BUSINESS RECORDER
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4th July, 2019

Industry-defence nexus

A country's defence preparedness demands self-reliance to the extent possible. This, in turn, requires a strong manufacturing base. Import of critical parts and components becomes uncertain during times of war, leaving you with the expensive and inefficient option of stockpiling if you fail to groom local industry.

There is strong evidence from around the world that the armed forces have taken the lead in developing indigenous manufacturing capability, especially in high-tech areas. US, Russia, China, France, Italy - and of late India - have been the trend-setters.

Procurement, or 'sourcing', is not the only tool in the kit to support local manufacturing. With the high obsolescence factor in armaments business many Defence Ministries invest in the R&D efforts of domestic firms in order to stay ahead of the curve.

In Pakistan the linkage between Defence requirements and domestic supply sources remains weak. Instead of developing private sector capabilities military has preferred to do it 'in-house'. Wah and Kamra typify armed forces trying to do it on their own, largely to the exclusion of local private firms.

Perhaps the military's thinking is driven by considerations of secrecy - no military wants information of its capabilities to be 'open source' - and greater control to ensure reliability of supplies. These are legitimate concerns but the experience of many countries demonstrates that associating the private sector does not necessarily compromise security concerns.

There are natural limits to 'in-house' capacity growth. You essentially have yourself as the customer; you restrict multi-purpose machines to single usage; you do not have a sufficiently large production base to absorb all the overheads; and you are not as nimble-footed as the private sector in raising and deploying finances.

Besides inherent cost efficiencies, an encouraged private sector has the potential to provide the kind of externalities and synergies that strengthen defence capabilities. A smart military-industrial-base policy would need to foster 'linkages effect' and 'technological diffusion'; both best achieved via the Private Sector.

Private sector by definition is more cost-efficient. It also has the advantage of a varied customer base that allows it to invest in multi-purpose machines and equipment. Further, as the world experience shows, it is more adept at acquiring and leveraging technology.

Most countries employ the 'offset' clause of defence contracts to give a leg up to local industry. These offsets require foreign suppliers to spend a specified percentage (typically it ranges from a low of 30% to as high as 120%) of contract value in purchasing country.

Offsets come in many forms. The most common ones are co-production, FDI, transfer of technology, and setting up export assistance and marketing companies. In its simplest form it requires a kind of counter-trade - buying something from the purchasing country.

The free trade puritans look upon offsets as a form of protectionism; harmful transgressions of free market rules. Indeed, the US prohibits government agencies to participate in offsets but private firms are free to enter into such arrangements. It so happens that the major defence suppliers, like General Dynamics and Lockheed Martin, are private!

Proponents like to market the offsetting concept in terms of a partnership that goes beyond the transactional seller/buyer relationship. They are also quick to remind that US's Buy American Act has the offsetting concept writ all over it.

To put it into perspective, India's recent almost $ 9 billion Rafale deal (controversial for other reasons) has a 50% offset clause, requiring the four principal suppliers led by Dassault to collaborate with Indian companies for military aerospace R&D and making Rafale components in India.

While the Dassault Reliance Aerospace joint venture has drawn the most attention there are several Indian companies who will benefit from the deal. The policy intent is to augment R&D and design capacity of Indian enterprises, leading to their becoming internationally competitive in high-tech areas like stealth, radar, and thrust vectoring for missile technology.

In major contracts our military too seeks some offsetting arrangements, but these are largely restricted to local assembly and development - and at military's own facilities. There is little genuine transfer of technology and the role of private sector is only peripheral.

It is an opportunity lost. We weaken our national research and design capability, needed as much for military applications as non-military, by denying to our engineering industry sophisticated technology that can be acquired through defence contracts. Country's manufacturing base is the poorer for it.

Private sector, with the potential to meet the requirements of multiple customers at home and abroad, clearly is better placed to boost the linkages effect and catalyse the synergistic sectors.

The highest policy levels tirelessly pontificate that the country's future is in engineering. We are reminded time and again that engineering goods constitute more than 60% of world trade, as against only 6% for textiles and apparel. Unfortunately, the pontification is not backed by any policies to incentivize the development of the engineering goods industry.

Engineering industry needs not just the benevolence of military's offset arrangements, although it will be a good starting point, but a wider commitment to the cause by the government. It needs a robust engineering development policy. Call it engineering-specific industrial policy if you wish.

With all its flaws auto policy has provided a developmental framework for the engineering industry. Auto parts are evolving from basic to precision engineering. Auto policy has helped lay the foundations of engineering industry that can now be built upon for the development of a viable military industrial base.

The essential ingredients of a defence-oriented industrial policy are sustained demand to provide economies of scale, acquisition and continuous upgrading of technology, managerial excellence that secures productivity enhancement and competitiveness, and development finance/working capital at rates comparable with foreign competition.

A smart policy can encapsulate all these essentials, with the military playing a critical role in promotion of tech-heavy joint ventures. The ultimate goal has to be to equip local industry to compete strongly in the global markets. There is a huge export potential out there!

The proposed industrial policy will have to make a distinction between muscle-building steroids and habit forming drugs. It will be necessary to provide local industry adequate tariff protection and some subsidies (to countervail the energy, infrastructure, and interest rate cost penalties) - but only for some time and on a diminishing scale.

It is time to build a defence-industry nexus. Will the Military take the lead?

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