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**COVID-19 AND THE SPANISH DEFENCE  
TECHNOLOGICAL AND INDUSTRIAL BASE:  
Impact and Policy Responses**

By

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They do not reflect the views of any organisation.*

*Comment*

## ABSTRACT

Spain's industrial policy does not consider the defence industry to be strategic, except for the aerospace sector. The Ministry of Defence (MoD) manages the relationship with the Defence Technological and Industrial Base (DTIB) and, consequently, it will be responsible for the management of the response measures to the challenges posed by COVID-19. The arms industry has not yet recovered from the serious damages of the 2008 economic crisis and the pandemic has come at the worst time, when the DTIB was about to take advantage of the opportunities created by the European cooperation programmes and the new investment cycle in Spain. In the short term, the lockdown has affected the industrial and research activities to a limited extent, but in the longer term, its impact threatens to jeopardise the expected recovery and aggravate the structural problems affecting the Spanish DTIB.

**Keywords:** *Spain, DTIB, Covid-19, GDP, Lockdown, SME*

In Spain, it is necessary to differentiate the industrial and technological base in a broad sense, civil and military, from the one specifically devoted to defence. The first includes 76 defence, security, aeronautics, and space companies with an estimated turnover of € 12 billion (around 1% of the GDP) with 57,000 highly technical qualified jobs. Export accounts for two-thirds of the turnover and the R&T for one tenth, according to the data of the main industrial association TEDAE.<sup>1</sup> By sector, 44% of the turnover corresponds to civil aeronautics, 32% to defence, 15% to land vehicles and ships, 8% to space, and 1% to security. By size, 70% are small companies, 23% midcaps and 7% large ones. In addition to the previous companies, the MoD has registered up to 373 defence suppliers, mostly Small and Medium Enterprises (SMEs), that account for 4.4% of the total national industrial production with € 6 billion in annual revenues.<sup>2</sup> Nevertheless, the DTIB is not regarded as a strategic sector for the national industrial policy as such, except for the aerospace part that represents 70% of the total<sup>3</sup>.

The 2008 economic crisis had a significant impact on the DTIB. The government reduced its defence spending (-25%), and the investment in equipment (-20%) and R&T (-62%). The budgetary cuts in the following years reached an amount of € 8.2 billion, approximately 16% of the European total, and the defence budget decreased from € 12.8 billion in 2008 to € 9.5 billion in 2014, according to NATO estimates. As a result, the domestic market fell to 19% in 2017 and exports reached 81% in the same year, signifying the DTIB had become dependent on external markets.

The recovery started in 2014. Defence budgets stopped falling after the NATO defence investment pledge, though they remained below 1% of the GDP without making significant progress towards the agreed target of 2%. In 2015, the MoD reviewed its Industrial Strategy and the Technology and Innovation Strategy for Defence. As of 2016, the MoD and the industrial sector coordinated their efforts to take advantage of the opportunities opened by the European Defence Action Plan and the European Defence Fund. They mobilised the DTIB to participate in all EU defence programmes (PeSCo, PADR

<sup>1</sup> "Activities Report 2018", Asociación Española de Empresas Tecnológicas de Defensa, Seguridad, Aeronáutica y Espacio (TEDAE), 2019, [https://www.tedae.org/uploads/files/1580379759\\_memoria-traduccion-pdf.pdf](https://www.tedae.org/uploads/files/1580379759_memoria-traduccion-pdf.pdf)

<sup>2</sup> "Perspectivas de la Industria de Defensa", Spanish Ministry of Defence, 2019, <https://www.defensa.gob.es/Galerias/dgamdocs/Perspectiva-de-la-Industria-de-Defensa.pdf>

<sup>3</sup> "Plan Integral de Política Industrial 2020", Spanish Interministerial Commission on Industrial Policy, p.52.

and EDIDP, Euromale, NGWS/FCAS). Lastly, the MoD launched in 2018 a new investment cycle in national programmes for € 15 billion (Frigates F-110, Eurofighter, VCR 8x8, among others) for the next 15 years.

All these developments have been affected by COVID-19. The 14 March lockdown forced the entire DTIB to close because the regulation of the emergency state did not include the DTIB among the essential sectors, even excluding aerospace companies despite their strategic nature.<sup>4</sup> Only the companies in charge of basic maintenance work for the armed forces and the ones that adapted their assembly lines to produce medical equipment remained open. The rest were able to resume their activity on 9 April, although they had to face disruptions in the supply chains, delayed deliveries and cost overruns due to the adjustment of the labour standards to the new sanitary requirements, not to mention that the largest part of the DTIB activity is located in Madrid, an area especially hit by the pandemic. In order to evaluate the impact of the pandemic, the General Directorate for Armament and Material (DGAM) asked the military inspectors to carry out an extraordinary audit along the supply chain to update the information of the Programme Offices<sup>5</sup>.

The MoD has maintained all the approved programmes so far and the government has extended the 2019 budget to the 2020 fiscal year, although it can suspend its execution anytime if necessary. The government has not drawn up a specific aid programme for the DTIB, so the companies will have to resort to the aid measures approved for the industry in general. They include extraordinary layoffs, fiscal incentives, conditional subsidies, and public guarantees for banks private loans. Nevertheless, the access to the aid measures is contingent upon the available funds and the compliance with the requirements, thus not all DTIB companies will be able to benefit from them.

The Achilles heel of the DTIB recovery is the Spain's limited financial capacity to help the companies in trouble. Spain's GDP is going to drop 8.6% in 2020 and the public debt could rise to 113.4% in 2020 and 114.6% in 2021 according to the International Monetary Fund (IMF).<sup>6</sup> The Spanish government estimates a higher downfall of 9.2% of the GDP in 2020

<sup>4</sup> Royal Decree 463/2020 of 14 March 2020 on the declaration of the emergency state, <https://www.boe.es/boe/dias/2020/03/14/pdfs/BOE-A-2020-3692.pdf>

<sup>5</sup> Pedro Fuster, Deputy Director General for Inspection, Regulation and Strategy, DGAM, MoD, Webinar IDS Conect, 7 May 2020, <https://www.infodefensa.com/es/2020/04/30/noticia-connect-analiza-webinar-pedro-fuster-efectos-covid19-industria.html>

<sup>6</sup> "World Economic Outlook", IMF, April 2020.

and the Confederation of Employers and Industries of Spain foresees a worst case scenario of -12% of the GDP if a new outbreak occurs.<sup>7</sup> In the short term, the government announced official credit lines up to € 100 billion for the whole economic sector. By mid-May around € 60 billion had been distributed and the government hopes to obtain additional funding from Brussels through the different EU financial aid programmes launched by the European Commission.

European companies in difficulty can now receive state aids under the conditions of the Temporary Framework of the European Commission, which could relieve the situation of the DTIB companies.<sup>8</sup> But given the greater capacity of countries such as Germany, France or Italy to mobilise funds to finance their industries, the Spanish DTIB could lose competitiveness compared to other European DTIBs.<sup>9</sup>

<b>Spanish Industry Support Measures - Overview</b>	
- Restriction to lockdown measures for DTIB	- No
- Cash flow support measures	- fiscal incentives, conditional subsidies, and public guarantees for banks private loans: <b>non-specific to DTIB</b>
- Suppression of penalties for delay	- /
- Specific support to SMEs	- A share of the financial aid package: <b>non-specific to DTIB</b>
- Extra orders to sustain industry or anticipated orders	- /
- Measures to limit the lay-off	- Employers entitled to suspend contracts or reduce the working time of their employees, with a proportional reduction of salary. Employees would be entitled to unemployment benefits to compensate: <b>non-specific to DTIB</b>

<sup>7</sup> “Actualización del programa de estabilidad 2020”, Spanish Ministry of Finance, April 2020, p. 6.

<sup>8</sup> COM (2020) 3516 of 8 May 2020 on the Amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, European Commission.

<sup>9</sup> According to Bruegel, and measured in terms of the 2019 GDP percentage, national aids (immediate fiscal impulse, deferral, and other liquidity/guarantees) account for 51.9% Germany, 25.8% France, 43.9% Italy, 12.2% Denmark and 11.7% Spain. Bruegel Datasets, 6 May 2020, <https://www.bruegel.org/publications/datasets/covid-national-dataset>

The new rules will deteriorate the competitiveness of the national industrial sector with regard to the rest of EU competitors. In this new uneven playing field, there is an increasing concern about the potential takeover of Spanish companies by European or third-country competitors backed by national subsidies, despite the legal measures adopted to prevent it both at European and national levels.<sup>10</sup>

Another DTIB concern is about the longer-term perspectives. On the one hand, foreseeable budgetary restrictions will reduce domestic and international demand, making it more difficult to launch new programmes or find alternative markets for exports. On the other hand, potential reductions of the European Defence Fund or the lack of national funds to co-finance EU defence programmes could put at risk the integration of Spanish companies into the European chains of supply.

Against this negative background, the DTIB could benefit from its great performance in supporting the health system, a good image reinforced by the presence of the armed forces in hospitals, streets, and logistics to protect the citizens. The positive political and social perception of the industrial assets could help the MoD to prevent discriminative cuts in the defence spending. Another positive argument to be considered is the need for the national DTIB to remain anchored in the EU industrial and defence developments, hence the need to prevent the European defence to become a casualty of the lockdown.<sup>11</sup>

There are still many unknowns to assess the final impact of COVID-19 on the arms industry. In the short term, the effects seem manageable if they do not last over time and if no new outbreaks occur. In the longer term, the pandemic will accelerate the global restructuring process that affects the arms industry. Therefore, public and private responses must combine both perspectives to mitigate damages to the industries and technologies best prepared to survive the current crisis and compete in the new global arms market after the recovery. ■

<sup>10</sup> The government has tightened the conditions to authorise direct foreign investment in industrial and technological sectors sensitive to the national economy, in line with the Regulation (EU) 2019/452 of 19 March 2020. After the pandemic, prior authorisations are now required for all investments above one million euros. Royal Decrees 8/2020 of 17 March 2020 and 11/2020 of 31 March 2020 on extraordinary measures to cope with the COVID-19 economic impact, <https://www.boe.es/boe/dias/2020/03/18/pdfs/BOE-A-2020-3824.pdf> and <https://www.boe.es/buscar/pdf/2020/BOE-A-2020-4208-consolidado.pdf>

<sup>11</sup> Alesandro Marrone et alia, "European Defence Should Not Be the Casualty of "The Great Lockdown"" in *Euractiv*, 27 April 2020.

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### **ARES GROUP**

*The Armament Industry European Research Group (Ares Group) was created in 2016 by The French Institute for International and Strategic Affairs (Iris), who coordinates the Group. The aim of the Ares Group, a high-level network of security and defence specialists across Europe, is to provide a forum to the European armament community, bringing together top defence industrial policy specialists, to encourage fresh strategic thinking in the field, develop innovative policy proposals and conduct studies for public and private actors.*

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