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

By

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Comment

ABSTRACT

Italy was the first European country affected by COVID-19 and where the pandemic hit the hardest. Its impact on aerospace and defence industry includes short term damages and a mid-term negative pressure on the Ministry of Defence's budget. The damages caused by the 52-day rigid lockdown have been only partially mitigated by the government's economic support. Small and Medium Enterprises suffered the most. The unprecedented increase of Italy's sovereign debt will push fiscal consolidation in the next years, thus impeding any increase of military spending towards NATO targets. As a result, the national DTIB will probably have to cope with limited government investments, hopefully channelled through EU defence initiatives.

Keywords: *Italy, DTIB, Covid-19, Lockdown, Military spending, Sovereign debt, Supply chain*

In Italy, the national Defence Technological Industrial Base (DTIB) is considered a strategic sector in both legal and political terms. From a regulatory point of view, already in 2012 an Italian law established specific norms on “strategic activities” including aerospace, defence and security industries, as well as major shipyards¹. From a political point of view, over the last two decades the Italian governments have consistently stressed the DTIB strategic character in several official documents, including Defence Minister Lorenzo Guerini’s guidelines presented to the Parliament in October 2019². This strategic characterisation did help mitigate the impact of the containment measures taken since March 2020 by Italy. Indeed, major aerospace, defence and naval industries were allowed to work under certain conditions, i.e. by incentivising remote working during the rigid and prolonged lockdown decided by Giuseppe Conte’s government.

However, such an exemption did not mean business as usual. Non-essential offices have been temporarily closed, and smart working was suddenly enforced without being able to properly reorganise neither the technological infrastructure nor the modus operandi. Considering the peculiar security needs of these industries – i.e. in terms of data exchange, documents access, platforms for online meetings, etc. – productivity and efficiency did suffer in order to preserve the companies’ overall security. This has had a negative impact particularly on new international bids. In this context, the impressive success of Fincantieri winning the US Navy contract represents an extraordinary exception³.

More importantly, the lockdown has been fully applied to many Small and Medium Enterprises (SMEs) working for both defence and civilian customers and/or prime contractors, thus creating huge damages in terms of production and revenues. Broadly speaking, the restrictions to people’s movement has also complicated the whole supply chain. Geography also matters. The pandemic has mostly hit regions such as Lombardia, Piemonte, Emilia Romagna, Veneto and Liguria, where the bulk of Italy’s manufactures

¹ Michele Nones, “La difesa delle attività strategiche”, in *AffarInternazionali*, 23 August 2012

² Ministero della Difesa, “Linee programmatiche del Ministro della Difesa”, 30 October 2019

³ Xavier Vavasseur “Fincantieri’s FREMM Wins US Navy FFG(X) Frigate Competition”, in *NavalNews*, 30 April 2020

operate – including the aerospace and defence sector. The former sees important industrial clusters also in Toscana, Lazio, Puglia, and Campania, but its core is in northern Italy. Here, the aforementioned exemption for the defence sector allowed important sites to work at limited pace during the lockdown, including the Final Assembly and Check Out facility in Cameri (Piemonte) which delivers F-35 to Italy and the Netherlands⁴.

Against this backdrop, the DTIB can apply for the economic support put in place by the government for the whole private sector. It includes taxes suspension, special bank loans guaranteed by the state, limited subsidies to SMEs, traditional and extraordinary layoff. They apply to manufacturing, services, etc. without specific provisions for the aerospace and defence sector. For instance, the layoff compensates the work and salaries decrease occurring from 23 February to 31 August 31⁵, thus alleviating labour cost for enterprises. Yet, the overall implementation of this support has been rather slow and it remains to be seen if its volume will be sufficient to deal with the economic emergency. Indeed, Italy's GDP has decreased by 4.8% in the first quarter, and the government foresees a 8% decrease over 2020⁶.

Much will depend on the timeline of the lockdown's gradual end. Most industries have been allowed to reopen since 4 May. Moreover, some regions including Veneto are willing to further ease the containment measures. Should the pandemic diffusion not peak again, the gradual lockdown's end will continue in May and June, and this will greatly help suffering SMEs to avoid bankruptcy. Vice versa, if a pandemic's dramatic revamp forced another quarantine, this would be a deadly blow to a large part of Italy's industrial base, including the supply chain of the aerospace and defence sector.

Beyond the short term, the COVID-19 effect on the Italian DTIB will come mainly through the subsequent state fiscal policies. The combination of economic recession and government measures to help the economy has pushed the planned 2020 deficit at 10.4% of the GDP, followed by a forecasted 5.7% in 2021. Accordingly, the Italian sovereign debt is expected to peak at 155.7% of the GDP in 2020, it was at 134.8% in 2019, and then to

⁴ "Riprende oggi la linea produttiva degli F35 alla Leonardo di Cameri", *La Stampa*, 29 March 2020

⁵ Matteo Prioschi, "Cassa integrazione guadagni in deroga 2020: chi ha diritto e tempi di pagamento", in *Il Sole24Ore*, 11 April 2020

⁶ ANSA, "Pil Italia in calo del 4,7% nel primo trimestre, -4,8% sull'anno", 1 May 2020

slightly decrease at 152.7% in 2021⁷. From that year onwards, a fiscal consolidation path is necessary to bring down both the deficit and the debt, although there are no public statements regarding this yet. This means that the government will already have to review its 2021 spending this year. In this context, within the ruling coalition, the defence budget has already been identified by many senators of the Five Star Movement as a target for savings, but other parliamentarians from the progressive parties Partito Democratico⁸ and Italia Viva⁹ have pushed back this idea.

In any case, the pressure will remain high in both short and mid-term. Some measures undertaken during the pandemic, such as hiring more personnel in public hospitals and schools, imply a structural increase of spending for welfare ministries. This means that the defence budget will not increase as requested by the 2014 NATO pledge. At the same time, the important role duly played by the military against the pandemic got significant media coverage: two military hospitals were set up within 72 hours in northern Italy; more than one hundred military doctors have worked in civilian hospitals; armed forces barracks have hosted 6,700 people affected by COVID-19; transport aircrafts and helicopters have made dozens of flights to move patients or equipment across Italy¹⁰. This may reinforce the political pressure to contribute more to internal security, thus preventing the downsizing of ongoing operation “Strade Sicure” – established in 2008 and employing domestically around 7,000 troops with the related costs¹¹. As a whole, maintaining the 20% investment of the defence budget in procurement and increasing the research and development activities will be difficult. The DTIB will thus have to struggle with an Italian defence budget not fully adequate in terms of both quantity and quality to support industrial cooperation through the European Defence Fund and the Permanent Structured Cooperation, because this budget will not increase and will be unbalanced towards personnel costs. A similar situation may happen in other EU countries should defence spending – and European defence – be victim of the lockdown¹². The hope is that Rome will channel its limited resources through European defence cooperation.

⁷ AGI, “Pil a -8% e perdite per 126 miliardi. Le stime del Def”, 24 April 2020

⁸ AnalisiDifesa, “F-35: così il PD stoppa l’interrogazione di Ferrara (M5S)”, 29 April 2020

⁹ Stefano Pioppi, “Difesa europea e F35. Come tenere la barra dritta secondo Garavini (IV)”, in *Formiche*, 28 April 2020

¹⁰ Alessandro Marrone, “Le Forze armate durante e dopo la pandemia”, in *AffarInternazionali*, 6 April 2020

¹¹ Ministero della Difesa, “Operazioni Militari”, last access 3 May 2020

¹² Alessandro Marrone et alia, “European defence should not be the casualty of ‘the Great Lockdown’”, in *EurActiv*, 27 April 2020

In the end, much will depend on both economic and domestic policies. The more the GDP will rise in 2021, the less military spending will be under pressure. The more politicians will consider the DTIB as part of the whole industrial re-launch needed to cope with the economic recession, the more defence investments will be maintained – and hopefully channelled into European cooperation. ■

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