

June 2020

# country report

Konrad-Adenauer-Stiftung Office USA, Washington, D.C.



## COVID-19 crisis exposes U.S. vulnerabilities in its supply chain

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### Is globalization still the model for the United States?

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In this election year in the United States one is reminded of President Trump's iconic slogan of his 2016 election campaign, "Make America Great Again." He promised he would bring well-paid manufacturing jobs back to the U.S., increase U.S. exports and reduce the American trade deficit. COVID-19 has confronted his efforts with the highest unemployment levels in America since the Great Depression in the 1930's. This serious dilemma has renewed a sense of urgency to create more manufacturing jobs in America and to become less reliant on outside sources for critical goods.

### Globalization in retreat

Even before the outbreak of the coronavirus disease (COVID-19), there was a discernible rise in U.S. protectionism coupled with tensions with its trading partners, in particular with China. There were warning signs that globalization, along with the institutions that foster it, were weakening. The pandemic, with its accompanying exposure of supply chain fragility, has accelerated this unraveling with calls in the United States to decouple from China and make the U.S. economy less dependent on manufacturing and supply chains with China. In particular, the pandemic in its early outbreak stages, illustrated U.S. shortages in medical supplies due to its dependence on the global market. The question arises, will decoupling from China be the harbinger of the end of globalization as the U.S. model?

Keith Krach, undersecretary at the State Department, emphasizes that the U.S. government has been working on reducing the reliance on foreign supply chains and that the Administration is turbo-charging this initiative. He elaborates that the Trump Administration is forging the "Economic Prosperity Network" where they will establish alliances among "trusted partners" and move U.S. production and supply chains away from China and back to America.<sup>1</sup> On May 26, the Trump Administration sent a comprehensive report to the U.S. Congress, *U.S. Strategic Approach to the People's Republic of China*, which is intended to be an amendment to the 2017 *National Security Strategy of the U.S.* The report reinforces the message that the U.S. sees itself in strategic competition with China and calls for "principled realism" regarding the U.S.-China relationship. The report does not use the word decoupling but emphasizes the willingness of the U.S. to take action against China when the U.S. sees its vital national interest at stake.<sup>2</sup>

The U.S. economy is deeply embedded in the global market. U.S. total trade with the world, including goods and services, was \$5.6 trillion in 2019 or equivalent to 26 percent of its GDP.

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<sup>1</sup> Krach, Keith. (2020, May 14). *The Economic Prosperity Network* [Video file]. Retrieved from <https://www.youtube.com/watch?v=upV9gh8yMSY>

<sup>2</sup> The White House (2020, May 26). *United States Strategic Approach to the People's Republic of China*.

China not only makes up 11 percent of total U.S. trade volume but is also the largest supplier for U.S. imports with U.S. importing \$471.4 billion in 2019.<sup>3</sup> Worldwide supply chains for multinational corporations make up 80 percent of world trade with intermediate goods being almost twice as big as trade in finished goods. For advanced manufacturing, as in the automobile sector, intermediate goods are especially important.<sup>4</sup>

Douglas Irwin of Dartmouth College and the Peterson Institute for International Economics points out that globalization – even prior to the COVID-19 crisis – has been receding since the financial crisis in 2008 with no significant recovery. There has been a decline of interdependence and integration through trade and investments, which has been coined “slowbalization” or even deglobalization.<sup>5</sup>

## National economic security vulnerabilities

The Trump Administration and a bipartisan U.S. Congress have been united in their concern about the Chinese company Huawei in its global presence as a maker of 5G telecom infrastructure. The Trump Administration has been preventing Huawei selling 5G equipment in the U.S. and has carried out a forceful diplomacy with governments around the world to similarly reject the use of Huawei 5G technologies. Huawei is considered to be intimately tied to the Chinese government and Chinese communist party. Their 5G technologies, the U.S. Administration alleges, could enable the Chinese government to spy on users of its technology. The case of Huawei and its 5G technology has become the symbol of the need for the U.S. national security policy to integrate economic and technology security concepts.

Back in February 2019, Senator Marco Rubio, Chairman of the Small Business and Entrepreneurship Committee, released a report “Made in China 2025 and the Future of American Industry.” The report outlines how key industry sectors in the U.S. need to respond to Chinese government ambitions to become the global leader in innovation and manufacturing. The report details U.S. loss of competitiveness and its global standing in manufacturing sectors vis-a-vis China, including aerospace, new energy vehicles, next-generation IT, advanced railway capabilities, biotechnology, robotics, energy and power generation, new materials, and agricultural machinery. This report’s central conclusion is that the U.S. needs a roadmap whereby the U.S. government reassesses its economic and trade policy options.<sup>6</sup>

The U.S.-China Economic and Security Review Commission (USCC), a bipartisan advisory body to U.S. Congress, published in November its 2019 annual report with policy recommendations to counter China’s ambition to build a world-class military structure, and also to lead in economic prowess and technological capabilities. Prominent in the report is the growing concern of U.S. reliance on China’s AI knowledge, new energy applications, new materials usages, and their advances in biotech and pharmaceutical products. It warns of the growing numbers of U.S. consumers who have become “heavily dependent” on China for

<sup>3</sup> Bureau of Economic Analysis, U.S. Department of Commerce. (2020, May 27). Retrieved from <https://www.bea.gov/data/intl-trade-investment/international-trade-goods-and-services> and <https://www.bea.gov/data/gdp/gross-domestic-product>

<sup>4</sup> UN Conference on Trade and Development (UNCTAD). (2013, February 27). *Global Value Chain and Development*. Retrieved from <https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=411>

<sup>5</sup> Irwin, Douglas A. (2020, April 23). *Globalization is in retreat for the first time since the Second World War*. Peterson Institute for International Economics. <https://www.piie.com/research/piie-charts/globalization-retreat-first-time-second-world-war>

<sup>6</sup> U.S. Senate Committee on Small Business & Entrepreneurship. (2019, February 12). *Made in China 2025 and the future of American industry*. [https://www.rubio.senate.gov/public/\\_cache/files/0acec42a-d4a8-43bd-8608-a3482371f494/262B39A37119D9DCFE023B907F54BF03.02.12.19-final-sbc-project-mic-2025-report.pdf](https://www.rubio.senate.gov/public/_cache/files/0acec42a-d4a8-43bd-8608-a3482371f494/262B39A37119D9DCFE023B907F54BF03.02.12.19-final-sbc-project-mic-2025-report.pdf)

drugs and active pharmaceutical ingredients. The argument is that this presents economic and national security risks and, “should Beijing opt to use U.S. dependence on China as an economic weapon and cut supplies of critical drugs, it would have a serious effect on the health of U.S. consumers.”<sup>7</sup>

Early in December 2019 and before the coronavirus became a pandemic, high-ranking Senators from both parties, among them Senator Mitt Romney (R-Utah) and Senator Elizabeth Warren (D-Massachusetts), raised concerns in a letter to Defense Secretary Mark T. Esper about U.S. “growing reliance” on drug products made in China and ask how the U.S. Defense Department and other key federal agencies intend to address this posing danger.<sup>8</sup>

The COVID-19 crisis has revealed U.S. vulnerabilities in a number of sectors. What is partially driving the U.S. to act in securing its supply chain is the concern that the Chinese government could weaponize existing interdependence in the U.S. supply chain by imposing export restrictions. One only needs to go back to 2010 during the dispute between China and Japan over the Senkaku (Diaoyu) islands, when China decided to limit its rare earth metals (REM) exports to Japan. Similarly, in 2010 China significantly reduced its exports of REM to the U.S. through export controls that were WTO non-compliant. Despite public and private initiatives taken to reduce U.S. dependence, the U.S. remained 74 percent dependent on REM from China.<sup>9</sup> Currently to address this issue, Senator Ted Cruz (R-Texas) has introduced legislation that seeks to establish domestic supply chain and to require the Defense Department to source REM from American production.

### COVID-19 pandemic supply chain vulnerability

The COVID-19 pandemic “turbo-charged” the urgency in the United States demanding to decouple from China and re-shore for critical supply chains. Americans realized that many medical supplies, medicines and medical chemicals as well as health care products were made only, or primarily, in China and thereby creating a heavy reliance the People's Republic.

The Commissioner of the Food and Drug Administration Stephen M. Hahn M.D. announced on February 27, 2020, that the FDA is closely monitoring the supply chain with the expectation that the COVID-19 outbreak would likely impact the medical product supply chain, including potential disruptions to supply or shortages of critical medical products in the U.S. He stated, “Because of China’s role as a major U.S. and global supplier of medical PPE, medical devices, antibiotics and active pharmaceutical ingredients, reduced exports from China have led to shortages of critical medical supplies in the U.S.” The FDA press announcement highlights that it had identified around 20 drugs that are solely sourced from China as well as 72 facilities in China that produce essential medical devices.<sup>10</sup>

In a report on medical supply chain and other trade issues, the Congressional Research Service, Congress’ think tank, provides an in-depth analysis on how shortages in medical

<sup>7</sup> U.S.-China Economic and Security Review Commission. (2019, November 14). *2019 Report to Congress*. Retrieved from: <https://www.uscc.gov/annual-report/2019-annual-report>

<sup>8</sup> U.S. Senate Letter to Secretary of Defense Mark Esper (2019, December 5). Retrieved from: <https://www.warren.senate.gov/imo/media/doc/2019.12.05%20Letter%20to%20DoD%20re%20pharmaceutical%20product%20supply%20chain.pdf>

<sup>9</sup> Congressional Research Service. (2019, June 28). *Trade Dispute with China and Rare Earth Elements*. Retrieved from: <https://crsreports.congress.gov/product/pdf/IF/IF11259>

<sup>10</sup> Food and Drug Administration. (2020, February 27). Press Announcement: *Coronavirus Supply Chain Update*. Retrieved from: <https://www.fda.gov/news-events/press-announcements/coronavirus-covid-19-supply-chain-update>

supplies grew, concomitant with an ever-increasing U.S. dependence on Chinese manufacturing and supply chains. The report argues that COVID-19 has broader implications on the interconnectivity of U.S. trade relations and more generally U.S. reliance on manufacturing and supply chains. It further argues that tariff liberalization alone is inadequate to address industrial policies needed to guarantee international regulatory standards, procurement terms and local content requirements. The report stops short of advising the U.S. government to seek comprehensive free trade agreements with regional partners, as for example to re-engage in a Trans-Pacific Partnership (TPP).

## U.S. government measures

Almost on a daily basis, the Trump Administration and the U.S. Congress signal their concerns about national security and health-related issues on the subject of supply chain, with PPEs only being the tip of the iceberg.

There are a number of drafts of legislation circulating in U.S. Congress regarding American supply chain security. Both chambers of Congress and both the Democratic and Republican Party are writing bills to decrease U.S. reliance on imports from China. When addressing U.S. dependence on China, they have medical supplies and defense-related goods on the top of the list. For example, there is the bipartisan and bicameral bill, *Strengthening America's Supply Chain and National Security* (S. 3538 and H.R. 6393), that was introduced in March 19 which prioritizes U.S. productive capacities and requires the Department of Defense to submit a report to Congress on U.S. reliance of certain imports of pharmaceutical products made abroad.

The U.S. Senate passed the *Holding Foreign Companies Accountable Act* (S.945) on May 20. As of the beginning of June, the bill has yet to be put up for a vote in the U.S. House of Representatives. Picking up on the recommendations made by the USCC, this bill would bar companies from issuing securities on the U.S. securities exchange if it failed to comply with the U.S. Public Company Accounting Oversight Board's audits for three years in a row. Although this bipartisan legislation is written to apply to all foreign companies, it is really targeting Chinese companies.

In response to the COVID-19 crisis, President Trump invoked the *Defense Production Act* on May 14 and signed into law an executive order authorizing America's development bank, the U.S. Development Finance Corporation (DFC), to invest into American manufacturing capabilities and shore up its supply chains.<sup>11</sup> The irony is that the DFC was created in 2018 to invest in economic projects in developing countries. On the same day when he spoke at a medical supply distribution warehouse in Allentown, Pennsylvania, he stated that the DFC "will now also invest in our country, helping to bring vital factories, pharmaceutical producers, and most importantly, jobs back home, where they belong."<sup>12</sup>

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<sup>11</sup> The White House. (2020, May 14). Executive Order: *EO on Delegating Authority Under the DPA to the CEO of the U.S. International Development Finance Corporation to Respond to the Covid-19 Outbreak*. Retrieved from: <https://www.whitehouse.gov/presidential-actions/eo-delegating-authority-dpa-ceo-u-s-international-development-finance-corporation-respond-covid-19-outbreak/>

<sup>12</sup> The White House. (2020, May 14). *Remarks by President Trump at Owens & Minor, Inc. Distribution Center; Allentown, PA*. Retrieved from: <https://www.whitehouse.gov/briefings-statements/remarks-president-trump-owens-minor-inc-distribution-center-allentown-pa/>

## Decoupling from China?

Stakeholders and policy experts in the White House plus Congress and think tanks are debating the level and nature of how to protect vital American supply chain relationships with China.

Nowadays, total decoupling has an assertive voice in the White House. Peter Navarro, President Trump's economic adviser, urges the U.S. to move away from its reliance on other nations and move toward generally building up its own manufacturing capabilities. During the White House press briefing on April 2, Navarro said "One of the things that this crisis has taught us (...) is that we are dangerously overdependent on a global supply chain." And that further, "Never again should we rely on the rest of the world for our essential medicines and (medical) countermeasures."<sup>13</sup>

Some commentators encourage that the U.S. embrace allies as trusted networks in American supply chains. James Jay Carafano, Vice President at The Heritage Foundation, emphasized that the U.S. should strengthen partnerships with "like-minded partners" and make them central to the U.S. supply chain. "America is better off doing business with its friends. Concern about the United States' over-reliance on trade with and supply chains based in China is certainly justified."<sup>14</sup> In a counter evaluation to such measures, Ian Bremmer, President of Eurasia Group and political risk consultant, sees global trading partners moving towards a fracturing of the global economy and the geopolitical environment. This development, which had already been a trajectory, is now accelerated due to the COVID-19 pandemic. He predicts that such de-globalization will be felt throughout the entire tech space, where there will be two different 5G systems, two different clouds, two different filters for data, and two different digital economies. In the long-term he expects that the interdependency between China and the U.S. will unwind.<sup>15</sup>

There are other ways of assuring U.S. access to critical products while at the same time minimizing vulnerabilities. Gary J. Schmitt at American Enterprise Institute and Craig Kennedy at The American Interest in a paper suggest regulating imports of strategic products where U.S. security and public health might be affected. Both authors recommend a supply chain analysis similar to what is done under CFIUS (Committee on Foreign Investment in the U.S.) where foreign entities are scrutinized when trying to buy American assets. The goal is to ensure that the U.S. is not dependent on strategic goods made in China.<sup>16</sup>

Skepticism for decoupling and re-shoring exists in the U.S. business community. John Murphy, senior vice president for international policy at the U.S. Chamber of Commerce, points out that building new manufacturing facilities in the U.S. could take many years and

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<sup>13</sup> White House Press Briefing. (2020, April 2). Retrieved from: <https://www.whitehouse.gov/briefings-statements/remarks-president-trump-vice-president-pence-members-coronavirus-task-force-press-briefing-17/>

<sup>14</sup> Carafano, James J. (2020, May 4). *Trump's New Marshall Plan*. Retrieved from: <https://www.heritage.org/defense/commentary/trumps-new-marshall-plan>

<sup>15</sup> The Chicago Council on Global Affairs (2020, April 20). Webinar: *Ian Bremmer on Geopolitical Risk in 2020*. Retrieved from: <https://www.thechicagocouncil.org/event/live-stream-ian-bremmer-geopolitical-risk-2020>

<sup>16</sup> Schmitt, Gary J. and Kennedy, Craig. (2020, May 1). *One Concrete Way to Start Decoupling with China*. Retrieved from: <https://www.the-american-interest.com/2020/05/01/one-concrete-way-to-start-decoupling-with-china/>

that, "We're concerned that officials need to get the right fact sets before they start looking at alternatives."<sup>17</sup>

## Conclusion

Many American policymakers and policy commentators contend that U.S. supply chains are too vulnerable and too global. In particular, they point to Chinese manufacturing supply chains. The COVID-19 crisis magnifies the urgency of global supply chain over-dependence and public health vulnerabilities with respect to medical supplies, equipment and pharmaceutical ingredients. Decoupling from China and re-shoring of manufacturing supply chains back home to America are being actively debated in Washington D.C. Some kind of revitalization of domestic U.S. supply chains and diversification of supply chains away from China, especially in medical equipment, is likely to be in the works. American policymakers and policy commentators are expanding the definition of national security to mean national economic security and national health security. They are debating fundamental questions about the U.S. role in the world.

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<sup>17</sup> Pamuk, Humeyra and Shalal, Andrea. (2020, May 4). *Trump administration pushing to rip global supply chains from China: officials*. Reuters. Retrieved from: <https://www.reuters.com/article/us-health-coronavirus-usa-china-administration-pushing-to-rip-global-supply-chains-from-china-officials-idUSKBN22G0BZ>