

# SECURING AMERICA'S SUPPLY CHAINS

## A Proposal for a Trusted Country System in Federal Procurement Policy

**A Report of the Strategic Supply Chain Initiative**

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# Executive Summary

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Domestic content rules and trusted sourcing as elements of federal procurement policy can play an important role in ensuring the resilience of supply chains that are essential to U.S. national security, economic continuity or long-term industrial capacity. Unfortunately, the Buy American Act of 1933 and other major procurement laws were enacted before the present era of global value chains (GVCs) and transnational production. Rather than try to patch up an anachronistic framework that originated nearly a century ago when both the U.S. and global economies were radically different, the federal government should replace the Buy American Act, the Trade Agreements Act (TAA) and other legacy laws and regulations with a new, comprehensive strategic supply chain legal framework to govern federal procurement policy.

We propose a new Trusted Country System based on critical components identified by stress tests of supply chains. The new Trusted Country system would replace the existing price-preference system embodied in Buy American, along with domestic or regional content rules in some areas, for a more flexible and targeted country of origin system that focuses on critical components and the industries that supply them. The Trusted Country System would minimize bureaucratic complexity and needless costs to businesses in the U.S. and allied nations, while maximizing U.S. supply chain security. In the words of U.S. Treasury Secretary Janet Yellen, “Favoring the friend-shoring of supply chains to a large number of trusted countries, so we can continue to securely extend market access, will lower the risks to our economy as well as to our trusted trade partners.”<sup>i</sup>

## **Additional Information**

### ***Domestic Sourcing and Federal Procurement: Legacy Legislation***

Domestic-content rules that govern federal procurement are based on a number of statutes and treaties that have been enacted or ratified over nearly a century, beginning in 1933.

#### **Buy American Act of 1933**

The Buy American Act of 1933 (41 U.S.C. §§ 8301-8305), as amended, generally prevents federal agencies from purchasing or leasing ‘foreign’ goods by requiring federal agencies to purchase

'domestic end products' and/or use 'domestic construction materials' in certain contracts above minimal monetary thresholds, absent waivers. Enacted in 1933, it is one of the earliest purchasing restrictions involving domestic content.

### **The Berry Amendment (1941)**

The Berry Amendment (10 U.S.C. §2533a) was enacted in 1941. At that time, it was narrowly tailored to ensure that US military uniforms and food for the military were produced in the US. Since then, items such as specialty metals were added. The amendment became permanent with the FY2002 National Defense Authorization Act (PL 107-107). Today, certain items that the Department of Defense purchases are required to be 100% domestic in origin (including the inputs of the purchased items and production).

### **The Kissell Amendment (2009)**

The Kissell Amendment (6 U.S.C. §453b) was enacted in 2009 and made permanent in 2013. It requires certain agencies in the Department of Homeland security to buy textiles, clothing and footwear from domestic sources when using appropriated funds to purchase these items and they are directly related to national security interests. As a practical matter, the Kissell amendment only applies in situations in which a trade agreement does not apply.

### **Trade Expansion Act of 1962 Section 232**

Through Section 232 of the Trade Expansion Act of 1962 (19 U.S.C. §1862), Congress delegated to the President the ability to impose restrictions on certain imports based on an affirmative determination by the Commerce Department that the product "is being imported in the United States in such quantities or under such circumstances as to threaten to impair the national security". Any interested party may request a Section 232 investigation and there are tight timelines on the Commerce department's investigation authority and the President's authority to take action. There have been a total of 34 investigations between 1962 and 2020.

Though enacted in 1962, this section continued provisions of the Trade Agreements Extension Act of 1958, which, in turn, expanded provisions of the Trade Agreements Act of 1954. Amendments to Section 232 of the Trade Expansion Act of 1962 have changed time limits, the advisory body, and limited the President's authority to adjust petroleum imports.

### **The Trade Agreements Act of 1979 (TAA)**

The Trade Agreements Act of 1979, as amended (19 U.S.C. §§ 2501-2581), allows the Buy American Act to be waived in the case of "eligible products" from "designated countries" in cases of federal procurement above a minimal designated dollar amount.

## **Build America, Buy America Act (BABAA) (2021)**

The Build America, Buy America Act (BABAA) was included in the Infrastructure Investment and Jobs Act (IIJA) signed into law at the end of 2021. The Act extends the reach of Buy America domestic preferences to federal financial assistance programs for infrastructure. It requires that all iron and steel, manufactured products and construction materials used in an impacted infrastructure project be produced in the United States. In addition to increasing transparency and limitations in the waiver process, it creates a Made in America Office in the Office of Management and Budget and directs the provisions be applied consistently with US obligations under international trade agreements affecting government procurement.

## **CHIPS and Science Act (August 2022)**

The CHIPS and Science Act (P.L. - 117-167) provides substantial financial incentives for the manufacture of advanced semiconductors in the U.S. through R&D and funding for previously passed legislation.

## **Miscellaneous Domestic and Regional Content Rules**

In addition to these major legislative frameworks, specific “buy America” procurement provisions are scattered through federal laws and trade treaties including the United States-Mexico-Canada Agreement (USMCA) include rules of origin requiring regional content to qualify for tariff-free treatment (75 percent in the case of automobile products under the USMCA). In addition, there are numerous executive orders to promote domestic content, deriving their authority from one or another of the statutes listed above.

# **The Inadequacy of Existing Domestic Content Laws**

Shortages of essential personal protective equipment (PPE) and drugs during the COVID-19 pandemic endangered the lives of many Americans and medical personnel, while the inflation-stoking shortages that have followed pandemic-caused lockdowns have illustrated the dangers of disruptions to supply chains of many kinds. At the same time, the deepening military and strategic

rivalry between the U.S. and China, and the crisis that has followed Russia’s invasion of Ukraine, have caused alarm over the extent of the dependence of U.S. military and civilian industries and consumers on China and Russia in particular.

Minimizing supply chain disruptions that can endanger U.S. national security, the economy

and long-term national productivity will require an all-of-government approach using many agencies and modalities and including different areas of public policy, from trade to tax policy and government-supported R&D. Together with other reforms, leveraging more than \$600 billion in annual federal government procurement contracts can make a major contribution to achieving these goals. A number of domestic content laws require federal agencies to procure goods that are produced in the United States. The Buy American Act of 1933 (BAA) imposes a price preference test on businesses with federal procurement contracts.<sup>ii</sup> The price preferences favor “domestic end products” and “domestic construction materials” that are produced in the U.S. and are slightly more expensive than foreign products. However, the BAA as amended gives federal government agencies the option of waiving the rules in certain circumstances. In addition, the Trade Agreements Act of 1979 (TAA) allows the president to waive domestic content restrictions in procurement in the case of certain countries that have trade agreements with the U.S.<sup>iii</sup>

In addition to the BAA and TAA, there are numerous buy america domestic content procurement restrictions embedded in specific statutes applicable to specific agencies. For example, in the case of the Department of Defense, the Berry Amendment requires that DoD purchase only goods with American content, such as specialty metals and flatware,

with certain exceptions.<sup>iv</sup>

Instead of the price preference system enshrined in the BAA and similar laws, the rules of origin system used in the United States-Mexico-Canada Agreement or USMCA (formerly NAFTA) and other U.S. trade agreements provides preferential tariff treatment for goods based on a percentage of the value of the good that originates in the territory of the treaty members. For example, the USMCA requires that 75 percent of the value of the automobile be made in North America, compared to 62.5 percent under the superseded NAFTA treaty. The USMCA provides that the value of regional content can be calculated by one of two methods: the transaction value method and the net cost method.<sup>v</sup>

These legacy laws and treaties fail to address today’s challenges because they are indiscriminate and costly in time and money.

**Indiscriminate.** The essence of strategy is the assignment of priorities. If everything is strategic, then nothing is. And yet the existing domestic content regime favors American goods of all kinds over others, regardless of whether the goods are strategically important or not.

A rational domestic content system would focus on distinguishing strategic goods—whether they are finished goods, components

or raw materials—from the rest. For example, a well-designed rules of origin system in the automotive sector might focus on microchips vulnerable to supply chain disruptions, rather than tires if the latter are not subject to shortages. And because a single group of components like microchips can be critical to many different industries, focusing on critical components would be more efficient than focusing on final products.

**Costly in time and money.** When the Buy American Act was enacted in 1933, the U.S. was much less integrated in the world economy. At the same time, many U.S.

manufacturing firms were vertically-integrated corporations, such as automobile companies that controlled every stage of production from raw materials to the finished product. Today, in contrast, up to a third of world cross-border trade takes place within multinational firms, among their formal subsidiaries or arm’s-length suppliers in different countries. The increasing rarity of wholly “made in America” products requires contractors for federal agencies to apply for waivers, even for non-strategic goods, at significant expense in time and money for taxpayers and businesses alike.

## *The Challenge of Supply Chains in the Era of Globalization*

When the Buy American Act was signed into law by President Herbert Hoover in 1933, it was much easier to distinguish products that were “made in America” than it is today. Thanks to outsourcing and offshoring, many familiar products are assembled today from parts that originate in many countries. Here are a few examples:

**Pharmaceuticals.** The production of drugs and other pharmaceutical products is a multistage process that begins with the combination of chemical inputs into “Advanced Pharmaceutical Ingredients” (APIs). The APIs are then processed by combining them with inactive materials to produce final dosage forms such as tablets or liquids (FDFs).

The United States sources 80 percent of its APIs from overseas.<sup>vi</sup> As of August 2019, the U.S. Food and Drug Administration (FDA) estimated that there were 1,788 API manufacturing sites supplying the U.S. market. Of those, 28% (510) were located in the United States, 31% (552) in China and India, and 41% (726) in other countries.<sup>vii</sup> For generics, the percentage of facilities outside the US is higher and “a substantial portion of U.S. generic drug imports come either directly from China or from third countries like India that use APIs sourced from China.”<sup>viii</sup> In fact, the U.S. generic drug industry can no longer produce certain critical medicines such as penicillin and doxycycline, and the APIs needed to make these antibiotics are sourced from China.<sup>ix</sup> In addition, as of March 2021,

52% of all FDA-registered final manufacturing facilities were outside the U.S.<sup>x</sup>

**Smart Phones.** The complexity of the global supply chains leaves the smart phone industry vulnerable to disruptions at multiple points. For example, raw materials for the electronic components including copper, gold, silver, platinum, palladium, and tungsten are sourced from many countries including Chile, China, Australia, Mexico, South Africa, Russia.<sup>xi</sup> For smartphones that use lithium ion batteries, cobalt and lithium are sourced from nations that include the Democratic Republic of Congo, Australia, China, and Russia.<sup>xii</sup>

The components, including the touch screen, microprocessors, and batteries, can number in the hundreds and are sourced from suppliers from all over the world. In 2019, Apple had more than 200 suppliers, with 93% of its top 200 suppliers were outside the U.S., in China, Japan, Taiwan, Europe and Latin America, among other countries and regions.<sup>xiii</sup> The final assembly of the iPhone is a complex process that takes 94 production lines and about 400 steps.<sup>xiv</sup> With the exception of Brazilian iPhones, all Apple iPhones are assembled in China before a completed iPhone is ready for a consumer.

**Automobiles.** Like many other industries, the automobile industry relies on suppliers that provide components directly to the brand-name manufacturers or original equipment manufacturers (OEMs) called Tier 1 suppliers. While these suppliers work with a variety of manufacturers, they tend to have closer relationships with one or two manufacturers.<sup>xv</sup> Some of the largest suppliers are based in Germany (Robert Bosch GmbH, Continental AG, ZF Friedrichshafen AG), Japan (Denso Corp., Aisin Seiki Co. Ltd), Canada (Magna International), Korea (Hyundai Mobis).<sup>xvi</sup>

Tier 2 suppliers, such as computer chip manufacturers, do not sell directly to the auto manufacturers and tend to supply a variety of industries.<sup>xvii</sup> However, despite their categorization, these components are just as essential to the production of a vehicle. For example, cars today can have dozens of microchips controlling processes like fuel management and stability control, and, in the case of luxury vehicles that have advanced features, there may be more than 100 processors.<sup>xviii</sup>

Ultimately, the car manufactures, Tier 1 and Tier 2 suppliers are all dependent on the availability of raw materials (or close to raw materials like steel or plastic) by Tier 3 suppliers. Disruptions at any of these stages of production can produce shortages, which in turn can drive supply-side inflation. The recent shortage of chips impacted auto manufacturing is one example.<sup>xix</sup>

# Beyond Incremental Reform

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To date, proposals for using federal procurement to preserve U.S. production or reshore strategic supply chains have been incremental, building on the legacy frameworks we have discussed. For example, the Biden administration has created a “Made in America” office to centralize decision-making about agency waivers for BAA, among other tasks. Many members of Congress have proposed new “Made in America” laws in addition to those which already exist.

Many of these incremental reforms are thoughtfully-designed and would be helpful. It is our judgment, however, that the legacy system of procurement preferences is so out of alignment with the realities of twenty-first century industry and commerce and the imperatives of national security that a more radical approach is necessary.

On rare occasions, usually following a great national crisis, Congress has engaged in comprehensive reform of laws and institutions in an entire area of U.S. public policy. Following

World War II, in the early years of the Cold War, Congress passed the National Security Act of 1947, which modernized the U.S. military and laid the groundwork for the contemporary system of U.S. intelligence agencies. Following the terrorist attacks on the U.S. of September 11, 2001, Congress consolidated twenty-two agencies into the new Department of Homeland Security, a Cabinet-level department.

Similar bold and transformative renovation is necessary today in the area of federal procurement policy. What is needed is not necessarily administrative centralization, which could produce new chokepoints, but rather a new approach to the issue of supply chain security, embodied in a new legal framework that would replace the BAA, the TAA and many other inherited laws. Rather than propose detailed legislation, in this concept paper we seek to provoke debate by proposing the general outlines of an up-to-date and flexible approach to supply-chain issues which we call the Trusted Country System.

## *Federal Procurement and Supply Chains: Recent Executive Actions*

Recent administrations have undertaken significant executive action, in the form of executive



orders and rule changes, focusing on domestic content requirements in federal procurement. The Biden Administration's actions for domestic content requirements in federal procurement in some cases has built upon actions taken during the Trump Administration.

On January 25, 2021, immediately after taking office, President Biden issued Executive Order (EO) 14005 Ensuring the Future Is Made in All of America by All of America's Workers pushing federal agencies to "maximize the use of goods, products and materials produced in, and services offered in, the United States."

EO 14005 created a Made in America office within the OMB to review waivers to purchase goods from outside the United States and directs the GSA to create a public website making proposed waivers and justifications available to the public.

The executive order also built on the Buy American Act (BAA) and directed the FAR Council to consider certain implementation issues such as replacing the "component test" (which says that a certain percentage of a product's cost must have a domestic origin), increasing the numerical threshold for domestic content requirements for construction materials and end products, and increasing the price preferences for domestic construction materials and end products. The EO does not apply to situations in which the Trade Agreements Act (TAA) applies.

The FAR Council published a final rule in March 2022 that increases the domestic content requirements under the BAA and gives preferences for critical products and critical components. This recent rule builds upon a final rule issued by the Trump administration in January 2021 and based on EO 13881, Maximizing Use of American-Made Goods, Products, and Materials, issued by President Trump in July 2019. The January 2021 final rule increased the domestic content threshold from 50% to more than 55% for most products (95% for products mainly made of iron and steel) and the price preference from 6% to 20% for large businesses, and from 12% to 30% for small businesses (excluding Defense Department procurements). The March 2022 rule increases the 55% of the total cost of products made wholly or predominantly of iron or steel through an escalation process - eventually requiring 75% by 2029.

# The Trusted Country System

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The Trusted Country System that we propose would eliminate and replace most legacy legislation in federal procurement policy—not only the BAA price preference system and various sector-specific “Buy America” rules but also regional value content rules like those found in the USMCA and various international trade treaties. Trusted Country rules of origin for components in supply chains are easier to oversee, less likely to antagonize U.S. trading partners and military allies, and less likely to require frequent and time-consuming waiver applications than the indiscriminate application of arbitrary price preferences or value-added content quotas.

Under the Trusted Country System, the cumbersome price preference system of the BAA would be eliminated and with it the need for agencies to waste valuable time submitting waivers for particular goods or contractors. Requirements in some areas for percentages of value added, another indiscriminate and

unnecessarily complex approach, would also be eliminated.

The federal government would make lists of trusted country trading partners. Rather than a single list of trusted countries, there might be several lists, with the closest and most reliable U.S. allies in one and non-U.S. allies in another. Depending on how critical they are, some essential strategic components and in some cases entire products or raw materials might be required to be sourced from the U.S. alone.

In addition, there should be lists of countries of concern, including but not limited to military rivals. The origins of non-critical components that are joined with critical components in the same finished product might be a matter of indifference, as long as they were not sourced from a country of concern or a foreign supplier over which a country of concern exerts control or significant influence.

# Identifying Critical Components With Stress Tests

What makes a component in a supply chain critical is not some innate characteristic, but rather its importance in a particular supply chain. A raw material input, intermediate input or finished product that might not be considered important or strategic in other contexts can be critical if a shortage or absence of that component could cause an entire complex supply chain to topple like a row of dominos, with disastrously ramifying effects.

Because the context determines whether a component is potentially critical or not, the component's criticality can be determined best by analytical exercises based on scenarios like prospective stress tests of supply chains. These stress tests could be carried out by federal agencies or perhaps a specialized agency tasked with this purpose.

Once a stress test or similar analysis suggests that a particular kind of component is critical, in light of the potential for a shortage to disrupt an entire national or transnational military or civilian supply chain, the next step would be to assign the component a "criticality level." The

most critical would have to be sourced entirely in the United States. Other critical components, important but less essential, could be sourced from allies and trusted trading partners of the U.S. Finally, some critical components could be sourced from any country in the world, other than those of concern for reasons of military rivalry, political instability or other factors.

In the case of the most critical components, American suppliers would have no foreign competition. But in the case of less critical components, American products would compete with foreign products on a level playing field. This approach promotes the goals of national security, national economic resilience and national industrial capacity in a far more focused and discriminating way than the inherited approaches of indiscriminate price preferences and local content quotas.

# New Supply Chain Visibility Requirements

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Stress testing supply chains to identify potential critical components will make it necessary to ascertain the nationality of the firms that produce particular raw materials, intermediate inputs and finished products. In the case of lead firms or original equipment manufacturers (OEMs) which outsource much or all of their production to arm's-length suppliers, this could be difficult.

The need for end-to-end supply chain visibility will impose some new costs on suppliers to the U.S. government, even as the costs imposed on suppliers by the complexity of the

existing BAA system and other legacy rules are reduced or eliminated. Weighed against the costs to American and global society of critical shortages during wars and cold wars, or the kinds of disruptions that were manifested in the COVID-19 pandemic and its aftermath, the cost to government contractors of compliance with end-to-end supply chain transparency rules would be trivial. In some cases, contractors might choose to insource some formerly outsourced activities or to shorten their supply chains, measures which might improve supply chain resilience and security.

# Minimizing Shortages and Disruptions

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Following the identification by means of stress tests or other analyses of critical components, their assignment to one of three levels of criticality, and their subsequent assignment to one of three groups of trusted countries of origin, the next stage under a new Trusted Country System would be federal government support to help particular industries avert potential shortages or expand their capacity. A variety of measures could be used for this purpose, from subsidies for stockpiling to federal grants and loan guarantees and tax incentives to promote investment in reshoring or expanding existing capacity. Of particular promise might be government-sponsored consortiums, with appropriate exemptions

from antitrust laws, designed to promote pre-competitive collaboration on R&D and investment in particular industries identified as critical to one or more major supply chains.

Existing authorities under the Defense Production Act (DPA) could be revised and expanded to enable the executive branch to help companies avert or overcome critical component shortages. It is important that any such revisions of the DPA allow the federal government, when it is in the U.S. national interest, to fund foreign firms or foreign governments in trusted countries of origin when strategic considerations make this important.

## *How A Trusted Country System Might Be Designed*

Here is one of various possible ways that a Trusted Country System of rules for federal procurement might be designed. After a stress test or similar analysis suggests that a particular kind of component is critical, the next step might be to assign the component a “criticality level” from one to three. Level One critical components might be required to be sourced entirely in the United States—perhaps in the continental United States, to minimize the threat of maritime interdiction. Level Two critical components, important but less essential, might be sourced from allies and trusted trading partners of the U.S. Finally, Level Three critical components might be sourced from any country in the world, other than those of concern for reasons of military rivalry, political instability or other factors.

Already the federal government defines the National Technology and Industrial Base (NTIB) to include the United Kingdom, Canada and Australia as well as the U.S.<sup>xx</sup> Building on this precedent, we propose that, for purposes of federal procurement, countries might be assigned to one of three groups: the Domestic Industrial Base (DIB), the Allied Industrial Base (AIB), and the Global Industrial Base (GIB). The Domestic Industrial Base would be limited to the United States and its territories. The Allied Industrial Base would be limited to military allies of the U.S. The Global Industrial Base would include all other countries in the world, except for designated Countries of Concern, from which critical components and resources could not be used without special permission.

On the basis of their criticality level designation, critical components would then be sourced from one of the three country groups. Depending on the criticality level, one hundred percent of a critical component would have to be sourced from the DIB, the AIB or the GIB. The origins of non-critical components that are joined with critical components in the same finished product would be a matter of indifference, as long as they were not sourced from a country of concern or a foreign supplier over which a country of concern exerts control or significant influence.

While American producers would not be favored, except for Level One Critical Goods, all producers in the United States would belong to all three country groups—domestic, allied and global. In the case of Level 1 critical components, American suppliers would have no foreign competition. But in the case of Level 2 and Level 3 critical components, American products would compete with foreign products on a level playing field. This approach promotes the goals of national security, national economic resilience and national industrial capacity in a far more focused and discriminating way than the inherited approaches of indiscriminate price preferences or local content quotas combined with waivers.

### Trusted Countries of Origin

<b>Component Criticality Level</b>	<b>Domestic Industrial Base</b>	<b>Allied Industrial Base</b>	<b>Global Industrial Base</b>
<b>1</b>	U.S. only		
<b>2</b>		U.S. and allies	
<b>3</b>			U.S. and all countries (other than countries of concern)


# Rethinking Supply Chain Security for the Contemporary World

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In his Annual Message to Congress on December 1, 1862, in the midst of the Civil War, President Abraham Lincoln observed: “The dogmas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty, and we must rise—with the occasion. As our case is new, so we must think anew, and act anew.”

This policy brief is a conceptual exercise, not a draft law. Pandemic-induced supply chain shortages and deepening great-power rivalries

require a different approach to supply chain security in an age of transnational production and global supply chains than those that were effective in the United States of a century or half a century ago. The purpose of this exercise is to suggest the need to go beyond tinkering at the margins in order to radically rethink the foundations of America’s inherited system of domestic content rules. That purpose will be achieved if this study inspires policymakers, stakeholders, and the American public to “think anew, and act anew.”



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Anita D'Souza is a senior fellow with Wye River Group. She brings a broad-based analytical skill set to the table with over 20 years of legal, policy and operational experience. She worked as general counsel at multiple Texas state agencies focused on state finance, compliance and oversight, including contracting and contracting policy. Anita has a B.A. with majors in Economics and Computer Science from Smith College, a JD from the University of Texas and an LL.M with a focus on international trade from the University of Edinburgh in Scotland.

# NOTES

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