How Do Offset Policies Affect the International Division of Labour?
The Case of the Defence Industry

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Abstract

Offsets represent a crucial issue in the field of defence industry and trade. Their importance has been constantly growing since the 1970’s, and a large majority of arms importing countries now possesses a formal or informal offset policy. These policies often aim at helping the importer’s defence industry to build relations with the foreign producer of the supplied equipment. In this paper we analyse how offsets can contribute to achieving this objective. Therefore we assume that that the foreign defence equipment producer faces search and switching costs in establishing industrial relations with the importing country’s companies. Economic literature on offsets shows that they can often be trade distorting. However, one of our most striking results is that, under certain conditions, they can improve the international division of labour in the defence industry.

Keywords: Offsets, Defence Trade, International Division of Labour, Search Costs, Switch Costs.