

#55

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

By

Torben SCHÜTZ

RESEARCH FELLOW, DEUTSCHE GESELLSCHAFT FÜR AUSWÄRTIGE POLITIK (DGAP)

June 2020

*The views expressed here are solely those of the author.
They do not reflect the views of any organisation.*

Comment

ABSTRACT

Germany considers its Defence Technological and Industrial base (DTIB) to be of strategic importance. It is crucial to the security of supply and a building block for cooperation within the EU and NATO. While the government's help to defence companies during the current crisis is quite extensive, it does not differ from that given to other industrial sectors. Moreover, procedural changes aiming to help the DTIB overcome the liquidity crisis caused by the economic shutdown, e.g. in procurement processes, take time to be implemented. Lastly, the mid-term impact on German defence spending is still unknown. Even though Germany is in a comparatively sound position economically, domestic conflict in the coalition government and national elections in 2021 might make defence spending a contentious issue in the coming year.

Keywords: *Germany, DTIB, Covid-19, Lockdown, Military Spending, Sovereign debt, Arms Exports*

Germany considers its Defence Technological and Industrial Base (DTIB) to be of strategic importance both in terms of security and defence policy, and of technology and industrial policy.¹ The German government recently reaffirmed this stance in the latest instalment of the *Strategy Paper of the Federal Government on Strengthening the Security and Defence Industry*² in February 2020, which replaced an earlier version from 2015.³ The German DTIB serves to increase the security of supply for security and defence organisations and the protection of critical national infrastructure. Moreover, an innovative, efficient, and competitive DTIB is seen as an essential building block for the alliance and cooperation capabilities of Germany and the EU, especially within NATO.⁴ In this context, the Europeanisation of armaments projects while preserving national key technologies is intended to increase the interoperability of the armed forces and also to enhance the competitiveness of the defence industry by economies of scale to achieve cost reductions.⁵ However, in the extensive support to industry provided by the German government, this strategic importance has made no difference in the treatment of the DTIB compared to its civilian counterparts during the current crisis.

Measures aimed at containing the spread of COVID-19 and the resulting economic downturn impact the German DTIB in several ways. First, the liquidity problems of individual companies might force them to seek state support in the form of state participation – that is partial ownership – or seeking mergers and acquisitions as a coping mechanism for structural problems arising in the crisis situation. Beyond the mere survival of companies, threats of hostile take-overs by hedge funds or foreign investors can also trigger state participation, at least for the duration of the crisis.⁶ Germany

¹ The Bundesregierung. (2020). *Strategy Paper of the Federal Government on Strengthening the Security and Defence Industry*. Retrieved 7 May 2020, from https://www.bmwi.de/Redaktion/DE/Downloads/S-T/strategiepapier-staerkung-sicherits-und-verteidigungsindustrie-en.pdf?__blob=publicationFile&v=4

² Ibid.

³ The Bundesregierung. (2015). *Strategiepapier der Bundesregierung zur Stärkung der Verteidigungsindustrie in Deutschland*. Retrieved 7 May 2020, from https://www.bmwi.de/Redaktion/DE/Downloads/S-T/strategiepapier-bundesregierung-staerkung-verteidigungsindustrie-deutschland.pdf?__blob=publicationFile&v=1

⁴ Cf. footnote 1.

⁵ Ibid.

⁶ “In an emergency, the state must intervene when technological sovereignty, supply security and critical infrastructures are threatened by hostile takeovers, Altmaier [Federal Minister for Economic Affairs and Energy, T.S.] said.” cf. Beckert, N. (2020). *Der Staat als Großaktionär - Wie die Coronakrise zu einer neuen Deutschland AG führen könnte*. Retrieved 8

updated and tightened its foreign direct investment (FDI) rules after the 2019 EU FDI legislation came into force in order to implement the EU regulation.⁷ Now, the Federal Ministry for Economic Affairs (BMWi) screens acquisition plans on a case-by-case basis. “Any acquisition of a company by foreign investors whereby these acquire ownership of at least 10% of the voting rights of a company resident in Germany can be subjected to such review.”⁸ Moreover, each screening “considers whether the respective acquisition poses a threat to the public order or security of the Federal Republic of Germany”⁹. Current economic hardships might also accelerate already ongoing structural changes in the German DTIB, even though other considerations initially triggered these. One example is the planned merger between two of the largest German naval yards: Lürssen and German Naval Yards.¹⁰

Second, COVID-19-related shutdowns disrupted both domestic and international supply chains. Besides the apparent interruption of supply chains due to a lack of production and logistics, the asynchrony of the crisis compounds the problem as production plans might falter due to the temporary absence of specific components. This asynchrony is likely more of a challenge for genuinely multinational companies such as Airbus and multinational programmes with geographically dispersed production facilities such as the Eurofighter. Nevertheless, it certainly affects most suppliers in one way or the other. Lastly, handling the crisis also binds valuable internal resources as companies have to intensify emergency planning and take measures such as changing production processes to protect employees against the virus.¹¹

Currently, a strong dependency on state contracts in the defence realm seems to be an advantage compared to the civilian markets. Being able to offset decreasing civilian turnovers with defence-related ones appears at least to be working for some companies. Rheinmetall, for example, does not expect grave economic consequences in its own business and for the year 2020 as it can offset losses in the automotive sector with

May 2020, from <https://www.tagesspiegel.de/wirtschaft/der-staat-als-grossaktionaer-wie-die-coronakrise-zu-einer-neuen-deutschland-ag-fuehren-koennte/25720006.html>

⁷ European Commission. (2019). *EU foreign investment screening regulation enters into force*. Retrieved 28 May 2020, from <http://trade.ec.europa.eu/doclib/press/index.cfm?id=2008>

⁸ Federal Ministry for Economic Affairs. (2020). *Investment screening*. Retrieved 28 May 2020, from <https://www.bmwi.de/Redaktion/EN/Artikel/Foreign-Trade/investment-screening.html>

⁹ Cf. footnote 8.

¹⁰ Frank, D. (2020). *Fusion von Lürssen und Germany Naval Yards*. Retrieved 14 May 2020, from <https://esut.de/2020/05/meldungen/20536/fusion-von-luerssen-und-german-naval-yards/>

¹¹ Federation of German Security and Defence Industries (BDSV). (2020). *Wochenmitte zum 15.04.2020 - Auswirkungen des Corona-Virus auf die Sicherheits- und Verteidigungsindustrie*. (unpublished federation-internal newsletter). p.1.

turnover from the defence sector.¹² Other sectors face more significant challenges, though: Airbus, mainly depending on the probably worst-hit industry – civilian airlines – might find it difficult to compensate for the loss of money in the division that generates three-quarters of its turnover. Though, according to a poll among defence companies, the most significant problem for the defence industry seems to lie in the postponement of approved and budgeted projects by the client (both related to exports, but also to the German state).¹³

Other support measures by the state are welcomed and used by about a third of security and defence industrial companies organised in the BDSV.¹⁴ Two support measures stand out. First, the Kurzarbeitergeld (literally: short-time work compensation) in which the state temporarily pays part of the employees' salaries. This measure will help to retain skilled workers in companies, thus mitigating their loss of valuable "on-the-job"-experience. Second, credits from the state-owned development bank Kreditanstalt für Wiederaufbau (Credit Institute for Reconstruction) are helping companies to reduce stress on their liquidity and profit.¹⁵ Moreover, the KfW credits features a dedicated programme for small and medium enterprises (SMEs), which make up a considerable part of the German DTIB. Other reforms designed to serve the same purpose seem to take effect as well: the Bundesamt für Ausrüstung, Informationstechnik und Nutzung der Bundeswehr (Federal Office of Bundeswehr Equipment, Information Technology and In-Service Support), is apparently in the process of splitting projects into smaller chunks and pulling milestones forward to enable earlier pay-outs to companies.¹⁶ However, the cooperation between companies and the procurement agency is not without problems: The rapid switch to teleworking has disrupted workflows and complicated contacts between the agency and defence companies – both in everyday procedural coordination for ongoing projects as well as the acceptance of new equipment by the agency.¹⁷

¹² Süddeutsche Zeitung. (2020). *Rheinmetall sieht keine gravierenden Folgen der Coronakrise*. Retrieved 9 May 2020, from <https://www.sueddeutsche.de/wirtschaft/ruestungsindustrie-duesseldorf-rheinmetall-sieht-keine-gravierenden-folgen-der-coronakrise-dpa.urn-newsml-dpa-com-20090101-200318-99-377409>

¹³ Cf. footnote 11. p.1.

¹⁴ The BDSV is very representative of the German DTIB, which means this statement can rather safely be extrapolated.

¹⁵ Cf. footnote 11. p.2.

¹⁶ Author's notes from Webtalks by the *Economic Council (Wirtschaftsrat der CDU e.V.)*, which is a German business association representing the interests of more than 11,000 small and medium sized firms, as well as larger multinational companies. Cf. The Economic Council. (unknown). *The Economic Council*. Retrieved May 11, 2020, from <https://www.wirtschaftsrat.de/wirtschaftsrat.nsf/id/english-de>

¹⁷ Cf. footnote 16.

German Industry Support Measures - Overview	
Restriction to lockdown measures for DTIB - No	
Cash flow support measures	Procurement agency is splitting projects into smaller chunks and pulling milestones forward : specific to DTIB
Suppression of penalties for delay	If industrial partners can prove causality between the lack of readiness to deliver/contractual performance and the corona pandemic, no penalties can be applied
Specific support to SMEs	Extra credit programme for SMEs by the state-owned development bank KfW : non specific to DTIB
Extra orders to sustain industry or anticipated orders	Ministries and agencies are tasked to find areas for short-term investments to prop up demand : non specific to DTIB
Measures to limit the lay-off	Kurzarbeitergeld, a measure in which the state pays a part of the employees' wages : non specific to DTIB

So far, the effect of the crisis on defence budgetary planning in Germany is unknown. While the defence budget for 2020 will be larger than in 2019 – totaling about € 45 billion¹⁸, and the defence expenditure as NATO counts it comes in it at about € 50.4 billion for 2020¹⁹ – no mid-term spending plan taking COVID-19 effects into account has been published so far. However, compared to previous estimates, tax revenues are expected to be € 300 billion lower in the coming years out to 2024.²⁰ This situation might lead to conflict within the governing coalition, especially regarding the way to reach NATO's 2 percent goal until 2030, as well as the intermediate goal to reach 1.5 percent in 2024. This

¹⁸ Federal Ministry of Finance. (2020). *Bundeshaushalt Einzelplan 14*. Retrieved on 28 May 2020 from <https://www.bundeshaushalt.de/#/2020/soll/ausgaben/einzelplan/14.html>

¹⁹ Tagesschau. (2020). *Deutschland kommt Zwei-Prozent-Ziel näher*. Retrieved on 28 May 2020 from <https://www.tagesschau.de/inland/militaerausgaben-deutschland-nato-101.html>

²⁰ Ismar, G. (2020). *Es fehlen 100 Milliarden Euro an Steuern - Die Coronakrise stellt Bund, Länder und Kommunen vor Riesen-Probleme*. Retrieved 11 May 2020, from <https://www.tagesspiegel.de/politik/es-fehlen-100-milliarden-euro-an-steuern-wie-die-coronakrise-haushalt-und-gesellschaft-belastet/25820534.html>

conflict will persist even though Germany might already temporarily reach 1.5 percent in 2020, as the immediate economic impact of the crisis and the “lag” of the defence budgetary planning could lead to a spike in the percentage – at about 1.58 percent in 2020.²¹ Lastly, 2021 will see federal elections in Germany, and defence spending might very well become a contentious issue in the election campaign. As seen with the recent debate about Germany’s role in NATO’s nuclear sharing, the Social Democratic Party (SPD), currently part of the coalition government with the Christian Democratic Union (CDU), seems to be moving into a more pacifist direction. Moreover, public support for higher defence spending shrinks as the shock of the Ukraine crisis in 2014 wears off.²² ■

²¹ Cf. footnote 19.

²² See for example: Steinbreher, M. ; Graf, T. ; Biehl, H. (2020). *Sicherheits- und verteidigungspolitisches Meinungsbild in der Bundesrepublik Deutschland*. Zentrum für Militärgeschichte und Sozialwissenschaften der Bundeswehr, retrieved 28 May 2020 from http://www.zmsbw.de/html/einsatzunterstuetzung/downloads/1_zmsbwbevoelkerungsumfrage2019.pdf. p.149.

#55

Comment

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

BY

Torben SCHÜTZ / RESEARCH FELLOW, DEUTSCHE GESELLSCHAFT FÜR AUSWÄRTIGE POLITIK (DGAP)

June 2020

The views expressed here are solely those of the author. They do not reflect the views of any organisation.

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.

CONTACT [Pilots]:

Jean-Pierre Maulny, Édouard Simon, Olivier de France, Sylvie Matelly

ares@iris-france.org

+33 (0)1 53 27 60 60

www.iris-france.org/ares

#AresGroup