THE NATIONAL INTEREST

To Compete with China, Build Out American Industrial Policy

Jerry Haar

September 13, 2023

Senator Barry Goldwater, the father of the modern conservative movement, declared later in life that debating the pros and cons of a welfare state was a useless activity—that instead, conservatives should focus on *what kind* of welfare state America should have. Much of the same can be said today surrounding the issue of industrial policy.

One of the few areas of bipartisan agreement today is the need for a strong and comprehensive industrial policy. As defined by the International Monetary Fund "industrial policy" refers to government efforts to shape the economy by targeting specific industries, firms, or economic activities. Contrary to common belief, industrial policy is not new to the U.S. From Alexander Hamilton's advocacy of a strong industrial system to FDR's New Deal and beyond, industrial policy, be it via NASA, DARPA and tax policy, has been ever-present.

Contributing to the prominence of industrial policy during the last decade are the pandemic (with scarcity of personal protection equipment); the growing economic and security threats from China; and populism strongly advocated by both political parties. Most recently, industrial policy has taken center stage via the Inflation Reduction Act, the Chips and Science Act, and the Bipartisan Infrastructure Law.

Five key drivers of industrial policy merit attention since they will shape not just the parameters and content of that policy but impact America's global competitiveness for the foreseeable future. These are:

Prioritization of sectors. No government has the time, attention, resources or expertise to promote a range of sectors and industries. Additionally, picking winners and losers can lead to market distortions and inefficient allocation of resources. But given the choice of government support for companies or industries, the latter is a far better bet. Just witness the case of energy company Solyndra during the Obama administration. That firm and three other subsidized companies went bust at a cost of $780 million. As concluded in a study by the Peterson Institute, US industrial policy has worked best when applied to whole sectors to subsidize research and development. Shining examples of smart industrial policy would be Mercedes-Benz plant in Alabama, Operation Warp Speed under the Trump administration, and North Carolina's Research Triangle Park.

Protection for steel, textiles, apparel, and solar panels merely raises costs and prices for consumers and abets retaliation by our trading partners.

R&D. A nation's ability to develop, expand and sustain its industrial prowess is contingent upon its research and development infrastructure. The U.S. spends nearly $700 million in R&D, 30% of world total, with most performed by the private sector. Yet, despite ranking second after Switzerland in the Global Innovation Index, U.S performance on other indicators is declining. For example, federal support for R&D declined from 31% in 2010 to 21% in 2019. Support of graduate student and number of students studying STEM are declining.
Especially disturbing is a recent report revealing that in 7 of 9 leading sectors, US firms' size-adjusted R&D spending had either declined or remained stagnant while Chinese spending rose.

Workforce. The availability, quality, and productivity of the workforce—at all occupational levels—are vital to successful industrial policies. In terms of productivity, the US ranking has fallen from 5th in 2015 to 12th in 2022. In all career fields, the average worker is productive for 60% or less each day. Looking at high school standardized test performance globally, the OECD reports that when comparing achievement scores in reading, math, and science, U.S. 15-year-olds rank 24th, 36th, and 28th respectively. Given this sorry state of workforce readiness, the only remedy is job training. The federal government's Workforce Innovation and Opportunity Act (WIOA) lets businesses hire and train skilled workers and get reimbursed for their efforts. Companies, unions, non-profit organizations and high schools and colleges also offer a range of training programs.

Place-based innovation. Many communities across the nation are left out of the high-tech economy. As the Council on Competitiveness notes, this risks creating a bifurcated country with stark disparities between high-tech centers and rural or rust-belt communities where closed factories and a loss of tax revenue and jobs have created a dire situation, especially for those for whom out migration is not an option, Congress has authorized $80 billion for this Biden initiative which would provide competitive grants for local projects that match resources with need, opportunity and capacity. It is unclear, however, whether poor, underserved, rural areas have the human resource base for upskilling and the ability to attract investment to foster and sustain place-based economic opportunities and revive economically depressed communities.

Trade policy. Trade is both a shaper and byproduct of industrial policy—shaper, in its catalytic role in the erection of tariff and non-tariff barriers and byproduct, in the resulting effects on employment, wages and prices. Punitive measures such as tariffs on Canadian lumber, steel and aluminum harm consumers far more than foreign exporters. And after all, more Americans purchase kitchenware, cars and refrigerators than work in steel plants. The Trump protectionist industrial policies cost $80 billion, including 166,000 jobs according to the Tax Foundation. If reelected Trump plans to impose a 10% tariff on all foreign goods. Efforts to further open foreign markets to U.S producers should be a centerpiece of American industrial policy, not erecting additional barriers to foreign imports. In this regard, the Biden administration's neglect of traditional trade deals is most disheartening.

Inarguably, industrial policy is here to stay; one cannot put toothpaste back into the tube. Those on the right must realize that industrial policy is not Soviet-style central planning, and those on the

left need to understand that in most all cases market-based incentives and solutions are the most effective course of action.

Fortunately, the U.S. industrial base is strong. The U.S. leads in fields such as bioscience, quantum computing, robotics, and other advanced industries. As for manufacturing, spending on the construction of new manufacturing facilities hit $196 billion, a 60-year high. But as former Treasury Secretary Larry Summers asserted "the doctrine of manufacturing-centered economic nationalism" is not the way to go, particularly when manufacturing accounts for a mere 8.3% of total employment.

Nor are market-distorting trade barriers such as "Buy American" provisions and subsidies for battery production and electric vehicles. Such subsidies discriminate against our allies such as South Korea and the EU who will likely counter with their own subsidies. Making matters worse are Biden administration requirements that companies that apply for subsidies for semiconductor manufacturing must provide childcare for their workers. As Robert Atkinson, president of the Information Technology and Innovation Foundation points out in the winter issue of *Wilson Quarterly*, America must restore and retain technological leadership. Cramming social policy down the throats of the producers impedes the path towards that goal.

With China nipping at our heels economically, the US must maintain (and regain) a competitive advantage. Carrots for industry, not sticks for competitors are the wisest course of action. America must institute not only robust industrial policies but smart ones, as well.

Jerry Haar is a business professor at Florida International University and a fellow of both the Woodrow Wilson Center and Council on Competitiveness. He is the co-author with Ricardo Ernst of *Globalization Competitiveness and Governability.*