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EXECUTIVE SUMMARY

Manufacturing Resilience: The US Drive to Reorder Global Supply Chains

by Mary E. Lovely

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Challenge: Fragmented and Fragile Supply Chains

Global Supply Chains (GSCs) are complex networks of manufacturers, suppliers, warehouses, distributors, and shippers who move products and services from one location to another. Prior to COVID-19, more than two-thirds of world trade occurred through supply chains in which production crossed at least one border, and typically many borders, before final assembly. Both the pandemic shock and recent geopolitical developments have exposed the fragility of US supply chains. Businesses that lowered costs through just-in-time inventory practices, single-source suppliers, and manufacturing in countries with unstable political situations were left more vulnerable to supply shocks that fueled inflation. Furthermore, heightened global tensions now threaten the prospect of economic cooperation while creating domestic political pressures for protectionist policies. In this paper, author Mary Lovely evaluates current strategies to bolster US supply chains, discussing the likelihood that each will reduce the potential of future disruptions against the costs to taxpayers and consumers.

Response: Three US Policies to Enhance Supply Chain Resilience

Author Mary E. Lovely categorizes recent efforts by policymakers to build supply-chain resilience into three forms: “reshoring,” “friendshoring,” and “derisking.”

Reshoring

Reshoring is transferring a business operation that was moved overseas back to its original country. Activities targeted for reshoring are generally those that lie at the core of production ecosystems deemed critical for economic resilience and growth. Such activities typically require a diverse set of co-located suppliers and promise to generate the domestic job creation needed to justify their big price tag for taxpayers. Two recently enacted pieces of legislation have major components aimed at promoting reshoring: the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act and the Inflation Reduction Act (IRA).

The CHIPS Act is designed to “bring back” to the US semiconductor manufacturing that is now concentrated in Asia. It provides roughly $53 billion in new funding for research on and manufacturing of semiconductors and workforce development and also subsidizes investment in semiconductor manufacturing. The IRA has multiple objectives aimed at enhancing economic resilience, including domestic production of clean energy supplies. Its allocation of $369 billion to clean energy and decarbonization projects is primarily focused on the production and implementation of clean energy technologies in the United States.

Friendshoring

Friendshoring is reducing supply-chain risks linked to "unreliable" countries by diversifying US supply chains and deepening relationships with a greater number of trusted partners. Friendshoring is an explicit recognition that not all domestic needs can be met by American production—that is, by reshoring. Unlike reshoring, friendshoring leverages trade to enhance resilience. Unlike open trade, however, friendshoring is confined to a designated circle of "trusted partners." Current US policy applications of friendshoring focus on creating regional networks of like-minded partners. Recent examples include the Indo-Pacific Economic Framework for Prosperity (IPEF) in Southeast Asia; the Americas Partnership for Economic Prosperity in Central and South America; and the US-Mexico-Canada Agreement (USMCA) in North America.

Derisking

Derisking is reducing bilateral tensions with China by diversifying trade flows. This terminology of "derisking" rather than "decoupling" the US relationship with China reflects the policy of reducing dependence on the country rather than explicitly excluding it from trade; it also reflects a change in focus away from all imports toward those where the risks from overdependence are most acute.

Three main economic arguments are often made to support the view that China's role in US supply chains must be reduced to increase economic resilience. The first is that China's dominating presence in global markets is itself a source of economic risk. The geographic concentration of production exposes all trade partners to economic shocks hitting the Chinese economy. Second, despite China's compliance with most World Trade Organization (WTO) dispute settlement rulings, US officials frequently state that China abuses the norms of the international trading system in ways that reduce the resilience of partner economies. Third, the Chinese government itself is a source of supply shocks because the concentration of production in China has grown along with its propensity to use trade as an instrument of economic statecraft.

Assessment: Evaluating Each Policy's Effectiveness, Cost, and Compatibility with Other US Goals

Based on policy design and on recent evidence, Lovely examines how effective these efforts are likely to be at reducing the risk of supply chain disruptions; what these efforts will cost American taxpayers; and how compatible they are with other US commitments.

Reshoring

First, the budgetary cost of reshoring initiatives is high. The CHIPS Act and the IRA, among other initiatives, may permit nearly $100 billion in annual spending on industrial policy over the next five years. Second, America's allies have raised loud objections, as they see the new industrial policies as both (a) an effort to move investment to the US and away from their own economies, and (b) a violation of WTO protocols. Third, while onshore supplies offer some shelter from external shocks, reshoring offers little insurance against shocks that originate at home. The baby-formula shortage in February 2022, which was exacerbated by a lack of foreign suppliers, offers a powerful cautionary tale. Reshoring thus diminishes some sources of risk while introducing others. Hence, reshoring is only tenable in a few critical sectors, and it is in friendshoring, not reshoring, that the US ought to focus its efforts on diverting trade away from China.

Friendshoring

While friendshoring may, through its current regional approach, diversify supply chains away from China, it has three significant downsides. First, these regional networks may also incidentally increase risk arising from geographically concentrated production disruptions. Second, it is unclear how these new regional networks will hold up in the face of new disruptions. No IPEF provisions bind the actions of participating governments. In the event of a sudden supply shortage, governments will be under no obligation to abstain from the use of export bans of the kind that threatened to disrupt trade flows during the pandemic. Finally, reducing the dependence of global supply chains on China will not be simple. An often-overlooked feature of exports from IPEF nations is that they rely on intermediates and materials sourced from China. Indeed, 11 of the 13 IPEF countries are already members of the Regional Comprehensive Economic Partnership, binding them to China through a preferential trade agreement. There are reasons to be hopeful, however: in setting common procedures for trade and formal mechanisms for coordination, the IPEF agreement may expand trade among its partners and encourage the harmonization of labor, environment, digital, and product standards at little-to-no cost.

Derisking

Finding ways to reduce the economic risks flowing from China is complicated by the country's dominant role in global value chains. China is deeply embedded in the complex webs of cross-border transactions that characterize modern, fragmented production. Then-president Donald Trump's trade war has been effective in reducing US reliance on direct imports from China, but it has also been costly for US consumers and businesses. To date, US Customs and Border Protection has collected $186 billion in tariff revenue from imports taxed by the trade war, an amount largely borne by

American businesses and consumers. While the US may be willing to bear the cost of a significant reduction in exposure to China, reducing direct US imports from China does not guard against risks originating there. China is the most important trade partner for almost all countries joining the US in IPEF negotiations.

Over time, as alternative sources of supply develop, America's Asian partners may reduce their reliance on China for parts and components as their own industrialization proceeds. Raising the domestic value added of manufactured exports is a key development goal across middle-income Asia, as well as in Latin America and Africa. Helping nations in these regions raise productivity and meet higher labor and environmental standards may be a valuable offshoot of diversifying GSCs.

Table 1: Summary of the Assessment of US Policies to Reshape Global Supply Chains

	Reshore	Friendshore	Derisk
Effectiveness	**High.** Induces investment via subsidies. Can lead to ecosystem development.	**Low.** Relies on coordination. No new market access or public investment.	**Moderate.** Moves final assembly but value added may remain concentrated in China.
Cost	**High.** Requires investment subsidies and tax credits; may also require user subsidies or tariffs.	**Low.** Lacks complementary development assistance and overseas project financing.	**Moderate.** Passes burden of higher-priced goods onto consumers. Reduces competitiveness of domestic manufacturers.
Compatibility with other objectives	**Problematic.** Incites subsidy race; may lead to supply glut. Violates WTO domestic-content rules.	**Favorable.** Encourages harmonization of labor, environment, digital, and product standards.	**Problematic.** Erodes US compliance with WTO disciplines. Creates tensions with partners who trade heavily with China.

Recommendations: The Way Forward to Reduce Global Supply Chain Risks

- More narrowly targeting reshoring efforts toward specific sectors would enhance the effectiveness of such policies. Reshoring often requires costly subsidies, which are tenable in only a few critical sectors. Further, open-ended commitments to altering supply chains create uncertainty among trade partners and private-sector players.
- Establishing a more cooperative approach toward friendshoring would reduce pressures for a subsidy race, specifically by allowing the US to adopt critical technology produced elsewhere. Without such cooperation and openness, the US risks failing to adopt the most promising technologies, thereby raising costs for US businesses and impeding productivity.
- Distinguishing between decoupling and derisking is important to the goal of avoiding rising geopolitical tensions. A meaningful way in which the US can clearly signal its desire to diversify rather than decouple would be to reform the Trump administration's tariffs on China. Tariffs could be retained where the US identifies an overdependence on Chinese suppliers.

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