



**Statement before the Special Committee on the Economic
Relationship between Canada and the United States**

***“The Economic Relationship between
Canada and the United States.”***

A Testimony by:

William Alan Reinsch

Senior Adviser and Scholl Chair in International Business, CSIS

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Thank you for the opportunity to testify. It's an honor to appear before this committee. I am testifying in my personal capacity and expressing my own views.

Policies promoting domestic procurement of goods and services are neither new nor unique to the United States. "Buy domestic" or "buy local" are common slogans in many countries and communities. In the United States, legislation specifying domestic preference for federal government procurement dates to 1933. These slogans, in our case "Buy American," have proved politically popular over the years, even though their actual impact was usually less than predicted. Most of these laws have waiver provisions that permit exceptions when there is no domestic availability of the product in question, when the price differential is above a specified threshold, or when the public interest requires it, and some administrations have interpreted those clauses liberally.

The United States is currently entering a stage when Buy American is likely to play a greater role in federal government policy, and I do not see immediate relief for those who oppose that, for three reasons.

First is politics. Buy American has always been a popular slogan, and in last year's election both our parties supported strong domestic procurement provisions. President Trump issued executive orders on the subject as did President Biden shortly after taking office. When the current administration was asked what the difference was between its policy and Trump's, the response was essentially that Trump's didn't work, and Biden's will. The voters the two parties are competing for—largely white, blue-collar workers in traditional manufacturing sectors—believe Buy American is an important policy that will create jobs for them, and President Biden seems determined to recapture as many of those voters as he can. Pursuing a more aggressive policy than President Trump did will be part of that effort.

The second reason is the Covid-19 pandemic, which has brought to light gaps in our supply chains that led to shortages of critical personal protective equipment, among other things. Some of the shortages were caused by panic buying and hoarding, and many of them were short term and ultimately resolved through market adjustments, but U.S. citizens were left with the realization that we did not have everything we wanted at the moment we needed it, and the government wants to take steps to make sure that does not happen again.

In starting that process, which currently is simply a set of comprehensive studies of supply chains in critical sectors, the administration, to its credit, has not proposed autarky and has acknowledged that working with our allies and partners is the best way forward. The extent to which that is lip service remains to be seen.

CSIS has studied this issue in the pharmaceutical sector and has recommended a trusted partner approach as the best way to insure adequate supplies of pharmaceuticals. That, in turn, raises issues of its own, such as who is a trusted partner, how you define trust, and what the obligations of the parties should be, but we believe it is the safest way to proceed.

The result of the pandemic has been to refocus supply chain management on resiliency and redundancy. Managers need not only plan A, but plan B and plan C as well, and all those alternatives will involve more domestic sourcing or nearshoring. They will also involve some movement away from just-in-time manufacturing to rebuilding inventories.

The third reason is related to national security and grows out of our deteriorating relationship with China. In the last 10 years, there has been a significant change in public opinion in the United States about China. In 2011, 51 percent of those polled had a favorable view of China and 36 percent a negative view. In 2020, those numbers were more than reversed—22 percent favorable and 73 percent unfavorable. Other polls asking whether respondents considered China a threat to the United States show similar results. This change has been echoed in the U.S. Congress, where elected officials of both parties have pronounced China a security threat and vie to see who can take the hardest line against it.

The debate has moved in two directions: running faster—improving our innovation capabilities in critical technologies to better compete with China—and slowing China down by restricting its access to U.S. technology. Both strategies have involved efforts to reorient supply chains away from China, sometimes by banning the use of Chinese equipment in the United States, as in the case of Huawei, and sometimes by encouraging companies to “decouple” from China and return manufacturing on shore.

At the same time, U.S. companies have been shortening their supply chains for reasons unrelated to US government policy: in response to political uncertainties in some countries, rising wages, and a desire to reduce transportation times and be closer to their customers. The sharp economic downturn in the spring of 2020 due to Covid accelerated that trend.

All these factors have combined to push companies to restructure their supply chains in ways that favor domestic production. The government has further encouraged that by beginning the process of identifying critical sectors of the economy, where companies in those sectors will be encouraged, probably through tax benefits, to return to the United States.

In addition, it appears the government will attempt to change its procurement rules to further favor domestic production. That will be a complicated undertaking, in part because 96 percent of federal procurement is already domestic. However, that number is a bit misleading because we treat some parts and components incorporated into a product as domestic even if they are imported. Changing that methodology will force some manufacturers to adjust their supply chains to include more U.S. content. This is not dissimilar from the auto rules in the U.S.-Canada-Mexico Trade Agreement.

There is an irony here. The new percentage of domestically sourced procurement is not likely to be much more than 96 percent. After all, how much higher can you go? It will be a less misleading figure than the current one, but it may prove difficult for the administration to make a convincing case to the public that its efforts have made any difference.

Federal procurement contracts for goods in fiscal year 2019 accounted for \$231.4 billion in spending, a relatively small amount compared to the size of the U.S. economy. The larger

economic impact is likely to occur with respect to supply chain adjustments that U.S. companies make either on their own or as a result of government pressure. There the key issue will be how we define “national security.” There were officials in the Trump administration who defined it very broadly, and a glance at President Biden’s supply chain executive order shows similar breadth. He has ordered urgent studies on four critical sectors: semiconductor manufacturing and packaging, batteries, critical minerals, and pharmaceuticals, but he has also ordered year-long studies of major sectors of the economy: defense industrial base, public health, information and communications technology, energy, transportation and agriculture. Taken together, these sectors amount to nearly 60 percent of U.S. GDP. If all the studies recommend actions to reorient supply chains to the domestic economy, the administration’s policy will have a significant impact.

Possible Canadian Government Responses

As an American, it is not my place to suggest what your government might do with respect to U.S. policy, but I will make three suggestions. First, the premise of NAFTA was to further integrate the three North American economies. While the agreement was controversial in the United States, there is no doubt it succeeded in its goal of greater economic integration. The Trump administration was less interested in integration, but I do not think the new agreement will move in the opposite direction. Economic integration on our continent, particularly between Canada and the United States, is inevitable, and it would be useful for your government to remind ours of that imperative from time to time. Instead of Buy American, we should be buying North American.

Second, since our security interests are closely aligned and we both benefit from close defense cooperation, Canada could also work with the United States in developing a definition of national security that does not overreach.

Third, the Canadian government could remind the United States of its obligations under the WTO Government Procurement Agreement and of its obligation to provide compensation if it limits other nations’ benefits.