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The Promise and Perils of Protectionism in the Defense Sector

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If there were ever a test case for the Trump approach to trade, it would be the defense sector, the part of our economy that delivers the bulk of the capabilities that protect our national security. Some of the administration's initial defense policies, such as its Buy American and Hire American [executive order](#) and recent memos sent to the [Department of Defense \(DoD\)](#) and other government [agencies](#) on enforcement of the [Buy America Act](#), seek to limit the purchase of items from foreign sources, stepping up support to the defense sector and the domestic production of defense capabilities. The policy moves made so far, however, have been limited in scope and likely also limited in their impact. The real action will begin if and when the administration moves forward to restrict imports of steel and aluminum under the national security authorities in [Section 232](#) of the Trade Expansion Act of 1962. Ironically enough, however, the impact of such a move on the defense sector could impose significant costs on national security, undermining its original purpose.

By the Trump approach to trade, I mean the use of protectionist government policies to make sure things are produced in the United States, even at the expense of higher costs for U.S. consumers and the risk of retaliation from our trade partners. The defense sector is a potential test case because there are critical national security capabilities that we want to ensure remain in the United States whenever we can, and that fact can serve as a justification for accepting significant costs. Take nuclear weapons as an example; we want to ensure that we retain as much control as possible over the ability to produce and deliver these weapons. While nuclear weapon technology is an extreme case due to its destructive potential and high barriers to entry, there are a variety of other technologies that we want to ensure are always available when we think we'll need them for our defense and where we want to retain some degree of government control. So there is a compelling reason why we sometimes adopt protectionist policies in the defense sector, and a variety of trade agreements recognize this by carving out an exemption for national security.

But the defense sector is not the simplistic monolith that was once imagined when catchy but mostly obsolete terms such as "[the military industrial complex](#)" were coined decades ago. In those days, tanks, aircraft, and ships were produced by companies that did the bulk of their production in house, using a small, mostly consistent set of suppliers. A shipyard in this classic defense production model would see mostly steel enter the shipyard at one end and an almost fully equipped ship slide down

the ways into the sea at the other end. Today's reality is far different. There is more value in the radars, missiles, and electronics on the latest Arleigh Burke-class [destroyer](#) than there is in the structure of the ship itself. And a logical corollary to the now oft-heard statement that the F-35 fighter is "[a flying supercomputer](#)" is that the electronics on board that aircraft are likely as significant to its military value as its aerodynamics and stealthy skin. Modern military systems depend on an extensive value chain of suppliers that extends well beyond what we traditionally have thought of as the defense industry. This value chain is inextricably linked with the supply chains for commercial electronics, diesel and jet engines, commercial aircraft, and the automotive industry, to name but a few. And like the commercial supply chains upon which it depends, the defense value chain is inherently global and is vulnerable to harm from policies that distort the value chain by increasing the cost of inputs or cut off access to critical components from overseas suppliers.

The U.S. government has traditionally pursued two types of protectionist policies in the defense sector. The first type is pro-domestic industry policies with broad scope but inherent flexibility such as the Buy America Act, which requires that items purchased by the government be assembled in the United States with a majority of U.S. content. These policies begin with a recognition that most items will not have 100 percent U.S. content and have also been modified over the years to exempt content from U.S. treaty partners who provide reciprocal access to U.S. goods. The administration's initial steps in this area have been measured and have included substantial fact gathering, which is encouraging. It will be important to ensure, however, that these policies retain the flexibility needed to be reasonably implemented given their wide-ranging scope and aren't used as a barrier to innovative capabilities provided by our allies.

A second type of protectionist policies is narrow in coverage but fairly absolute in requirements. An example is the [specialty metals clause](#) that requires metals such as titanium and certain hardened steels be 100 percent produced in U.S. plants with very few exceptions. These more absolute restrictions can have exceedingly complex effects on the defense value chain. While they can serve to protect the existence of critical strategic capabilities in the United States, they also have the potential to distort the defense value chain by adding cost to and narrowing the availability of critical inputs. They can sometimes delay the delivery of ships, fighters, and tanks to war fighters, and they can impose structural distortions too, making it extremely difficult to access commercial elements of the value chain. Commercial suppliers are often not willing to adjust their manufacturing processes to meet rigid domestic content requirements for DoD, which is ultimately a relatively small customer in global market terms. As a result, strict domestic content requirements can have the effect of divorcing the defense value chain from its commercial counterpart. That can be a major disadvantage for DoD in areas where commercial value chains are highly innovative and dynamic as is the case in electronics.

It is in this second category where the Trump administration is reportedly considering major actions restricting the imports of steel and aluminum with the defense sector in mind. The need for certain critical metals to be produced in the United States is likely to serve as the national security justification for whatever actions the Trump administration adopts under the Section 232 authority. While we don't yet know what the administration has in mind, there is potential for its actions to disrupt the production of defense equipment whose existing supply chains were established under the current

rules. New restrictions could also cut us off from important capabilities in areas where our allies and partners have world-class capability that we need. There is also the prospect that our trade partners may retaliate and target U.S. defense exports in return. President Emmanuel Macron of France has called for new “Buy European” policies to support Europe’s own defense sector. This could ultimately result in real harm for U.S. national security that exceeds the national security benefit. Ultimately, changes in government policy should not be thought of primarily as tests, and the potential for damage to national security means the administration should tread very carefully in these waters. The Trump administration should observe the principle of first, do no harm, in considering trade actions that relate to the defense value chain and carefully investigate the medium- and long-term consequences of its policies. Even the natural test case for the Trump approach to trade shows the potential for serious trouble.

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