

Defense Offset Policy in Indonesia

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Abstract. Offset mechanism is a policy of the defense industry sector which had been increasing since 1950. Offset implementation has provided some profit-making such as offset obligations in the United States to encourage exports and offset policy in India that had been increasing since 1959 through the use of modern technology facilities by creating the National Aerospace Laboratories (NAL). On the other hand, Indonesia as one of the pioneers in the implementation of defense offsets is still heavily dependent on the procurement of defense equipment from other countries. Therefore, this study aimed to analyze the implementation of defense offsets in Indonesia and the importance of the defense offset policy in Indonesia. Thus, this study is able to contribute to public policy in Indonesian literature. This study used a qualitative approach to conduct a study in the defense industry with the application of defense -related offsets in Indonesia. The results showed that the low competitiveness of the defense industry is due to the low quality of human resources, lack of research and development programs in the field of defense industry and the lack of legal protection in the defense offset policy.

Keywords: defense offset, defense industry, policy defense industry, offset

Abstrak. Mekanisme offset pada sektor industri pertahanan telah meningkat sejak tahun 1950. Implementasinya telah memberikan beberapa keuntungan seperti membuat kewajiban bagi Amerika Serikat untuk mengimbangi peningkatan ekspor produk industri pertahanan dan kebijakan offset di India yang meningkat sejak tahun 1959 melalui penggunaan fasilitas teknologi modern dengan menciptakan Aerospace Laboratories Nasional (NAL). Di sisi lain, Indonesia sebagai salah satu pelopor dalam pelaksanaan pertahanan offset masih sangat tergantung pada pengadaan alutsista dari negara lain. Oleh karena itu, penelitian ini bertujuan untuk menganalisis pelaksanaan industri offset di Indonesia dan pentingnya kebijakan pertahanan dalam mengimbangi kebijakan publik di Indonesia. Dengan demikian diharapkan, kajian ini dapat memberikan kontribusi bagi kebijakan publik dalam literatur kebijakan pertahanan di Indonesia. Kajian ini menggunakan pendekatan kualitatif dalam menganalisis industri pertahanan dengan aplikasi yang berhubungan dengan offset di Indonesia. Hasil penelitian menunjukkan bahwa rendahnya daya saing industri pertahanan disebabkan karena rendahnya kualitas sumber daya manusia, kurangnya program penelitian dan pengembangan di bidang industri pertahanan dan kurangnya perlindungan hukum dalam pertahanan offset kebijakan.

Kata kunci: industri pertahanan, pertahanan offset, pertahanan offset kebijakan, offset

INTRODUCTION

Offset mechanism has become one of policy forms in defense industry sector, the objective of which is to protect the domestic economy by anticipating a deficit in the trade balance. The trade balance deficit is caused by the great value of imports in order to meet the needs of weaponry in strengthening the domestic defense. The production of defense equipment in the country allows the reduction of import costs and the weight on the trade balance so as to reduce pressure on the exchange rate and encourage local production. Thus local production can utilize existing resources to produce other goods and services (Markowski and Wylie 2010). This encourages the productivity of material use that contribute negatively to the local defense.

Offset demand in defense industry has been increasing since 1950 (Hall and Markowski, 1994). Up to the present, offset has been adopted by more than 130 countries in the world (Wood 1992). The United States, for example, as a major country whose defense industry in between

1993 and 1997 had accumulated around \$19 billion from offset obligation to support export of \$35 billion (Taylor 2003). While in India, offset policy has come to the stage of collaboration, supported by the mastery of technology through Defense Research and Development Organization (Misra, 2012) and qualified engineers in global level for research and development parameter (Hartley, 2006). India has also owned the facility of modern technology in its defense industry since 1959, i.e. through National Aerospace Laboratories (NAL) (Mani, 2010).

It is different with the offset in Indonesia, where there is no policy integration of the development of defense-equipment industry as seen from the unconcerned policy and high bank interest rate, resulting in low competitiveness of defense-equipment industry in Indonesia (Muna, 2010 and Karya Indonesia, 2011), even though defense offsets in Indonesia has been conducted since the beginning of 1960s and Indonesia has been the pioneer of defense offset implementation (Muradi, 2008). This is due to the fact that Indonesia is still greatly dependent on defense-equipment sources from abroad,

particularly the US (34%), France (12%), Germany (12%), Russia (10%) and the UK (9%); while Indonesian domestic industry is only capable of contributing to 5% of the total defense-equipment owned by TNI (Widjajanto and Keliat, 2006).

So far offset is more affected by the market change of global defense, i.e. the decline of defense budget in the US and Europe, as well as the rapid increase of military expense of developing countries. Many experts predicted that the accumulation of global offset obligation shall reach \$500 billion in 2017, where 60% is provided by the US industry. Offset is appealing for national government and defense companies since it is related to economic interest and the key strategy. In such perspective, a deeper and up to date understanding on the offset trend is required to evaluate future evolution and its thorough implication on international weapon trade (Ungaro, 2013).

The latest study published by two consulting companies, Frost & Sullivan (2013), predicted that the value of military offset obligation demanded by 20 countries shall reach around \$424,570,000,000 in between 2012 and 2021, where Asian Pacific countries such as Indonesia, South Korea and Taiwan show the highest increase.

Offset is a contract that obliges the seller to transfer additional economic benefit to the buyer as a requirement for the selling of goods and services (Taylor, 2003). Apart from the relation of buyer-seller, the variety of offset can be in the form of sub-contract, technology transfer, counter-trade, foreign investment, market aid, trainings, co-production and licensed production. Taylor considered that if offset is designed effectively in the procurement setting, characterized by imperfect competition, the lack of information transfer, and incomplete contract, then it will actually be able to improve the welfare.

International Transparency defines offset as a mechanism of inter-temporal exchange of goods and services, present transactional package, and goods-selling in the future (countertrade) approved by the buyer government and the supplier company during the purchase of military defense-equipment and related services or its subsequent work (Mirus and Yeung 2001, Martin 2007). In the mean while Baranowska-Prokop (2009) defined offset as a range of industrial and commercial compensation practices required as a condition of the purchase of defense goods or services.

The idea of offset emerged in order to make possible partial compensation issued for foreign army and military equipment (Ministers two Gospodarki, 2009). This makes offset not only related to the problems of economy and international resolution, but also to politics, since it is one of the instruments that contributes to economic development. On the other hand, offset mechanism forces the producers to buy parts of national defense-equipment product that can encourage the growth of defense industry.

In its relation to offset policy toward self sufficiency of defense industry, Matthew (2006) divided it into

four stages. First, off-the-self, i.e. conducting import of weaponry system directly. Second, licensed production/co-operation, i.e. when the capacity of defense industry has added its product by licenses. Third, collaborations. Fourth, self sufficiency, i.e. the independence of defense industry.

Based on the concept and offset policy of defense industry, the research aims to analyze the offset policy of defense industry in Indonesia toward the roadmap of defense industry self-sufficiency, by studying and comparing it with the offset policy of defense industry in India, as a country that has successfully reached defense industry self-sufficiency.

RESEARCH METHODS

The research uses qualitative approach, a methodology that involves interpretations to comprehend and explain certain phenomenon (Creswell, 2003). According to Creswell (2003), in qualitative approach "the researcher builds a complex, holistic picture, analyzes words, reports detailed views of informants, and conducts the study in a natural setting". The object of the study in this research is defense offset policy in Indonesia. While the process of data collection was conducted through literary study from the previous researches, focus group discussion (FGD), and existing data statistics (Bryman, 2012).

Literary study was used to find for studies related to the concept of offset policy and defense industry, both from international journals, internet, books and other sources of literature. Further, FGD was conducted with the Ministry of Defense, related to the initiation of Regulation Formulation concerning Defense Offset in the meeting room of Directorate General of Defense Potential's (Ditjen Potthan) Building, in Jakarta by involving stakeholders related to defense industry and offset policy. While the existing data statistics were the secondary data from previous researches or official report from institutions related to the research.

RESULT AND DISCUSSION

The implementation of defense industry requires synergy and integrity of the entire stakeholders of defense industry, i.e. users, defense industry and the government (Bakrie, 2010). Related to the type of budget allocated, the procurement process of defense-equipment of TNI often undergoes constraints in fulfillment timing, for example in the procurement process of border-security communication tools. There is also constraints in Domestic Loans facility where in 2010 it was not disbursed according to the schedule since there was a constraint since the budget from Domestic Loans could not be used for foreign procurement.

In terms of the resource use of foreign loans, the experience hitherto is to use the Export Credit facility

(KE) with long and slow bureaucracy for each process in each node of procurement system. This makes the defense-equipment procurement take a long time, whereas technology is developing rapidly, and the time for absorbing the budget is limited. At this stage, the implementation of MEF (Minimum Essential Force) through the procurement system of defense-equipment encounters a lot of problems, since the existing stages of interests in turn slow down the process of execution, resulting on the inefficiency of operational system. The defense-equipment is getting obsolete, or even dangerous for human safety and the environment (see the Annex of the Minister of Defense of the Republic of Indonesia Regulation Number 19 of 2012).

Related to the use of KE funds that had been considered problematic, in the Annex to the Regulation of the Minister of Defense of the Republic of Indonesia Number 19 of 2012, there are eight recognized problems, namely (1) the blue book allocation determination of foreign loans in each Strategic Plan (Renstra) that is always late; (2) the long foreign loan process (over 36 months), requiring more than 30 steps, thus involving various institutions; (3) the foreign loans are very much dependent on the creditor countries; (4) the negotiation issue of material contract that must be followed by the negotiation of loan; (5) foreign loans are very difficult to get a bank guarantor for military materials; (6) foreign loans are highly influenced by the availability of pure rupiahs as accompanying advances; (7) the disbursement of approval process (asterisk revocation) against accompanying pure rupiah requires a relatively long time; (8) the concept of operations requirements (Opsreq) with the availability of foreign loans are often not balanced.

This indicates the need for improvement of the defense economy in Indonesia (Keliat, 2010). One solution to address the problems of the budget is the application of the defense offset scheme. Offset mechanism will be able to overcome the limitations of budget and will reduce or even eliminate the dependence of the rupiah against the dollar that has hitherto been one through the mechanism of KE facility. The commoditization of money as a result of the payment needs in international sale will also be partly eliminated. This is due to the fact that the parties involved in the transaction can directly evaluate the suitability of goods quantity and the demand.

The experience of offset trade agreements with Russia and South Korea in the defense-equipment purchase actually proves that the commoditization of currency as a logical consequence of foreign purchases did not fully happen. Offset agreement only serves to reduce the negative impact of the use of money as a commodity to be traded. While the role of banks as providers of payment services on behalf of the buyer against the seller was still maintained. Only, the existence of the offset trade agreements can prevent the recurrence of rejection of the

L/C from Indonesian banks as had happened during the monetary crisis of 1998. The function of such payment in international trade is no longer a necessity in the presence of an offset agreement.

The Sukhoi offset agreement for the purchase of Watch tower Missile Destroyer (PKR) 10514 of the Netherlands and several other weapons systems acquisition done through offset schemes, for example, can be very beneficial by the issuance of the Presidential Decree No. 42/2010 to form KKIP as the representative of the government, that is by using the scheme against other transactions bilaterally. Thus, the problems of using KE facility, that puts weight on foreign exchange and reduces factors affecting the fluctuation of the exchange rate in the future, can be measured. What is needed now is that the offset agreements are bilaterally made as common practices in the international sale in Indonesia through G to G.

Defense offsets as part of counter trade is no longer a new thing for Indonesia. Defense offset mechanism for defense-equipment procurement has been going on since the early 1960s, although only seriously done when IPTN, PT. PAL, and PT. PINDAD cooperated with the state armament manufacturers and strategic industry in the mid-1970s, with a variety of weaponry and strategic industry, ranging from light weapons, rockets, helicopters, speed boats, corvettes, up to the aircraft. However, the practice of defense offsets in Indonesia has not been able to meet the needs of defense weaponry integrally, due to a variety of obstacles surrounding the readiness of human resources, the capability of the budget, and the lack of other resources, like the manufacture materials of weapons such as iron and steel and so forth. Mechanisms of defense offsets in defense weapons procurement has been done with three types of offsets that is license purchase, co-production, and co-development.

Defense industry is one of the strategic sectors of the industry whose major characteristic is the presence of high technology and innovation inherent in each stage of the production process. The existence of national defense industry in the defense offset policy, once receiving a greater share of development as well as greater support, will effectively support the stages toward an independent defense industry, capable of competing with similar industries from other countries. The defense offset policy may even evade the dependence on other countries that could potentially weaken the bargaining power of the nation in international forum. Therefore, the defense offset policy becomes a strategic tool for faster mechanisms of transfer or indigenization process of technology (Mathew, Maharani and Fitriany, 2011). On the other hand, a variety of strategies in the procurement system of weaponry product of defense offset industry is also required, among others, through off the self, co-production/licensed production, international development and research, joint production/collaboration and self-sufficiency (Taylor 2003, Mathew 2006).

Table 1. The Data Base of Defense-Equipment Transfer in Indonesia 2004-2009

Indonesia Arms Transfer Database in mill US\$ (SIPRI, 2010)							
	2004	2005	2006	2007	2008	2009	Total
Canada		1		1	2		4
China			12	5	3		20
Czech Repb.					1		1
France	9	14	31	44	21	13	132
Germany	32	7				1	40
Italy				15	4	4	23
Netherlands	7			297	149	149	602
Poland				9		12	21
Russia	27				41	184	252
South Africa							0
South Korea		2		185	7	90	284
Spain		5	5	5			15
Sweden	3						3
USA	4	2	10	16	15		47
Total	82	31	58	577	243	453	1444

Sumber: SIPRI Year Book, 2010

Countries with a minimum defense industry capacity will directly import the weaponry system from countries or foreign supplier companies (off the shelf) (Matthews, 2006). Damn The Torpedoes (2009) states that the off-the-self approach can be seen from the purchase of submarines, corvettes and frigates from Europe during the 1980s. In accordance with the passing administration, the procurement policy of weaponry system was almost entirely off-the-shelf. The off the shelf acquisition data of defense-equipment in Indonesia during the period of 5 years (SIPRI Year Book, 2010) can be seen in Table 1.

CONCLUSION

Defense offset policy can overcome the limitations of the budget, the ability to master the technology, and unproductiveness of the off-the-shelf acquisition of defense-equipment to achieve the self-sufficiency stage of national defense industry to meet MEF target. The package of trade counter, obtained through offset agreements, can be a means to grow lucrative benefits in various sectors of economy, trade(exports) and investment.

The present practice of defense offsets in Indonesia has not been well coordinated and its contribution to the defense industry is very difficult to measure. The low competitiveness of defense industry is due to the still low quality of its human resources, lack of research and development programs in the field of defense industry, and the lack of legal protection in the field of defense offset policy. Thus, a comprehensive and holistic formulation of defense offset policy regulations by accommodating various interests of defense stakeholder is necessary to make the implementation effective. On the other hand, a support from the government is required to schedule the completion of the measured arrangement of offset

policy regulation. For defense stakeholders in Indonesia, the utilization of defense offset policy to build defense industry is vital and selectively encourages the offset. The result of studies on the defense offset policy can contribute significantly to the formulation of defense offset policy regulation in Indonesia.

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