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CHAIRMAN

PRESS RELEASE

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OPENING STATEMENT OF CHAIRMAN DUNCAN HUNTER

Full Committee Hearing on the Impacts of Defense Trade Offsets.

This afternoon we meet to receive testimony on the impacts of defense offsets on the U.S. defense industrial base.

I welcome our panel of witnesses representing companies in the defense industrial base and the defense workforce. Gentlemen, thank you for taking the time to appear before the committee on this important subject.

This hearing is the first in a series of hearings during which the committee will explore how defense offsets work today and more importantly, what are the long term economic implications for the entire defense industrial base.

Offsets are the compensation required by countries as a condition of the purchase of defense products. Direct offsets are usually in the form of co-production, subcontracting, technology transfer, training, production, or financing activities associated with the product being sold. Indirect offsets are where the compensation is not associated with the product being sold. Offsets are usually described as a percentage of how much you sold compared to how much you had to give away.

The Lockheed Martin sale of 48 F-16 fighters to the Polish Government illustrates both sides of offsets. The F-16 contract is worth $3.5 billion. The estimated value of the corresponding offset deal is $9.7 billion. Thus, this sale carries a 260 percent offset or roughly 2.6 times the value of selling the F-16s by themselves. It is true that some of the transactions are either inflated or have credit multipliers that reduce the actual cash value of the offsets. But any way that you look at this sale, we gave away much more than the Polish government purchased.

Before the members you will find the “Interfax Poland Weekly Business Report” which is a partial listing of the offsets given for the F-16 sale.

As an example of direct offsets, Pratt & Whitney purchased a Polish factory, modernized it, and established a manufacturing line that manufactured lower complexity, F-100 engine components for the Polish F-16s. These components and assemblies are then shipped back to the U.S. for assembly into the engine.

Let’s now briefly look at the indirect offsets on the list. These are offsets that are not associated with the F-16 production. In the earlier days of offsets, it often resulted in buying high tech weapons like F-16s in return for soy beans or tennis shoe contracts. Now it has grown to an unacceptable level. Look at item number 22, the purchase of Roll-on Roll-off Ships from a Polish shipyard. Lines 25 and 26, the purchase of tooling for Cessna and Lycoming from Polish sources. Lines 29 and 30, the purchase of components for land moving equipment. The purchase of aircraft and helicopter parts, automotive parts, pressure-cast aluminum parts, electronics parts, accelerator technology from the University of Texas. All for a total of $9.7 billion dollars.

The free-trade mantra is for free and open competition. Does anyone really think that American shipyards had fair and open competition for the ships included in this deal?

So why does the government stand by idle and watch this market distorting behavior, where unit price and quality are less important than the size of the economic bribe? They do because it's the law. The U.S. government cannot enter into, encourage or finance offset agreements. The decision whether to engage in offsets, and the responsibility for negotiating and implementing offset arrangements, resides with the companies involved.

In fairness, it must be recognized that American defense contractors have used offsets in the past, quite successfully, to make export sales. In the past, the U.S. dominance in the defense sector meant that offsets were generally small. Sweeteners to close a deal at levels of 30 percent offsets were common. These deals were good for American industry and the American worker. Even as the offsets grew towards 100 percent, they were still creating jobs. But now, the European defense industries compete head-to-head with the U.S. companies for an ever shrinking foreign defense market. The result: a buyer's market that demands higher and higher offsets. Today, offset requirements regularly reach levels of 200 and even 300 percent of the value of the sale. No one wants to blink, for they may lose the sale to the Grippen or the Mirage. And so the cycle continues to spiral upward.

There is irony in this story. On the commercial side of trade, the WTO outlaws offsets. But because the WTO excludes national security transactions from these requirements, offsets are tacitly approved for defense trade. The irony continues. Our close allies and trading partners cry foul when the Congress seeks to ensure the capability of our defense supply base with a 50 percent domestic source requirement in the Buy American Act and then disingenuously ignore the fact that they apply 200 percent offsets to their own purchases.

So, we face a very complex problem that once was small but has now reached a level that demands that it be brought under control. We must find that balance of fair and free defense trade where the U.S. prime contractors are not at a competitive disadvantage and yet are not required to leverage away someone else's market in order to compete in the global defense trade.

Today, we begin to delve into this issue in earnest as we pursue possible changes in policy to halt this unfair practice that accelerates the erosion of the critical portions of the U.S. defense industrial base.

Our witnesses today will start us down this road by helping us understand the magnitude of this practice and hopefully identify what courses of action are worthy of further consideration.

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