

# Congress Should Use Targeted Restrictions—Not Domestic Content Requirements—to Protect Defense Supply Chains

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## KEY TAKEAWAYS

China's growing influence over international supply chains poses a grave threat to the United States' ability to acquire goods and materials for national defense.

While reducing reliance on foreign supply chains is a worthy goal, overly broad domestic content regulations would raise costs and harm the defense industrial base.

Congress should use specific, targeted restrictions to ensure that the U.S. is not dependent on its chief competitors for key defense components.

The U.S. Department of Defense (DOD) spends billions of dollars each year acquiring materiel, from submarines and tanks to uniforms and cutlery. In today's strategic competition with China, secure supply chains for these items are vitally important.

In the name of securing supply chains, Democratic policymakers have proposed new sweeping domestic content requirements over the past few years. These rules would increase requirements that defense goods be made by U.S. companies, in the U.S., primarily of U.S.-made components. In the process leading up to the National Defense Authorization Acts for fiscal years (FYs) 2022<sup>1</sup> and 2021,<sup>2</sup> Members of Congress proposed new increases to the percentage of defense components that must be manufactured in the United States. Members also proposed new requirements specific to the shipbuilding industry.<sup>3</sup>

This paper, in its entirety, can be found at <http://report.heritage.org/ib5254>

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The Biden Administration has also been a proponent of domestic content requirements, especially the Buy American Act.

The Administration created a new “Made in America” office in April 2021, and then published a Notice of Proposed Rulemaking in July suggesting increased percentages of required domestic content for government purchases.<sup>4</sup> However, the proposed changes have not yet been implemented, and the Made in America office’s exact function is unclear.

Proponents of these changes stated that they were intended to strengthen the U.S. defense industrial base and secure defense supply chains—a top concern. In theory, domestic content requirements make supply chains more secure by reshoring them to sovereign U.S. territory, where they are less susceptible to shocks (such as a global pandemic), interruptions due to conflict, or security breaches (like China’s intellectual property theft).

However, sweeping “Buy American” domestic content requirements are not the most effective way to strengthen defense supply chains. Often, these requirements are not proposed in good faith, as many politicians employ them to protect parochial constituent interests. The requirements also tend to have negative side effects, especially when they are imposed across all defense acquisitions rather than targeted to specific supplier countries, industries, or items of concern.

In today’s strategic competition with China, secure supply chains for defense items are vitally important. China is both the pacing threat driving U.S. defense acquisition policy, and (through its entanglement in U.S. defense supply chains) the biggest risk to America’s ability to acquire the materiel it needs. To allow the U.S. to compete with China, defense acquisition regulations must address threats to supply chain security—efficiently and in a way that makes the most of limited defense dollars.

Domestic content restrictions do not accomplish this: They raise defense costs and have the potential to harm America’s relationships with allied countries. This *Issue Brief* describes both the goals and the effects of domestic content requirements and offers more effective alternatives for protecting vital defense supply chains.

## Background

The foundational domestic content legislation is the Buy American Act of 1933. The law requires that government acquisitions be 100 percent domestically produced and composed of at least 50 percent domestically produced components.<sup>5</sup> The law was enacted to protect domestic industry—and domestic jobs—during the Great Depression. At the time, there was

no thought of protecting the defense industrial base; indeed, U.S. defense spending during the 1930s was only 3 percent of gross domestic product, compared to roughly 40 percent during World War II.<sup>6</sup>

The Buy American Act, the legislation that set the precedent of domestic content requirements for defense acquisitions, predates the U.S. as a global military power and predates the modern defense industrial base. Other restrictions pertaining to specific countries, companies, and types of acquisitions have been added to federal regulations.

## The Logic Behind Domestic Content Requirements

Proponents for domestic content requirements employ a few justifications to support their arguments for keeping the existing requirements or, indeed, expanding them.

First, a key rationale for domestic content requirements is that they ensure that the industrial base for key defense items—from initial design to final production—continues to exist in the U.S. In order to fight and win wars, the U.S. military needs the uninterrupted ability to buy planes, tanks, ships, ammunition, and more. Ideally, these items should be better than what the enemy is using. For the military to have access to these items, someone needs to be able to design them, make or otherwise acquire their constituent parts, assemble the items, and test their effectiveness. The most reliable and secure sources for components and end items are those located on sovereign U.S. territory, since the government exercises more control over domestic firms than those located overseas. Domestic industries in turn are free from foreign government influence that can impact overseas firms. An important factor is that domestically produced components and end items do not need to be shipped long distances, potentially over routes subject to interruption.

Sometimes the justification for country-specific content restrictions is directly related to security, ensuring that the U.S. does not rely on its adversaries for defense components and protecting its intellectual property. A key example of this is Subpart 225.770 of the Defense Federal Acquisition Regulation Supplement (DFARS), which prohibits the DOD's purchase of almost any item or component from a communist Chinese military company.<sup>7</sup> This prohibition not only ensures that U.S. taxpayer dollars are not supporting China's industrial base, but also helps to prevent the U.S. defense industrial base's dependence on Chinese suppliers.

Another reason for domestic content requirements—whether acknowledged explicitly or not—is protectionist: Domestic content requirements

(in theory) protect American businesses and jobs, to a degree shielding industries from competition in the global marketplace. The point in these cases is not to protect certain businesses for the sake of national defense, but to protect them for the sake of the businesses themselves. Advocates of this point of view argue that, without protection, America risks losing entire sectors (such as textile manufacturing) to companies overseas, and that maintaining possession of the sector under consideration is in the nation's best interest.

## Increasing Domestic Content Requirements Does More Harm than Good

The downside of the Buy American Act, along with any proposals to increase its requirements, is that it is a sweeping regulation that does not account for the incredible diversity of end products, components, companies, and countries that it affects. This creates a variety of problems.

**Limits Options, Raises Costs.** First, domestic content requirements limit the pool of products available for government purchase, and they especially limit the pool of suppliers available to prime contractors and subcontractors. In some cases, meeting strict domestic content requirements would be impossible because some items or materials are not produced domestically. The metalloid antimony is a good example: The U.S. does not mine antimony and is 100 percent dependent on imports<sup>8</sup> for the antimony needed to produce defense end items like batteries and flame-retardant fabrics.<sup>9</sup>

In many cases, foreign-sourced components may cost less than their domestically produced equivalent. In these cases, program costs will be higher because of domestic content requirements. Higher program costs translate to fewer items that can be procured by the DOD.

Ultimately, these purchase restrictions serve to reduce competition in an already consolidated defense industrial base. The defense industrial base has shrunk dramatically since the Cold War. Since the collapse of the Soviet Union, the largest U.S. defense contractors consolidated from 15 firms to five.<sup>10</sup> This has had a dramatic impact across sectors: The DOD went from having 13 prime contractors for tactical missiles down to three, and from eight prime contractors for fixed-wing aircraft down to three.<sup>11</sup> The complex network of subcontractors and lower-tier suppliers shrank in turn as a result of reduced defense spending. This has led to far more cases of single-source and sole-source suppliers in the defense industrial base.

TABLE 1

## Qualifying Countries Not Subject to “Buy American” Statute

- Australia
- Belgium
- Canada
- Czech Republic
- Denmark
- Egypt
- Estonia
- Finland
- France
- Germany
- Greece
- Israel
- Italy
- Japan
- Latvia
- Luxembourg
- Netherlands
- Norway
- Poland
- Portugal
- Slovenia
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom

**SOURCE:** Defense Federal Acquisition Regulation Supplement, Subpart 225.872-1, [https://www.acq.osd.mil/dpap/dars/dfars/html/current/225\\_8.htm#225.872-1](https://www.acq.osd.mil/dpap/dars/dfars/html/current/225_8.htm#225.872-1) (accessed March 24, 2022).

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Single-source suppliers not only increase risk for defense programs by creating single points of failure, but they also act as monopolies for particular components. Companies can charge higher prices for their products when they have no competition for the government’s business.<sup>12</sup> By cutting out potential competition from overseas firms, domestic content requirements reduce competition in the industrial base and raise the total costs for defense programs.

**Disregards Trade Relationships, Defense Alliances.** Domestic content requirements fail to account for the wide variety of relationships the U.S. has with foreign countries—and the number and variety of binding legal agreements the U.S. has with allied and partner countries.

The Buy American Act is not enforced for goods from many foreign countries because of existing U.S. bilateral trade agreements. The DFARS states that “as a result of memoranda of understanding and other international agreements, DoD has determined it inconsistent with the public interest to apply restrictions of the Buy American statute” to products from 26 enumerated countries, listed in Table 1.<sup>13</sup>

When prime contractors must demonstrate to the government that the item they have produced is made substantially of domestically sourced components, any components sourced from these “qualifying countries” count as domestically produced.

This is certainly the largest loophole for the Buy American Act, but it is not the only one. In addition to bilateral trade agreements, multilateral security cooperation agreements like the National Technology and

Industrial Base (NTIB) agreement with the United Kingdom, Canada, and Australia also allow the U.S. to have closer defense production relationships with allies irrespective of domestic content requirements.<sup>14</sup>

Congress can propose any number of changes to domestic content requirements, but it has limited authority to change the international agreements that exempt dozens of countries from these new regulations.<sup>15</sup> The Constitution gives the President, not Congress, the power to communicate with foreign states. If the President does not want to change a trade or security agreement with a foreign country, Congress does not have the authority to negotiate directly with that country without the President's participation. The Constitution does, however, give Congress the authority to "regulate commerce with foreign nations," which may authorize Congress to pass domestic legislation or to take other actions that force the President to comply. There is no clear legal process for this, however, which makes it all the less likely that Congress would attempt to renegotiate these agreements for the sake of domestic content requirements. Effectively increasing the domestic content of defense end items is therefore much more difficult than simply passing new legislation.

This is a good thing. As a general principle, sweeping domestic content requirements like the Buy American Act are problematic when they are written to apply equally to competitor states like China, rogue states like North Korea, trade partners like Switzerland, and close allies like the United Kingdom. Exceptions specified in international agreements strengthen U.S. relationships with these countries, from the level of direct defense cooperation (as with other countries in the NTIB) down to the level of mutual economic interest.

## Recommendations for Congress

There are better alternatives to ensure the resilience of the defense industrial base than domestic content requirements. Congress should therefore:

1. **Evaluate the risks of overseas defense production and determine proper mitigation steps.** Sweeping domestic content regulations are a bad policy, but there is a truth behind what they accomplish: Domestic production is more secure than overseas production. However, there are different levels of risk in overseas production depending on the country, and different levels of tolerable risk depending on the item being produced. The DOD should create a repeatable methodology to evaluate the supply chains supporting its various programs, determine which are vulnerable, and act from there to mitigate those vulnerabilities.<sup>16</sup>

2. **Use targeted restrictions—meaning, only where they are necessary for security purposes.** There are many motives for policymakers to suggest new domestic content requirements, but the only ones with legitimate justifications are those based on national security concerns. In order to ensure that domestic content regulations help, rather than harm, the defense industrial base, they should be country-specific, sector-specific, or even item-specific. For example, requiring all defense items to be made 100 percent in the United States is impractical, but prohibiting the acquisition of commercial satellite services from China, North Korea, Russia, or any state sponsor of terrorism (as currently required in the DFARS) is a smart security choice.<sup>17</sup>
3. **Continue to incorporate allies and partners into the U.S. defense industrial base.** Defense alliances are vitally important. When its allies have strong defense industrial bases, and when they use the most technologically advanced military equipment, it benefits the United States. The U.S. should make good use of partnerships like the NTIB and should consider whether to add other allies to existing partnerships.
4. **Avoid passing sweeping domestic content requirements for defense acquisitions.** Increasing the domestic content requirements of the Buy American Act is an ineffective policy solution to supply chain insecurity. Instead of implementing new domestic content requirements across all defense acquisitions, Congress should opt for the precise tools recommended here.

## Conclusion

U.S. national defense depends on secure supply chains for defense end items. Policymakers are right to be concerned about defense supply chain vulnerabilities, from dependence on foreign suppliers (particularly China) to a lack of competition in the industrial base. However, they should avoid the temptation of sweeping regulations like new domestic content requirements and should instead use targeted restrictions to ensure that the U.S. is not dependent on its chief competitors for key defense components.

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