

## INFLUENCE OF THE ECONOMIC CRISIS PROVIDED BY COVID-19 ON THE LEVEL OF THE DEFENCE INDUSTRY

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**Abstract:** Analysis of data on arms exports worldwide reveals relative stability in the international arms market that increased in 2019 compared to 2018, by about 4%, with growth in the United States of 6.6%, equal to that of China. This trend in the United States of America may diminish considerably in the coming period, given the limitation of the increase in the defence budget from fiscal year 2021, and in the case of China, the sars-CoV-2 coronavirus crisis will have effects including in the defence industry. Recent developments resulting from the economic crisis caused by the medical emergency caused by the COVID-19 pandemic, induced by the worldwide spread of the SARS-CoV-2 coronavirus, will also have effects in the defence industry, mainly on the the basis of the contracting of gross domestic product at state level. To overcome this crisis situation in the defence industry, innovative measures are needed to enable the development of state-of-the-art military products adapted to the market requirements and defence needs of resource-enabled States financial support, while accelerating the work of the applied Research and Development sector that will enable such products to be produced

**Keywords:** crisis, coronavirus, military products, innovation, exports.

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### 1. Introduction

The COVID-19 pandemic affects many industrial sectors, and companies will be affected, many of which will go bankrupt, and some large companies will significantly reduce their business or restructure their business- including their product range.

Of course, this global crisis also affects the field of defence industry that is connected to the world economy, in the sense that many of the companies producing military products depend, to, a large extent, on subassemblies that occur in the civil industry (e.g. high-performance machine tools, military industry-specific consumables).

Experts in the field consider that the COVID-19 pandemic is likely to cause a recession of defence proportions on three distinct levels, namely: budgetary, industrial and political-strategic.

In order to understand in detail the effects that COVID-19 will have on the defence industry, it is necessary to take into account three main variables, namely: the duration of the pandemic, its economic consequences and the responses that will come from both the states and the European Union and NATO.

Europe and North America are expected to face an unprecedented economic recession in 2020. In order to effectively combat the epidemiological crisis generated by COVID-19, national governments are now employing significant financial resources for the public health sector and providing livelihoods to the citizens of these states, which will inevitably lead to cuts in defence budgets. Even if the percentage will maintain the same budgetary allocation (e.g. 2% of GDP in the case of Romania), by nominally decreasing GDP, the defence industry will be affected, given the considerably smaller amounts that will be allocated to the defence industry. This is also favoured by wage expenditure, which remains constant, with reductions to be made from expenditure on investments in new military products.

The aerospace and defence industry in Europe and North America will not only suffer from these cuts in the global military sector, but will also be affected by the crisis of commercial airlines, which has reduced orders to large companies such as Airbus and Boeing, while share prices have fallen significantly in international financial markets. All

of these elements can help create trade tensions between the EU and the US, as both blocs are likely to feel obliged to protect their defence industrial sectors from short-term losses.

The EU's next Multiannual Financial Framework (MFF) must be completed by the end of 2020. If the European Union transfers its available resources to deal with the public health crisis and the upcoming economic recession, both the European Defence Fund (EDF) and the EU military mobility project will risk a substantial reduction in the budget. These decreases in resources for the development of the European defence industry will have direct consequences in terms of the development of new products by the defence industries of the EU Member States. From this point of view, Romania will feel this shock strongly, given that European funds were a valuable source for the domestic defence industry that could be used, including in the Research and Development sector.

Another very important aspect that has been highlighted by experts is the lack of solidarity currently perceived by several EU Member States, which demonstrates how the pandemic also poses security challenges for the EU at strategic level. In this context, we mention the case of Italy, which activated the EU Civil Protection Mechanism at the end of February 2020; however, by 10 March 2020, no Member State had responded to its request for support. This, unfortunately, reveals the lack of solidarity at EU level, as well as the 'selfishness' manifested by certain important EU member states, which creates the favourable premises for the erosion of cohesion at European level, with effects including in security. This dangerous centrifugal trend is enhanced by the dissemination of fake news, in particular by Russian propaganda, which has become very active in the context of the COVID-19 pandemic, their aim being to denigrate the European institutions, European leaders, as well as government ones in the Member States (Bode, 2020).

In this context, if the extraordinary measures necessary to deal with the pandemic and its socio-economic consequences are not taken at EU level, the Union will be called into question by European citizens, more than with the migration crisis of 2015 and previous financial crises. The materialisation of this risk would obviously translate into stronger support for eurosceptic ideological formations, which will take advantage of citizens' uncertainty to gain political support and gain power in the EU Member States, with effects in terms of democracy and even the increasing possibility of the European Union's de-isolation.

At a time when pandemic anxieties at the population level are further fuelled by fake news and information warfare triggered by entities- in particular- in the coordination of the Russian Federation, such a political storm would be extremely difficult to manage at EU level. In this context, at the level of the government and the EU institutions it is necessary to have effective measures in place for the rapid recovery of the economy, including the defence industry sector which employs many people (Wolf, 2020).

At the same time, the defence industry also has a characteristic that does not allow employees of high-profile companies to retrain, in the sense that there is a high degree of specialisation of the workforce. Another very important aspect of the high specialisation of the labour force in the defence sector is the possibility of its dismissal during a crisis period, with negative effects after this period which will require the hiring of staff. In order to resolve this situation, it is necessary to have a coherent and effective strategy at the level of the Romanian Government, designed by the Ministry of Economy, in cooperation with the Ministry of National Defence, which provides concrete measures for the retention of personnel from companies active in the national defence industry, taking into account, first of all, the strategic character of this industrial sector.

## **2. Risk of reducing the defence budget**

The COVID-19 pandemic is likely to have a negative impact on the world economy, to which national governments are likely to respond with considerable financial investments aimed at economic recovery. As a result, many military experts now question whether this will involve inevitable cuts to the defence budget.

At present, given that this health crisis is far from over, it is impossible to carry out a comprehensive assessment. However, it is now important to try and carry out a predictive analysis of future developments in the defence industry, as the development of the pandemic crisis can continue for a long time. In order to carry out this predictive analysis of the evolution of the defence industry, the analytical method of scenarios can be chosen, through which several scenarios can be imagined, starting from the most favourable to the most unfavourable, as well as at least three intermediate scenarios.

The application of the analytical method of the scenarios requires particular efforts and costs, in the realization of these scenarios will be involved military, experts in the field of defense industry, economists, medical professionals, as well as high-level managers from the ministries of profile (e.g. Ministry of Economy, Ministry of National Defence, Ministry of Public Finance, Ministry of Health).

Some experts in the field note that the CoVID-19 pandemic will indeed have negative consequences for defence budgets, but they will mostly not materialise until 2021-2022. According to them, despite the current medical crisis, governments are aware of the importance of supporting economic activities, including those of the aerospace, security and defence industries, and will therefore continue to make significant investments in the sector. Some experts believe that cuts to the military would cause more problems for industries already affected by the commercial aircraft order crisis, such as Airbus and Boeing.

Other experts argue that military spending will fall not only in Europe, but in every country affected by the virus worldwide, which will affect the way business is conducted worldwide. The experts who have joined this view believe that it is possible to make a forecast of future defence expenditure compared to the 2008-2009 financial crisis. In the following years, the regions most affected by the crisis (e.g. Western Europe) had a direct negative impact on their military spending. Differently, regions that have been less affected by the economic crisis (e.g. Asia and the Middle East) have not had any decreases in their defence budgets. Because the COVID-19 pandemic appears to be affecting the whole world, the cuts are likely to take place globally, affecting the entire industry.

There are major differences from the crisis of 2008-2009, in the sense that the crisis was of a financial nature and affected, in particular, small and medium-sized companies that were not able to resize and adapt their economic and investment policies, whereas this crisis of a medical nature affects almost all industrial sectors, except those in the food industry and courier companies which have seen increases.

The East Asian and Oceania states are hit hard by the economic recession, which is likely to have a negative impact on military spending. For example, in Japan, the government is trying to implement measures to save budget funds, with this state having a strong defense industry that invests heavily in the R&D sector.

In Europe, today, as in 2008, Western and Mediterranean countries seem to be facing the worst consequences of the crisis, with direct effects including in the defence industry. Military experts point out that the states most affected by the pandemic also happen to be those that are more militarily active, such as Great Britain, France and Italy, because they are the ones that deploy more troops in North Africa, the Sahel and/or the Middle East. As regards foreign and defence policy, as military spending in several NATO countries will be constrained in the coming years, this will, by default, limit the possibility

of using the armed forces for external purposes. This aspect also applies to political will, as it is not clear whether political leaders will be willing to push for foreign policy commitments in times of internal security crisis and/or economic recession.

Another expert noted that after the 2008 crisis, it took six years of low military budget before a reversal of this trend, which was mainly caused by the persistent threat of the Russian Federation that arose from the war in Ukraine and the annexation of the Crimean Peninsula. The question can be contextualised whether, this time, Europeans will again face an external security crisis that will require an increase in defence budgets, or whether Europe is heading for a prolonged fall in military spending.

Other experts point out that the 2008 financial crisis and subsequent recession were very different from the one the world is now entering. The first has been characterised by budget cuts, while today's one concerns the economic incentives needed to address both supply and demand shocks. The failure to perceive the defence sector as particularly important in industrial recovery will indicate a lack of understanding of its dual nature, and this will turn into a semnificative crisis for the aerospace and defence industries. An example in this context is the aviation industry that will be most affected, given the dramatic reduction in commercial flights. Thus, aircraft companies are heavily affected, given the sharp drop in demand from commercial airlines, which have dramatically reduced their activity. As mentioned above, this also has a negative effect on the aerospace and defence sectors, as several main contractors have both a civil and military aviation industry. During this period, many commercial aeronautical companies suspended contracts for the delivery of new aircraft or, at best, postponed these deliveries for indefinite periods.

Several experts appreciate that Europe will not suddenly become incapable in terms of military potential and investment in this area. However, an uneconomically and strategically unmotivated reduction in military spending, at the same time as the decline of the European Defence Technological Industrial Base (EDTIB), will lead to a political problem in defining the EU's ambitions in terms of strategic autonomy. This, in the long term, can lead to an increase in tensions between the EU and the US, with direct economic and political-military effects (Marrone and Credi, 2020).

In addition, some experts note that not every country will lose the same degree of GDP, influence and power worldwide. Thus, the balance between power and ambition will change, sometimes quite substantially, at both regional and global level. This will create windows of opportunities that can be strategically exploited by ambitious competitors who are likely to be less affected by the crisis, such as the Russian Federation and China. They could represent Europe in the face of new direct threats to its security interests, i.e. situations where the activation of Article 5 of the NATO Treaty. Indirect challenges, for example, in new tensions at NATO or EU level or in changing the security situation in the Middle East or the South China Sea, must also be taken into account.

The more Europe will focus on the internal problems caused by the crisis caused by COVID-19, the more room for manoeuvre will be given to the states concerned (e.g. the Russian Federation, China) in other regions, which will lead to the deterioration of its strategic interests.

### **3. Pandemic crisis and NATO**

In the short term, NATO member states will focus most of their political and economic attention on relations with the pandemic and the management of the socio-economic impact afterwards. Governments must meet the expectations of society and their electorate, and the same is true for international organisations run by Member States, such

as NATO. Not coincidentally, major Allied military exercises have already been reduced, postponed or cancelled, including Defender Europe 2020.

The political-strategic dimension of the pandemic crisis will therefore become inherent on NATO's agenda, with consequences that are hard to predict militarily. Military experts appreciate that NATO will have to prove its ability to contribute to the political and security challenges posed by the COVID-19 pandemic crisis. As a result, in this crisis situation, NATO is likely to place greater emphasis on civilian actions to support Member States at the expense of military missions.

Other experts express concern about the possibility of such a focus on NATO's non-military activities, especially given the context of the security challenges of the Russian Federation vis-à-vis the Central and Eastern European States. In this respect, a balance will have to be struck between civil and military operations, in full compliance with the mandate of the organisation which must ensure the security of its members. In other words, although Western countries are living a new reality under the pandemic, some of the activities that NATO is carrying out must remain in place in order to guarantee collective defence, political cohesion and solidarity. In this note, some experts warn that only a few European countries are able to operate militarily in a pandemic environment and even fewer are able to provide assistance abroad through the deployment of the armed forces.

Other experts point out how, in the wake of the COVID-19 crisis, the international system will neither become more efficient nor strengthen in the sense that no major geopolitical changes are expected. Geopolitical trends will continue in the same trend, although they could be accelerated by the effects of the virus, in the sense of increasing accusations regarding the outbreak of the COVID-19 pandemic (e.g. accusations between the US and China).

Broadly speaking, the pandemic's consequences for NATO could be decelerate in the short, medium and long term. In the short term, it will consist of the withdrawal of soldiers from current allied operations until the reduction of military exercises in 2020, affecting both the situation on the ground in operational theatres and the availability of forces (Rempfer, 2020). The medium- and long-term effects of covid-19 on NATO will mainly be to reduce the budget of the Allied States and unable to meet the capability objectives they have undertaken (Brzozowski, 2020).

One expert highlighted how the severe decline in GDP of some countries could, paradoxically, help them achieve the 2% defence spending target set by heads of state and government at the NATO Summit in 2014. This presents a critical perspective on the risk of exaggerating the importance of a single input parameter in the assessment of military capabilities. However, such a parameter is of significant political importance in the US. Another expert actually stressed that the defence cuts of European allies could be used by the current US administration to further criticize Europe and gain negotiating levers on important dossiers on the transatlantic agenda.

Some experts pointed out that both NATO's and the EU's contributions to the pandemic crisis are very limited and that this runs counter to the narrative that European defence is meant to protect its population. They called on NATO and the EU to engage in a process of developing the collective capabilities needed to contribute to the pandemic crisis. Failure to achieve this would seriously compromise their role and credibility in the eyes of European and global public opinion, with negative consequences for the commitments of political leaders to both organisations (Bunkall, 2020).

#### **4. The role of change in the armed forces**

In several Western countries, the armed forces are actively contributing to cope with the negative effects of the COVID-19 pandemic crisis. In some cases, like Italy, this is

not the first time that the military has actively contributed to the management of national emergencies under the leadership of civil protection. However, the level and duration of such an engagement in the context of the current pandemic crisis is likely to result in more than in previous experiences.

At the same time, the line between security and defence is still blurred and diffuse. Police are increasingly using drones and other new technologies to observe people, to implement unprecedented blocking restrictions. Any military equipment that may be useful is currently used, from strategic and tactical lifts to military hospitals, as well as to patrol missions carried out by the military in certain areas (Sabbagh, 2020).

In this note, some experts raised the issue of privacy in relation to the extraordinary security measures and controls applied. As the EU is a community of values, not just interests, it is crucial that its members do not resort to new technologies in the same way that China does.

Another expert pointed out that, for example, in France, the armed forces played a greater role during the 2015 terrorist attacks, than in the current pandemic crisis. Consequently, it has been suggested that at the level of the expert community it focuses on finding new solutions for civil protection, probably using non-military instruments. For example, technologies used in the fight against climate change and natural disasters could be used in current circumstances in order to resolve COVID-19 pandemic crisis (Amaro, 2020).

With regard to security and stability in the vicinity of Europe, according to some experts, the spread of the virus in the Middle East and Africa is likely to be followed by a call for humanitarian response at international level and possibly crisis management and/or stability operations. Indeed, in such regions, the pandemic could also generate new conflicts or revive the old ones, causing new instability. This, in turn, would require the imposition of external peace in order not to escalate into a humanitarian disaster and/or regional destabilisation. In general, the answer will depend on the political readiness and military readiness in Europe and the US to engage in armed intervention while dealing with the pandemic or its economic consequences at home (Imbert, 2020).

### **5. EDF and Europe's economic recovery**

The discussion also focused on European cooperation in the defence sector and, more specifically, how crucial such cooperation will be in terms of military spending during pandemic budget cuts.

The view that budget cuts necessarily lead to increased international cooperation for the achievement of economies of scale was considered by several participants without reason, after being shown in the wake of the 2008 financial crisis. Indeed, it was recalled how, at that time, the European Defence Ministries did not invest in new international acquisitions, as they were barely carrying out the ongoing programmes through cuts imposed by the finance ministries. Thus, several governments have decided to maintain their small and inefficient national programmes, rather than using European cooperation, to ensure that they deal with their own procurement decisions and related industrial benefit.

Taking this as a lesson learned, some experts consider that the possible cuts in defence budgets that will be caused by the pandemic will not be a driving factor for closer cooperation between EU Member States. Rather, an incentive such as the co-financing of the EDF is needed. A possible reduction in the EDF budget, in the context of the new MFF, would thus lead to negative consequences for public procurement cooperation in the defence sector.

Some participants insisted on the urgency of directing most of the EU's efforts towards achieving European strategic autonomy, thus prioritising investments in joint

projects rather than in national or non-EU programmes. At the same time, the pressure to ensure the share of industrial work "at home" could turn into a low use not only of American supply, but also of European, if domestic producers are able to offer decent solutions.

Finally, many agreed on the importance of including a defence angle in the economic debate that political leaders will have on the relaunch of industries and small and medium-sized enterprises in Europe. The aerospace and defence sectors should be considered a strategic economic sector, especially in view of its high-tech nature. Consequently, some have stressed that defence investment will have to support the economy, particularly in the period 2020-2021, as part of a global European economic recovery plan. For such a recovery to be successful, industrial cooperation in the field of defence within the EU is needed, and this can be done by ensuring that its members know that they can rely on the EDF and other European incentives.

## 6. Conclusions

When looking at the aftermath of the COVID-19 pandemic, it is possible to develop a best and worst-case scenario for the subsequent economic recession, thereby reducing military budgets, losses to the European aerospace and defence industry, more transatlantic tensions and, above all, damage to the cohesion of the European integration process that has brought peace and stability to Europe.

At best, the EU institutions and the Member States would engage with solidarity and cooperation to address the multiple aspects of the crisis, while, at worst, the EU would emerge from the pandemic with serious economic, social and political recessions.

These scenarios also relate to the international security environment. Some military experts were concerned, as the worst-case scenario now seems most likely, given the measures taken by national governments. They argued that the world risks becoming worse than it is today in terms of stability and security, with the US dividing the world between friends and enemies- according to a short-term, narrow interpretation of its national interests, and China has strengthened its military forces, as well as its influence abroad at an alarming rate.

In conclusion, the pandemic and its economic impact have direct and in-direct implications for defence policies in Europe and different scenarios are possible. The ability of Member States and EU institutions to act together in a decisive way will make a difference, with a significant impact on European security.

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