

Doom, Boom or Hibernation? Covid-19 and the Defense Industry

Written by Johan Eriksson and Giampiero Giacomello

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JOHAN ERIKSSON AND GIAMPIERO GIACOMELLO, JUL 7 2020

Undeniably, the general effect of the Covid-19 crisis on the global economy is very bad, implying widespread recession. Many observers, including the International Monetary Fund, believe the impact will be comparable to the Great Depression of the 1930s, if not worse. Global GDP is plunging, and trade and travel is hit particularly hard as borders were closed and national governments have responded to the pandemic in insular, if not isolationist ways. On a general, global level, defense spending and arms production have declined rapidly, following five years of straight growth. A recent poll shows that a large majority of defense companies – 69% – believe the impact of Covid-19 will be “hard” or “moderate”, while a remaining 31% of respondents believe the impact will be “low”. Early on, defense company stock prices declined rapidly, in some cases over 50% from February to March 2020. Importantly, however, effects of the Covid-19 crisis are not necessarily the same across the defense industry.

The aerospace sector has been hit particularly hard, with an almost complete shutdown of international traffic and transportation in the Spring of 2020. Military aerospace is not immune to this downturn, although air forces and other state-run aerospace organizations continue operations. Simultaneously, the capacity for rapid reaction and major campaigns is most likely considerably lower than under normal circumstances.

Military aerospace is to a degree sharing infrastructure with civilian aerospace – an effect of dual-use reforms, economy of scale-thinking, and national path-dependencies. Thus, when civilian aerospace crumbles, it has a negative impact also on defense, particularly in terms of infrastructural resilience. However, even if aerospace in general is in trouble, there are signs that military aerospace is affected to a lesser degree than its civilian counterpart, even within the same company. Boeing, for example, has had orders cancelled and has been forced to cut its workforce. Yet, Boeing also recently announced that its military branch for the first time in a decade will become bigger than its civilian side. The effects are reportedly similar across the aerospace community.

Moreover, since many military units cannot function without staff working in close physical proximity, they are prone to contagious disease. Notably, at least four US and one French aircraft carriers have been hit hard by Covid-19, in particular the US Theodore Roosevelt with more than 100 infected (as of 9 April 2020), and the French Charles de Gaulle, with nearly 700 infected (as of 16 April 2020).

It seems safe to conclude, even at this early stage of the pandemic, that the immediate negative effects are on the supply-side. Deliveries are delayed or cancelled, with cascading effects on productivity, marketing and delivery of products and services. In countries with harsh lockdown measures, workers and staff were sent home. For example, production of the F-35 was quickly halted in Italy and Japan. Another example is Italian ship builder Fincantieri, which halted its production in March 2020.

Other companies, however, have managed to expand rather than decline. Lockheed Martin, the world’s biggest defense company, had a record year in sales in 2019 (nearly \$60 billion), and they are expected to do even better in 2020. While deliveries of the F35 are expected to be delayed, Lockheed Martin is hiring nearly 5,000 people even in the midst of the current crisis and despite disruptions in supply chains. This suggests that big players can take a hit and bounce back more easily than smaller and less diversified companies with limited capacity to withstand

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disruptions. Small business may be hit the hardest, while medium and especially big sized companies fair better because of differences in economies of scale, company liquidity, subsidies, and government contracts. Indeed, it seems that Lockheed Martin is trying to take advantage of the current crisis and add new market share to its already dominant position in the industry.

In countries where society has been kept relatively open, for example Sweden, the economic effects seem to be comparatively less negative, as reported for example by Sweden's biggest defense industry SAAB Group, producer of fighter jets, navy ships, radar and surveillance systems. Even in Sweden, however, workplaces including defense industry plants are not at full capacity, either because employees are sick or because they must stay home and take care of sick family members. Consequently, chains of supply are delayed or have in some cases come to a full stop.

Furthermore, the Swedish Security & Defense Industry Association (SOFF) reports that in Sweden, the experience is similar to that of most other Western countries, with aerospace hit hard, but also with a rapidly increasing demand on protective gear (including for CBRN), in communications, and with other businesses related to blue light operations. Moreover, Sweden has been the target of intensified cyberattacks and disinformation campaigns in the wake of the Covid-19 crisis, which has also increased the demand for cybersecurity solutions.

Some European defense analysts have argued that countries such as Russia and China at the time (early April 2020) seemed to be less affected than most Western European countries. Along similar lines, a group of European defense industry experts warned against cutting defense spending as a way of coping with the economic hardship that the covid-19 pandemic has caused. These experts argued that major cuts to European defense spending – including R&D – would not only hamper Europe's military security, but also have negative effects on the wider economy. These experts warn that Russia and China might become more assertive geopolitically if European defense is weakened. Reportedly, however, at least the Russian defense industry is in steep decline. Thus it is by no means certain that Russia has the capacity to take advantage of European cuts in defense spending. Moreover, it is noted that the increasingly dual-use nature of defense industry implies that cuts in defense spending negatively impacts on wider sectors such as information and communications technology, satellite services, surveillance systems, and transportation.

Indeed, in the midst negotiations of the EU budget, the EU high representative, Josep Borrell, has already warned member-states not to cut defense spending and it might as well be that more reasonable prepositions still prevail. The fear of slashed defense spending in Europe has been shared by some observers of what is happening with US defense spending. Despite the enormous US national debt, however, the US government does not seem prepared to cut defense spending, including R&D. In early June 2020, Pentagon announced a rescue package for defense firms, amounting to \$135 million.

To a degree the negative effects on security and the defense industry can be averted by massive governmental subsidies, new contracts, take-overs, and other forms of intervention. However, popular support for maintained or increased spending of taxpayers' money on defense, including R&D, will not improve simply by reiterating the claim that "the world is a dangerous place" or that "the geopolitical landscape is changing". For the ordinary voter/taxpayer, it is arguably more convincing to point at the spillover and dual-use effects of technological development in the defense industry – exemplified by radar, microwave technology, the Internet, and global positioning systems. While new defense technologies are not necessarily originally intended for dual-use or spillover for civilian purposes, political decisions on regulations and standards may facilitate such developments. Pointing at spillover and dual-use effects would be a more proactive and vote-winning strategy than weary fear-mongering.

Is it possible that pandemics like the covid-19 crisis might open up for a new type of defense, including new types of defense technology? "Social distancing" (i.e. physical distancing between people to prevent contagion) has become a new global mantra. Interestingly, the new emphasis on physical distancing goes hand in hand with the pre-corona trend of automatization and robotization of defense. With drones, cyber and satellite surveillance – states can provide defense at a distance, without risking the lives of frontline soldiers – whether the threat is a missile or a deadly virus. It is likely that pandemics such as the covid-19 crisis will intensify this trend, resulting in even greater reliance on drones, AI, satellites, and automated systems. Governments will increasingly put bots rather than boots on the

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ground.

While the impact of the covid-19 crisis on defense industry varies across states and sectors, there are some general noteworthy patterns. In particular, the world has become increasingly insular, nationalistic, even isolationist. Global value chains have been disrupted. International cooperation in response to Covid-19 has been weak, and defense industry is no exception. Protectionism is rising. There is now a greater emphasis on national self-reliance, not only concerning the supply of vaccines, for which there is fierce competition, but also in wider concerns for safety and national security. The national security state is again in focus – but now with a wider agenda in which there is a blurred boundary between military and societal security.

For a defense industry which hitherto has become increasingly internationalized, the disruption of global value chains is particularly devastating for small and medium-sized and niched companies. State-sponsored rescue programs might save some of these companies, allowing them to hibernate. Bigger and more diversified players seem to do much better, with some possibly getting stronger than before. Finally, it is a safe bet that the demand for physically distanced defense technology will increase.

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