

## How to get industrial policy right – and wrong

Trade restrictions and preferential treatment of US companies will hurt the people America's new approach is meant to help

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Within rich countries, globalisation has contributed to industrial decline and regional inequality © Spencer Platt/Getty Images

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Economic policy today seeks to address a dizzying array of challenges — to stem inflation, shore up supply chains, and create jobs while also spurring innovation, fighting climate change, bolstering national security, and preparing for a range of future crises and shocks.

In the US, the emerging toolbox for tackling these diverse issues centres on “industrial policy”, with two key components. The first is public investment to help make the economy greener and more inclusive. The second is a revival of a “Buy American” policy which includes funding provisions, as well as trade and immigration policies that favour US companies and workers and reduce the inflow of foreign goods and people across the border.

While several countries are already emulating this approach, its effectiveness is uncertain, and it may even make some problems worse, or create new difficulties in the process.

Consider our experience with globalisation. For many years, economists disputed the idea that it was contributing to rising inequalities in advanced economies. By now, though, the effects of decades of rapid globalisation are clearer.

It drastically reduced inequality between countries and lifted billions of people worldwide out of poverty. Likewise, free trade and increased global manufacturing lowered prices and increased variety for consumers. But within rich countries, globalisation contributed to industrial decline and regional inequality. Soaring profits did not trickle down to workers and consumers as much as expected, resulting in wage stagnation and widening gaps between rich and poor.

Proponents of the emerging US industrial policy argue that both public investment and Buy American will help mitigate these harmful effects and empower the US worker. Unfortunately, they are only half right.

Public investment is definitely worth trying. Of course, careful design and a healthy dose of caution are needed. But it is worth the effort simply because past attempts to correct globalisation’s adverse effects have failed. The most notable — Trade Adjustment Assistance for US workers affected by offshoring — has had disappointing results and was eventually scrapped. Moreover, people want more than just income assistance; they care about good jobs, with dignity and career progression.

The obvious issue with industry-focused public investment is its unpredictability. Sometimes it succeeds — see Airbus, for example, or Korean and Taiwanese support for semiconductors. But sometimes it fails, as was the case with China's Great Leap Forward under Mao Zedong. The learning curves can be long and steep. But in addition to helping reduce inequality, the potential benefits certainly outweigh the risks.

Targeting the US high-tech and renewables sectors, for instance, has a good shot at spurring innovation and accelerating decarbonisation. Buy American, on the other hand, is fraught with problems. Closing the country's borders will not help the US solve its most pressing challenges — and it will jeopardise industrial policy's laudable goals.

To take one example: discouraging cheap imports of solar panels from China, currently the world's lowest-cost solar producer, will slow down the green transition just as US public investment seeks to accelerate it.

And while it might sound patriotic, Buy American will worsen inequality. Trade restrictions and preferential treatment of US companies will increase prices, making inflation harder to control and hurting the poorest Americans most. And without expanding immigration, it is not clear that there are enough workers with the appropriate skills to implement the Biden administration's ambitious public investment plans.

Globally, Buy American inhibits international co-operation precisely when it is most needed. It also curbs economic growth and poverty reduction efforts in low-income countries, slowing or ceasing decades of hard-won progress on global inequality.

What is needed, then? For industrial policy to achieve its ambitions, we should embrace public investment that is place-based, carefully targeted and internationally co-ordinated. But Buy American and its equivalents in other countries should be de-emphasised. Rather than using industrial policy as an excuse to close borders, we should focus on maximising the benefits of public investment while minimising its risks.

The two ingredients of US industrial policy are at cross purposes. Before becoming a global template, the recipe needs a tweak: carefully sift the first ingredient, but omit the second.

