Opinion **Trade Secrets**

The US ‘friendshoring’ experiment risks making enemies

Favouring political allies when constructing supply chains is expensive, tricky and possibly self-defeating

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Alan Beattie YESTERDAY

It wasn't just US observers who were surprised and intrigued last week when West Virginia senator Joe Manchin remembered his hitherto largely nominal party affiliation and cut a constructive deal with the Democratic Senate leadership on climate and clean energy policy.

Viewed from abroad, the agreement is also notable for proposing one of the first apparently genuine examples of "friendshoring" — favouring strategic allies when building supply chains — seen in the wild. It has delighted Canadian automakers by extending a tax credit to electric vehicles assembled in North America, not just the US. It also favours battery minerals processed by economies with which the US already has preferential trade deals.

Manchin is not exactly noted as an instinctive internationalist, but discussions about energy security and cross-border oil pipelines with Canadian companies and politicians seem to have convinced him of the wider strategic imperative of building supply chains that exclude China.

The appeal of friendshoring (also known as ally-shoring) has risen sharply. It was first elevated by the US's geopolitical tension with China and then accelerated by the sanctions and trade blockades that have followed Russia's invasion of Ukraine. But the concept remains fraught with multiple difficulties.

First, it's not always clear who your friends are and how you should choose them — and indeed choose between them. There may be fireworks lighting up the skies above Ontario at the Manchin deal. But the EU, Japan and South Korea might indignantly also stake some claim to being regarded as geopolitical allies, even friends, of the US. Brussels has already complained about the discriminatory nature of an existing proposed EV credit confined to US-made products. It is highly unlikely to be cheered up — or convinced that the tax credits comply with World Trade Organization law — by the charmed circle expanding to include only Canada and Mexico.

The deal's other provision, to favour battery minerals produced or recycled in countries with which the US has a preferential trade deal, is also problematic. The list includes South Korea but not the EU, despite years of painful negotiations over a trade agreement between Brussels and Washington, nor Japan.

Second, making a snapshot decision on political reliability more generally is hard enough, but trying to work out which friendships are likely to endure is almost impossible. That also goes for other countries assessing the loyalty of the US. Another presidential term for Donald Trump, or another economic nationalist in the same vein, and supply chains constructed according to Joe Biden's foreign policy preferences could rapidly be smashed in another tantrum of indiscriminate protectionism.

In any case, few countries will want to be an immutable part of a US friendshoring gang if it opens them up to strategic and commercial retribution from Beijing. It's not just about emerging markets such as Vietnam and Brazil that have good strategic relations with the US but are also heavily woven into supply networks involving China. EU governments have also resisted automatically being dragged into the US's corner — for example declining to institute a blanket ban on Huawei's participation in 5G networks.

Third, the tools authorities have to refashion supply chains along strategic lines are clumsy and expensive. On the export side, governments can restrict sales of sensitive technology, as the US and EU have done over semiconductors and other products for Russia and China. But with imports, companies will go for cheap inputs and it will take serious fiscal or regulatory effort to make them shift suppliers on a large scale. That has implications for public finances or product prices, or both.

Unless the EV tax credit improbably fosters such an incredibly efficient North American supply chain that it will be able to outcompete all-comers even when it is removed, US consumers will end up paying more for their cars. It might be a tough sell to argue that the public has to pay higher taxes or buy more expensive products because of a contentious official assessment of political risk, itself subject to self-interested lobbying from domestic producers.

Finally, politically-motivated supply interruption isn't necessarily the biggest threat to vital imports in any case. True, there are sometimes very obvious impacts from government interference for strategic ends, such as the current food and fertiliser shortages caused by Russia blocking exports from the Black Sea. But even before the war in Ukraine, the world economy had suffered a crunch in many supply chains.

Those reflected shocks to manufacturing production and demand and the global shipping industry rather than malign interventions by hostile governments. It will mean another awkward conversation if voters see supply chains laboriously re-engineered by state intervention and then not work anyway.

Assuming the Manchin deal survives, the tax credit provisions will be a valuable test of the ability of governments in general and the US in particular to mould supply chains according to strategic considerations. The questions about the proposals are clear. Are they legal? Are they affordable? Will they work? It's incumbent on proponents of friendshoring to show that the answers are yes.

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