Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

May 23, 2022

Industrial Policy and International Trade

Supply-chain vulnerabilities revealed by the COVID-19 pandemic have intensified debate in Congress about the proper role of the government in the U.S. economy. The debate also reflects growing concerns about how some foreign governments use state support and guidance to boost their industries, thereby potentially causing the United States and others to lose global market share and competitiveness. China's statist model of economic development, for example, relies on a comprehensive industrial policy that nurtures a wide range of strategic and emerging industries through government measures, including subsidies and protection against import competition. The scope and scale of these market-distorting practices can create an uneven playing field for U.S. firms.

Concerns also exist about the extent to which the United States lacks production capacity in certain industries and relies on imports considered essential to public health and national security. Recent legislative activity has focused on providing a greater government role and more coordinated approach to U.S. industrial development (see **textbox**). Some stakeholders criticize these measures as a departure from the more market-led approach to the industrial sector that the U.S. government adopted in the 1990s and generally applied over the past few decades. Such a departure, they argue, could trigger a spiral of industrial subsidies and increased protectionist measures by other countries, potentially adversely affecting global economic growth and the rules-based trading system.

Select Efforts to Support U.S. Industries

Creating Helpful Incentives to Produce Semiconductors (CHIPS) for America Act (Title XCIX, P.L. 116-283). It establishes investment and incentive schemes to support U.S. semiconductor manufacturing, R&D, and supply chain security.

Infrastructure Investment and Jobs Act (P.L. 117-58). Among other matters, it establishes requirements and incentives to support R&D and energy infrastructure and cybersecurity, and ensure a supply chain for critical minerals and battery materials.

United States Innovation and Competition Act of 2021 (S. 1260) and the ***America Creating Opportunities for Manufacturing, Pre-Eminence in Technology, and Economic Strength (COMPETES) Act of 2022*** (H.R. 4521). As part of a wider set of China-focused measures, they would provide funding to support U.S. semiconductor manufacturing, R&D, and supply chain security.

Office of Manufacturing and Industrial Innovation Policy Act of 2021 (S. 997/H.R. 2279). It would call for the establishment of a national strategic plan for manufacturing and industrial innovation and promote government and manufacturing sector collaboration.

What is Industrial Policy?

While there is no formal definition, *industrial policy* commonly refers to a comprehensive, deliberate, and more or less consistent set of government policies designed to change or maintain a particular pattern of production and trade within an economy. It generally involves policies designed to promote emerging industries or prop up declining ones, as well as the channeling of resources into specific sectors and activities considered important for economic growth. A variety of instruments can be used to implement an industrial policy, including: subsidies; tariffs and other trade restrictions; rules; regulations; technical standards; tax incentives; government procurement regimes; and preferential access to credit. In addition to aiming to accelerate economic growth, industrial policies can be designed to safeguard national security, create employment opportunities in specific industries or regions, achieve environmental and social sustainability, or improve the competitiveness and export performance of domestic firms. The impact and effectiveness of such policies in achieving these goals is subject to debate.

Some analysts maintain that industrial policy need not be executed through an explicit strategy. In the United States, some experts consider various economic policies and programs that have the effect of favoring one industry or type of firm over another to constitute an *ad hoc* and *de facto* industrial policy. As such, U.S. industrial policy has consisted primarily of interventions that are not made on the basis of any comprehensive or systematic set of guidelines delineating the kind of production and trade that should be fostered. Instead, they are implemented through generalized or cross-industry policies (e.g., corporate tax rate reductions) and industry or firm-specific policies (e.g., tariffs and support/subsidies for EV battery production).

Economic Debate Over Industrial Policy

Arguments for industrial policies come in several forms, but most are not compelling on economic grounds alone. With some exceptions, economists generally argue that policies aimed at influencing the composition and level of output and trade can create market distortions and impose costs on the economy as a whole that exceed any potential benefits. This is especially the case if policies are not carefully designed and the industrial program is captured to further private rather than national interests. In addition to direct government expenditures (e.g., through grants, loans, industry specific tax credits), industrial policy may also impose costs related to inefficient resource allocation, implementation, higher prices, and foreign retaliation.

In a market economy, there is a strong presumption that competitive forces channel resources into their most productive uses. However, markets sometimes fail to do so. When this happens, government intervention to correct market failures may be appropriate. A proper role for industrial policy, some experts argue, is to identify those failures and provide appropriate government support (e.g., subsidies). Yet, beyond R&D and the diffusion of information on results and innovations, there is skepticism among economists about the government's ability to identify legitimate candidates for support. Experience with industrial policy in Japan, South Korea, Brazil, and other

countries has been mixed. Various case studies suggest that political objectives and heavy state interference in the management of industries and firms have often undermined their attempts to become globally competitive. Other studies credit industrial policy with advancing the economic development of countries like China.

The United States and Industrial Policy

U.S. policy generally aims to support U.S. industrial and technological development through market-based measures that promote R&D and business development. Policies that may seek to preserve certain defense capabilities exist, but these are largely focused on technologies intended for dual use or military applications. Growing concerns about China's extensive use of statist practices, which have supported its growing global industrial and economic role, as well as perceived vulnerabilities highlighted during the COVID-19 pandemic, have led some Members to support broader and more coordinated countermeasures to advance U.S. economic competitiveness and national security. These positions tend to reflect a view that market forces by themselves are insufficient to protect U.S. interests and capabilities in light of China's practices, as well as those of other actors of concern.

In addition, during the past decade, pressure for preserving existing jobs and industries through state intervention has increased. Higher levels of unemployment among some groups of the labor force and slower wage growth in certain economic sectors have made it more difficult for some workers to adjust to changes in technology, demand, and international competition. Some analysts favor a comprehensive U.S. industrial policy. They argue that the *ad hoc*, *de facto* nature of U.S. industrial policy tends to keep resources in less efficient areas. For example, trade adjustment programs, they say, may have the unintended effect of reducing incentives for some workers and capital to relocate. In this case, without strong positive incentives to adjust, they argue that resources will not be employed elsewhere in a timely fashion. Such proponents maintain that the government should supply incentives to facilitate the transfer of resources to growing industries and, in some cases, prop up contracting or non-competitive ones in the interest of U.S. national security.

Additionally, some supporters argue that, as a relatively open economy, the United States is adversely affected by other countries' industrial policies. In their view, a robust U.S. industrial policy could mitigate these effects by, for example, countering China's exploitative economic practices. Opponents argue adopting such a policy would result in a misallocation of resources in the economy, stifle innovation, and harm U.S. productivity and economic growth. They warn that it would also involve the government in picking "winners and losers." A more effective approach, they say, would be to negotiate new trade rules that reduce or eliminate such practices. For example, some Members have encouraged the Administration to work closely with allies to address trade concerns and initiate or participate in regional trade agreements, such as the revised Trans-Pacific Partnership.

National and Economic Security Drivers

National security, defined broadly to include economic security, is frequently invoked as justification for industrial policy. Supporters argue that imported goods or services essential for national security could be "weaponized" or denied by foreign countries, thus requiring support for domestic production. Some critics dispute the need for support given the competitive and geographically diverse nature of the global marketplace. Supporters counter that certain products sometimes cannot be stockpiled at a reasonable cost or imported in sufficient quantities or in a timely manner. This was the case at the outset of the pandemic, for example, when the United States and other countries faced shortages of critical medical products. In such cases, policymakers may decide to subsidize producers and suppliers or protect them from foreign competition to safeguard national security. Whether these concerns and aims are legitimate, or whether a U.S. industrial policy would be effective in achieving them, is subject to debate. Such policies are generally thought to introduce market distortions and undermine economic efficiency, and, hence, economic growth. As a result, policymakers may weigh these potential adverse effects against the potential benefits.

Global Rules and Constraints

International trade rules generally limit countries' ability to use policies or subsidy schemes that target specific industries within their territories and result in increased exports. Many of these rules are embedded in World Trade Organization (WTO) agreements and bilateral and regional preferential trade arrangements. For example, the WTO Agreement on Subsidies and Countervailing Measures (ASCM) provides rules governing the subsidization of goods and recourse for countries whose interests are harmed by subsidization. However, some stakeholders point to perceived weaknesses in the ASCM and emerging issues that current rules may not cover adequately. Often, critics point to China, arguing that, to date, trade rules have not fully constrained China in adopting its industrial policy.

Outlook and Issues for Congress

Recent developments present Congress with questions about the manner and extent to which the U.S. government can and should alter existing production and supplier arrangements. While increased government intervention in the economy may not necessarily provide long-term net gains, as many economists contend, some Members view trade concerns with certain partners as requiring a U.S. industrial policy to level the playing field or safeguard national security. Others see these efforts as an undesirable shift in economic policy given the historical U.S. approach and potential costs. Additionally, some countries may seek to adopt similar policies, thereby increasing protectionism that may undermine economic growth and the rules-based global trading system. To avoid potentially costly trade and subsidy "wars," Congress may wish to engage formally with the Administration to pursue reforms and update trade rules in a way that matches the complexities and realities of today's global economy and advances U.S. security and economic interests.

See also CRS In Focus IF10964, *"Made in China 2025" Industrial Policies: Issues for Congress*.

Andres B. Schwarzenberg, Analyst in International Trade and Finance

IF12119

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.