

Peterson Institute for International Economics

Mary E. Lovely on what's really going on with global supply chains

September 10, 2026, 11:00 AM to 11:30 AM EDT

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[00:00:42.24] - Anjali V. Bhatt

Hi, and welcome to PIIE Insider Live. I'm Anjali Bhatt, Communications Director and Research Fellow here at the Peterson Institute for International Economics. Insider Live has been on summer vacation, But we're back for what will be a very busy fall, and there's a lot to talk about. I have a lot of questions, and PIIE's experts will answer it all. Before we begin, I'm also very excited to announce that PIIE is now on Instagram. So please go follow us @PetersonInstitute for videos with the little fuzzy mics, some animated charts, little swipty graphic explainers, and even clips of this podcast because everything is clipping now. So please go follow us on Instagram @PetersonInstitute. Anyway, so today we're speaking with Mary Lovely, PIIE's Anthony M. Solomon Senior Fellow. If you're watching on Zoom, feel free to put your questions in the little Q&A box thing. So, hi, Mary. Thanks for joining us.

[00:01:32.14] - Mary E. Lovely

Oh, it's my pleasure, Anjali.

[00:01:33.29] - Anjali V. Bhatt

Okay, so what is going on with global supply chains, and how would you say that global supply chains have changed since, I guess, the start of the first Trump administration?

[00:01:45.26] - Mary E. Lovely

Yeah, those of us at the Peterson Institute have been asked this question since the first month that the tariffs went on. And of course, as everyone knows, they were staggered over a period between 2018 and 2019, maintained by the Biden administration, which even added a few, particularly on sectors that the Biden administration wanted to encourage, including semiconductors and EVs. And then we had the erratic tariffs roll out from the Trump administration, on again, off again exemptions, et cetera. So we're asked this question a lot. We're finally beginning to get some data that tells us how supply chains have reorganized in

light of this. And of course, most of this reflects the tariffs on China alone. It's still too early to see how the Liberation Day, so-called Liberation Day tariffs, have affected supply chains. That's a work in progress, as are the tariffs themselves. Some of them are going up and down and exemptions. So we'll have to wait for another PIE Live to see what happens there. But our own work is focused on how supply chains have adapted to primarily the tariffs on China. And this has important implications, both for the costs that U.S. companies have to pay, the costs that U.S. consumers have to pay, but also, I think importantly, economic security.

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Because behind a lot of the bluster that we see from the Trump administration, there is a real concern shared across the aisle that the U.S. has become too dependent on Chinese manufacturing for many goods. And we're— we are really responding to that concern by looking at how supply chains have changed with the use of this very blunt instrument, which is broad across-the-board tariffs.

[00:03:45.15] - Anjali V. Bhatt

Yeah. I mean, and there's so much there. Like you said, we've been studying this for almost 10 years now, which is crazy. But let's start with the— I think it was your most recent paper with our excellent colleague Christine Wan. So it's titled Made with China: Global Supply Chains and the Limits of US Decoupling. So like we said, one of the ways that US policies have tried to change global supply chains were the first Trump administration tariffs, and the Biden administration left them in place and then added a couple of their own. And the point was to change where the US imports stuff from. And largely, especially those sort of first tranches were to make the US less dependent on Chinese manufacturing. So in the Made with China paper, to actually measure how supply chains have moved, you and Christine, one of your main measures is bilateral trade versus value-added trade. What's the difference and why does it matter?

[00:04:51.11] - Mary E. Lovely

Okay. So we knew from our own work inside PIIE, but also from lots of work people within the think tank and academic community that as our trade with China was going down, our trade with other countries was going up. So China's share of our bilateral exports fell from about 22% in 2018 to 9% last year. That's an enormous amount of goods that we're now sourcing from other countries. The question is, how did that happen? I mean, 5 years, 7 years might seem like a long time, But in terms of moving value chains, it is not. So especially on more high-value, high-tech, or specialized inputs, what's really happening? And we had some clues because everybody could see that countries like Vietnam that were increasing their imports to the US

dramatically were also increasing their own sourcing from China. So we had sort of this shadow or echo saying, hey, there's a lot of stuff that's coming from China landing in Vietnam, being transformed. This is not what we think of as transshipment. Transshipment is really technically defined as like when a computer lands in Vietnam and Vietnam just slaps a Made in Vietnam label on that Chinese-made good.

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Instead, we're looking at parts coming from China being assembled or otherwise transformed within Vietnam and then coming to the United States. So what we wanted to look at was what—how much has the value of Chinese-made content that arrives in the US changed over time? That's different than how much stuff, you know, leaves a Chinese port and arrives in the US. This is looking at all Chinese-made content that comes through these third countries.

[00:06:46.07] - Anjali V. Bhatt

So that means that— so trade and value-add is looking at all of the stuff that was originally made in China, and then it goes to another country. And in that third country, the stuff that's made in China is put into other things, and then that finished product is then shipped to the US.

[00:07:05.14] - Mary E. Lovely

Yeah, I mean, a good example is laptops. Our colleague Chad Bown has documented how our imports of laptops from China has fallen dramatically since the the first round of tariffs under the first Trump administration. And imports from Vietnam have risen to fill the gap. Well, how did that happen? Well, interestingly enough, and it makes sense, right? Parts are coming from China into Vietnam. So that laptop that we see from Vietnam contains significant Chinese content. And we want to capture that in our calculation. This hadn't been done. There was no number that we could point policymakers to and say, this is happening. And so Christine and I used trade data and what are called input-output tables, which sound kind of fancy, but basically record how various— what various countries use to produce goods, including imports and domestically sourced goods. So it would capture Vietnamese imports of, say, chips from China into that laptop, as well as Vietnamese value-added, so the assembly part into the US. And we trace that for all the countries that we trade with. And we found something that's very different than what the headlines would have us believe. So we look at the paper, there's a trade number release.

[00:08:39.10]

It says, hey, look, you know, US trade with China is way down. And that makes us think, hey, high five.

[00:08:48.07] - Anjali V. Bhatt

Decoupling is happening.

[00:08:49.11] - Mary E. Lovely

Decoupling is happening. When we look at the amount of Chinese value-added, Chinese content that's coming into the US, we don't see anything like that. We estimate that if you look at the foreign value-added that's coming into the US, the Chinese share has fallen very little, only 2 percentage points. So basically, this decoupling is not happening. And from an economic security point of view, that is very important because we've seen in the past that if China can control just one part of the value chain, we can still be subject to a vulnerability or a choke point, as we're seeing with critical minerals today or rare earths. So we think this is an important finding and something worth discussing. It also has important policy implications.

[00:09:39.11] - Anjali V. Bhatt

So before we get into the policy implications, we mentioned Vietnam, but are there any other countries that we're seeing a lot of this, not transshipment, but value-added trade going through that the US is now importing more from?

[00:09:53.01] - Mary E. Lovely

Well, Mexico is another one. And of course, Mexico is on the hot seat with the renegotiations for the US-Canada-Mexico Agreement underway. We have a lot of Chinese content coming in from Mexico just by numbers relative to the total basket. But that's because we import a lot from Mexico, now our number one import source. So that might be disturbing, except that the Chinese content in Mexico in most sectors is growing slowly and for most sectors is below 10%. There's, of course, special concern in electronics. and in motor vehicles, auto parts. But otherwise, even though it has grown, it's not, you know, where we think this is a danger point. It has grown much more rapidly and is much larger in Vietnam, where in electronics we see more than a quarter of the content of that, on average, of that laptop coming from Vietnam originating in China. I might add that we might be undercounting as well because China has done a lot of outward FDI into these countries, and Chinese-owned factories may be using more Chinese content than the average. And we're looking at average input-output tables that we use capture those average recipes that firms are using to make the goods.

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So I would say Vietnam and Mexico are clearly key in this, and we do a deep dive into both of them in our policy brief.

[00:11:29.21] - Anjali V. Bhatt

So what does this mean for all of the various tariffs that the second Trump administration has imposed? Because they're different from the first-term tariffs in a lot of ways. They're on a bunch of different countries. I mean, China was one of the targets, but, you know, they're on lots more countries, different sectors, sort of different levels. Will that change these supply chains? Will that change how Chinese content is getting into the US now? Will it make the US less— will the new tariffs make the US less reliant on Chinese inputs?

[00:12:08.10] - Mary E. Lovely

Yes, I think it will affect it. Although there'll be some hysteresis. Some of the things that have happened won't be nudged away by these changes, especially since the Trump administration's tariffs seemed to change by the month. But what we document is that Chinese content coming into the US indirectly, has really increased as an overall share of what we consume from China. It's now about a quarter of what we consume from China is coming in indirectly. That's a very large percentage. And it's really unlikely that that's going to change that much. But the tariffs have in some sense helped to level— these new tariffs have leveled the playing field between Vietnam and other countries. So where you might have had a very high tariff on China, compared to a Vietnam or a Malaysia or a Mexico. Now with these tariffs going up and because of the Supreme Court ruling against the use of IEPA tariffs and what happened in Busan, which we can talk about, where really it's unlikely that the administration will raise the blanket tariffs on China above 20%, we're seeing a much smaller differential. And so that means that this impetus that firms have to move away from China is really now much reduced.

[00:13:28.26] - Anjali V. Bhatt

So if there isn't that much impetus now to move out of China, and therefore these— the tariffs probably won't make the US less reliant on Chinese inputs, what other trade policies are there that could do what the tariffs apparently are not doing?

[00:13:51.13] - Mary E. Lovely

Well, I would say that the administration is quite quietly rolling out a bunch of different initiatives that would allow them to enforce, uh, the movement away from China. Um, an important one is

the agreements on reciprocal trade, which contain a variety of legal mechanisms to force other countries to align with U.S. trade preferences. And these include agreements to align with the US on our trade policies, such as we levy countervailing duties or anti-dumping duties or use Section 301 on our export controls. For some countries, there's even investment screening requirements. The problem with these is that they have not been ratified by any other country. I think except one. And in the US, of course, it's never going to go before Congress. So it's—these are not codified in US law. So they might evaporate as quickly as we saw the Indo-Pacific Economic Framework from the Biden administration evaporate. The US is also right now has out for comment some new rules from Customs and Border Patrol that would require multinational companies to identify the content of the things they're importing and make it harder for foreign foreign importers of record to use informal means. So basically, while other countries are doing trade facilitation, this is a sense of trade harassment to try to really increase the costs of importing inputs into this country.

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So there are a number of mechanisms that the Trump administration is pursuing to try to drive China out of these supply chains. Again, none of this is strategic. That is a criticism that I have leveled against the trade— the broad-based tariffs from the beginning. Economic security requires us to have diversified supplies of certain goods. Semiconductors is one that the US has already embraced. But there's a whole host of other things where China has a very large share of global imports— global exports, rather. And we should be identifying those goods and using a variety of tools to target those goods and developing new sources of supply. It's not just about raising the cost of importing chemicals or other things from China. It's about having alternatives. Right now, it just really has raised the cost of American businesses. And one thing I think that's really interesting in what we found is we look at whether other countries' supply chains are changing in the same way that the United States supply chains are changing. And we find that it simply, you know, is— the US is becoming very idiosyncratic in its supply chains. It's not happening. Their indirect share of Chinese inputs is not increasing after 2018 like the US.

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That tells us it probably was the tariffs that was the cause. But it also tells us that Germany, Japan, all the other countries in the G7, they're not subjecting their domestic firms to the same higher costs that we are subjecting our own exporters to. Now, why do I say higher costs? Well, because these do-arounds actually raise costs for American companies. Much of what we import from China is intermediate inputs that are used in American factories and for American manufacturing. So I think this is a real problem moving forward in terms of US competitiveness.

[00:17:31.27] - Anjali V. Bhatt

There's a lot there that we can talk about. Yeah, I think we just fixed trade policy. But let's talk a little bit more about these agreements on reciprocal trade, because I know that's the other paper that you and Christine worked on this summer. You guys have been very busy this summer. I was doing Instagram, you guys were doing research. But so these agreements on reciprocal trade that, again, that you wrote with Christine Wan, or these ARTAs, they're not like actual free trade agreements in the traditional sense. And like you said, they haven't been ratified by Congress or by other countries. So they're just sort of handshake agreements, we could kind of say. But basically in these agreements, so the US has agreed that they'll change the tariff rate on products from that country in exchange for concessions. Yeah. From that country, they so and so you said like there are a lot of there are a lot of legal tools in that and a lot of sort of different things that that they have to align with in terms of investment promises and other sort of non-tariff barrier you know mechanisms that that exist. But yeah, so like you said before, the arts are being used to to force alignment.

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with U.S. policies? What does— how can these agreements that aren't ratified, how can they force alignment with U.S. policies?

[00:18:54.18] - Mary E. Lovely

Well, the U.S. has shown its willingness to use a variety of tools to keep the pressure on these countries to fulfill some, at least some of these concessions. So they may use security issues, moving troops around, Right now, the US administration is focused on South Korea. They really want South Korea to begin to invest in the US, which is part of its agreement with the US, was investment concessions. And much of the Korean public views this as not in the interests of Korea. So the US is continuing to put pressure on them to make them change their mind about that. We see in the agreements of reciprocal trade very interesting differences in the language. Some countries' language is very stringent, you will adhere. In others, it's very loosey-goosey. Christine developed this heat map approach with our wonderful graphic designers, and we have that out on our website as a PIIE chart, and I've also posted it on LinkedIn. It's interesting that the country that really had to adhere to the US, align with the US most clearly, and probably was most willing to was Taiwan, from whom we get an enormous amount of advanced chips, the key fabricator of advanced chips in the world.

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But it's interesting that these requests were made of countries in Asia, so part of the Asian production network of which China is the center now, but not of the 2 Latin American countries that have already signed ARTs with the US. So there's variation across the arts that reflect the reality of the centrality of China in East Asian production networks, really Asian production networks. This is going to prove to be a real problem. These countries have, particularly in Southeast Asia, have signaled repeatedly that they don't want to be caught in the middle of choosing China or the US. And in fact, both sides have promised to put the squeeze on them if they choose one side or the other. And so adhering to these arts is going to be difficult. We're already seeing a report this morning from Bloomberg that Malaysia's data center for its telecoms will include Huawei chips, clearly not aligning with U.S. security interests. But Malaysia has a close relationship with China. All of these countries are deeply integrated into production networks that include China. For many of them, China is their most important import partner and export destination. So asking them to turn their back on China is, is really going to be very problematic.

[00:21:51.29] - Anjali V. Bhatt

Yeah, so I mean, could these agreements, these ARTs, be used to get these countries to reduce their reliance on China? Is there a way to enforce you know, this alignment with US policies of excluding Chinese inputs from supply chains. Do the arts have any way to enforce that and sort of force them away from China?

[00:22:15.20] - Mary E. Lovely

Well, you know, I think there's a number of possibilities. One, they can slow roll it. We're seeing that some of the countries are slow rolling. We could see outright defiance. We're seeing that with Canada.

[00:22:25.06] - Anjali V. Bhatt

Well, they don't have an ART, right?

[00:22:26.17] - Mary E. Lovely

No, they don't have an ART, but they are responding to what was a series of requests from the US that they felt impinged on their sovereignty. And all of these things in some sense impinge on a country's sovereignty to determine its own trade policy, its own rules of origin, who it signs a trade agreement with, how it creates investment screening. So they're going pretty deep. So you could have slow roll, you could have outright defiance, you could have countries that just say, we're not doing it, so raise the tariffs up on us, US. Or we could see something that I think

they'll try to do, which is almost like 2 separate supply chains, one that includes China, one that doesn't. And while that may seem like a win for the US, it's going to be much higher cost for the US. And we're already seeing, as I mentioned, that the supply chains that serve the US are becoming increasingly idiosyncratic, isolated, higher costs, less transparent. And I think that's a problem for a nation that really would like to stay competitive, but also increase transparency of what's in its supply chains and increase its economic security.

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You know, removing China from supply chains in certain sectors is, in a sense, buying an insurance policy. We think China has a— there's some non-zero probability that China might use this as a choke point. We want to guard against that. We don't buy insurance on everything. We're not going to buy insurance on China cutting us off from children's boots or from clothing. Presumably, there's other places we can get it. And it's not a national security crisis if we can't, or we have to wait a few months while other countries fill the gap. And I think this administration is beginning to admit that because, as we see as we move toward the Xi-Trump summit, that they're talking about a board of trade and lowering tariffs on so-called non-strategic goods. We don't know what those goods are. We can imagine that they would be things like clothing, household goods, toys, perhaps. We don't know what's actually in there, but it makes sense that these are not important goods for economic security. But it will require policymakers to, you know, in a sense, pull up the big boy pants or big girl pants and say, these are important, we have to identify them.

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And the American taxpayer is going to have to pay more for that insurance. We can't pretend that we can just you know, strong-arm other countries into doing our work for us, it does have a cost. We've already seen that with the tariffs, which have been borne mainly by US firms and US consumers.

[00:25:02.25] - Anjali V. Bhatt

Yeah. So I think that that's— I think the, you know, the sort of the insurance framing and that it'll cost, you know, US consumers more is a really interesting point, because if it comes down to economic security and national security, that is something that in theory we should be willing to pay more for. And if separating these supply chains out is an economic security strategy, is it so bad if there are sort of supply chains with China and supply chains without China? Is that a sustainable strategy for the US?

[00:25:39.21] - Mary E. Lovely

In some cases, it may be. But the US has to be very strategic about which it chooses. The broad-based tariffs clearly are the result of not making that choice. Now, we have made a choice in semiconductors, and I think most Americans agree with that choice. Americans have shown themselves willing to entertain the idea of tariffs, support tariffs, for example, to protect American jobs. It's a longstanding tradition in the US that the impact of imports on, on jobs and industries can be offset with tariffs. We have a variety of laws that already allow us to do this. We don't, we don't need all these strange 301 cases. So I think the American public, if it is brought to them and explained, would be willing to pay the price. But again, it has to be a situation where decisions are made. And there's always, you know, the unfortunate case that tariffs enrich some people even as they cost me and you money. And we're seeing that when exemptions are given to firms selectively, there's a lot of room there for corruption. So we've seen this in the record with developing countries over and over again, and it's not impossible that this has happened in the United States.

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So we're seeing more firm-specific or even sector-specific tariffs that really reflect lobbying and other types of concessions that are given for domestic political reasons. I'm sorry to say that. We like to think that America, you know, is a place where you can do clean business. But it's a problem when we are identifying certain sectors or certain firms. So, for example, we already have cases where we're willing to have lower tariffs if goods are used in aerospace. or in pharmaceuticals. And I ask, why those sectors? Why are their jobs more valuable than my job or your job? So there's a lot there to really begin to unpack.

[00:27:51.11] - Anjali V. Bhatt

Okay, well, time flies. We're almost done. But we have a question here from Mara Lee who says, what do you think will result from the Great Transshipment Scam report? Which you will have to explain what that is. Do you think it will result in more UFLPA detentions, which you will also have to explain what that is, or that other countries will agree to rules of origin to keep Chinese goods out of their products? So great transshipment scam report and UFLPA detentions.

[00:28:21.19] - Mary E. Lovely

Okay. So the White House, it was right after actually we released our paper on value-added trade, released a report arguing that a lot of the— that China was getting into the United States through transshipments and tech Which is different from— Yeah, technically, it's really just

taking the goods, slapping on a Made in Malaysia stamp, and sending it to the US. And there clearly is some of that. But careful study for Vietnam has shown that it's only about 8% or 9%. And it's happening mostly through Chinese plants in these countries. And you can imagine that that's the case. So it's not the majority. And other countries that have received this activity have become alternatives to China are actually benefiting from it. They're getting factory jobs and a chance to get into global value chains that they might not have had given super competitive China right next door. So there's some good here that's happening. And it's not transshipment. Some people call it rerouting. I like to think of it as trade diversion. It's going through these countries with Chinese inputs. So this report was released, and I think that it was almost immediately dismissed as almost hysterical and not really very well founded in terms of the empirical basis for the claims that were made in the report.

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Is it going to change how other countries operate? I don't think so. I think most— I just came back from China and we've been talking to people throughout Asia. I mean, I think they see it as another reflection of this administration's sort of attempt to use tariffs for everything. And again, just highlights the bind that they're in wanting to maintain good security, commercial, cultural relations with the United States and with China. Okay.

[00:30:28.15] - Anjali V. Bhatt

Well, we are at time, so let's wrap up here, Mary. Much to think about, especially, you know, in the next sort of 3 to 6 months. There's a lot happening. What will you be watching for, sort of, I guess, you know, between now and the end of the year?

[00:30:43.20] - Mary E. Lovely

Well, clearly, we are going to be watching a bunch of things related to Chinese exports and so-called export surge, whether it exists, what sectors it's in, what's, what's causing it. Part of my work also focuses on the Chinese economy, and we have lots of questions about that. Why are they being unable to really stimulate their domestic consumption so that more of these goods are consumed domestically rather than being exported to the global market? We're going to be looking at trade in rare earths? Is China coming across meeting the obligations that they made in Busan? You know, the US— Mark Carney said the US signs agreements in pencil. We want to see, did China sign its agreement in pencil? So that and much more. So export surges, critical minerals, looking at trade flows and how they're changing. We'll continue also, of course, always keep our finger on the pulse of how supply chains are changing.

[00:31:44.01] - Anjali V. Bhatt

And that's what we do here at the Peterson Institute. All right. Well, thank you so much, Mary, for explaining trade and value-added arts and much more. And thanks to all of you for joining us for this edition of PIIE Insider Live. What did you think? What do you want to see next? Let us know at meetings@piie.com. And if you're not already, subscribe to PIIE Insider, the newsletter, at piie.com/subscribe and follow us on Instagram @PetersonInstitute. Thanks again to Mary for joining us, and thanks again to all of you. The next Insider Live will be a special edition with an in-person audience here at PIIE featuring Inu Monarch on October 7th. We hope to see you there. Thank you.