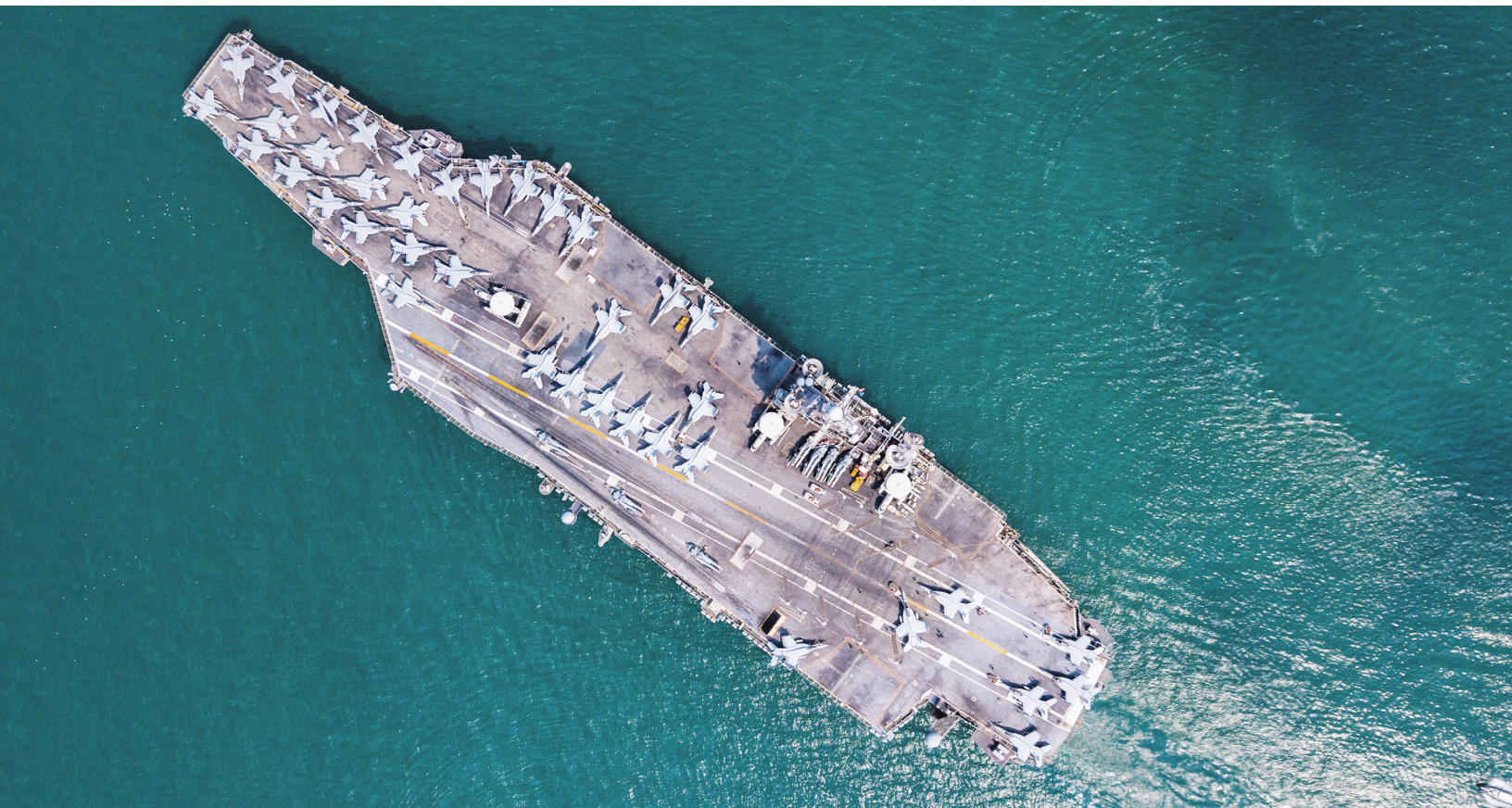


Aerospace & Defense Practice

# Aerospace and defense spending: What will be the next normal?

Defense budgets might be stable now, but governments may reduce spending in the aftermath of the COVID-19 pandemic.

*by John Dowdy*



**The rapid onset of the coronavirus** has had starkly different effects on industries. In commercial aerospace, suppliers saw profits fall precipitously as flights were grounded, production rates dropped, and whole factories idled. In contrast, defense markets and manufacturers appear to be largely unscathed, although they have weathered some disruptions. But this may soon change. Defense spending is driven by annual budget cycles rather than daily load factor, so changes can take longer to manifest. As we enter a new fiscal year, defense manufacturers could face big headwinds.

The shift may not occur immediately, however. Broadly speaking, two factors have historically had the most influence on defense spending: threats and affordability. Both will come into play in the aftermath of the coronavirus pandemic as governments calibrate the relative importance of the threats they face against their new economic realities. In keeping with past patterns, countries may give most weight to threats, real or perceived, over the near term. If there are anticipated or ongoing conflicts, their defense budgets will probably increase. Over the longer term, however, economic factors tend to prevail, and governments may set defense budgets in line with their diminished resources.

### **Shifting priorities**

COVID-19 is a human tragedy, above all, and the continued spread of the coronavirus remains a principal source of global uncertainty. But as my colleagues have argued, we must solve for both the coronavirus *and* the economy; the dual imperative of our time is the desire to preserve lives and livelihoods. Both will require substantial resources for public health and for economic rejuvenation. Many countries are reallocating substantial sums to disaster assistance and health measures to preserve lives. Although this shift is essential during the pandemic, it will likely put enormous pressure on the public purse and could force cuts in other areas.

South Korea shows early signs of this trend, with leaders recently announcing that they were shifting resources to disaster relief in response to the pandemic. Money came from education, agriculture, and environmental protection but mostly from defense.<sup>1</sup> This example is particularly significant, given that South Korea is still technically at war, frozen in conflict with its immediate neighbor to the north. Furthermore, South Korea was more effective than its peers in addressing the public-health dimensions of the pandemic, since a swift medical response and widespread testing allowed the country to reopen its economy faster than other advanced countries. If South Korea is altering its budgetary priorities, others are likely to follow.

History is also instructive when contemplating future defense budgets. When the German Council on Foreign Relations analyzed defense spending in the aftermath of the 2008 global financial crisis, it found that many European countries cut their defense expenditures by a greater proportion than the fall in their GDP—roughly 1.5 times as much.<sup>2</sup> In broad terms, a 10 percent decline in GDP translated into a more than 15 percent reduction in defense expenditures.

Now consider available government funds. Public debt was mounting in many advanced economies even before the global financial crisis of 2008, and it swelled further as the recession caused a drop in tax revenues and a rise in social-safety-net payments. As the recession eased, many expected to see a wave of deleveraging. But from 2008 to mid-2017, global government debt more than doubled to reach almost \$60 trillion. Consequently, countries now face greater financial constraints because they have less dry powder than they did in 2008.

Although the future is highly uncertain, scenarios suggest that the economic impact of the COVID-19 pandemic could exceed anything experienced since World War II. If historic trends repeat, governments

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<sup>1</sup> Jon Grevatt, "Covid-19: South Korea cuts defence budget in response to pandemic," *Jane's*, April 16, 2020, janes.com.

<sup>2</sup> Sophia Becker, Christian Mölling, and Torben Shütz, "Deterrence and defense in times of COVID-19: Europe's political choices," *DGAP Policy Brief*, April 9, 2020, Number 9, pp. 1–10, dgap.org.

# The pandemic has taught us the value of resilience and planning ahead.

are likely to curtail defense spending to fund other priorities. But with government debt at high levels, there is less money to go around. Together, these forces may put many countries on the brink of a deficit-driven defense downturn.

## Valuing resilience

Is the world is going to be any safer or more dangerous than it was a few months ago? Writing in *Foreign Affairs*, Barry R. Posen considered this question as he contemplated whether the pandemic has increased or decreased the motive and opportunity of states to wage war.<sup>3</sup> He pointed to the inhibition caused by economic hardship and the pacifying effect of pessimism to argue that defense budgets may decline. Time will tell if he is correct.

Regardless of the size of a country's defense budget, there may well be changes in how governments define national security—and that could shift priorities for defense missions and tasks. The

pandemic has taught us the value of resilience and planning ahead. Although defense budgets have normally been fairly “sticky,” the coronavirus might prompt leaders to favor investments that bolster national resilience and take a homeland-first lens. Their new focus could include traditional capabilities, such as robust air defense and strengthened coastal defenses, as well as cybersecurity, enhanced protection of national infrastructure, greater capacity to support civil authorities in a national emergency, and, of course, biodefense.

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The post-9/11 era might be giving way to a postpandemic paradigm. Whether this next normal will permanently alter the world order is still uncertain, but it is likely to have drastic implications on how leaders think about national security and foreign policy. One thing seems quite clear: absent an escalation or emerging tensions in great-power competition, we can expect downward pressure on defense budgets around the world.

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<sup>3</sup> Barry R. Posen, “Do pandemics promote peace? Why sickness slows the march to war,” *Foreign Affairs*, April 23, 2020, [foreignaffairs.com](https://www.foreignaffairs.com).

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