

Regional Defence Economic Outlook 2021

The Middle East and North Africa

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This memo complements Defence Economic Outlook 2020 (DEO 2020), which assessed the global power balance focusing on the major world powers, with a regional outlook on the Middle East and North Africa. The memo aims to provide a regional perspective not contained within DEO 2020. Similar to DEO 2020, the regional power balance in this memo is described in terms of military expenditure and macroeconomic trends during the period 2010-2019, focusing on the five largest military spenders. Furthermore, the memo provides a description of the defence industrial capabilities of these countries, as well as the regional security environment.

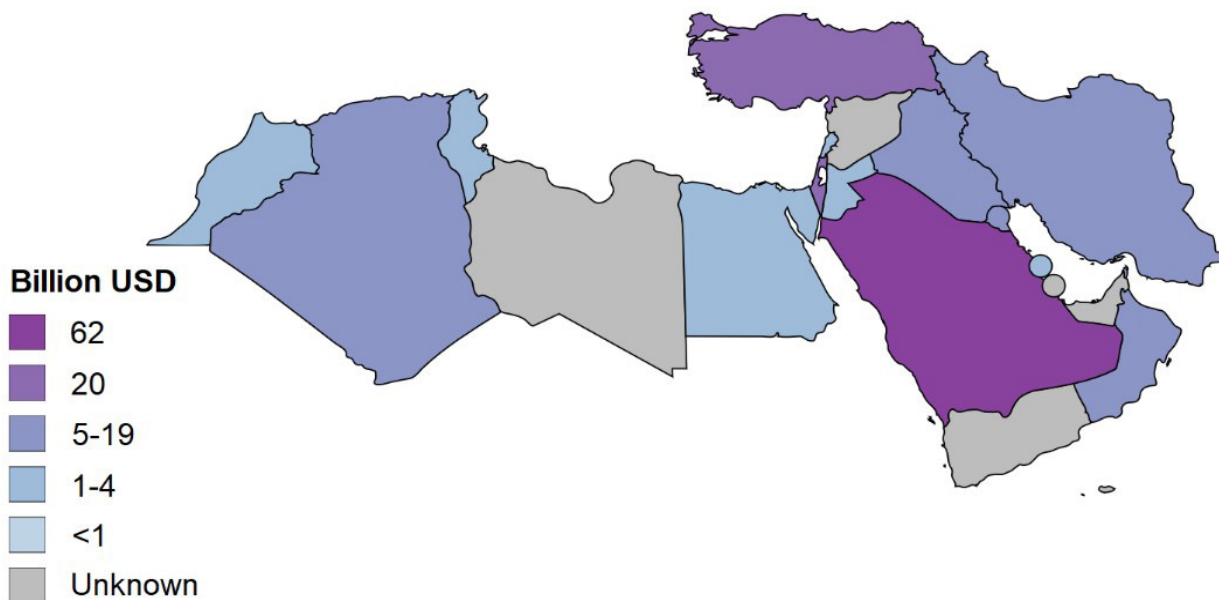


Figure 1: MENA military expenditure, 2019, current prices. Source: SIPRI (2020).

MILITARY EXPENDITURE

The Middle East and North Africa (MENA) region has on average increased its military spending during the past decade, slightly increasing its global share from 7.3 percent in 2010 to 8.7 percent in 2019. Saudi Arabia is the largest spender in the region, accounting for USD 61.9 billion in 2019, over a third of total regional spending, see Table 1. Israel spent USD 20.5 billion or about one eighth of the regional total in 2019 and has increased its spending during the last decade. However, this expansion has slowed in recent years.

Turkey spent USD 20.4 billion, also one-eighth of the regional total, having increased its military expenditure steadily between 2010 and 2019. Iran spent USD 12.6 billion in 2019, which is significantly less than in 2010. Meanwhile, Algeria was the largest military spender in North Africa with USD 10.3 billion in 2019, having increased its spending notably since 2010. However, the pace of expansion has decreased in later years. Due to a lack of data, Qatar, Syria, the United Arab Emirates (UAE) and Yemen have been excluded from the SIPRI Military

Table 1: Top 5 military spenders in the MENA, 2019. Source: SIPRI (2020).

Country	Billion USD (current prices)	Share of region (%)	Share of GDP (%)	Average change 2010-19 (%)	Average change 2017-19 (%)
Saudi Arabia	61.9	38.1	8.0	N/A	-6.4
Israel	20.5	12.6	5.3	+3.0	+0.9
Turkey	20.4	12.6	2.7	+7.4	+16.4
Iran	12.6	7.8	2.3	-3.9	-19.1
Algeria	10.3	6.4	6.0	+8.3	+1.9

Expenditure Database since 2015. For this reason, these countries are not taken into account among the top 5 military spenders, even though especially the UAE is very likely to qualify to the list.

REGIONAL SECURITY

The MENA remains a volatile region, characterised by both rivalries between states and within states, as well as threats posed by non-state actors. By late 2017, international coalition forces had largely managed to dismantle ISIS, preventing it from establishing a de facto state across Iraq and Syria. The death of ISIS leader Abu Bakr al-Baghdadi, during a raid led by US Special Forces in October 2019, was a further setback which led to a change in the terrorist organisation's leadership. However, ISIS is still thought to possess significant resources in financial and personnel terms despite the loss of territory, and has continued to carry out attacks during 2019 and 2020. Various self-proclaimed adherents to ISIS have also managed to expand in North Africa, as well as in the western Sahel region in West Africa.

The Syrian civil war, which started in 2011, is currently in its tenth year. Russian and Iranian intervention has been key in propping up President al-Assad's regime, enabling him to stay in power. However, large parts of Syria's territory are still contested between the Syrian government and various non-state actors. Furthermore, Turkey has been involved in Syria since 2016, intensified by the 2019 military intervention in the northern part of the country against Kurdish forces which had until then been part of the US-backed Syrian oppositional forces. This was met with harsh reactions from several European countries and did not ease the already strained relationship between Turkey and its NATO allies.

Saudi Arabia and Iran are locked in historical mutual mistrust and are engaged in several conflicts by proxies, including the aforementioned Syrian civil war. Saudi Arabia has since 2015 led a military intervention into Yemen targeting the Iranian-backed Houthis. The Saudi-led coalition includes other regional powers such as the UAE, and is backed by the US and several European countries. The conflict, which has led to a severe humanitarian crisis, is

now in its seventh year. The Saudi-Iranian rivalry is likely to continue being among the key factors in shaping regional security given that the two countries are involved in most of the wars and conflicts in the Middle East.

Another key factor concerning regional security developments is the intra-Sunni conflict, with Saudi Arabia, the UAE, Egypt and Bahrain pitched against Qatar and Turkey. The conflict stems from discord between the two sides during the past decade, where Saudi Arabia and its allies accuse Qatar and Turkey of supporting the Muslim Brotherhood and other militant Islamist organisations in the region. Qatari foreign policy, especially the country's relations with Turkey and Iran, is also a major source of concern for Saudi Arabia, the UAE, Egypt and Bahrain. Qatar has developed closer ties with Iran since the intra-Sunni conflict started, e.g. through increased Qatari-Iranian economic cooperation during the blockade imposed upon Qatar by Saudi Arabia and its allies. The intra-Sunni conflict has been reflected in various regional conflicts, such as the Libyan civil war, where the respective factions have often ended up supporting opposite sides. In January 2021, the Gulf Cooperation Council (GCC) member states, including Qatar, Saudi Arabia, the UAE, Bahrain, Kuwait and Oman, signed a declaration with the purpose of restoring ties, previously severed in 2017, between Qatar and its neighbours plus Egypt. However, unsolved issues still risk reigniting the conflict.

Israel also has an antagonistic relationship with Iran, whose nuclear program Israeli representatives, such as Prime Minister Benjamin Netanyahu, have referred to as an 'existential threat' to Israel. Israel shares Saudi Arabia's fear of an Iranian land corridor to Lebanon through Iraq and Syria, and wants to prevent Iran from establishing permanent military bases or arms factories in Syria and the delivery of weapons systems to Hezbollah in Lebanon. These concerns have prompted Israel to carry out frequent air strikes in Syria targeting Iran's installations or deliveries of weapons to Hezbollah. Israel is also committed to oppose Iranian forces in Syria from getting close to its border. An additional source of conflict is the Iranian support to the Islamist terrorist organisation Hamas in Gaza. A recent development related to Israel are the so called Abraham

Accords, a term which refers to normalisation agreements between Israel and various Muslim countries in the region, including the UAE, Bahrain, Morocco and Sudan. The agreements were reached in late 2020, with the US and the Trump administration serving as intermediary.

In 2018, the US decided to withdraw from the Joint Comprehensive Plan of Action (JCPOA), also known as the Iran nuclear deal, struck in 2015 between the Islamic Republic and the so called P5+1 powers. Following US re-imposed sanctions on Iran and measures to hinder Iranian oil exports, Iran has gradually weakened its commitment to the nuclear deal. Tensions in the Persian Gulf have been increasing during the past few years. In September 2019, the Houthis in Yemen claimed responsibility for drone attacks against Saudi Arabian oil infrastructure. However, the US and Saudi Arabia accused Iran of being the ultimate perpetrator behind the attacks. The antagonistic relationship between the US and Iran reached a new boiling point when Iranian Revolutionary Guards Corp commander Qasem Soleimani was assassinated by a US drone strike in early January 2020. The Iranian reaction included a missile attack against Iraqi military bases hosting U.S. forces. Furthermore, Iran decided to abandon its nuclear deal commitments, by ignoring the limits on uranium enrichment. The Biden administration has renewed diplomatic efforts towards Iran, possibly including a return to the JCPOA agreement.

The direct US presence in the Middle East has decreased since the withdrawal from Iraq in 2011. It is worth noting that US dependency on petroleum and oil imports from Persian Gulf countries has also decreased drastically during the past decades, with increased domestic petroleum production. However, the US remains a key player in the region, and its military campaign played an important role in dismantling the ISIS “caliphate” in Syria and Iraq. Furthermore, the US has several allies in the region, notably Israel, Saudi Arabia, the UAE and Egypt, which are central to US regional security policy. Additionally, Bahrain harbours the US Navy’s Fifth Fleet whereas Qatar hosts the largest US military base in the Middle East. The US also possesses a number of bases, so called contingency locations, in North Africa, in southern and northern Libya, as well as in Tunisia.

In northern Africa, Libya has been in turmoil since 2011, when long-time leader Muammar al-Gaddafi was ousted and killed. The civil war between the Government of National Accord (GNA) and the Libyan National Army (LNA), led by Khalifa Haftar, ended with a ceasefire in October 2020. The warring sides each had support from a number of foreign actors. Turkey provided armed support to the GNA side, whereas the LNA side had military backing by Russia, the UAE,

and to some extent Egypt. There is currently an on-going peace process, but the situation remains fragile.

MACROECONOMIC TRENDS

The volatile security environment as well as the continued downward trend of oil prices during the past decade have impacted oil exporters in the MENA region. Rapid growth of public debt was a concern for oil exporters in the region even before the coronavirus pandemic, due to factors such as low economic growth and slow fiscal consolidation. Following credit expansion during the coronavirus pandemic, debt levels for most countries in the region can be expected to increase further.

Saudi Arabia experienced declining growth in 2016 and onward, after a period of GDP growth rates averaging 5.2 percent between 2010 and 2015. In 2020, a contraction of close to 4 percent is estimated, followed by an uptick to 3 percent in 2021. Government debt in Saudi Arabia went from 1.6 percent of GDP in 2014 to 22.8 percent in 2019, and saw an estimated increase to around 33 percent in 2020. Meanwhile, inflation levels are low and stable in comparison to some neighbours in the region. Given the volatility of the oil market, further promotion of non-oil growth in the Saudi Arabian economy is likely to continue as a key focus area.

Israel’s economic growth rates have been stable the past decade, averaging 3.8 percent between 2010 and 2019. Following the covid-19 pandemic, a contraction by approximately 6 percent is expected in 2020. Inflation rates are low, whereas government debt corresponded to 60 percent of GDP in 2019, albeit down from 70 percent in 2010. By 2021, public debt is estimated to reach up to 80 percent. Apart from the direct impact of the pandemic, long-term challenges to economic growth and stability include low productivity growth and gaps in infrastructure.

Turkey saw steady economic growth in the beginning of the past decade, averaging 6.8 percent between 2010 and 2017. Growth stagnated in 2018 and 2019, but is expected to have remained positive, at a level of approximately 1 percent, in 2020 amidst the covid-19 pandemic. However, economic stability was threatened even before 2020, due to high inflation and a depreciating currency. Public debt amounted to 33 percent of GDP in 2019 and is expected to increase to around 45 percent in 2021.

The Iranian economy has experienced a roller-coaster ride the past decade, with sharp ups and downs. This can partly be explained by the shifting imposition and lifting of international sanctions related to the nuclear deal. The past few years, following the US withdrawal from the JCPOA in 2018, have been marked by a sharp downturn in oil production and oil exports, as well as a decline in the

unofficial exchange rate. Other explanatory factors include a continued lack of structural reforms to improve business conditions, reduce corruption and revitalise the financial sector. Even before the coronavirus pandemic, Iranian government debt level increased from 12.7 percent of GDP in 2014 to 44.7 percent in 2019. The average inflation rate during the past decade has been high, over 20 percent. The Iranian economy contracted by more than 6 percent in 2019 and a further decline in GDP by around 1 percent is expected to have taken place in 2020 during the pandemic.

Algeria has a highly oil dependent economy, with oil exports constituting the bulk of total exports as well as the main source of income for the state. Falling oil prices have thus had a substantial impact on the Algerian economy. Structural reforms and long-term efforts to diversify growth are under way, but oil dependency is likely to persist for the foreseeable future. The growth rate has declined from 3.8 percent in 2014 to 0.8 percent in 2019. Following the coronavirus pandemic the estimate for 2020 is an economic contraction more than 5 percent. Since 2010, the public debt has increased from 10 percent of GDP to 46 percent of GDP in 2019. It is estimated to increase further, to 66 percent of GDP in 2021.

The coronavirus pandemic has exacerbated some economic trends in the region, such as increases in public debt and declines in economic growth. The possibility of a sharp increase in growth after the pandemic cannot be ruled out, but such developments remain to be seen. Despite falling oil prices and pandemic related credit expansion, military spending is likely to remain protected in most cases due to internal and external security concerns.

DEFENCE INDUSTRY

Saudi Arabia was the world's largest arms importer between 2015 and 2019. The country is heavily reliant on foreign arms suppliers. In 2016, only 2 percent of the armed forces' equipment was produced domestically. Saudi Arabia's main source of military equipment is the US, followed by the UK and France. However, the country strives to strengthen its domestic arms industry and has the ambition to allocate at least half of its defence budget to national defence contractors by 2030 and become a leading global arms producer. Efforts taken towards this goal include the establishment of the regulator and licensor General Authority for Military Industries (GAMI) and the defence company Saudi Arabia Military Industries (SAMI), in 2017. There is also a goal to increase industry and defence R&D spending between 10 and 12 times by 2030. However, it remains to be seen if these highly ambitious goals can be met.

Israel has the most advanced defence industry in the region, capable of producing state-of-the-art equipment such as armoured vehicles, unmanned systems, guided weapons and cyber security equipment. Israel's domestic defence industry provides its armed forces with a technological advantage over other regional powers. The US has provided continuous assistance to the development of Israel's domestic defence industry. Israeli arms exports reached record levels between 2015 and 2019, 77 percent higher than in the previous five-year period.

Turkey also possesses an advanced defence industry, although it is still reliant on foreign components and technology. Turkey's decision to procure the S-400 air defence system from Russia increased tensions with its NATO allies, and even led to the US cancelling a delivery of F-35s in 2019. In order to reduce the reliance on Western suppliers, not least US ones, President Erdogan has stated the ambition of complete self-sufficiency by 2023. The 2018 currency crisis, which heavily depreciated the Turkish currency, made arms imports more expensive and gave further incentives for self-reliance. There are some indications of self-sufficiency. From being one of the top arms importers in the world in the late 1990s, Turkey has consistently dropped in ranking among importers, with an increasing amount of systems produced domestically.

Iran has been subject to various UN embargos since 2006, limiting the country's arms imports and exports alike. As part of the JCPOA nuclear deal, it was stated that provisions restricting Iranian conventional arms imports and exports would start being lifted five years after the adoption of the JCPOA. Thus, the UN arms embargo expired in October 2020. The restriction on arms imports means that the country has mainly depended on the domestic defence industry to meet its needs. Iran's defence industry is quite advanced by regional standards, but without the ability to import and access foreign technology it has so far been unable to supply modern weapons systems. Nevertheless, Iran allegedly has the largest and most diverse ballistic missile arsenal in the Middle East, most of which has been imported. Iran regards its missile capabilities as a key deterrent, whereas the US and its regional allies view it as a potent threat. Almost all known arms deliveries to Iran since 2005 have been from Russia or China. Iran also has a long history of missile cooperation with North Korea, more or less under the radar, which reportedly resumed during 2020. In 2016, Iran received four S-300 air defence batteries from Russia, not covered by the arms embargo, marking the first major arms imports since 2007. The recent removal of the UN arms embargo allows the signing of previously illegal arms export deals to Iran,

the main benefactors of which will most likely be Russia and China. However, there remains a variety of sanctions against Iran, including a restriction of goods and technology which can be used toward developing nuclear weapon delivery systems.

Algeria depends heavily on arms import to obtain modern equipment. During the period 2015-2019 it was the sixth-largest importer of arms globally. Its main supplier during this period was Russia, followed by China and Italy. In recent years the country has made efforts to develop its own defence industry, as illustrated by joint ventures for licensed production of Italian and German equipment.

SUMMARY

Military expenditure trends have diverged in recent years among the countries in the region, having both increased and decreased depending on country. Whereas spending rates in Turkey have increased markedly, that of Iran has declined significantly.

Regional security in the Middle East and North Africa is still characterised by ongoing conflicts, exacerbated by foreign involvement and rival interests, as well as by

non-state actors such as ISIS. Even though US interest in the region has seen a decline during the past decade, it is unlikely to disappear given the continued significance of the region, especially given the large Russian and Chinese presence.

Volatility in oil prices has impacted the largely oil-dependent economies of Saudi Arabia, Iran and Algeria in recent years. Furthermore, the covid-19 pandemic has shook the region and been followed by increasing public debt and reduced economic growth. Turkey may be a possible exception, as the country seems to have avoided an economic contraction due to the pandemic. However, the Turkish economy did experience troubles even before the pandemic.

Defence industrial ambitions, especially in Saudi Arabia and Turkey, are marked by ambitions for greater autonomy. Even Israel, which has the most advanced arms industry in the region, is to some extent dependent on foreign equipment and technology. Overall, reliance on arms imports from abroad remains significant, and all of the top five regional military spenders, with the exception of Iran, are ranked among the top 15 arms importers in the world. ■