions. On the other hand, it has been acknowledged that in certain cases offsets may be detrimental because of added costs. While Danish industry reportedly had not experienced any added costs from offsets by the middle of the 1980s, Denmark's offset policy now acknowledges added costs. Finland estimates a 10–15 percent cost increase per offset agreement (JAS Industrisamverkan, 1986, pp. 64,68). Its National Audit Agency, together with its 1999 finding that Finland's acquisition of the US F-18 combat aircraft did not result in the expected offset gains (except with regard to technology transfers), suggested that the country's offset policy be revised to reflect the possibility of offset-related higher costs.¹² Subsequently, in 2002, the Ministry for Trade and Industry suggested that offset demands can be made for less than 100 percent compensation or even, in certain cases, zero. Such an option already exists in the Norwegian policy.

The question remains: are offsets beneficial? Unfortunately, national conclusions as to net gains are not always comparable and often controversial. A Norwegian report in 2000 pointed to this general problem, especially on account of the low quality of available data (Halvorssen and Vamraak 2000, p. 41). A US General Accounting Office report concluded that the work of the US Presidential Offset Commission may result in better

agency coordination with regard to offset data collection which had not been efficient until then (US GAO, 2000). The many ways to arrange and calculate offset requirements—such as complicated IP arrangements, multipliers, saved offsets, accepting offsets together with export credits and government loan guarantees as parts of an export order, etc.—complicate evaluations as well as comparisons. The percentage figure given for the value of an offset agreement does therefore not necessarily correspond to the actual work offered by the supplier or the work that the supplier becomes involved in. Recognition of these problems, increasing the demand for higher-quality data—including national policies mandating regular reviews of offset implementations—will likely result in improved evaluations of offset benefits and drawbacks. The first Nordic evaluation report is expected in 2008.

Civilian versus military offsets

All Nordic countries have increased the use of offsets as a tool for military-industrial participation and relevant technology transfers. Their policies have become more explicit and specific. Some of the countries combine non-military and military-industrial offset goals but Sweden's policy has completely moved away from mixed goals to a 100 percent military-industrial offset policy only. This does not imply that all countries should have a military-only offset policy—the opposite is, of course, possible within limits agreed to by the EU and international trade organizations. In particular, it is possible for Nordic countries, as arms exporters, to emphasize civilian offsets when negotiating offsets with a foreign recipient, especially if that recipient is a developing country where basic human needs have not yet been fulfilled.

Cost versus participation

All Nordic countries are relatively small military producers. Problems with implementing offsets in small states are illustrated by Denmark in particular. Further reductions in the Nordic military-industrial base are not unlikely, and Denmark's current problems may be experienced by other Nordic countries in the future.

One particular factor limiting offsets is the use of commercial “best-practice” in military acquisitions. Subcontracts for the US Joint Strike Fighter (JSF) project are signed on a commercial basis, and no buyer should expect offset benefits. This raises the issue of cost versus participation. All foreign participants, with the exception of the British, have had to accept less than full participation—and thus also less than total influence—in the balance between costs and expected gains. Norway and Denmark each paid \$10 million to be associate JSF partners during the initial development phase until 2001. In the current and more expensive engineering and manufacturing development phase they each pay between \$125–150 million for getting subcontracts and (perhaps) being competent buyers more than 10 years into an uncertain future.

Acquiring advanced military equipment is not easy or cheap for small states that wish to support their own limited defense industrial base. Ambitions have to be redefined and expectations perhaps lowered. Direct imports will become more important as complements to indigenous development and manufacture.

Importers, exporters, or partners?

While all Nordic countries have offset policies as importers of major military equipment, they have not formulated such policies as exporters. One explanation is that with the exception of Sweden, Nordic countries have limited military exports. But the use of industrial participation to support domestic military-industrial development will spill over to the countries' military exports. No Nordic country is therefore simply either an arms importer or an arms exporter. This plays into the NORDAC idea that instead of demanding offsets from each other the countries should abandon them altogether. It has been noted that policies in both Norway and Finland permit not demanding offset work under certain circumstances, and both Denmark and Sweden have acknowledged that more international cooperation could make offsets unnecessary. The Swedish arms manufacturer's 2003 policy recognizes that there may be instances when the application of the IP principle could be reduced or not be used at all.

Stating goals is easier than overcoming, by practical measures, existing difficulties. National protectionism exists in Europe. Countries and agencies remain wary of harmonization or to give up technological leads, just as individual companies are unwilling to lose their competitive edge for the "common good." In effect, an offset policy may be used as a protective measure. Paradoxically, the differences in military-industrial size and competence that remain between Sweden and the other Nordic countries could complicate cooperation. Among Nordic countries, Sweden has the largest military-industrial base and is its major arms exporter. Sweden's 1999 government offset policy, its 2002 arms acquisition agency guidelines, and the 2003 policy document of its arms manufacturers' association all aim to support Sweden's military industry. This may send a message to other countries that these are policies to be used to gain national and company-specific benefits. To avoid being co-opted by Swedish policy, other Nordic governments and agencies may seek closer relations with non-Nordic partners.

In addition to national and regional Nordic policies and aims, several military companies in the Nordic countries are partly or wholly owned by foreign companies. Foreign ownership became possible with privatization and the development of companies' commercial strategies. Foreign interests can support or complicate Nordic as well as broader cooperation and influence national military company strategies and developments.

Changes versus challenges

The application of national offset policies among individual European states, including the Nordic ones, may be affected by pan-European developments in the European effort at arms-export policy harmonization, continued changes in national military-industrial bases, and more commercially-based acquisition decisions both in Europe and in the USA. In the European military-industrial future, there may be no room left for a distinct "Nordic dimension." The likelihood is that most or all military production and acquisitions in Europe will become coordinated and international. The development and success of future European arms acquisitions will be decided by the answers to four questions linking military doctrine, the European Security and Defense Policy, and defense-industrial policy: what should be produced, for what purpose(s), by whom, to be used by whom? Not all European countries are likely to participate in all aspects of

military production, nor to be involved in every military operation. The degree of harmonization in military production in Europe will be a reflection of Europe's perception of its role(s) and responsibilities as well as its ability to agree on a common road map.

National offset goals and regional European developments may be incompatible. To guide European developments, its governments need to take the reins together. Offsets are not a separate issue but part of Europe's military-political development. The EU needs to formulate implementation guidelines for a common, long-term European policy to sustain and develop *common* and *shared* strategic industrial and technological skills. The aim would be to establish cost-effective military acquisitions within a European security and defense policy. Some nations and military companies will be winners, others will be individual losers but to the benefit of all. For the latter, the outcome is not necessarily bad in the long-term if competitive civilian activities are established, activities that are likely to have a stronger positive impact on economic development and company success than military activities.

We may have come full circle as a result of increasing recipient demands for military IP and investment. Offset has become a buzzword whose meaning today has become confused. Perhaps it is time to return to traditional forms of military transfers: direct transfers of complete weapon systems, license manufacture (individually or in the form of consortia), and weapons R&D cooperation. Separate recipient demands—be they military or not—can be supported in ways other than by being linked to a particular military acquisition.

Notes

1. Finland and the Soviet Union arranged countertrade deals as a result of Finland's purchase of 24 MIG-21 combat aircraft in 1962. When Denmark in 1968 ordered 46 Draken combat aircraft from Sweden, and when Finland ordered 12 Swedish J-35 Draken in 1970 and 50 UK Hawk-50 light combat and trainer aircraft in 1977, both Denmark and Finland demanded local assembly to offset employment losses and to sustain and gain skills.
2. The major offset arrangement was with General Electric in 1983 for the further development by Volvo Flygmotor of the GE-404 engine and its licensed manufacture for Sweden's air force and, in part, also for foreign customers.
3. In Norway the offset history has not been properly documented. Moreover, two offset studies prepared during the 1990s by the Norwegian Center for Economic Analysis (ECON) have limited distribution and were not available for this comparison.
4. A full list of references, especially to the policies, guidelines, and revisions in the Nordic languages is available directly from the author.
5. The titles of the Swedish and Norwegian 1999 policy documents are similar, although Norway has kept the term "offset arrangements" rather than the more common term "industrial participation" (IP). For Norway, export of defense products still seems to have the highest priority together with indirect defense offsets. Sweden, in contrast, has a "cooperative" policy emphasizing defense IP. Similarly, Finland and Denmark define their policies as IP or cooperation policies. It should be noted, however, that Norway uses so-called Industrial Cooperation Agreements (ICAs) as its most important offset tool.
6. Personal communication with the National Agency for Enterprise.
7. The term R&T is becoming more common, paralleling the use of R&D (research and development). The difference between the two is not always clear but one purpose of using the R&T phrase is to emphasize the importance of relevant technology development,

- including technology demonstrators, rather than the development of prototypes of complete military platforms.
8. Neither multipliers nor banking are mentioned in the Swedish policy guidelines but are referred to in studies of earlier Swedish policy (see Ahlström, 1992a, 1992b).
 9. See *Defence Industry*, November 2001, p. 13; *Countertrade & Offsets*, 22 October 2001, pp. 5–6.
 10. *Financial Times*, 11 December 2001, p. 6.
 11. Sweden's 1999 policy states that offsets should not normally be demanded in international cooperation unless partners make such demands. Similarly, a Danish memorandum from 28 August 2001 states that as long as there is no free defense market in Europe, offset agreements will be used. The Danish memorandum mirrors the formulations used in a European Defense Industries Group (EDIG) June 2001 policy paper (see EDIG, 2001).
 12. See Sköns (2004) for a description and discussion of Finland's (and Sweden's) offset audit efforts.

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