

# THE IMPACT OF COVID-19 ON GLOBAL SUPPLY CHAINS AND SANCTIONS

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## Supply Chains and Sanctions

The coronavirus outbreak has once again placed a spotlight on global supply chains, particularly those that are involved in the fabrication of medicines, medical equipment, and vaccines. Right now, much of the discussion around these supply chains is in the arena of high-level politics. Observers and officials of a protectionist bent—such as Peter Navarro, a trade adviser to Donald Trump—have used the [occasion to emphasize that](#) “if we learn anything from this crisis, [it is that] never again should we have to depend on the rest of the world for our essential medicines and counter-measures.” Others have argued instead that this is why protectionism is inherently [counterproductive](#) and [dangerous](#). Global supply chains are likely to leave the realm of elite debate if and when the effects are felt more directly by consumers and in visible ways, such as the shortage of fresh fruits or vegetables. The result will be political pressure on leaders around the world to reduce national exposure to international trade, perhaps not just in areas associated with coronavirus response and mitigation. Underscoring this point, on 1 May, the Trump Administration issued an [Executive Order](#) that restricts the procurement of components and equipment for the U.S. “bulk-power system,” arguing that “unrestricted” trade in these goods “augments the ability of foreign adversaries to create and exploit vulnerabilities in bulk-power system electric equipment, with potentially catastrophic effects.”

Setting aside completely whether investing the effort in deglobalizing supply chains is sound or sensible, moves to do so will have important effects on global economic statecraft. States that presently have an outsized advantage in the use of such tools—the United States in particular—may find that shifts away from global supply chains are damaging to their ability to use economic leverage, especially sanctions. States that are more vulnerable to these tools, on the other hand, may find their exposure to sanctions reduced, alongside lost advantages from international trade and business; in essence, less reliance on international supply chains could do the work of sanctions.

## Deglobalizing All Supply Chains Is Impossible

First, let’s define “global supply chains.” The term is often bandied about, but there are two common usages at present. The first is the most straightforward: the involvement of companies from a wide range of countries that are all involved in the manufacture of a



given product. Take, as a case in point, the Apple iPhone. [According to Apple](#), the iPhone is composed of parts from hundreds of entities and [dozens of countries](#). It may be a US product in one sense, sold as it is by a US company, but it is a global product in many practical respects. The second usage is becoming a little more common in general parlance and, for simplicity's sake, can best be described as goods involved in international trade.

For purposes of clarity, this paper is intended to focus on the former rather than the latter, with its emphasis on an effort to prevent a range of goods from being produced in a variety of locales abroad and then imported. The motivation behind individuals supportive of this concept varies. Some see it as a vital component of robust, enriching employment. Still others see it as a necessity to avoid vulnerability to foreign influence or pressure. The overarching concept remains the same regardless: it is contrary to national interest for goods to be manufactured in bits and pieces abroad, and—from both the left and the right—the “maximum efficiency” approach taken toward existing supply chains needs to change.

That said, as a threshold matter, deglobalizing supply chains is much easier said than done, particularly in an economic system that still prizes competition, free enterprise, and the minimum necessary government regulation and interference in business decision-making. Domestic production of some crucial goods and their components may be intensified in the aftermath of the coronavirus, and incentives may be provided to onshore such manufacturing in the future, at least for those countries capable of making such investments. It is also possible that changes to tax codes, investment regulations, and the like could shift the balance of economic interests for companies away from offshoring production of such goods. Still, even in those areas, source materials may still be required from abroad, and a whole range of other inputs—including the medical research necessary to combat future outbreaks—may involve an inherent amount of international activity. A localized supply chain is likely to be expensive, possibly with regressive effects on the poorer segments of society. Moreover, curtailing substantial foreign participation in manufacturing may be contrary to international development goals.

Localizing the global economy is not in the cards given the diversity of inputs required for maintaining the standards of modern life and the conflicting policy inclinations of even some of its advocates. At least, an *immediate* attempt to domesticate the global economy is unlikely; the implications of a broader confluence of economic populism, nationalism, xenophobia, and skepticism in economic liberalism may have *longer-term* effects that are beyond the scope of this analysis.

## Moves to Localize Some Supply Chains Will Still Have an Effect

Even if it is possible to dismiss such a straw man, this should not be taken to mean that some elements of this effort might not be successful. The coronavirus outbreak may prove to be a significant motivator (if only in a few sectors), as are concerns regarding working class employment as governments try to deal with the global economic crisis. Moreover, as the outbreak affects broader trade currents (including trade in food), demands from constituents for protection and government intervention are likely to go beyond specific industries around the coronavirus mitigation effort.



The result may be a conscious effort on the part of governments as well as multinational companies to slim down their global supply chains to prevent the risk of future disruption. Such disruption could come as a result of wide-ranging foreign government action as well as further outbreaks that result in one factory's closure in a foreign country paralyzing an entire production line. Indeed, even if a governmental diktat to onshore supply chains is never forthcoming, the cost, benefit, and risk [assessments](#) of nervous businesses may encourage shifts in this direction. Something similar may already be occurring with respect to financial institutions, which have engaged in derisking activity already with respect to [sanctioned jurisdictions](#) and may have an incentive to do the same with respect to sanctioning jurisdictions.

Taken in combination with several years of trade tensions epitomized by the Trump administration's full-throated embrace of tariffs with adversary and ally alike, the result may be to localize supply chains to an appreciable degree with outsized effects on economic statecraft.

## For the Sanctioner

In some respects, a less globalized supply chain may be conducive to the efforts of sanctioners. After all, a function of sanctions is to deny access to financial and other economic systems for malicious actors. The United States often speaks of its financial sanctions in this way, underscoring the imperative of "[safeguarding the financial system against illicit use](#)" in the application of sanctions tools. A supply chain that is less reliant on foreign sources would also be one less vulnerable to attack, misuse, and manipulation.

However, this is only the narrowest mission of sanctions. Both historically and in the present era, the use of sanctions has been focused as well on the application of leverage for foreign and national security policy making. A less globalized supply chain would reduce trade, imposing significant limitations on the efficacy of sanctions as a tool and reducing their salience.

After all, sanctions do their work by "restrict[ing] or prohibit[ing] what is normally permissible conduct."<sup>1</sup> Put another way, sanctions create pressure by preventing something that can usually occur. They work by denying optimal activity for their target, making them have to do things in less efficient (and perhaps less effective) ways. They force the target to find work-arounds but also—hopefully—to consider in doing so whether the activity that prompted the imposition of sanctions is worth all the bother.

A globalized supply chain means that there are potentially dozens of points of leverage and possible areas for disruption via sanctions. The aforementioned example of the iPhone is instructive. Even if the direct sale of iPhones was not prohibited by the United States to a particular country, sanctions actions taken by any one of those dozens of countries to preclude their components being included in an iPhone destined for such a country could prove immediately disruptive. For sanctioners, this means that, even if the root item could not be prevented from being transferred, there may be dozens of opportunities to deny access to it by interfering with that supply chain.

In a different way, that is precisely how the United States has structured its sanctions programs against Iran, North Korea, and Venezuela: by denying access to the United States and directly sourced products, to be sure, but also by identifying other aspects of the broader



value chain that are involved in trade. For Iran, for example, this meant going after not only goods but also banking, insurance, shipping, and other services that are necessary for a good to get from any other place to Iran. But there is no particular reason why the United States could not have worked backward as well, precluding the transfer of items not by targeting the service providers from production to export but instead all the way through the manufacturing process. For its part, when seeking to apply pressure on the United States, [China did precisely this](#), targeting the supply of rare earths required for use in modern telecommunications and threatening to do so again.

A more localized supply chain would reduce these available points of leverage and not just by limiting the types of goods that could be disrupted. By also reducing the need for shipping, banking, insurance, and other services, sanctioners might find that the associated services that are—for now—available for pressure might be less susceptible. Arguably, sanctions would therefore be more targeted if employed, but with a much smaller array of available targets to choose from, the effect would probably be—on net—fewer avenues for pressure even if pressure once imposed might be intense.

The damage to sanctions policy would not be limited to these areas, however. While more localized supply chains would reduce the avenues for direct pressure, they might also reduce the overall sense of exposure that sanctions pressure can create. For example, when the United States threatened to impose sanctions on European energy companies for purchasing Venezuelan oil, they didn't just threaten to curtail their access to US products and materials in the energy sector; they also threatened access to US finance, intellectual property, and the like. This is because the scope of sanctions is not just about what is directly targeted and put on the line for sanctions (which might be an asset freeze or travel ban, for instance) but also the ability of a sanctioned entity or individual to operate normally in the international economy. This could come as a result of reputational damage or reluctance on the part of investors and other companies to pursue joint ventures, particularly if other entities or governments believed that the sanctioner would come after anyone associated with the illicit actor.

Sanctioners might also lose the ability to influence state policy. Much of the value of sanctions, after all, lies not in their actual execution but rather their threatened use. By invoking sanctions as an option, sanctioners can convince foreign governments to intervene directly in problematic business activities and stop them. But this national influence derives less from fears that the US secretary of state will make loud speeches that cast aspersions on the countries in question and more that sanctions targets fear that their broader economic interests might be put into doubt by the US secretary of state working at home to restrict transfers of valuable commodities or technologies. By reducing their exposure to international economic currents through more localized supply chains, sanctions targets may be less nervous about challenging the threats issued and daring sanctioners to take their best shots.

While many different sanctions users might find themselves particularly at risk from such a change in supply, the United States is probably more at risk in such a scenario than others because (1) it uses sanctions more often than any other government, and (2) it is particularly dependent on indirect sanctions pressure to target most of its adversaries owing to years of direct embargoes and other sanctions. For this reason, limiting the US place in international



supply chains and its participation in them could be particularly damaging to the US government's ability to invoke, threaten, and use sanctions tools. Indeed, to the extent that it is no longer a major supplier or producer of crucial goods, the United States could find itself making a sanctions threat that is of materially less peril than in years past.

## For the Sanctioned

All of this may sound like music to the ears of the sanctioned. Reducing exposure to sanctions also amounts to the dissipation of pressure on the sanctioned, allowing them to engage in whatever conduct others find objectionable. Indeed, one can see in the Iranian drive for indigenization and the North Korean *juche* approach glimmers of a serious attempt to source goods at home and avoid the problems caused by international trade.

But, of course, therein lies the problem: while approaching autarky may sound like a safe bet for sanctions mitigation, it comes along with the lost benefits of trade, mass production, and distribution. In some cases, these are direct and material: the inability to obtain particular goods and services because they simply are not made at home or because they would prove too expensive if diverse and wide supply chains were not used. In other cases, they are of longer consequence, such as the inability to obtain goods and services that would allow for the development of a particular resource or exploitation of a natural resource. Moreover, it is often hard to do while providing for economic growth. It is worth noting, in this context, that while the North Koreans still adhere to *juche* in theory, a core tenet of the Kim Jong Un regime has been opening North Korea to greater international trade to improve the economy.

## Conclusion

Of course, no one is seriously suggesting a drive to pure autarky in suggesting more localized supply chains. But even in the absence of this straw man, both sanctioners and the sanctioned would probably stand to lose if supply chains were considerably more local across the board. The question then becomes the degree to which a localization drive can be successful and what goods might be found in and out. The problem is that such efforts are often hard to modulate. Protectionist measures applied by one country to address an identified need often result in retaliation by those affected, sometimes targeting different goods. Efforts to localize supply chains would probably create similar pressures and incentive structures, with similar risks.

This is not to say that some goods cannot and should not be produced at home. But, as [the Economist](#) pointed out on April 11, 2020, while there are “sensible” reasons to identify some industries as strategic and to adopt policies accordingly that might result in greater localization, “governments should anoint them cautiously.” This is not simply for the economic risks and costs that come along with the effort. There are also geostrategic implications of such a maneuver, especially in the United States.

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## Notes

1. Richard Nephew, *The Art of Sanctions: A View from the Field* (New York: Columbia University Press, 2017).



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## About the Author

**Richard Nephew** joined the Center on Global Energy Policy in February 2015 directly from his role as principal deputy coordinator for sanctions policy at the US Department of State, a position he had held since February 2013. Nephew also served as the lead sanctions expert for the US team negotiating with Iran. From May 2011 to January 2013, Nephew served as the director for Iran on the national security staff, where he was responsible for managing a period of intense expansion of US sanctions on Iran.



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