

## Industry Takeaways From The Defense Industrial Base Report

By Zach Mears, Susan Cassidy, Justin Ganderson and Jeff Bozman

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Peter Navarro, assistant to the president for trade and manufacturing policy, recently offered in a New York Times op-ed that “[a] strong manufacturing base is critical to both economic prosperity and national defense.”[1] The Trump administration’s maxim that “economic security is national security” is rooted in several government initiatives, ranging from large-scale policy reforms (like renegotiating the North American Free Trade Agreement[2] and strengthening the so-called “Buy American Laws”[3]) to more granular contracting procedures (like the U.S. Department of Defense’s proposed changes to commercial item contracting[4] and increased scrutiny of security across all levels of defense supply chains).[5]

Business leaders should therefore pay close attention to the government’s long-awaited interagency assessment of the manufacturing and defense industrial base, which recently was made available in unclassified form.[6] The report was commissioned by Executive Order 13806, which described “[s]trategic support for a vibrant domestic manufacturing sector, a vibrant defense industrial base, and resilient supply chains” as “a significant national priority.”[7] The Department of Defense served as the lead agency coordinating the report, in partnership with the White House’s Office of Trade and Manufacturing Policy.

Throughout the 140-page report, the interagency task force identifies myriad threats, risks and gaps in the country’s manufacturing and defense industrial base, and concludes that “[a]ll facets of the manufacturing and defense industrial base are currently under threat, at a time when strategic competitors and revisionist powers appear to be growing in strength and capability.” To address these concerns, the task force lays out a methodology, diagnosis and framework for policy recommendations and gives the government significant flexibility in crafting responses. The report recommends — and we expect the president to issue — a follow-on executive order directing action on those responses. That creates an opportunity for industry to participate in shaping the major implementing policies and regulations that are coming.



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## Overview of the Report

A key benefit of the report is the clear, detailed description of the task force's methodology. This provides a road map for industry partners, particularly those in the supply chain below the large prime contractor level, to offer targeted inputs and comments.

- The task force categorized the relevant "sectors" of the manufacturing and defense industrial base. These include "traditional" sectors like aircraft, munitions and shipbuilding, and "cross-cutting" sectors like electronics, cybersecurity, and the U.S. workforce.
- Working groups then identified the "macro forces" on those sectors that "represent the root causes of ten risk archetypes." Macro forces include those that are self-inflicted ("U.S. government business practices" and "sequestration and uncertainty of U.S. government spending"), and those that arise from external actors and market forces ("industrial policies of competitor nations" and "decline of U.S. manufacturing capability and capacity").
- The resulting "risk archetypes" include threats like sole sources, single points of failure, erosion of domestic human capital and infrastructure, and foreign dependency.

The report then summarizes its four overarching findings:

1. The impacts and risks primarily affect "sub-tiers" of the supply chains, rather than the major defense prime contractors.
2. "A surprising level of foreign dependence on competitor nations exists." The report highlights crucial opportunities to leverage capacity and capability of allied nations.
3. Human capital challenges are pervasive, including the decline of science, technology, engineering and mathematics, and manufacturing trade skills among American workers.
4. Critical capabilities are moving offshore, both to capture foreign market share and to take advantage of cost-savings opportunities.

The appendices to the report include various case studies supporting the task force's assessment of each sector, highlighting the challenges currently faced by the manufacturing and defense industrial base. The report concludes with a "blueprint for action," summarizing current and future efforts that are "the groundwork for important actions, mitigations, and ongoing monitoring that will result in America's ability to continue supporting a secure, robust, resilient, and ready industrial base."

## Key Takeaways

Although the report does not incorporate detailed policy solutions, it does identify current actions and potential future efforts and recommendations. From the report's framing and the language of these findings and proposals, we can draw some initial conclusions.

First, the report highlights tools the Defense Department already has to mitigate some of these risks. The report describes the government's authorities to make "direct investment in the lower tier of the

industrial base” through programs like Title III of the Defense Production Act, and the “Manufacturing Technology” and “Industrial Base Analysis and Sustainment” programs managed by the undersecretary of defense for acquisition and sustainment. IBAS, for example, leverages a fund authorized by 10 U.S.C. § 2508 “to address critical issues in the industrial base and address supply chain vulnerabilities.” Effective use of these tools could address some risks without the need for additional legislative or executive creations.

Second, allies and partners can play a crucial role in offsetting the risks presented by “competitor nations.” The focus of the report’s threat analysis is unmistakably on China. Whereas recent legislation like the Foreign Investment Risk Review and Modernization Act, which updated the authorities of the Committee on Foreign Investment in the United States, largely declined to identify China by name (with some exceptions), this report candidly addresses the threats the task force sees from Beijing.

Building on a key line of effort in the Department of Defense’s National Defense Strategy, the report recommends addressing those threats by working with allies and partners through constructs like the national technology and industrial base “and similar structures.” The NTIB — meaning the United States, Canada, Australia and the United Kingdom — represents one of the most exclusive “clubs” of allies. Opportunities to leverage the NTIB abound, and leaders in business and government are already leaning in to them. For example:

- The British secretary of state for defense, the Rt. Hon. Gavin Williamson, praised the NTIB in remarks at the Atlantic Council in August.[8] The United Kingdom was added to the NTIB in the Fiscal Year 2017 National Defense Authorization Act.
- Raanan Horowitz, the CEO of Elbit Systems of America, made a compelling case for identifying “major allies for the technology and industrial base,” much as the United States does for “major non-NATO allies.”[9] That construct would create a prioritized structure to bring innovative technology into the United States, and in turn advance domestic production and manufacturing. Such a solution could bring some coherence to the existing network of bilateral Security of Supply and Reciprocal Defense Procurement Agreements, catalogued in the report. Industrial security agreements already allow U.S.-based subsidiaries to leverage parent companies’ capabilities to the advantage of the United States, but those procedures can be unwieldy and, in certain cases, quite limiting. Solutions like those Horowitz describes balance the dual requirements to safeguard national security and capitalize on the industrial capabilities of allies and partners.
- Bipartisan leaders in Congress, including thought leaders like Reps. Mike Gallagher, R-Wis., Stephanie Murphy, D-Fla., and Steve Knight, R-Calif., are finding ways to support innovative solutions for the industrial base. Reps. Murphy and Knight led a bipartisan effort to streamline the Small Business Innovation Research and Small Business Technology Transfer programs, strengthening the ability of small businesses to play key roles at multiple tiers of defense supply chains.[10] Rep. Gallagher called for a legislative follow-up to the task force’s report, noting in a June 2018 hearing that “as the Pentagon finalizes its response to the White House directive on a review of the industrial base, it might be useful for Congress to do something similar, a parallel effort in a sort of systematic way, both to analyze that report and ... do our own analysis of the industrial base.”[11]

Third, the report recognized the significant vulnerabilities with regard to software, as the DOD has transitioned from hardware to software-intensive systems. Software for many weapon systems is being sustained with processes that were developed for hardware-centric systems. Given the evolving cybersecurity threat and the scale of destruction that could result from a hack of a DOD weapon system, this represents a key risk area for the government. The report concludes that both a unified source of clear software engineering policy and a renewed commitment to workforce enhancements in the STEM area are necessary to help mitigate this risk.

Fourth, procurement reform efforts will feature prominently in the policy solutions. Macro forces include “deleterious U.S. government business and procurement practices,” and the report notes that “[m]any of the current policies and practices of the U.S. Government, and DoD in particular, strain the industrial base and reduce incentives to supply to DoD, resulting in an inability to meet national security demands, increasing foreign vulnerabilities, and a DoD challenged to meet its goals in an era of expanding strategic competition.” These concerns cannot be addressed simply through changes to the Buy American laws or increased scrutiny of component content. Rather, the task force acknowledges that comprehensive acquisition policy reforms must reduce barriers to entry, shorten contracting timelines, and improve the skill of the government’s acquisition workforce. The report commends the work of the Section 809 Panel, which will publish its third volume of recommendations in early 2019. Government contractors can anticipate major changes in this area, and should consider how best to contribute to the discussion, including through the rule-making process.

Finally, the report signals future action with respect to supply chains that cross borders, especially into China. It describes Chinese policies of “economic aggression” and the security risks associated with dependency on China, using the market for printed circuit boards as a prime example. The report argues for “relief from unlawful and otherwise unfair trade practices,” but it is important to note the context of this argument: It appears alongside discussions of the United States’ relationship with China. Stakeholders in allied nations hope that the different risk profiles of allies and competitors will lead the administration to align its response to trade disputes accordingly. Trade remedies might be useful tools in dealing with adversaries, but the administration could deploy other policies to influence the behavior of allies, or at least sharpen the bluntest trade instruments (like Section 232 tariffs) by crafting exceptions for key allies like Canada. The framing of the report highlights this opportunity to accomplish those twin aims — helping U.S. industry withstand truly unfair trade practices, while shoring up a reliable supply of resources from allies and partners — while also developing longer-term policies to reinvigorate key domestic capabilities.

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[1] Peter Navarro, America’s Military-Industrial Base Is at Risk And Here’s What the White House is Going to Do About It, N.Y. Times, Oct. 4, 2018, available at <https://www.nytimes.com/2018/10/04/opinion/america-military-industrial-base.html>.

[2] See, e.g., John Veroneau, Marney Cheek, Gina Vetere & Kate McNulty, United States and Canada Conclude Negotiations to Revise NAFTA, Covington Alert, Oct. 2, 2018, available

at [https://www.cov.com/-/media/files/corporate/publications/2018/09/united\\_states\\_and\\_canada\\_conclude\\_negotiations\\_to\\_revise\\_nafta.pdf](https://www.cov.com/-/media/files/corporate/publications/2018/09/united_states_and_canada_conclude_negotiations_to_revise_nafta.pdf).

[3] See, e.g., Justin M. Ganderson, Frederic M. Levy, E. Sanderson Hoe & Scott A. Freling, 4 Takeaways From The 'Buy American' Executive Order, Law360, Apr. 19, 2017, available at <https://www.law360.com/articles/914680/4-takeaways-from-the-buy-american-executive-order>.

[4] See, e.g., Justin M. Ganderson, Susan B. Cassidy, Alexis N. Dyschkant & Jason N. Workmaster, How DOD Plans To Change Commercial Item Contracting, Sept. 12, 2018, available at <https://www.law360.com/articles/1081892/how-dod-plans-to-change-commercial-item-contracting>.

[5] See, e.g., Susan Cassidy, Zachary Mears, Heather Finstuen, Ashden Fein, Catlin Meade & Jeffrey Bozman, Who's in Your Supply Chain? Contractors Face Increasing Compliance Obligations and Restrictions, Covington Alert, Aug. 30, 2018, available at [https://www.cov.com/-/media/files/corporate/publications/2018/08/who\\_is\\_in\\_your\\_supply\\_chain.pdf?\\_ga=2.268398798.1390662464.1539616470-1826105222.1516034387](https://www.cov.com/-/media/files/corporate/publications/2018/08/who_is_in_your_supply_chain.pdf?_ga=2.268398798.1390662464.1539616470-1826105222.1516034387).

[6] Interagency Task Force Report, Assessing and Strengthening the Manufacturing and Defense Industrial Base and Supply Chain Resiliency of the United States, Sept. 2018, available at <https://media.defense.gov/2018/Oct/05/2002048904/-1/-1/1/ASSESSING-AND-STRENGTHENING-THE-MANUFACTURING-AND-DEFENSE-INDUSTRIAL-BASE-AND-SUPPLY-CHAIN-RESILIENCY.PDF>

[7] Exec. Order No. 13806, 82 Fed. Reg. 34597 (July 21, 2017), available at <https://www.federalregister.gov/documents/2017/07/26/2017-15860/assessing-and-strengthening-the-manufacturing-and-defense-industrial-base-and-supply-chain/>.

[8] A Conversation with UK Defense Secretary Gavin Williamson CBE MP, Atlantic Council, Aug. 7, 2018, available at <http://www.atlanticcouncil.org/events/webcasts/a-conversation-with-uk-defense-secretary-gavin-williamson-cbe-mp>.

[9] Raanan I. Horowitz, A Strategic Approach to Foreign Investment and U.S. National Security, Business Executives for National Security, available at [https://www.bens.org/pages/whiteboard/digest\\_bens-whiteboard\\_horowitz](https://www.bens.org/pages/whiteboard/digest_bens-whiteboard_horowitz).

[10] Kevin Derby, Stephanie Murphy, Steve Knight Team Up Again to Help Small Businesses, Sunshine State News, Oct. 14, 2017, available at <http://sunshinestatenews.com/story/stephanie-murphy-steve-knight-team-again-help-small-businesses>.

[11] Navy and Air Force Depot Policy and Infrastructure Issues: Hearing Before Subcomm. on Readiness of the H. Armed Servs. Comm., 115th Cong. (2018) (statement of Rep. Gallagher).