



Korea: Defense Budget and Procurement Procedure of DAPA

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A. Summary

The Republic of Korea (ROK) continues to be a major defense and security ally of the United States in the Pacific region. The country maintains the sixth largest military force in the world. In June 2010, U.S. and the ROK agreed to delay the transition of the wartime operational control (OPCON) until December 2015. This was originally supposed to occur in April 2012.

In 2010, USD 25.7 billion was allocated to Korea's defense budget. This accounted for 14.7 percent of the Korea's total government budget. The ROK sought a seven percent increase in defense spending for 2011. National defense is ROK's top priority as it looks to beef up defense capabilities against potential threats from North Korea. Planned increases were mostly aimed at safeguarding its territory against the North's unconventional provocations such as the March torpedo attack on the ROK Navy vessel and the recent firing of artillery onto South Korean territory.

After the sinking of the navy vessel "Cheonan" near the inter-Korean West Sea border, the ROK government considered an overall change of "Defense Reform 2020" and a full top down review of defense requirements were begun. It is expected that the force improvement plan would focus more on command and control, land systems, maritime patrol/littoral support and armor. In fact, USD 91.6 million is allocated for basic fund for R&D of a submarine launched mobile mine, infrared flares, local air defense radars, and radars for marine patrol vessels. In addition, USD 100.6 million is also allocated for the emergency Cheonan budget allocation among which about USD 26.1 million will be spent for improvement of navy equipment.

After the November 22, 2010 artillery attack on Yeonpyung island (the West Coast of the ROK) by North Korea, President Lee is reviewing the entire 2011 defense budget which is currently being prepared. He has begun by cancelling several projects that were priority items before the Cheonan and the artillery attack. It is expected that there will be a holding pattern as Korea continues to revise what products/systems they may need, given the new threat assessment.

End of Summary

B. Defense Budget Level of Republic of Korea

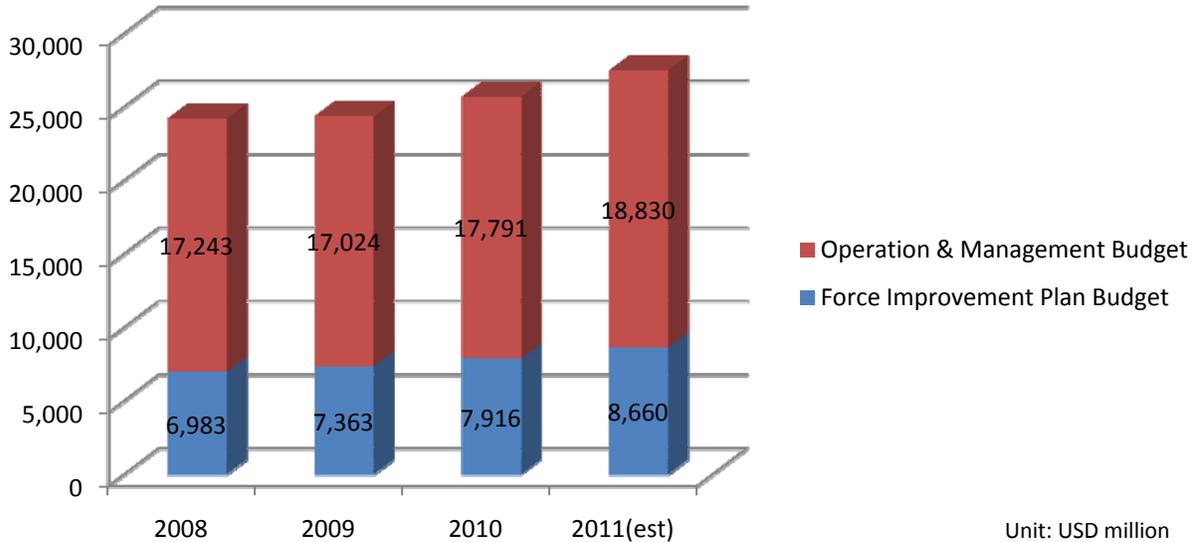
The FY 2010 ROK Defense budget reached USD 25.7 billion which is a 3.6 percent increase from the previous year. On a percentage basis, 69.2 percent for Operation & Management(O&M) and 30.8 percent for Force Improvement Plan(FIP) is allocated under the defense appropriation. All offshore purchases come out of the FIP budget. For FY 2011, the Ministry of National Defense (MND) requested a total of USD 27.5 billion among which USD 8.6 billion will be spent on force improvement. The total proposed budget is a 6.9 percent increase compared to the previous year in which the budget for the FIP was increased 9.4 percent.

- Overview of Defense Budget

(Unit: USD, M= million)

Description \ Year	2008	2009	2010	2011(Est)
Total Defense Budget	24,226 M	24,386 M	25,707 M	27,489 M
Force Improvement Plan (FIP)	6,983M	7,363 M	7,837M	8,660M
Operation & Management (O&M)	17,243M	17,024M	17,791M	18,830M
Exchange Rate	USD1=W1,100	USD1=W1,170	USD1=W1,150	USD1=W1,150

(Source: Monthly Aerospace Magazine: August 2010)



Note: Given the sharp decline in Korean Won/US Dollar exchange rates in 2008/2009, the above table distorts the positive growth.

Primary spending is expected for the below force improvement plan:

Estimated Budget	Type of Force Improvement
US\$10.7 million	Secure of reconnaissance & search equipment, rigid inflatable boats (RIB), thermal observation device (TOD), etc.
USD\$22.7 million	Search & counter submarine capacity improvement
USD\$161.1 million	Acquire capacity for counter regional provocation measure
USD\$2.5 billion	Support and operational capacity enhancement for combat equipment including armor vehicles, vessels and fighter aircraft
USD\$132.6 million	Aircraft Upgrade
USD\$51.3 million	Upgrade of weapon systems including night vision device, night artillery, sentry equipment.

C. Procurement System in ROK's Defense Industry

The ROK's defense procurement agency, Defense Acquisition Program Administration (DAPA) is a sole government agency in conducting and executing the procurement of defense equipment. Established in 2006, DAPA is the primary government agency conducting ROK's defense procurement. Commercial sales in the defense industry account for 65 percent of government procurement.

In July 2010, DAPA selected 7 tasks for its ACTD (Advanced Concept Technology Demonstration) that included multi-purpose artillery operation systems, nano explosive technology, vessel propellers for automatic cavitation speed control, mine resistant ambush protected systems, laser explosive disposal devices, unmanned submarines and multi-purpose small missiles. A total of USD 11 million will be spent for the development of initial technology within the ACTD program.

Procurement Plan of DAPA in 2011

DAPA began its new procurement plan for 2011. The plan shows the direction of defense spending. Many of the projects will be executed through local R&D. However, U.S. suppliers will have the opportunity of working with local manufacturers who will be the primary developers.

(Unit: USD, M= million)

	Budget	Remarks
KF-X(Korean Fighter Development)	13.0 M	Develop locally
FA-50 Mass production	8.7 M	Local Development with U.S. technology cooperation
KF-16 (BLK52) Upgrade Program	8.4 M	Develop locally with foreign technology cooperation
Next Generation Armored Vehicle Wrecker	7.1 M	Local Technology
GPS Guide Kit for Mid-Range Missiles)	6.5 M	ADD (Agency for Defense Development is primary developer for which foreign technology cooperation is required)
KAH (Korean Attack Helicopter)	5.6 M	Korea Aerospace Industries is the primary contractor
Next Generation electronic warfare system	5.6 M	Develop locally by LIG Nex1 by ADD guidance
Small unit tactical simulators for K series armored vehicle	3.9 M	Develop locally
Corp.-level UAV system reconnaissance purpose crops UAV System Development	3.3 M	Develop locally
Next Generation Mil/Sat (Military Satellite) Communication System	3.1 M	Develop locally
FFX Program (Ulsan class Batch II)	2.7 M	Shipbuilding will be made by local shipbuilder.
(FFX) BATCH-2		Foreign systems are required for mounted systems
Next Generation Anti-Artillery	2.5 M	Develop locally. Foreign radar systems will be required
NBCRS(Nuclear, Biological, and Chemical Reconnaissance System)	2.5 M	Domestic product is available
Fixed Long Range Radar	2.3 M	Potential opportunities for foreign suppliers depends on type of technology acquisition

SLMM (Submarine Launch Mobile Mine) Program	2.2 M	Develop locally with ADD guidance
Next Generation TOD (Thermal Observation Device)	2.1 M	Develop locally by Samsung Thales
AO-X Program (Next Generation Logistic Support Vessel)	2.1 M	Develop locally
Korean CMW(Combat Mobile Vehicle)	1.9 M	Develop locally
MIMS-C	1.7 M	Develop locally
Detailed Search and Rescue Devices	1.4 M	Procurement will be made through FMS for integrated systems for helicopters
Local Air Defense (Capfiller) Radars (Next Generation Limited region Aircraft Warning Radars)	0.4 M	Develop locally
Others	0.02 M	
Total	91.3 M	

Procurement Volume by DAPA

U.S. companies maintain primary supplier position in Korea while position of major supplier of Germany and Israel is changing. U.S. provided weapon systems to R.O.K. totaling USD 3,013 million and USD 1,151 million in 2008 and 2009 respectively. In 2009, many contracts of US companies with DAPA have been made through foreign military sales (FMS).

Commercial sales in defense industry account for 65 percent of DAPA procurement. However, the Ministry of Defense encourages more government-to-government foreign military acquisition programs because it will reduce unit cost of arms deals. Large portion of Korea's export of defense products is beneficiary to Korea's defense offset program.

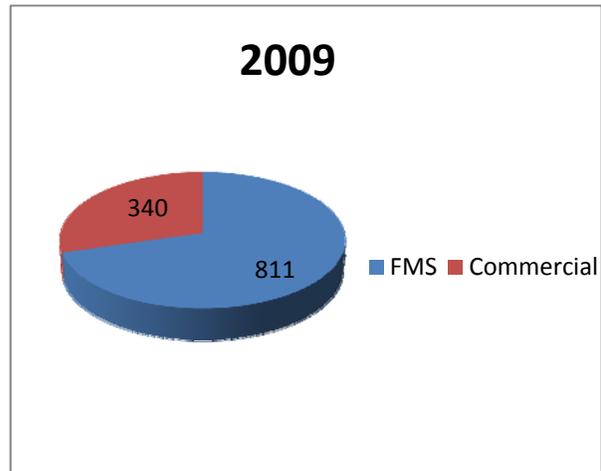
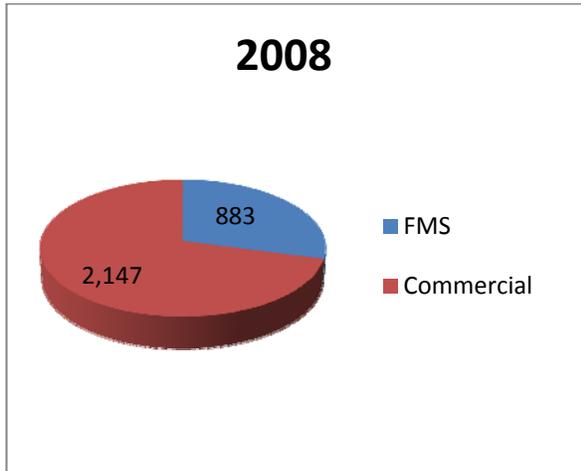
The table below shows the contract value that has been conducted by the DAPA for the last two years:

(Unit: USD, M = million)

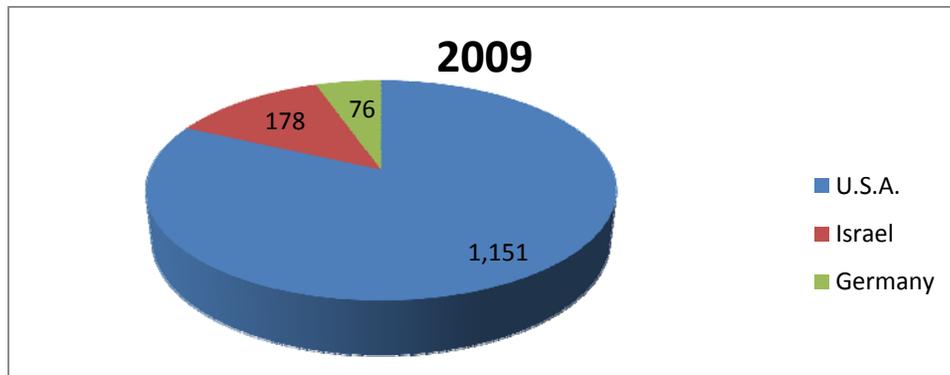
		2008	2009
Total Contract Amount		6,223.6M	1,682.2M
U.S.A.	FMS	883.3M	810.9M
	Commercial	2,147.8M	340.0M
Contract Value By Countries		Top 3 Countries in 2008	Top 3 Countries in 2009
		USA - 3,013.1M	U.S.A. – 1,150.9M
		Germany -334.9M	Israel – 178.3M
		116.5 M (Indonesia)	Germany – 76.4M

Export	1,031.4M	1.165.9M
Export to U.S.A.	333.1M	398.0M
Exchange Rate	USD1=W1,100	USD1=W1,170

(Source: International Defense Cooperation Division, DAPA)



Type of procurement



Three Leading Foreign Supplier Countries in 2009

Procurement Procedure of DAPA

The Ministry of Defense encourages more government-to-government foreign military acquisition programs. It is not mandatory to have a local consultant/agent to participate in defense projects in Korea. Companies that would like to supply their products/systems to DAPA are required to register with DAPA. It takes about 10 days to process DAPA registration. Required documents include application for registration, pledge for security (should be notarized), and company's business registration. Soft copy is available at www.d2b.go.kr. Foreign companies may submit above documents via fax through 82-2-2079-6129.

D. Defense Plan & Support on Defense Industry

The ROK military unveiled plans to acquire precision missiles and advanced mobile artillery in order to position radars and systems after the North Korean artillery attack on November 23. In addition, President Lee called for procuring the world's most advanced defense systems to thwart the North's aggressions.

The Joint chiefs of Staff (JCS) and DAPA requested an additional USD 229 million from the National Assembly. About USD 32.3 million would be spent to upgrade AN/TPQ-36/37 Firefinder radars that was introduced in the 1990s. Also, the ROK Army requested a budget for purchasing hostile artillery locating (HALO) systems while DAPA asked the National Assembly to allocate USD 48.7 million to buy GPS-guided Spike missiles in a bid to destroy North Korean artillery hidden in caves and tunnels.

A massive overhaul of the state-led defense industry was proposed in October by presidential advisors' in order to reshape the country's domestic market-oriented industry into a new source of exports. The blueprint for the reforms mainly aimed at curtailing the role of the state-run Agency for Defense Development (ADD) while boosting the participation of civilian sectors. The reforms will enable the defense industry to turn into a new growth engine for the future. The blueprint was aimed at making Korea the world's seventh largest defense exporter by 2020 with USD 10 billion in sales by 2020, with defense exports reaching USD4 billion each year. Korea's defense industry production stood at USD 6.5 billion in 2008, while defense exports amounted to USD 253 million. In contrast to the local trend led by the merger and acquisition of defense giants, 91 local companies focused on competing in the USD 6.3 billion-domestic market while the USD 253 million in arms exports during 2008 comprised only 0.5 percent of the global market.

To achieve its goals, Korea needs to diversify its defense export markets by expanding trade with Africa and Asia. The exports will be not only selling finished products but also components and services. So far, ADD led research and defense companies primarily focused on manufacturing activity for the domestic market and not local production for export. In addition, Korea's defense products became unattractive in overseas markets due to their high price. President Lee identified defense technology as one of the stimulus sectors to help ROK come out of the recent recession that the Korean defense industry experienced.

F. Market Access & Obstacles

DAPA conducts formal negotiations on price, technology transfer, local work share, and offset packages, which are required by the Korean government for all projects in excess of USD10 million. Contractors should mind that DAPA is the only agency that is authorized to negotiate on behalf of MND for defense products and services, as well as being the only agency that can authorize offset credits, dictate terms and conditions, or make changes to delivery schedules or required deliverables. As price is an important element in the final decision-making process, separate cost analysis will be conducted on candidate weapon systems by DAPA.

Import duties are generally waived for official defense purchases. Commercial tax rates apply to commercial purchases in the defense sector. All items that are to be left in Korea must be declared with Korean Customs. All goods for commercial use and any prohibited goods must be declared. Goods imported for exhibition may be entered under bond, deposit, and/or Carnet. There are no market entrance barriers to the Korean defense market. U.S. standards are generally accepted in Korea. Most defense systems in Korea are based on American standards.

Defense Offset Program:

Korea's defense "Offset Program" is designed to acquire state-of the art technology and exporting

components and parts of the requirement. DAPA will prepare and implement the offset program when the estimated main contract amount exceeds USD10 million and integrates the requirements from each service. DAPA shall negotiate and sign the "Offset Contract" based on the "Estimated Main Contract Amount".

Offset rate: First, there are two types of DAPA contracts which is subject to the offset deal. The rate of applying the offset deal will be more than 50 percent of the main contract amount, when the main contract is carried out by DAPA through multiple bidders. The applying rate of offset deal is more than 30 percent of the main contract amount when the main contract is carried out by DAPA through sole source procedures.

The offset is classified by "Direct Offset and Indirect Offset"

- a. Direct Offset – Direct Offset means the technology transfer and the export of parts to be produced, which are directly related to the military equipment or materials procured from the contractor.
- b. Indirect Offset – Indirect Offset refers to the transfer of technology or the export of parts which are not directly related to the acquired military equipment or materials procured from a contractor.

Restriction on Utilizing Commission Agents/Defense Consultants

On 23 April 2010, DAPA announced the establishment of guidelines on the utilization of commission agents. Its news release states, the purpose is to address public concerns and needs regarding defense acquisition and to perform foreign purchases in a more transparent and effective manner.

The new policy requires DAPA to enter into contract directly with foreign prime contractors without the intervention of a commission agent for major acquisition programs exceeding USD \$2 million. The policy applies only to Force Improvement Programs (FIP), which include purchases, development, upgrades, and associated installations. Smaller value FIP projects and sustainment projects are not affected. To confirm no involvement of an intermediary, a DAPA form called "Confirmation of Direct Transaction" needs to be signed by the manufacturer.

If an agent should be utilized (for those programs exceeding the program value of \$2M), the contract between the manufacturer and its agent, which includes information on the commission fee, is required to be provided to DAPA. The submission of the contract agreed between them will play a role as an evaluation element for source selection. Also, the scope of their work is limited to the following: (1) acquiring information pertaining to purchases; (2) keeping contact with foreign company; (3) performing work related to supply discrepancy and post-delivery compensation; and (4) acquiring estimates.

Local Agent/Representative: Defense equipment is marketed in Korea through FMS and DCS sales channels. Please note that although it is not mandatory to use consultants to apply for tenders, U.S. manufacturers and suppliers of defense equipment generally utilize a well-qualified agent in Korea who is familiar with the Korean defense systems, current status of Korean defense industry and who knows key decision members of Korean Army, Navy and Air Force (ROKA, ROKN and ROKAF), DAPA and ADD. In many cases, agent/manufacturer representative personnel in the defense industry have prior military experience. Local agents should register and be certified by DAPA to supply products and services to the MND.

G. Trade Promotion

As the Defense Acquisition Program Agency (DAPA) will conduct the formal contracting, the show and tell program to this organization is also essential.

Presentation at DAPA is one of the best marketing tools to introduce new product/systems/services to potential customers. DAPA provides this opportunity every two or three months announcing this plan in on its web site. Interested party may contact the responsible division directly to confirm the future schedule:

Acquisition Policy Division, Acquisition Plan Bureau
Defense Acquisition Program Administration (DAPA)
2-15 Yongsandong 2 ga, Yongsan-gu
Seoul 140-833, ROK
<http://www.dapa.go.kr>

- Upcoming Trade Shows

U.S. companies may wish to participate in local trade shows to promote their technology and equipment in Korea. Post recommends that U.S. suppliers consider the following shows as potential promotional vehicles in Korea.

Seoul International Aerospace & Defense Exhibition 2011 (Seoul Air Show 2011)
Date: October 18-23, 2011
Venue: Seoul Airport
Organizer: Korea Aerospace Industry Association (KAIA)
11th Flr., 923-5, Mok-dong, Yangchun-gu, Yungdeungpo-gu
Seoul 158-715, ROK
Tel: 82-2-761-1542, Fax: 82-2-761-1544
E-mail: kscho@seoulairshow.com, www.seoulairshow.com

H. Reference & Contacts

-Government, Associations and Research Organizations:

Agency for Defense Development (ADD)
111 Soonam-dong, Yousung-gu,
Daejeon, Chungnam, ROK

Korea Defense Industry Association (KDIA)
13th Flr., Sungwoo bldg., 51-1, Dohwa 2-dong, Mapo-gu
Seoul 121-715, ROK
<http://www.kdia.or.kr>

R&D Center, Defense Agency for Technology and Quality (DTAQ)
2-15 Yongsan-dong 2-ga, Yongsan-gu,
Seoul 140-833 Korea
www.dtaq.re.kr

For More Information

The U.S. Commercial Service in Seoul, Korea, can be contacted via e-mail at: myoung.soo.lah@trade.gov,
Phone: 82-2-397-4516; Fax: 82-2-739-1628 or visit our website: www.buyusa.gov/Korea.

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