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

By

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*The views expressed here are solely those of the author.
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Comment

ABSTRACT

The United States was quick in trying to shield its defence industrial base from the disruptions caused by the COVID-19 pandemic. The sector was declared critical infrastructure and the Pentagon adapted contract rules to infuse the industry with more cash. Yet, the disruption in commercial markets, the global supply chain delays, the move to telework, and health related shutdowns have brought many smaller businesses into difficulties and have caused larger companies to adjust their output targets for this year. At this point it is hard to make predictions for the future, but it is likely that the American defence industry will feel the fallout from this crisis – especially as defence budgets are likely to contract in the next couple of years.

Keywords: *COVID-19, DTIB, United States, Small businesses, Supply chain, Defence spending*

In the United States, the defence industrial base is considered a vital part of national security. When governors across the United States started to issue stay-at-home orders in response to the coronavirus, Navy Vice Admiral David Lewis, director of the Defence Contract Management Agency, stressed “we need the industrial base to stay open. (...) There are still soldiers, sailors, airmen and Marines in harm’s way around the world. They still need their parts, they still need their equipment.”¹ In a memorandum signed by Ellen Lord, Department of Defence’s Undersecretary of Defence for Acquisition and Sustainment, the government declared the defence industry to be critical infrastructure in order to keep production sites open.² But despite this special protection, the defence industry is feeling the effects of the crisis. Small businesses have been particularly hard hit. While dedicated government and industry effort currently contain the worst, the future looks uncertain.

A SWIFT GOVERNMENT RESPONSE

The US Government moved quickly to protect the defence industrial base. The sector was declared critical infrastructure almost as soon as the first state-mandated stay-at-home orders went into effect. The Pentagon issued a statement that contractors are “expected to maintain their normal work schedules.”³ Congress also included the defence sector in the historic CARES Act stimulus package, signed by President Trump on 27 March 2020. It provided \$10.5 billion out of the \$2 trillion in emergency funding to the Department of Defence (DoD).⁴ The Pentagon is directing \$250 million of this emergency fund to help defence firms and announced that they would request more support in the next fiscal

¹ Lopez, T. C. (5 May 2020). “DOD Focuses on Sustaining Industrial Base Through Pandemic”, DOD News, retrieved on 20 May 2020 from <https://www.defense.gov/Explore/News/Article/Article/2177093/dod-focuses-on-sustaining-industrial-base-through-pandemic/>

² Lord, Ellen M. (20 March 2020). “Memorandum for Defense Industrial Base”, Department of Defence, retrieved on 27 May 2020 from <https://media.defense.gov/2020/Mar/22/2002268024/-1/-1/1/DEFENSE-INDUSTRIAL-BASE-ESSENTIAL-CRITICAL-INFRASTRUCTURE-WORKFORCE-MEMO.PDF>

³ Capaccio, A. (20 March 2020). “Pentagon Urges Defense Industry to Sustain Work Amid Outbreak”, Bloomberg, retrieved on 20 May 2020 from <https://www.bloomberg.com/news/articles/2020-03-20/pentagon-urges-defense-industry-to-sustain-work-amid-outbreak>

⁴ Shane, L. (25 March 2020). “Latest Emergency Coronavirus Funding Package Includes Tens of Billions for Defense,VA”, Military Times, retrieved on 20 May 2020 from <https://www.militarytimes.com/news/pentagon-congress/2020/03/25/latest-emergency-coronavirus-funding-package-includes-tens-of-billions-for-defense-va/>

packages.⁵ The stimulus bill also earmarked \$17 billion for “businesses critical for maintaining national security.”⁶ Additionally, the Pentagon announced that they were committed to keeping the industry afloat and that contractors would not be penalised for delays due to the pandemic. They also opened the door to request equitable adjustments of contracts due to delays caused by the COVID-19 pandemic, which means that increased production costs due to delays may be passed down to the DoD.

In order to help small businesses in particular, the DoD introduced new cash-flow rules. They are paying higher progress payment rates for acquisition projects: for larger companies the rate increased from 80% to 90%, and for smaller contractors from 90% to 95%.⁷ According to the Pentagon, the goal is to infuse the industrial base with additional cash. To date, a total of 1,400 contracts have been adapted to these new terms.⁸ The DoD is working with their primary contractors to ensure that the additional money reaches secondary suppliers as these companies are a critical part of the defence infrastructure and are more vulnerable than larger suppliers.⁹ Despite these measures, Ellen Lord said the ministry was expecting a three-month delay across all major acquisition programmes.¹⁰

⁵ Gould, J. (21 April 2020). “COVID Closed Mexican Factories That Supply US Defense Industry. The Pentagon Wants Them Opened”, Defense News, retrieved on 20 May 2020 from <https://www.defensenews.com/2020/04/21/covid-closed-mexican-factories-that-supply-us-defense-industry-the-pentagon-wants-them-opened/>

⁶ Lipton, E. and Vogel, K.P. (25 March 2020) “Fine Print of Stimulus Bill Contains Special Deals for Industries”, New York Times, retrieved on 28 May 2020 from <https://www.nytimes.com/2020/03/25/us/politics/virus-fineprint-stimulus-bill.html>

⁷ Tirpak, J. A. (1 May 2020). “The Defense Industry After COVID-19”, Air Force Mag, retrieved on 20 May 2020 from <https://www.airforcemag.com/article/the-defense-industry-after-covid-19/>

⁸ Insinna, V., Mehta A. (8 April 2020). “The Pentagon’s Supply Chain Faces an Economy Under Siege”, Defense News, retrieved May 20, 2020 from <https://www.defensenews.com/coronavirus/2020/04/08/the-pentagons-supply-chain-faces-an-economy-under-siege/>

⁹ Lopez, T. C. (5 May 2020)

¹⁰ Mehta, A. (20 April 2020). “Pentagon Bracing for a Three-Month Slowdown on Major Defense Equipment”, Defense News, retrieved 20 May 2020 from <https://www.defensenews.com/pentagon/2020/04/20/pentagon-bracing-for-three-month-slowdown-on-major-defense-equipment/>

US Industry Support Measures - Overview	
- Restrictions for lockdown measures for DTIB	- Memorandum from the DoD to maintain normal work schedule in a sector identified as critical infrastructure.
- Cash flow support measures	- Direct support to the DoD and direct financial support to the aerospace industry through March stimulus bill. - Increase of progress payment rates.
- Suppression of penalties for delay	- Yes
- Specific support to SME	- Higher progress payment rates - Primary contractors instructed by the DoD to distribute cash to sub-contractors
- Extra orders to sustain industry or anticipated orders	- Agencies (such as the Air Force) are holding virtual pitch days - Contract awards accelerated where possible. ¹¹ - 250 M \$ defence production act Title III contract
- Measures to limit the lay-off	- <i>Paycheck Protection Program</i> : a loan enabling small businesses to retain their workforce ¹²

SUPPLY CHAIN DISRUPTIONS AND THE STRUGGLE OF SMALL BUSINESSES

Despite these swift measures, the defence industry is still feeling the effects of the crisis, as the pandemic disrupted transnational supply chains. In Mexico, for example, the defence and aerospace sector was not included in the list of businesses exempted from shutdowns. Factories in Tijuana producing vital parts for companies such as Boeing, General Electric, Lockheed Martin, and others were closed as the virus was spreading.¹³ As a result of such disruptions, the production for Lockheed Martin’s F-35 fighter jet was

¹¹ Tirpak, J. A. (1 May 2020).

¹² U.S. Small Business Administration (2020). “Paycheck Protection Program”, retrieved on 28 May 2020 from <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program>

¹³ Sieff, K. (1 May 2020). “The U.S. Wants Mexico to Keep Its Defense and Health-Care Factories Open. Mexican Workers Are Getting Sick and Dying”, The Washington Post, retrieved 20 May 2020 from https://www.washingtonpost.com/world/the_americas/the-us-wants-mexico-to-keep-its-defense-and-health-care-factories-open-mexican-workers-are-getting-sick-and-dying/2020/04/30/14b18d04-85e1-11ea-81a3-9690c9881111_story.html

significantly slowed down.¹⁴ On 19 May, the company announced that they will not be able to fulfil their delivery targets for 2020.¹⁵ Stories like these have fuelled the debate around the dependence of US defence companies on international supply chains. Recently, President Trump criticised the F-35 supply chain disruptions and declared, “we should make everything in the United States!”¹⁶ Mid-March, President Trump signed an executive order that would support manufacturers in the US. Additionally, both parties in Congress are working on bills to decrease the US’ reliance on Chinese goods in particular.¹⁷

But disruptions are not only caused by international suppliers. Health concerns led to temporary shutdowns of several US production sites, such as Boeing factories in Pennsylvania and Washington State where the KC-46 tankers and P-8 maritime surveillance planes are produced.¹⁸ In addition to closures, telework also seemed to cause some disturbances. Some companies indicated that they were operating at about 20% capacity due to disruptions caused by the pandemic.¹⁹

Small businesses seem to be the hardest hit by these developments. Some companies had to let contractors go and put employees on part-time work which further hampers their ability to deliver on contracts.²⁰ In a survey by the National Defence Industry Association, 54% of participating small businesses indicated that they had difficulties performing on contracts. Especially companies dependent on commercial markets such as the dual-use aerospace industry, supplying parts for companies such as Northrop Grumman, Textron,

¹⁴ Insinna, V. (21 April 2020). “F-35 Deliveries Could Slow Down as COVID-19 Jolts Lockheed’s Supply Chain”, retrieved 20 May 2020 from <https://www.defensenews.com/air/2020/04/21/f-35-deliveries-could-slow-down-as-covid-19-jolts-lockheeds-supply-chain/>

¹⁵ Insinna, V. (19 May 2020). “Lockheed Slated to Miss F-35 Delivery Target in 2020 as Supply Chain Struggles to Keep Up”, retrieved 19 May 2020 from <https://www.defensenews.com/breaking-news/2020/05/19/lockheed-to-slow-f-35-production-as-supply-chain-struggles-to-keep-up/>

¹⁶ Clark, C. (14 May 2020). “Trump on F-35: ‘We Should Make Everything’ in US”, Breaking Defense, retrieved 20 May 2020 from <https://breakingdefense.com/2020/05/trump-on-f-35-we-should-make-everything-in-us/>

¹⁷ Shalal, A., Alper, A. Zengerle, P. (18 May 2020). “US Mulls Paying Companies Tax Breaks to Pull Supply Chains from China”, Reuters, retrieved on 11 June 2020 from <https://www.reuters.com/article/us-usa-china-supply-chains/u-s-mulls-paying-companies-tax-breaks-to-pull-supply-chains-from-china-idUSKBN22U0FH>

¹⁸ Harper, J. (14 April 2020). “Pandemic: Coronavirus Rattles the Defense Industrial Base”, National Defense Magazine, retrieved 14 May 2020 from <https://www.nationaldefensemagazine.org/articles/2020/4/14/coronavirus-rattles-the-defense-industrial-base>

¹⁹ Insinna, V. & Mehta A. (8 April 2020)

²⁰ Maucione, S. (28 April 2020). “Coronavirus Is Hitting Small Defense Companies but There May Be a Silver Lining”, Federal News Network, retrieved 20 May 2020 from <https://federalnewsnetwork.com/defense-main/2020/04/coronavirus-is-hitting-small-defense-companies-but-there-may-be-a-silver-lining/>

or General Dynamics are struggling.²¹ 22 62% of respondents in the NDIA small business survey said that the current crisis affected their cash flow.²³ The longer the crisis lasts, the harder it will be to retain their workforce.

AN UNCERTAIN FUTURE

At this stage it is hard to say what the long-term consequences of the COVID-19 pandemic for the American defence industry will be, but there are a couple of factors that are reason for concern. With over 36 million Americans unemployed as of Mid-May, hopes that the economy would quickly bounce back to pre-pandemic levels have been dashed. With many defence companies at least partly dependent on the commercial market, it is questionable whether the current government support to the industry will be sufficient and how sustainable it is.

The government itself may also become a less reliable client as defence budgets will not remain untouched. Even if the US defence budget should remain steady at 3.2% of the GDP, with the expected losses to overall economic output, the Pentagon is looking at \$350 to \$600 billion in budget losses over the next ten years.²⁴ Furthermore, the pandemic has led to a bipartisan consensus that “national security” needs to be redefined.²⁵ This is likely going to lead to increased pressure to reallocate defence spending to other causes such as the aching US healthcare system.²⁶ Additional pressure on the defence budget could be caused by US efforts to reduce dependencies on international suppliers – especially on China.²⁷ Such relocations to the United States are probably going to be more costly, leaving the Pentagon with even less purchasing power.²⁸ These potentially more expensive supply

²¹ Werner, B. (1 May 2020). “Defense Industry Weathering COVID-19 Economic Slowdown”, USNI News, retrieved on 27 May 2020 from <https://news.usni.org/2020/05/01/defense-industry-weathering-covid-19-economic-slowdown>

²² Insinna, V., Mehta A. (2020, April 8)

²³ NDIA (2020) COVID-19 “Small-Business Impacts Survey – Preliminary Survey Results Summary”, retrieved 20 May 2020 from https://www.ndia.org/-/media/sites/ndia/policy/documents/small-business-covid-19-survey_final.ashx?la=en

²⁴ Egel D., Shatz, H. J., Kumar, K. B., Harshberger T. (7 April 2020). “Defense Budget Implications of the COVID-19 Pandemic”, Commentary RAND Corporation, retrieved 20 May 2020 from <https://www.rand.org/blog/2020/04/defense-budget-implications-of-the-covid-19-pandemic.html>

²⁵ Hartung, W. D & Freeman, B. (17 April 2020). “How the Military-Industrial Complex Is Using the Coronavirus”, The Nation, retrieved 20 May 2020 from <https://www.thenation.com/article/world/coronavirus-defense-budget-spending/>

²⁶ Hartung, W. D & Freeman, B. (17 April 2020).

²⁷ Spiegel, P. and Edgecliffe-Johnson, A. (5 November 2019). “US Navy Secretary Warns of ‘Fragile’ Supply Chain”, Financial Times, retrieved on 27 May 2020 from <https://www.ft.com/content/b9260d54-fcf4-11e9-98fd-4d6c20050229>

²⁸ Egel D., Shatz, H. J., Kumar, K. B., Harshberger T. (7 April 2020)

chains will also have an impact on European suppliers dependent on parts produced in the US, as well as those EU member states buying US produced systems. Additionally, because of increased costs the US industry might be more inclined to push exports more aggressively, creating increased competition for the European defence companies.

With the presidential election on the horizon this November, the issue of defence spending could likely pick up steam. But regardless of who the next President is, defence budgets will likely suffer and the industry will feel the effects. ■

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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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