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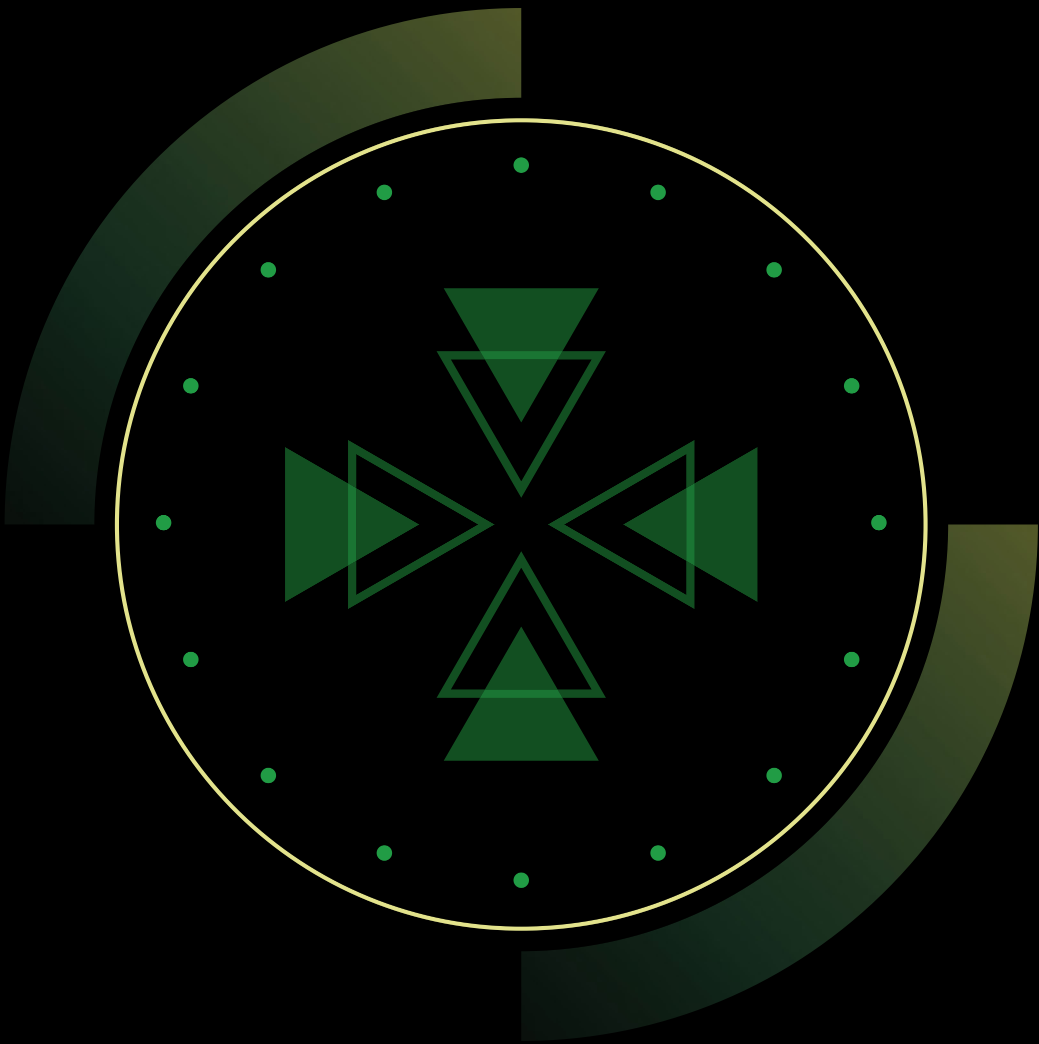

GCC - Creation of a localized defense industry: A new path to the future

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Abstract

Many Gulf Cooperation Council (GCC) countries are striving for the same ambition, to localize defense industrial spending and as a result boost their economies, reduce their reliance on foreign imports and attract and develop the intellectual capital needed to allow them to compete on the global stage. This white paper aims to explore Deloitte's point of view and discuss the competing challenges that countries in the region are facing as they strive to achieve these ambitions.

Aspiration

Many countries within the GCC hold an aspiration to establish or expand their local defense industry, transitioning their considerable defense budgets away from funding imports from large defense contractors in the West, China, Russia and South Korea to supporting the growth of domestic economies, reducing the risk of changes in international government policy by designing, manufacturing and supporting locally produced military equipment.

Drivers

The factors that underpin the aspiration can be considered from a range of Political, Economic, Social, Technological and Legal viewpoints.

The reliance of imports from overseas manufacturers either directly or through Foreign Government Sales (FGS) often comes at a political price. In addition to the restrictions that can be imposed by foreign governments in relation to the use of equipment or the functionality of equipment, changing political posture and policy can introduce risk in relation to maintaining ongoing supply or support. Moving away from this reliance on external partners, eliminates the risk in the supply chain and provides the freedom for a country to develop and maintain its own military equipment without constraint.

While oil reserves in the region are among the largest in the world with doubtless more to be discovered, natural resources will not last forever, resulting

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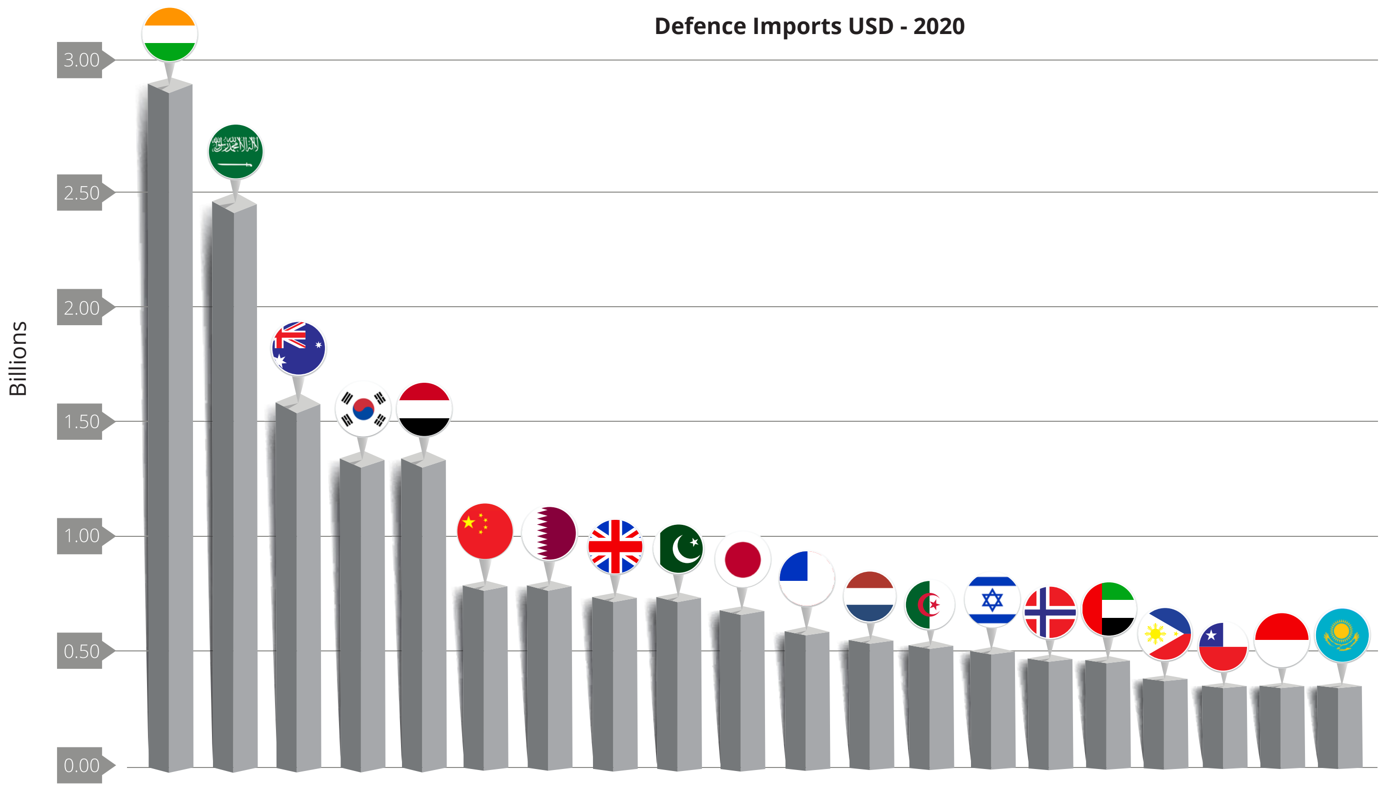
in economic diversification being a key strategy across the GCC. With such large military equipment budgets and a historic propensity to import equipment for from overseas, military industrial development is an obvious and meaningful opportunity to help diversify the economy. In 2020 alone, 5 countries in the Middle East appeared in the top 20 of military equipment importers with gross imports of c$5.5bn. Switching from a preference to import to a preference to buy locally will



not only generate direct local spending, but based upon world bank indices, will generate a macro-economic impact of c4x-5x meaning that shifting US $10bn of purchasing to local suppliers will have an overall economic benefit of US $40bn - US $50bn.

In addition to the economic impact of localization, exports also represent an exciting opportunity both within the region and further afield.

Currently the GCC countries rely heavily on imported labor, but with a highly educated young workforce, advanced university systems and a military industry which needs to be built around an extensive research and development base, a localized defense industry introduces new and exciting opportunities for engineers, designers and business people alike.

The dependance on imports with “black box” technology means that GCC countries do not hold the Intellectual Property (IP) restricting their ability to develop and exploit knowledge and knowhow for new and adjacent opportunities. Locally designed and developed equipment would alleviate this constraint and serve as a catalyst for advancement in military and dual-use industry sectors.

Possible approach to create a localized defense industry

Overview

With localization of military industrial activity being a common goal across the region, countries could collaborate to maximize the opportunity. Creating increased competition in the global defense market by introducing new entrants from multiple GCC countries would seem somewhat counterproductive, instead, it is suggested that a regional approach could be adopted with different countries focusing on building the capability for the region as a whole and leading on exports. This approach could lead to, for instance, the UAE taking a regional lead on maritime equipment due to its strategically important coastline and possibly Saudi Arabia focusing on air capability due to its expansive landmass, GCC countries could then work together to ensure that the already limited regional ‘talent’ can be concentrated to design, develop and manufacture world leading capability in chosen areas.

Signs of such cooperation are already emerging, for instance with the UAE’s NIMR, part of the EDGE group announcing plans in February 2021 to establish a manufacturing facility in Saudi Arabia which will exploit the UAE’s investment in the design and development of military fighting vehicles and at the same time utilizing the relatively large domestic workforce in Saudi Arabia to manufacture and maintain equipment for requirements in the UAE and Saudi.

In conjunction with this potential approach to cross-regional cooperation, there is also a need it makes sense to consider the localization opportunity both top down and bottom up. From a top down perspective, the region could look to identify the key capability areas in which it wants to dominate and either look to build new products or participate in international

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initiatives such as the UK led 'Future Combat Air System (FCAS)' program which is looking to develop the next generation system of systems to achieve superiority in the air. Developing such capabilities which are critical to the security requirements of many GCC countries will require the world's brightest minds and investment typically beyond the financial appetite of any one country. For this reason, multi-nation government backed consortia could be established, fueling access to the skills and investment needed for success. GCC countries have historically shielded away from direct involvement in such initiatives, opting to buy the 'finished product' such as was the case with the typhoon or F35 fighter aircraft. GCC countries should look to embrace these initiatives in the future as they not only provide the ability to influence the design and development of new systems but they also further localization, with the member countries securing largescale manufacturing contracts on behalf of the entire consortium.

This top down approach should be teamed with a bottom up 'tactical' localization initiative designed to simply take the systems, sub-systems, assemblies or components which represent the significant demand and look to localize their manufacture and support. Relatively speaking this tactical approach is easy to deliver by understanding the forward demand, considering the nascent capability in a country and supporting companies to build the necessary capacity and competency to satisfy local requirements.

In identifying the demand and establishing the supply, it is important to ensure that strategic 'fit' is also considered. There is no strategic value investing in building industrial capability in areas which do not align to the strategic ambition of the nation, for instance there is little strategic advantage investing in manufacturing capacity for tires when the nation wants to be respected for its high tech industrial sector. For this reason, each opportunity should be considered for its 'desirability', i.e. how well it aligns to the strategic ambition and its 'feasibility', i.e. how easy it is to create the required industrial capability to meet the demand. When desirability and feasibility are considered in conjunction with the scale of the opportunity, it is possible to prioritize initiatives which best contribute to the overall ambition.

In order to deliver on the localization opportunities, the industry typically needs to be incentivized to invest, mainly using financial incentives such as grants, loans or tax incentives or through non-financial incentives such as demand guarantees. Embarking on delivering these localization opportunities requires a formal program with effective governance and dedicated leadership meaning that organizations such as Saudi's General Authority for Military Industries (GAMI), Qatar's Barzan Holdings and the UAE's Tawazun are critical as the focal point for defining, designing, leading and governing the collection of initiatives that will together deliver the countries' localization ambitions.

Reference

1. Sourced from Knoema

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Contacts

Robin Tullett
Partner, Consulting,
Deloitte Middle East
rotullett@deloitte.com

Sameer Asghar
Partner, Consulting,
Deloitte Middle East
samasghar@deloitte.com

Stuart Russell
Senior Manager, Consulting,
Deloitte Middle East
srussell@deloitte.co.uk