PROJECT SYNDICATE

The New Industrial Politics

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Recent scholarship has done much to reopen the case in favor of selective government intervention to promote specific industries in particular places. But the success or failure of industrial policies has never been a purely economic issue.

MARRAKESH – Industrial policy is back. It is back with a vengeance in the United States, where for decades the dominant ideology and policy minimized government efforts to influence the structure of the economy. Now, in contrast, we have the Infrastructure Investment and Jobs Act, the CHIPS and Science Act, and the Inflation Reduction Act, all with significant industrial-policy components.

And what happens in the US doesn't stay in the US. Other countries, similarly seeking to preserve and enhance their industrial bases, have responded with comparable measures. The question is whether the return of such government-led efforts should be welcomed.

Industrial policy has a long history, extending back to Alexander Hamilton, America's first Treasury secretary, and his Report on Manufactures (1791), if not even further back to Jean-Baptiste Colbert, first minister under King Louis XIV in the 1660s. By the end of the twentieth century, however, industrial policy had fallen out of favour. Simple models of the market economy provided no rationale for selective government intervention to promote specific industries in particular places.

Evidence supporting the efficacy of industrial policies was weak. Offering tax breaks and tariffs, it was observed, opened the door to rent seeking, leading to dissipation of resources and the extension of subsidies to inefficient, undeserving producers.

Recent scholarship, however, has done much to reopen the case. New theorising has lent intellectual rigor to the "big push" model of industrialisation, whereby markets left to their own devices fail to coordinate the simultaneous expansion of complementary industries, none of which are viable in the absence of the others. This research has also refined our understanding of the conditions under which temporary protection can enable an infant industry to stand on its feet. It has shown that even under a well-designed regime of intellectual property rights that balances incentives for innovation against the benefits of diffusion, developers of new technologies may fail to capture all the returns to their efforts.

On the empirical front, recent economic histories provide convincing narratives of the pivotal role of government policies in fostering industrialisation in the nineteenth century. Rigorous studies document how place-based policies such as the Tennessee Valley Authority continued to encourage manufacturing employment in the affected region even after federal transfers had lapsed.

Other new work shows how World War II-era investments in American defence-industry plants resulted in permanent increases in regional employment and in a persistent expansion of high-wage manufacturing work. Still other recent research traces how the Heavy and Chemical Industry Drive of the 1970s in South Korea continued to promote the expansion and dynamic comparative advantage of the targeted industries, together with those of their suppliers, even after the program ended.

This scholarship has been undertaken against the backdrop of two trends, one domestic and one international, making its conclusions even more timely and compelling. Domestically, it became clear that delegating control over economic development to the market risked leaving behind significant populations and regions.

That market forces, left to their own devices, do not automatically lift all boats is basic economics, of course, though for a time the point was conveniently forgotten in the name of ideological purity. Ultimately, concentrations of poverty and steady depopulation in regions like Appalachia served as a powerful wake-up call. The populist backlash against a governing elite that allowed these conditions to persist created a political rationale for more interventionist policies, if only to help that elite stay in power.

Internationally, geopolitical rivalry between China and the West created a rationale for policies to re-shore and further develop industries deemed essential to national security. Economic theory and international law have long recognised the existence of a national-security exception to free trade. Tensions with China have been a reminder of this fundamental fact.

But even if the dynamics of industrial development, problems of depressed regions, and imperatives of national defence provide compelling economic rationales for industrial policy, the political-economy objection remains. Rent seeking is pervasive. There is uncertainty about which sectors and firms will boost their efficiency with an infusion of public funds. Which industries deserve the national-security exception is a contested issue.

In other words, what ensures that the political process will deliver policies targeting the right industries, those that are deserving on the aforementioned grounds?

Recent research on the economics of industrial policy needs to be complemented by work on its political economy. Can decisions about whom to subsidise be delegated to independent commissions on the model of US military-base-closure commissions?

If authority is delegated instead to a programme director seconded from industry or academia, as in the case of the US Advanced Research Projects Agency, how will this director be selected? What will ensure that this person consults adequately with recipients of funding and that recipients' performance is closely monitored?

"It is the economy, stupid," the political campaign strategist James Carville famously observed. That may be a useful mantra for winning elections. When it comes to successful industrial policies, however, it's the politics.

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