The Brazilian Defense Roadmap: Offsets as a tool to transform the local defense industry environment

Secretariat of Economy and Finance of the Air Force
Ministry of Defense

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SCOPE

To understand how the National Defense Strategy of Brazil alters the focus on the offsets requested by the Brazilian Military.
Roadmap

- The National Defense Strategy of Brazil
- Impacts on Brazilian Defense Industry
- Transfer of Technology and Industrial Cooperation
- Effects of Large Defense Programs
- Changes in Law
What is “offset” for the Brazilians?

“In the past, Brazilian armed forces purchased military hardware as a sort of “barter” – Italian subs traded for coffee before WW II, British jets for cotton afterwards. (…) But armed forces now think on ‘offsets’ as a way to generate employment and to obtain transfer of technology, and not as a simple exchange of primary products.”

Folha de São Paulo 19-11-2007
A Traditional Way of Thinking

“To obtain \textit{reciprocity} from foreign suppliers of goods and services, focusing primarily on civilian and military aerospace activities, aiming equally development and technological modernization of the Brazilian Defense Industry and, \textit{exceptionally}, other areas of interest as deemed convenient by the Government.”

Air Force DCA 360-1
Offset as “Compensation”

All and any direct or indirect compensation practices agreed among the parties, as an opportunity when goods and services are being imported, focused on generating industrial, commercial or technological benefits, in the form of:

Co-production
Licensed production
Subcontracting
Investment

Training
Marketing
Buy-back

Order 764/ MoD, 2002
A Standard Strategy for Commercial, Industrial and Technological Compensation

- “To promote the growth of technology and quality levels of the Brazilian Aerospace Industry, modernizing methods and processes of production and implementing new technologies.”

Air Force DCA 360-1
A Change:

“We have decided to employ the National Defense Strategy as a tool for economical development and technological autonomy.”

Luiz Ignácio Lula da Silva

President of the Federative Republic of Brazil
“Drive to change; this is what the nation requires from its sailors, soldiers and aviators. It is not only a matter of funding and equipping the Armed Forces. It has to do with having the Armed Forces transformed to better defend Brazil.”

END/2008

**CARACTERISTICS**

- Greater involvement of the Brazilian society in defense;
- Recognition of the need to provide a defense structure in sync with Brazil’s political and economical stature;
- Addition of defense issues into the national agenda.
STRUCTURING AXES

REORGANIZATION OF THE ARMED FORCES

REORGANIZATION OF THE NATIONAL INDUSTRY OF DEFENSE

COMPOSITION OF THE TROOPS OF THE ARMED FORCES
(...) "The Plan focuses on middle and long term strategic actions, and aims at modernizing the national defense structure, acting upon three structuring axes: reorganization of the Armed Forces, the restructuring of the Brazilian industry of defense materials, and the troop composition policy for the Armed Forces."  

(...)  

"The restructuring of the Brazilian industry of defense materials is intended to ensure that the equipment needs of the Armed Forces are met and be based on technologies that are domestically mastered."  

(...)  

"inserting defense issues into the national agenda and designing a long term planning for the defense of the country is an unprecedented fact in the Brazilian State. This establishes a new step in the treatment of this relevant theme, intimately linked to national development."  

(...)
(...) 

"Partnerships will be attempted with other countries, aiming at developing technological training and the making of national defense materials to gradually rule out the need to purchase imported services and products. Whenever possible, these partnerships will be built as an expression of a more comprehensive strategic association between Brazil and the partner country. This association will stand out in defense collaboration and development efforts, and it will be ruled by two orders of basic motivation: international and national."

(...) 

"Brazil will always make clear to the foreign parties that it intends to be a partner, and not a client or buyer. The country is far more interested in partnerships to strengthen its independent capacity building, than in purchasing finished products and services. In principle, these partnerships should anticipate that substantial part of research and manufacturing should be done in Brazil, and will gain further importance when they are an expression of comprehensive strategic collaborations."

(...)
“make sure that purchasing follows the guidelines of the National Strategy of Defense and its design over the time.”

“Joint initiatives of Armed Forces research organizations, national education institutions and Brazilian private companies will be encouraged.”

“link the purchasing of foreign defense materials to the substantial transfer of technology, including through partnership arrangements for research and manufacturing in Brazil of part of these products or their substitutes;.”
Legal Basis

• **Constitution of Brazil**
  - **Article 218.** The State shall promote and foster scientific development, research and technological expertise.
  - **Article 219.** The local market is part of the national patrimony and shall be supported so as to improve cultural and socio-economic development, promote welfare of the people and achieve technological autonomy of the country.
Legal Basis

• **Ministry of Defense**
  - Order 764/MD, Policy and Directives for Offsets, 2002.

• **Air Force**
  - Order Nº 1.396/GC4 – Institutes the Air Force Offset Committee, under the AF General Staff, 2005.
  - ICA 360-1 – AF Regulation for Offset Activities, 2005.
Legal Basis

• **Navy**
  - Order n° 59, 18 Feb 2010, Brazilian Navy Offset Guidelines.
  - Order n° 180/EMA, 10 Aug 10, Navy Offset Committee;
  - EMA-420 – Navy Logistics Manual (Chapter 06);
  - SGM-102 – Navy Acquisition Rules (Chapter 14).
  - Players: Offset Committee, Navy General Staff, Navy Departments, General Secretariat of the Navy, EMGEPROM, Navy Secretariat of C&T (SecCTM).
  - SecCTM is responsible for the technical opinion in acquisitions, concerning offsets related to ToT.
  - Focus is on the development of the Defense Industry.
Legal Basis

• Army
  – Order nº 201/EME, Brazilian Army Rules for the Management of Commercial, Industrial and Technological Agreements, 26 Dec 2011.
    – Creates the “System for the Management of Commercial, Industrial and Technological Agreements” (SISGAC)
    – Establishes the Offset Permanent Committee, composed by representatives from the Army Departments and IMBEL.
    – Moves from “best efforts” to mandatory obligations.
<table>
<thead>
<tr>
<th>Comptroller</th>
<th>Ministry of Defense</th>
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</thead>
<tbody>
<tr>
<td>Offset area</td>
<td>Defense</td>
</tr>
<tr>
<td>Threshold</td>
<td>FOB 5 million US$, 12 months</td>
</tr>
<tr>
<td>Minimum obligation</td>
<td>100% commercial contract</td>
</tr>
<tr>
<td>Timeframe</td>
<td>Contract duration</td>
</tr>
<tr>
<td>Source of obligation</td>
<td>Direct commercial sales or subcontracting (indirect supply)</td>
</tr>
<tr>
<td>Multipliers</td>
<td>Empirical, case-by-case basis</td>
</tr>
<tr>
<td>Penalties</td>
<td>Brazilian administrative legislation</td>
</tr>
<tr>
<td>Focus</td>
<td>Defense and aerospace industry sectors</td>
</tr>
<tr>
<td>Direct offsets</td>
<td>Preferential</td>
</tr>
<tr>
<td>Indirect offsets</td>
<td>Acceptable</td>
</tr>
<tr>
<td>Eligible activities</td>
<td>Transfer of technology, investments, co-production, licensed production, marketing support, training, other forms of countertrade.</td>
</tr>
<tr>
<td>Manager</td>
<td>Air Force</td>
</tr>
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<td>---------------------------------------------------------------------------</td>
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<tr>
<td>Liquidated damages</td>
<td>Yes</td>
</tr>
<tr>
<td>Bank guaranties</td>
<td>Usually 5% of the obligation</td>
</tr>
<tr>
<td>Multipliers</td>
<td>1 to 4</td>
</tr>
<tr>
<td>Waiver</td>
<td>Sole-source suppliers, government-to-government international agreements (except under competitive environments)</td>
</tr>
<tr>
<td>Banking</td>
<td>50% of new commercial contracts, 5 years, transferable under the same holding</td>
</tr>
<tr>
<td>Pre-offsets</td>
<td>No, but may be considered in a case-by-case basis</td>
</tr>
<tr>
<td>Swaps</td>
<td>No, but may be considered in a case-by-case basis</td>
</tr>
<tr>
<td>Industrial Participation</td>
<td>Acceptable, but only if joint projects are defined upfront and milestones are established</td>
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<tr>
<td>Penalties</td>
<td>Credit-increase based settlements may be accepted</td>
</tr>
<tr>
<td>MOU</td>
<td>Mandatory, even if the beneficiary is an AF organization</td>
</tr>
</tbody>
</table>
Economical: At least US$ 18.75 billion in exports for the next 20 years

Social: Create and sustain direct and indirect jobs

Technological: Create leading edge technology. New competences in the engineering field.

Political: Better regional integration

Strategical: Global projection. Potential for exports to over 70 countries.
Politics → Power → ST&I of military value
A Change in Thinking...

09/03/2010 - President Luiz Inácio Lula da Silva said last Tuesday (...), that the decision for the fighter acquisition program was still not taken due to its importance to defense capabilities. "FAB (the Air Force) has already made its analysis and have pre-selected three models that are able to fulfill its needs. Now it is time for the government to make the strategical, political and economical analysis so as to decide which proposal will bring greater benefits for the Brazilian Society".
And Rules!

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Brazilian Defense White Book

- Supplementary Law 136, 2009: The Defense White Book is fundamental for the Country and is a key document for Policies, offering Government views in respect to defense. It is public domain and describes a broad spectrum of strategical policies for long term defense planning. It also allows budget and multi-annual planning for defense programs.
# Large Defense Programs

<table>
<thead>
<tr>
<th>Program</th>
<th>Scope</th>
</tr>
</thead>
<tbody>
<tr>
<td>F-X2</td>
<td>Fighter jets</td>
</tr>
<tr>
<td>Sisfron</td>
<td>Border surveillance</td>
</tr>
<tr>
<td>SisGAAz</td>
<td>&quot;Blue&quot;</td>
</tr>
<tr>
<td>PROSUPER</td>
<td>Ships</td>
</tr>
<tr>
<td>M-113</td>
<td>Modernization</td>
</tr>
<tr>
<td>PROSUB</td>
<td>Submarines</td>
</tr>
<tr>
<td>F-5M</td>
<td>Fighter modernization</td>
</tr>
<tr>
<td>KDC-90</td>
<td>Tactical airlifter</td>
</tr>
<tr>
<td>ECO-95</td>
<td>Helicopters</td>
</tr>
<tr>
<td>Mi-17-5</td>
<td>Helicopters</td>
</tr>
<tr>
<td>VBTP-MR</td>
<td>APC Guarani</td>
</tr>
</tbody>
</table>

Sources: MoD, ABIMDE
Government Procurement Regulations

- **LAW 8.666/93 – Art. 3\(^{rd}\)** - The procurement process must (...) promote sustainable national development (...).

- **§11.** RFPs (...) may ask for (...) offset provisions.

- **DECREE Nº 7.546, 2 AUG 2011:**
  - Preference margin for Brazilian Industry;
  - Creates the Comissão Interministerial de Compras Públicas – (Inter-Ministry Commission for Government Acquisitions), which regulates preference margins and evaluates offset proposals;
  - CI-CP is composed by the Ministries of **Finance, Budget and Planning, Development, Industry and Commerce, Science and Technology** and **Foreign Affairs**, eventually other ministries, such as Defense.
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