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Executive Summary

In the wake of the COVID-19 pandemic and rising U.S.-China tensions, American policymakers have again embraced "industrial policy." Both President Biden and his predecessor, as well as legislators from both parties, have advocated a range of federal support for American manufacturers to fix perceived weaknesses in the U.S. economy and to counter China's growing economic clout.

These and other industrial policy advocates, however, routinely leave unanswered important questions about U.S. industrial policy's efficacy and necessity:

What is "Industrial Policy"? Advocates of "industrial policy" often fail to define the term, thus permitting them to ignore past failures and embrace false successes while

preventing a legitimate assessment of industrial policies' costs and benefits. Yet U.S. industrial policy's history of debate and implementation establishes several requisite elements – elements that reveal most "industrial policy successes" not to be "industrial policy" at all.

What are the common obstacles to effective U.S. industrial policy? Several obstacles have prevented U.S. industrial policies from generating better outcomes than the market. This includes legislators' and bureaucrats' inability to "pick winners" and efficiently allocate public resources (Hayek's "Knowledge Problem"); factors inherent in the U.S. political system (Public Choice Theory); lack of discipline regarding scope, duration, and budgetary costs; interaction with other government policies that distort the market at issue; and substantial unseen costs.

What "problem" will industrial policy solve? The most common problems purportedly solved by industrial policy proposals are less serious than advocates claim or unfixable via industrial policy. This includes allegations of widespread U.S. "deindustrialization" and a broader decline in American innovation; the disappearance of "good jobs"; the erosion of middle-class living standards; and the destruction of American communities.

Do other countries' industrial policies demand U.S. industrial policy? The experiences of other countries generally cannot justify U.S. industrial policy because countries have different economic and political systems. Regardless, industrial policy successes abroad – for example, in Japan, Korea and Taiwan – are exaggerated. Also, China's economic growth and industrial policies do not justify similar U.S. policies, considering the market-based reasons for China's rise, the Chinese policies' immense costs, and the systemic challenges that could derail China's future growth and geopolitical influence.

These answers argue strongly against a new U.S. embrace of industrial policy. The United States undoubtedly faces economic and geopolitical challenges, including ones related to China, but the solution lies not in copying China's top-down economic planning. Reality, in fact, argues much the opposite.

Introduction

American policymakers on the left and right have once again embraced "industrial policy" to address fix alleged U.S. market failures and to counter China's own economic interventions. As of this paper's writing, expansive new legislation supporting specific domestic industries could – with vocal support from the White House – pass Congress later this year. Unfortunately, the public discourse has thus far elided several essential questions about what "industrial policy" actually is; how past U.S. attempts at industrial policy (properly defined) have fared; whether proposed industrial policies today can fix the economic problems they target; and whether the industrial policies of other countries – particularly China – demand that the U.S. government follow suit.

This paper will systematically answer each of these questions, addressing both economic theory and practice (as demonstrated through numerous historical and current examples of U.S. industrial policy in action). Overall, these answers reveal numerous problems that argue strongly against the adoption of new U.S. industrial policies and establish a high bar for future government action.

What Is "Industrial Policy"?

Assessing the necessity and efficacy of U.S. industrial policy requires first defining the term. Without this definition, industrial policy advocates can claim that past failures are not, in fact, industrial policy, while other policies tangentially related to government action are clear industrial policy successes. There also is the risk, as pointed out by economist Herbert Stein in the 1986 book, *The Politics of Industrial Policy,* to "adopt so loose and sweeping a definition of industrial policy that it becomes virtually synonymous with overall economic policy,"[1] thus precluding a legitimate assessment of industrial policy's costs, benefits, and overall desirability. As fellow economist Mancur Olson stated in the same book, often industrial policy proposals "are so vague that they invite the reaction that industrial policy is neither a good idea nor a bad idea, but no idea at all; that it is the grin without the cat."[2] In short, if everything is industrial policy, then nothing is.

Industrial Policy's Requisite Elements

Fortunately, industrial policy's long history of academic debate and implementation in the United States establishes several requisite elements that combined can identify whether past or proposed government initiatives are properly considered "industrial policy." For example, in examining U.S. industrial policy efforts in the 1920s and 1930s, economic historian Ellis Hawley explained—

> By industrial policy I mean a national policy aimed at developing or retrenching selected industries to achieve national economic goals. In this usage, I follow those who distinguish such a policy, both from policies aimed at making the macroeconomic environment more conducive to industrial development in general

> and from the totality of microeconomic interventions aimed at particular industries. To have an industrial policy, a nation must not only be intervening at the microeconomic level but also have a planning and coordinating mechanism through which the intervention is rationally related to national goals, a general pattern of microeconomic targets is decided upon, and particular industrial programs are worked out and implemented.3

As the Mercatus Center's Adam Thierer wrote in a 2020 article, Hawley's definition shows that "targeted and directed efforts to plan for specific future industrial outputs and outcomes is at the heart of a proper understanding of industrial policy."[4] Such "outputs and outcomes" must also occur within national borders: government procurement of foreign-made semiconductors, for example, cannot be "industrial policy." Thus, industrial policy is inherently nationalist, with government support for domestic industry either indirect (e.g., tariffs, quotas, and "Buy American" mandates) or direct (e.g., subsidies for American companies, jobs, or investments).

Finally, industrial policy "output and outcomes" are *commercial* in nature, distinguishing them from both basic scientific research and defense procurement (e.g., fighter jets). The former has no targeted or strategic commercial application. The latter, as explained by economists Richard Nelson and Richard Langlois in the 1980s, is categorically different from commercial-oriented industrial policies because (1) as the sole consumer of such goods, the federal government has a unique and deep knowledge of the products or technology at issue and its own needs therefor, as well as a strong and direct interest in obtaining high-quality deliverables; (2) the public strongly believes in the legitimacy of the government's primary mission (thus minimizing politicization and short-termism); and (3) commercial spillovers are an unintended benefit, as opposed to the main purpose, of government action.[5]

Similar definitions and policies were offered by industrial policy advocates themselves in the 1980s and 90s, the last heyday of U.S. industrial policy. This includes former Clinton Administration official Robert Reich in *The Next American Frontier* (1983)[6]; Historian Otis L. Graham in *Losing Time: The Industrial Policy Debate* (1992)[7]; and former Commerce Department official Erik Pages in *Responding to Defense Dependence* (1996).[8] More recently, the Carnegie Endowment's Uri Dadush[9] and the Hudson Institute's Arthur Herman (citing a 2006 paper by economists Howard Pack and Kamal Saggi) have echoed these historical definitions.[10]

Thus, both advocates and critics coalesce around four essential features of "industrial policy":

- A focus on manufacturing, to the exclusion of services and agriculture;
- Targeted and directed *microeconomic* (firm or industry-specific) support (e.g. tariffs or subsidies), as opposed to "horizontal," sector- or economy-wide polices (e.g., corporate tax rate reductions or patents);
- A government plan to fix "market failures" (including negative "externalities") and thereby achieve in targeted industries/companies clear, specific, and measurable commercial outcomes, such as jobs, investments (R&D, capital expenditures, etc.), output, or products, that are *better* than what the market could provide in the absence of industrial policy; and
- A requirement that these market-beating commercial outcomes be generated within national borders.

As Duke University economist Michael Munger explained[11], industrial policy is *not* aimed at making the macroeconomic environment more conducive to industrial development in general, targeting the *levels* of research or jobs or even industrial activity we have generally in the United States, or even correcting perceived or real shortcomings of markets by any means necessary. It is dictating the specific *composition* of commercial industrial activity within the nation to achieve a broader national goal.[12] Thus, for example, industrial policy does not say "we need to lower carbon emissions" (via, for example, a carbon tax or a non-discriminatory consumer subsidy paired with unilateral free trade in environmental goods); it says "we need to lower carbon emissions *by subsidizing or protecting American solar panel companies and workers*."

What Industrial Policy Isn't

Many of the "industrial policies" that advocates propose contain the four elements above, but often these same individuals add events or transactions that cannot be considered "industrial policy" without rendering the term inutile. A pro-industrial policy symposium hosted by the conservative think tank American Compass, for example, contains proposals for reshoring "core digital technologies"; subsidies for biopharmaceutical and semiconductor manufacturing; and local content restrictions on electrical grid equipment and medical goods.[13] All seek to encourage domestic production of targeted commercial industries pursuant to a broader national strategy and therefore qualify as "industrial policy" rightly understood. On the other hand, the symposium adds "active" labor market policy; environmental regulatory reform; an infrastructure bank; World Trade Organization reform; and vigorous antitrust action by a new "Department of Economic Resilience." Yet while each might tangentially benefit domestic manufacturing, none directly supports a specific industry or targets specific market-beating commercial outputs.

This confusion permeates the current debate over industrial policy here and abroad. In fact, many (if not most) of the "successes" that proponents raise are not "industrial policy" at all and often border on the absurd. This includes Apple and the smartphone (and almost every piece of essential hardware that it contains); Microsoft Windows; Google, Google Maps, and the entire internet; supercomputers; semiconductors and semiconductor lasers; digital optical networks; the graphical user interface; GPS; LCD screens; LED screens; plasma displays; artificial intelligence and speech recognition; videoconferencing; closed captioning; Linux and cloud computing; nanotechnology; renewable energy (lithium batteries, wind power, solar panels); nuclear energy; fracking; seismic imaging; LED lighting; airbags; the civilian aviation industry, and jet engines in particular; the pharmaceutical and biotech industries, as well as "most innovative drugs" (including HIV/AIDS treatments and mRNA technology); magnetic resonance imaging; advanced prosthetics; the human genome project; hybrid corn; and lactose-free milk![14]

Yet few of these modern marvels are the direct result of "industrial policy" in any legitimate sense. For example, proponents routinely cite the U.S. Defense Advanced Research Projects Agency (DARPA) support for (or even "invention" of) the commercial internet as a poster child of industrial policy success. However, leaving aside the missing manufacturing nexus, DARPA did *not* have a plan for, or even anticipate, the internet – there was no "mission-oriented directionality" to the government support provided, nor was there any effort to make ARPANET or early email a broader commercial success (instead of simply "data links to connect computer facilities doing defense-related work"). Indeed, a decade earlier the Defense Department had *terminated* research by the Air Force into "a decentralized communications grid distinct from the traditional telephone," and those involved in ARPANET explained that DARPA "would never have funded a computer network in order to facilitate email."[15]

Overall, ARPANET's contributions to the commercial internet (packet switching and early email) were just that – *contributions*, as were private sector efforts such as early 20th radio and TV technologies, Xerox's ethernet in the 1970s[16], and Randy Seuss' "Computerized Bulletin Board System"[17] around the same time.[18] Just as surely, government funding has supported various research that was later applied by private companies to produce commercial information technology successes. But none of these scattershot government contributions to one part of an eventual commercial success can properly be considered a coherent, strategic “industrial policy.”

This conclusion may sound obvious, but the argument is common, especially in the tech sector.[19] As noted, for example, it is routinely asserted that the U.S. government – via “industrial policies” developing core components and financial support for Apple – “invented” the iPhone![20] However, as documented by researcher José Luis Ricón Fernández, such assertions equate as “industrial policy” any government support at any point in the history of a product’s or company’s creation and assign all credit for the innovation to the state. In particular, the “industrial policy” leading to the multi-touch screen was actually National Science Foundation and CIA funding for basic research at the University of Delaware into an entirely different field (neuromorphic systems), and the researchers independently developed the multi-touch system to aid their state-funded research. Meanwhile, another private company (Bell Labs) was developing a similar technology without state support. The connection between the state and several other core smartphone technologies was similarly attenuated and unplanned, with foreign or private alternatives emerging in parallel. Furthermore, state funding for Apple was just a small, government secured loan issued by a private bank supplementing substantial private startup capital that the company had already gathered. In other words, “Apple was steaming ahead before the involvement of the [state-backed loan] and given what we know, it is most reasonable to assume that it would have continued to do so hadn't there been government involvement.”[21]

Leaving aside even the wholly private innovation of packaging all of these technologies into the iPhone itself and making it all affordable, crediting these technologies to “industrial policy” renders the term meaningless. Economist Alberto Mingardi has found that such problems routinely plague the much-heralded examples of American industrial policy "success."[22]

The Space Program is also often cited as an industrial policy success story, but, as economist John Kay explains, its lessons are limited at best:

> Apollo was a success because the objective was specific and limited; the basic science was well understood, even if many subsidiary technological developments were needed to make the mission feasible; and the political commitment to the project was sufficiently strong to make budget overruns almost irrelevant. Centrally directed missions have sometimes succeeded when these conditions are in place; Apollo was a response to the Soviet Union's pioneering launch of a human into space, and the greatest achievement of the USSR was the mobilisation of resources to defeat Nazi Germany.[23]

It's unfathomable to think that the U.S. government – and American voters – will have the political will for another such "moonshot," especially for commercial objectives that, unlike space exploration, lack a traditional government nexus. Furthermore, products (e.g., athletic shoes and baby formula) developed from "space technologies" arose not from a central industrial plan but were instead the result of decentralized, private actions utilizing directionless, government-funded research.

Finally, the COVID-19 vaccines developed under "Operation Warp Speed" have been heralded as a triumph of American industrial policy[24], but the first vaccine to market (Pfizer/BioNTech) disproves the assertion. BioNTech was a German company that had been working on mRNA vaccines for years and began its collaboration with Pfizer (based on an earlier working relationship) months before the U.S. government began OWS in May 2020 or contracted with the companies for a vaccine in July of that same year. (Management actually predicted in April 2020 that distribution of finished doses would occur in late 2020.) The companies famously refused government funds for R&D, testing and production – efforts that instead leveraged Pfizer's substantial *pre-existing* U.S. manufacturing capacity, as well as multinational research teams, global capital markets and supply chains, and a logistics and transportation infrastructure that had developed over decades. In fact, the Trump administration's contract with Pfizer was for finished, FDA-approved vaccine doses only and expressly excluded from government reach essentially all stages of vaccine development (i.e., "activities that Pfizer and BioNTech have been performing and will continue to perform without use of Government funding").[25] There is even some evidence that OWS' allocation of vaccine materials to participating companies (some of which still have not produced an approved vaccine) may have impeded non-participant Pfizer's ability to meet its initial production targets and expand production after the vaccine was approved.[26]

Surely, some state support (e.g., support for mRNA research and a large vaccine purchase commitment) was involved both before and during the pandemic, but it all lacked the necessary commercial, strategic, or nationalist elements of "industrial policy." In fact, mRNA visionary Katalin Karikó actually left her government-supported position at the University of Pennsylvania "because she was failing in the competition to win research grants" and thus "moved to the BioNTech company, where she not only created the Pfizer vaccine but also spurred Moderna to competitive imitation."[27] The NIH grant supporting her early work actually came through her colleague, Drew Weissman, and "had no direct connection to mRNA research."[28] Other efforts, such as Moderna's mRNA vaccine, had more state support, but the BioNTech/Pfizer vaccine shows that it was not a necessary condition for producing a wildly successful COVID-19 vaccine.

What Obstacles Must Industrial Policy Overcome in the United States?

U.S. industrial policies face several obstacles that prevent their effective implementation. This section provides the most common of those obstacles, as well as real world examples of how they have plagued past U.S. industrial policy efforts – and thus why new industrial policy proposals should in general be opposed.

The Knowledge Problem

Perhaps the most widespread industrial policy obstacle is the "knowledge problem." In "The Use of Knowledge in Society," economist F.A. Hayek explained that the information needed to secure the best use of scarce national resources "never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess." Because this information is unique and ever-changing, central planners cannot discern it via aggregate, retrospective statistics: "The continuous flow of goods and services is maintained by constant deliberate adjustments, by new dispositions made every day in the light of circumstances not known the day before, by B stepping in at once when A fails to deliver."[29]

Thus, decentralized, market-based economic activity in general produces better outcomes than centrally-planned ("by one authority for the whole economic system") activity because the former better mobilizes the diffuse knowledge – via price signals and millions of individual, real-time, dynamic transactions – needed for economic actors to make relevant decisions (production, investment, purchases, sales, etc.). Because no single actual person possesses all such knowledge in real-time, economic planners must show how their "solution is produced by the interactions of people each of whom possesses only partial knowledge" and fixes "the unavoidable imperfection of man's knowledge and the consequent need for a process by which knowledge is constantly communicated and acquired."[30] They rarely do.

A core part of industrial policy's knowledge problem is timing: because markets are constantly evolving, the facts (products, investments, supply and demand, etc.) on which an industrial policy is designed will inevitably be different than the facts that exist at the time it is approved, and they will likely change again (and again) upon implementation. History repeatedly has shown that the "critical technology" (and suppliers) of today is often not so "critical" tomorrow.

Past U.S. industrial policy efforts have often struggled to surmount the Knowledge Problem, particularly in high technology goods. As technology experts Patrick Windham, Christopher T. Hill, David Cheney noted in 2020, for example, "US efforts in the 1990s to identify 'critical technologies' did not succeed, partly because it is hard to predict which technologies will be most valuable in the future."[31] The Carnegie Endowment's James L. Schoff cites these efforts among the U.S. "technonationalism" failures in the 1980s and 1990s. He documents how past U.S. efforts to support "critical technologies" (as defined by a "National Critical Technologies Panel") through trade and investment restrictions, subsidies, and public-private consortia failed because the government – worried about Japan at the time – could not foresee how the marketplace would develop. They therefore focused on current national champions like Motorola and Toshiba and missed how the internet would transform mobile and digital technologies and "stimulate the rise of internet titans like Google, Amazon, or the modern version of Apple" who today "possess some of the world's most coveted technology, investing more than most governments do to push new boundaries and accelerate change through design and systems integration."[32] After noting another U.S. government miscue – seeing Japan as an unstoppable technological powerhouse – Schoff explains that "U.S. firms prospered because of their ability to innovate and compete effectively, not because of such technonationalist or protectionist measures.[33]

Even if policymakers pick the right industry, moreover, they can struggle to identify and support the right product in that industry. As Lincicome explained in a 2017 Cato Institute policy analysis, for example, U.S. semiconductor policy in the 1980s saw Dynamic Random Access Memory (DRAM) chips as central to national security and the future of U.S. global technology leadership, and believed trade restrictions would encourage new U.S. entrants in the DRAM market. Yet no such investments occurred because "American companies were actually exiting the DRAM market, having already discerned that their future was not in the 'high-volume, low-profit commodity' but in advanced microprocessors, specialty chips, and design."[34]

Similar problems plagued contemporaneous U.S. supercomputer policy, which targeted older technology and "vector" supercomputers produced by U.S. Cray and Japan's NEC, just as those products were losing out to non-vector supercomputers, and as the supercomputer industry was undergoing major structural changes that rendered trade protection obsolete.[35] As the American Enterprise Institute's Claude Barfield explained in his book *High Tech Protectionism*, "With supercomputers, as with semiconductors and flat panels, government officials either never understood or willfully ignored the structure of the industry and the nature of worldwide competition in the sector [and] seemed blissfully unaware of the technological trajectories of the industry."[36]

Examples of Knowledge Problem failures are not limited to history books. For example, the Trump administration in March 2020 invoked the Defense Production Act (DPA) to push domestic manufacturers to make more ventilators, which were deemed essential to fighting the coronavirus at that time. By the summer, however, medical professionals determined that ventilators were not as critical as once thought, but producers continued to churn them out under government orders, leading to reports of the goods "piling up" in a strategic reserve or being donated to "countries that don't need or can't use them."[37] According to the a December 2020 report from the U.S. International Trade Commission, other DPA-funded medical goods production will only come online after mid-2021[38] (with the pandemic firmly under control), even though there was evidence of a domestic medical goods glut in late January.[39]

Public Choice – Especially in the American System

Government industrial policy plans also face obstacles inherent in the political system that produces and implements those policies. As detailed in the work of Public Choice Theory, political actors act not in the "public interest" but in their own rational self-interest and thus use the political systems in which they operate to make themselves, not the general public, better off. Elected officials' primary goal is therefore re-election, whereas bureaucrats strive to advance (or protect) their own careers.

Public choice distorts both the design and implementation of industrial policies. On the former, elected officials frequently advance legislative policies that confer concentrated benefits upon small, homogenous, often local interest groups and impose diffuse (but larger) costs upon the public, because only the former groups have sufficient motivation to follow the issues closely and apply political pressure (lobbying, campaign contributions, and votes) based thereon. Because the public is "rationally ignorant" about these policies (and thus does not tie their votes or contributions to them), elected officials act rationally in supporting them, even when the policies are known to produce net losses for the country. This "collective action" problem not only generates "pork barrel" projects (often through "logrolling" bargains, in which legislators trade votes on each other's pet project), but also makes reform or elimination of these programs exceedingly difficult, regardless of their efficacy.[40]

The same political pressures that distort elected officials' support for an industrial policy can similarly distort the federal bureaucracy's work to effectuate it. Research shows, for example, that government agencies' agendas often mirror those of the members of the congressional committees that primarily oversee them – members that often actively seek out these committee assignments to affect the regulatory agencies beneath them. Similarly, studies show that agencies can become "captured" by motivated special interest groups (or their elected benefactors) who use the agency to further their own narrow interests at the broader public's expense.[41] Even where political pressure is limited (often by design), capture can occur where bureaucrats lack the same level of specialized knowledge as the entities they regulate and thus grow to rely on those entities for both information and manpower.

The U.S. political system amplifies the public choice hurdles facing industrial policies for two key reasons. First, large segments of Congress are replaced (or threatened with replacement) every two years and the president every four. This dynamic not only injects "short-termism" and uncertainty into the decisionmaking process, but also makes elected officials more risk-averse and focused reelection instead of the long-term national interest. Thus, as Mancur Olson explained in 1986, "It is precisely in the areas of uncertainty like high technology and new industries that private venture capital has the greatest advantage" over government.[42] This dynamic has likely worsened since the 1980s, for example because of longer presidential campaigns that far exceed those in other countries.[43] Representatives today essentially start campaigning for the next election shortly after winning the last one.

Second, the U.S. has a well-developed lobbying and interest group system, which would inevitably affect (and likely deteriorate) the design and implementation of any significant industrial policy. As Olson explained, because "existing organized interests" would greatly influence any industrial policy, "proposals for an industrial policy that would allegedly allocate capital on preferential terms to new firms in emerging industries with special promise must explain how they would ensure that the lobbying power of established and often declining industries and firms would be kept at bay" such that "sunrise" industries and firms that lack a strong lobbying presence could prosper.[44] The effect of interest group pressure on federal industrial policy formation and implementation has doubtless increased since Olson first opined on the issue 35 years ago.

Past U.S. industrial policy efforts show how public choice issues can thwart planners' intentions. For example, Windham, Hill and Cheney note that, along with the aforementioned Knowledge Problem issues, U.S. "critical technologies" efforts in the 1990s failed "because decisions about R&D funding priorities inevitably become political, as groups and leaders vie to have their favorites supported" – a process that "results in a broad list that pleases everyone but is largely useless as a guide to policy."[45]

When policies are implemented, moreover, politics often intervenes – even in systems designed to be implemented from the political process. U.S. supercomputer policy in the 1990s was essentially client-service for one U.S. company, Cray, and its computer model while ignoring other American market entrants, such as IBM, Hewlett-Packard, Intel, and Sun Microsystems that offered different, and arguably better, products.[46] To block a potential National Science Foundation purchase of a supercomputer made by Cray's Japanese rival NEC, the House of Representatives "passed legislation sponsored by Rep. David R. Obey (D-Wis.), whose district includes a Cray facility, that would virtually ensure the contract goes to Cray,"[47] and the Commerce Department imposed record-setting antidumping duties of 454% on Japanese supercomputer imports in 1997. The latter pressured NEC to agree, in exchange for Cray dropping the case, to invest $25 million in Cray and give it exclusive rights to sell NEC's "vector" supercomputers in United States.[48] This legal extortion scheme was all the more brazen, given that Cray did not even make a "vector" supercomputer at the time its case blocking NEC's model was settled.

Today, supposedly impartial Commerce Department's abuse of the U.S. antidumping law, which permits remedial duties on "dumped" imports found to injure U.S. manufacturers and workers, is common practice. The agency's actions result in duties that go far beyond the levels needed to remedy, as the law intends, injurious dumping, while also revealing a U.S. agency captured by domestic interest groups (especially the steel industry), unconcerned with the views of diffuse consumers (including other manufacturers), and unburdened by congressional or judicial checks on its authority.[49]

More recent U.S. government efforts to support clean coal and carbon capture technology (CCT) have also fallen victim to politics. A 2018 review by George Mason University's David Hart of 53 energy technology demonstration projects funded by the 2009 American Recovery and Reinvestment Act (ARRA) and administered by the U.S. Department of Energy (DOE) revealed that coal-related CCT projects "dominate[d] the portfolio from a fiscal perspective… accounting for about five out of every six dollars allocated to energy-demonstration projects during the Obama era." They also were subject to more lenient private cost-sharing requirements and over-optimistic government expectations as to whether they would attract follow-on private investment and were disconnected from "the benefits that each sector might reasonably expect to receive from a project."[50] Meanwhile, technologies with more potential, such as nuclear power, renewables, and gas-fired electricity plants, were ignored.

The government's special treatment of CCT projects, Hart notes, was due at least in part to politics – especially when it came to the largest project in DOE's portfolio (receiving almost one quarter of all government funding), FutureGen:

> This megaproject, which dates back to 2003 and was terminated for the first time in 2008, was revived through ARRA funding earmarked for its Illinois site. President Obama, then a senator from Illinois, had vowed during his 2008 campaign to support clean coal technologies, and the state of Illinois (which had invested its own funds in the project) and its representatives in Congress (and those of surrounding states) pushed to include it among the "shovel-ready" projects eligible for the stimulus. Much like the Clinch River breeder reactor demonstration project…, the local fiscal benefits of FutureGen apparently weighed heavily in its vampire-like rise from the dead.[51]

Another federally-funded clean coal project – the demonstration plant in Kemper, Mississippi – was excluded from Hart's analysis because it had a different funding source, the 2006 Clean Coal Power Initiative, but this "model of President Obama's climate plan" suffered from similar public choice problems.[52]

Then, of course, there is the case of Solyndra and the Obama administration's "Section 1705" loan program funded by the ARRA. As the Mercatus Center's Veronique de Rugy explained, Solyndra spent almost $1.8 million on lobbyists, employing six firms with ties to Congress and the White House, while DOE reviewed its loan application. Overall, almost $4 billion in DOE grants and financing went to companies with connections to officials in the Obama administration. She adds that "nearly 90 percent of the 1705 loan guarantees went to subsidize projects backed by large, politically connected companies including NRG Energy Inc. and Goldman Sachs."[53]

Two separate analyses – from the Reason Foundation[54] and Georgetown University[55] – found a significant connection between Section 1705 loans' size and their recipients' lobbying efforts. These results are consistent with recent research finding that politically-connected firms (as measured by contributions to homes state elections) were "64 percent more likely to secure an ARRA grant and receive 10 percent larger grants" than other, less-connected companies, yet "state-level employment creation associated with grants channeled through politically connected firms is nil."[56] Analyses have also found that the Section 1705 and other ARRA-funded loan guarantee programs administered by DOE suffered from other political problems, such as conflicting statutory mandates, time constraints, or uneconomic objectives such as job protection and "Buy American" rules.[57]

Most recently, a *New York Times* investigation into Maryland vaccine manufacturer Emergent Biosolutions – a "longtime government contractor that has spent much of the last two decades cornering a lucrative market in federal spending on biodefense" – found that the company invested heavily in lobbying while ignoring various safety and manufacturing best practices; had effectively "captured" the government agency, the Biomedical Advanced Research and Development Authority, authorized to disburse and monitor pandemic-related contracts; yet, despite repeated contracting failures, was rewarded with a $628 million contract to manufacture Covid-19 vaccines. Emergent's actions ultimately imperiled millions of doses of Johnson & Johnson vaccines and weakened the Strategic National Stockpile by monopolizing its "half-billion-dollar annual budget throughout most of the last decade, leaving the federal government with less money to buy supplies needed in a pandemic."[58]

These examples show not only how public choice can undermine, if not actively work against, industrial policy objectives, but also that even systems designed to be governed by neutral arbiters and be insulated from political pressures have nevertheless become distorted by politics – just as Public Choice Theory predicts.

Lack of Discipline

American industrial policies can also suffer from a lack of discipline regarding scope, duration, and budgetary costs – often due to public choice issues. Unlike private actions, the success or failure of which is usually adjudicated – often ruthlessly – by the market, government policies often live or die based on political considerations rather than their actual efficacy. As the Brookings Institution's Linda Cohen and colleagues explained in their 1991 book, *The Technology Pork Barrel*:

> The second difference between public and private decisionmaking is the institutional structure in which decisionmakers are evaluated. Although retrospective evaluation of R&D is difficult and imperfect in the private sector, it is facilitated by the shared recognition that R&D is intended to provide financial returns to the company and by the presence of quantitative, quite easily observed, indexes of success, such as sales, unit costs, accounting profits, and evaluation of the firm in capital markets. In the public sector, the ultimate external test of an R&D program is its ability to generate more political support than opposition.59

The authors – sympathetic to U.S. industrial policy – examined six federal industrial policy programs originating in the 1960s and 1970s and intended to develop commercial technologies for the private sector: the Supersonic Transport, the Applications Technology Satellite Program, the Space Shuttle, the Clinch River Breeder Reactor, Synthetic Fuels from Coal, and the Photovoltaics Commercialization Program. (They omit basic research and defense projects from their retrospective cost-benefit analysis for the same reasons discussed in the section above on defining "industrial policy.") They deemed only one program – NASA's satellite activities – as "worth the effort," but it was killed before being completed. Four others were "almost unqualified failures," costing billions, crowding out more meritorious R&D projects, yet enduring long after fiscal, technological, and commercial failure was established – a survival owed to political pressure (especially financial benefits accruing to numerous congressional districts) and captured regulators. They conclude that "the history of the federal R&D commercialization programs… is hardly a success story," and that case studies overall "justify skepticism about the wisdom of government programs that seek to bring new technologies to commercial practice." This is because "American political institutions introduce predictable, systematic biases into R&D programs so that, on balance, government projects will be susceptible to performance underruns and cost overruns."60

George Mason University's Hart summarized the *Technology Pork Barrel* problem in his 2018 paper—

> Once a project's spending spigot is turned on, its geographically concentrated fiscal benefits attract political support without regard to technological payoffs or commercial viability. Large projects are particularly attractive to legislators whether or not the technologies being demonstrated are ready to be scaled up, and even if cost, schedule, and performance targets are consistently

> missed. According to this view, white elephants are a virtually inevitable outcome of the U.S. political system.61

Numerous other industrial policy projects justify this conclusion, despite Hart's personal optimism that these forces might be controlled. For example—

- The Jones Act (Section 27 of the Merchant Marine Act of 1920) restricts domestic shipping services to U.S.-built, -owned, -flagged, and -staffed vessels, in order to foment a strong domestic shipbuilding industry and a ready supply of merchant mariners during wartime, yet has presided over the long-term degradation of both the industry *and* the oceangoing merchant marine fleet.[62] Despite these failures, the law has not only persisted for a century, but actually been made *more restrictive* in recent decades – in large part due to the well-developed lobbying machine that is the U.S. shipbuilding industry, maritime unions, the Jones Act fleet, and other groups (including at least one foreign government) that benefit from the policy's continued existence.[63]
- The U.S. ethanol program has also lasted for decades despite numerous studies showing corn-based ethanol to impose substantial economic and environmental damage, while raising food prices and *undermining* U.S. climate goals.[64] Yet these mandates are championed by almost every presidential candidate visiting Iowa; even the pro-deregulation Trump White House expanded them in 2018; and "politicians of both parties are conspiring to keep it alive despite knowing full well what its problems are."[65]
- The U.S. antidumping law has been subject to widespread and decades-long criticism from economists, legal scholars, and trading partners, and various aspects of its

administration have been ruled repeatedly illegal by federal courts and adjudicatory panels under U.S. trade agreements (e.g., the World Trade Organization and North American Free Trade Agreement).[66] Yet the law not only continues to be in force – accounting for hundreds special duties today – but has been repeatedly *expanded* by Congress to achieve desired protectionist results and to permit even greater abuse in the future.[67] The U.S. government also routinely ignores WTO rulings against Commerce Department antidumping abuses – practices that are becoming increasingly common.[68]

- Clean coal megaprojects FutrureGen and Kemper persisted in the face of repeated failures and numerous cost overruns because of their political value (and political problems in case of failure). As the *New York Times* wrote of Kemper, "The system of checks and balances that are supposed to keep such projects on track was outweighed by a shared and powerful incentive: The company and regulators were eager to qualify for hundreds of millions of dollars in federal subsidies for the plant, which was also aggressively promoted by Haley Barbour, who was Southern's chief lobbyist before becoming the governor of Mississippi."[69] As noted above, FutureGen was actually revived from the dead because of its importance for President Obama and his home state of Illinois. That it and other DOE projects were ultimately canceled, Hart notes, likely resulted from a unique confluence of "temporary" events: the ARRA's 2015 expiration date for fund disbursement, a bipartisan push for fiscal austerity, and partisan Republican opposition to Obama-era industrial policy projects.[70] Only the first item might be replicable today. Even the "success" of the Petra Nova project "suffered chronic mechanical problems and routinely missed its targets before it was shut down" in 2020.[71] Although it "demonstrate[s] the

> difficulties carbon capture and storage as a whole will face to achieve operational stability and economic viability,"[72] DOE remains committed to clean coal today.[73]

Surely, not every U.S. industrial policy boondoggle lasts as long as the Jones Act, but the examples above – and many others – reveal that the risk is significant and problems pervasive.

Interaction with Other Policies/Distortions

Industrial policies' implementation is also often undermined by other government policies that may have distorted the market at issue. As the Brookings Institution's Shanta Devarajan explained—

> The analytical case for industrial policies is based on the idea that there is a market failure that is preventing industrialization and so some form of government intervention, such as a subsidy, is necessary to correct that failure. The case is usually made in the form of elegant economic models that portray the market failure and show how intervention can lead the economy to higher growth. Most of these models assume that the relevant market failure is the only distortion in the economy. In the real world, however, these economies are full of distortions, such as labor market regulations, energy subsidies, and the like. In this setting, correcting the market failure associated with industrial policy may not promote industrialization; in fact, it may make matters worse. … Instead of relying on simple models that assume away all other distortions, governments would do better to identify the biggest distortions in the economy (such as energy subsidies) and work on correcting

> them. And if the biggest distortion cannot be moved, then governments need to take that into account in identifying the next biggest distortion to be addressed.[74]

Conflicting U.S. subsidies are a common problem in the United States. As discussed in the following section on industrial policies' costs, for example, some DOE funding for CCT was allocated to subsidized, politically-powerful ethanol producers, despite the product's increasingly obvious shortcomings. Without government support for ethanol, other energy demonstration projects might have been funded instead, perhaps with better results.

Then there are the U.S. laws and regulations that make industrial policy projects slower and more costly. DOE loan guarantee applicants, for example, must comply with the Davis-Bacon Act (mandating high wages and favoring labor unions) and "Buy American" laws (mandating domestic content and favoring U.S. manufacturers) – both of which increase project costs and paperwork.[75] Buy American restrictions also can limit U.S. companies' access to needed materials or lead to project delays, and they confounded ARRA-funded infrastructure projects intended to boost the U.S. manufacturing sector.[76] These same projects also had to comply with the National Environmental Policy Act (NEPA), as well as similar laws at the state-level, which require government review and approval of federal actions "significantly affecting" the environment. A recent assessment of NEPA by Eli Dourado of the Center for Growth and Opportunity found that publication of NEPA-required "environmental impact statements" (EIS) takes an average of 4.5 years, and that ARRA projects were "subject to around 193,000 NEPA reviews including over 7,200 environmental assessments and 850 EISs. During the time the reviews were being performed, no funds for the projects could be disbursed and no work could begin."[77]

Bipartisan efforts to overhaul NEPA have thus far proven unsuccessful, and Democrats – who currently control the U.S. government – have expressed a desire to apply both Buy American and Davis-Bacon to future industrial policy initiatives.[78] In fact, both were included in the bipartisan U.S. Innovation and Competition Act, which passed the Senate in June 2021 and seeks to subsidize semiconductor production and other "key technologies."[79]

These entrenched, policy-driven distortions and others can turn projected industrial policy successes into costly failures – exacerbating market failures rather than fixing them. Policymakers should therefore focus on correcting distortions caused by current policies before adding another layer of distortion via new industrial policy.

High Costs – Seen and Unseen

Finally, industrial policies impose substantial costs beyond the budgetary line item assigned to a specific project. This includes not only substantial cost overruns but also numerous unseen costs imposed on other parts of the U.S. economy – costs that often undermine an industrial policy's own objectives.

Seen Costs

As discussed above regarding U.S. industrial policies' lack of discipline, projects frequently fall victim to "cost overruns" well beyond initial budget projections. Borrowing costs (given the perpetual U.S. budget deficit) also magnify this expense. For example, DOE in 2014 claimed that its green energy lending programs are "making money" because the agency ignored the interest costs that U.S. taxpayers paid to finance the loans at issue. As Brookings' Donald Marron explained at the time, DOE's alleged $810 million "profit" became a $780 million *loss* when Treasury's borrowing costs were included.[80] While interest rates are currently at record lows, they will almost certainly not stay that way – thus raising industrial policy project costs.

Furthermore, it often takes years to determine whether a project merits its cost. For example, DOE in 2014 congratulated itself at the opening of the subsidized Abengoa cellulosic biorefinery in Hugoton, Kansas, but that plant was shut down in 2015 and sold off at a severely discounted price as part of a 2016 bankruptcy proceeding.[81] By 2018, the entire U.S. cellulosic biofuel industry was on the ropes[82], and the Hugoton facility still sits idle today.[83]

Finally, cherrypicked industrial policy successes often obscure a wider portfolio of failures (and thus higher costs per success). For example, Hart's review of DOE energy demonstration projects found that only three of ten CCT projects, which accounted for 82 percent ($3.49 billion of $4.24 billion) of all funding, were active in 2018, with the "huge" FutureGen project among the failures.[84] Since then, the Petra Nova power project was mothballed after suffering frequent outages and missing its carbon sequestration goals.[85] Archer Daniels Midland's Illinois Industrial Carbon Capture and Storage Project (which captures CO2 as a by-product of ethanol production), is still operating but has reached only half of its annual emissions storage target.[86] Only Air Products and Chemicals' carbon capture facility in Texas (which received $284 million from DOE) can be considered successful.[87] Was it worth the total CCT portfolio cost of $3.5 billion?

Other industrial policy portfolios raise similar issues. While Tesla famously paid back its $485 million loan under the Advanced Technology Vehicle Manufacturing (ATVM) program, Fisker Automotive went bankrupt without paying off its $529 million loan; Ford's $5.937 billion loan and Nissan's $1.448 billion loan also remain outstanding.[88] Presumably, they will be paid back, but this story remains unwritten.

Unseen Costs

Beyond these seen costs are the many hidden ones that even government industrial policy "successes" impose on the economy, including indirect costs paid by private parties; deadweight costs to the economy; opportunity costs; misallocation of resources; unintended consequences; moral hazard and adverse selection; and uncertainty.

Indirect costs paid by others. Industrial policies that restrict access to goods and services from disfavored (usually foreign) suppliers raise prices for both the restricted items and their favored competitors, imposing significant costs on consuming companies and individuals. For example, tariffs that President Trump implemented to boost the U.S. steel and aluminum industries have been repeatedly found to raise foreign and domestic steel prices, thus harming downstream U.S. manufacturers and reducing GDP.[89] Pervasive "Buy American" rules, which generally restrict government contracts to domestic producers, have similarly been found to act as a barrier to entering the U.S. market and to raise domestic prices in the same way that a tariff does.[90]

Deadweight costs. Trade restrictions or taxation to fund industrial subsidies also impose deadweight costs on the economy. For example, by raising domestic prices a tariff not only redistributes to producers money that consumers used to save when buying cheaper, non-tariffed imports, but also reduces domestic consumption overall. This portion of the "consumer surplus" is simply destroyed—a "deadweight loss" that makes the United States as a whole worse off in the amount of wealth destroyed (money that consumers, pre-tariff, could have saved, invested or spent on other things). Economists have repeatedly found that import restriction impose substantial deadweight costs on the U.S. economy – a key reason why so few economists support them.[91] High tax rates have been found to impose similar costs.[92]

Opportunity costs. Industrial policy programs that entail government spending also entail opportunity costs, as explained by St. Louis federal Reserve Economist Michelle Clark Neely:

> Each subsidy given to an industry or firm generates an opportunity cost: the cost of foregone alternatives. In other words, to correctly evaluate a policy, you need

> to know not only what you're getting, but also what you're giving up. Based on industrial policy experiments in several countries, most economists have little confidence in the government's ability to measure these benefits and costs properly.[93]

Given that both time and federal budgets are finite, government industrial policies replace efforts and money that could have been spent on other priorities, potentially imposing significant opportunity costs in the process. In *The Technology Pork Barrel,* for example, Cohen and Noll explain that the Clinch River Breeder reactor "absorbed so much of the R&D budget for nuclear technology that it probably retarded overall technological progress."[94] Other nuclear projects and the Space Shuttle likely had similar, net negative effects.[95] As noted above, more recent government over-spending on Emergent BioSolutions' pricey anthrax vaccines left less money available to purchase other medical goods, such as N95 masks, for the Strategic National Stockpile, thus contributing to its shortages when COVID-19 arrived in 2020.[96]

These opportunity costs are sometimes mentioned when government industrial policies publicly fail, but must also be considered for "successes" too. As Duke professor Daniel Gross explained, we celebrate that World War II shifted the scientific establishment "from whatever work they're doing before to instead focus their energies on atomic fission and radar," but "it's difficult to know, and easy to overlook, what we might have also left behind."[97]

Once opportunity costs are considered, "successful" industrial policies can end up undermining the U.S. economy and various strategic national objectives.

Misallocation of resources. Industrial policies also often distort private investment decisions, pushing resources away from productive transactions, businesses, or industries. When the Trump administration pushed automakers to produce ventilators that were never needed, their efforts occupied machinery, labor and capital that could have been used to make cars that subsequently were in short domestic supply. The since-canceled $765 million loan to turn Eastman-Kodak into a pharmaceutical ingredient company caused the company's shares to surge 1900 percent, and its market capitalization "ballooned more than twentyfold, to about $2.2 billion at one point"[98] – private capital that could not be invested elsewhere (e.g., in actual U.S. pharmaceutical ingredient producer Fujifilm). Even after the government loan was stymied, and without any new plan for long-term financial viability (along with continued poor financial performance[99]), the company's shares still traded at three-to-four times their pre-loan announcement price, thus diverting for several months (if not longer) hundreds of millions of private investment dollars away from other companies.[100]

Industrial policies can also discourage private investment in industries that the government is actually trying to promote. As Harvard's Josh Lerner explained with respect to the Obama-era DOE's green energy subsidies, "The enormous scale of the public investment appears to have crowded out and replaced most private spending in this area, as [venture capitalists] waited on the sideline to see where the public funds would go…. Rather than being stimulated, cleantech has fallen from 14.9% of venture investments in 2009 to 1.5% of capital deployed in the first nine months of 2019."[101] With respect to the ATVM program in particular, *Wired* magazine found in 2009 that "this massive government intervention in private capital markets may have the unintended consequence of stifling innovation by reducing the flow of private capital into ventures that are not anointed by the DOE," and then provided examples of this very thing.[102]

Finally, potential industrial policy beneficiaries can divert resources from their actual business to obtaining federal benefits (lobbying, grant-writing, etc.), thus undermining the former. *Wired* notes, for example, that "Aptera Motors has struggled this year to raise money to fund production of the Aptera 2e, its innovative aerodynamic electric 3-wheeler, recently laying off 25 percent of its staff to focus on pursuing a DOE loan. According to a source close to the company, 'all of the engineers are working on documentation for the DOE loan. Not on the vehicle itself.'"[103] Kodak spent almost $800,000 on lobbying before it received its DPA loan, and Emergent BioSolutions has spent millions on lobbying and winning federal contracts. Overall, countless millions of dollars – dollars that could have been spent on producing better products – have instead been spent on political efforts by companies in the steel[104], shipbuilding, ethanol, and other industries that are common U.S. industrial policy targets.[105]

Unintended consequences. Industrial policies produce consequences that not only were unforeseen by government planners but also undermine the policies' own objectives. As already noted, U.S. subsidies intended to spur various energy innovations repeatedly discouraged them. Steel protectionism has boosted less productive and innovative firms' lobbying efforts and financial returns, thus discouraging overall innovation (R&D spending and creative destruction) in the industry.[106]

Numerous other examples abound. U.S. semiconductor policy in the 1980s and 1990s sought to boost domestic producers' global competitiveness (while diminishing their Japanese competitors) but instead enriched Japanese chipmakers (via quota "rents" and government-backed collusion) and helped to turn Korean companies into global leaders.[107] Jones Act shipping restrictions, intended to bolster national security, have pushed American energy consumers to buy from Russian producers and American shippers to use Chinese shipyards for repairs. Restrictions on imports of machine tools from major producer countries in the 1980s fueled the growth of China's machine tools industry.[108] Ethanol subsidies and mandates have reduced cropland, increased food prices, and harmed the environment. "Buy American" restrictions tied to federal transportation subsidies raised the price of domestically-produced transit buses and discouraged the purchase of more efficient foreign-made buses, thus lowering the quality and use of public transit (frequency and coverage), increasing traffic congestion, and harming the environment.[109] Outside of the United States, European innovation policy stymied innovation[110], while Japanese industrial policy slowed productivity growth.[111] The list goes on and on.

Moral hazard and adverse selection. Industrial policies also can generate moral hazard (i.e., encouraging actors to engage in overly-risky behavior by protecting them from the consequences) and adverse selection (i.e., the tendency to attract the riskiest or least-responsible actors). Research shows, for example, that government loan guarantees that insure lenders against incurring losses from default can encourage banks to take on risky borrowers, discourage them from undertaking standard due diligence to apply for credit guarantees, and attract a disproportionate share of risky borrowers, thus resulting in inefficient resource allocation overall.[112]

In the United States, the poster child for these problems was the Section 1705 loan guarantee program and the $535 million loan to solar panel manufacturer Solyndra that it supported.[113] As explained by economist Ryan Yonk, the scandal with Solyndra was not that the company failed, but that its loan application – which a 2015 Inspector General report found was plagued with deficiencies and misrepresentations about a company with publicly-known problems[114] – was ever approved in the first place.[115] In a comprehensive assessment of all DOE loan and loan programs implemented between 2009 and 2016, the Heritage Foundation's Nick Loris found that projects routinely featured "[f]ailed companies that could not survive even with the federal government's help," and added that "[b]oth Government Accountability Office (GAO) and DOE Office of Inspector General reports identify that the loan programs were fraught with inefficiencies, lack of due diligence, and inadequate oversight and management."[116]

Uncertainty. Industrial policies often generate uncertainties due to their inherent political nature (frequent elections, program lapses, etc.) and potential to generate trade disputes or retaliation from foreign trading partners. Numerous studies, for example, have shown that U.S. tariffs during the Trump administration increased trade policy uncertainty and thereby decreased investment and economic growth.[117] These results are consistent with the general economics literature showing policy uncertainty to undermine investment, employment, and economic growth. As University of Chicago's Steven J. Davis explained, "a variety of studies find evidence that high (policy) uncertainty undermines economic performance by leading firms to delay or forego investments and hiring, by slowing productivity-enhancing factor reallocation, and by depressing consumption expenditures. This evidence points to a positive payoff in the form of stronger macroeconomic performance if policymakers can deliver greater predictability in the policy environment."[118] Both theory and practice show why it is difficult, if not impossible, for U.S. industrial policies to achieve such predictability. These outcomes not only undermine the common argument that industrial policies fix market "short-termism" – they are similarly afflicted (if not more so) – but also impose significant economic harms.

Almost all of these seen and unseen costs arose in the 2009 government bailout of General Motors and Chrysler, which was deemed an industrial policy "success" by the Obama administration because they only "cost" taxpayers about $10 billion (the difference between the current-dollar value of funds the government "invested" and recouped).[119] However, this total ignored the true (interest adjusted) cost to taxpayers, which the Congressional Budget Office estimates was 40 percent higher ($14 billion).[120]

Furthermore, as Daniel Ikenson explained in a series of Cato Institute analyses[121], even this larger cost figure ignores all of the bailout's hidden costs for the U.S. economy, such as: that the $61 billion allocated to these large corporations could have been better spent at the time (for example, via direct payments to and retraining for autoworkers); the long-term costs to GM and Chrysler because they were not reorganized via standard bankruptcy proceedings; the costs (e.g., lost business) incurred by Ford and other U.S.-based automakers who did not receive special treatment, as well as the costs to U.S. consumers and the economy because these companies' better products and business models were not rewarded with additional business; the moral hazards that resulted from encouraging the continuation of the companies' and the union's irresponsible practices; the costs to bond-holders and other investors who did not receive the fair value of their holdings, along with the long-term effects of short-circuiting U.S. bankruptcy law; the political costs of protecting political favorites (here, unions); and the cost of uncertainty about whether and when political actors will again decide to intervene in the market and legal system, citing the bailout as precedent.

These costs are large and never mentioned.

If It Creates One Tesla?

Some industrial policy advocates argue that these seen and unseen costs are an expected but necessary part of backing ventures too risky for private capital and are worth the expense if the project ultimately supports one big winner (e.g., Tesla Motors). Even assuming that Tesla's story is fully written or that electric vehicle proliferation benefits average Americans, however, this argument must have limits: would government-backing of Tesla be worth 1 trillion dollars-worth of waste, failure, and cronyism? Two trillion? Surely, some amount of "losers" – individuals and the economy overall – would be too much, even if the government picked one "winner" in the process. Costly public failures might also undermine public confidence in the government and support for future federal policies, industrial or otherwise – jeopardizing the next Tesla (or more worthwhile targets) rather than nurturing it. Solyndra did this very thing.[122]

These arguments, as well as other industrial policy defenses, also require quantifying the benefits that alleged successes confer upon not merely recipient companies and workers (a low and obvious standard) *but the U.S. economy more broadly*. Positive externalities, market-beating

R&D spillovers, and faster economic growth are often claimed, but these benefits are rarely supported with hard evidence and thorough empirical analysis. Indeed, a core theme of McCloskey and Mingardi's book, *The Myth of the Entrepreneurial State,* is the lack of rigorous and systematic empirical analyses of the overall efficacy of nation's industrial policy (as opposed to whether specific projects achieved certain deliverables). Pack and Saggi examined the issue in 2006 and explained a key hurdle to such an analysis:

> Although there are cases where government intervention coexists with success, there are many instances where industrial policy has failed to yield any gains. The most difficult issue is that relevant counterfactuals are not available. Consider the argument that Japan's industrial policy was crucial for its success. Because we do not know how Japan would have fared under laissez-faire policies, it is difficult to attribute its success to its industrial policy. It might have done still better in the absence of industrial policy—or much worse. Given this basic difficulty, only indirect evidence can be obtained regarding the efficacy of industrial policy. Direct evidence that can "hold constant" all the required variables (as would be done in a well-specified econometric exercise) does not exist and likely never will.[123]

The authors nevertheless conclude at that time that "[f]ew of the empirical analyses find that sectoral targeting has been particularly effective."[124] Since then, literature reviews – including that of Ángel Zúñiga-Vicente, et al in 2014[125], Lane in 2020[126], and Karlson, Sandström and Wennberg that same year[127] – have come to essentially the same conclusions: the few empirical studies of industrial policy tend to focus on specific transactions and issues (as opposed to the aggregate, economy-wide effects of industrial policy); often suffer from methodological or data limitations; and have produced mixed, country-specific results. They therefore cannot permit strong conclusions about the success or failure of industrial policy writ large.

Finally, one must also consider whether an industrial policy success would have occurred in a market without the supporting program at issue. Often, subsidized successes perform no better than their un-subsidized competitors. The most obvious example is the BioNTech/Pfizer vaccine achieving the same or better results than vaccines with far more government support, but many others exist. Yonk's 2020 assessment of DOE loan guarantee programs, for example, finds that, "[t]he early evidence suggests few loans are extended that would not otherwise be attained."[128] He adds—

> Most Section 1705 funding has gone to large corporations who already have access to capital for investments in research, development, and deployment. Recipients of LPO guarantees include multiple Fortune 200 companies, utility companies, and multinationals. Many are wholly owned by yet larger companies. The application process itself all but ensures that only large, established companies will be capable of participating in the program. Applicants can expect to pay between $150,000 and $400,000 in fees before even being considered.

As noted above, other analyses of the program have come to the same general conclusion. Semiconductor consortium SEMATECH's work has also been found to have produced deliverables that the market could have provided (and did previously without government assistance[129]). An 2020 analysis of 25 cleantech startups funded by the U.S. Advanced Research Projects Agency-Energy (ARPA-E) in 2010 found "no clear evidence that [awardees] perform differently from similar cleantech startups as a whole in terms of acquisition/IPO, survival or VC funding post-award within 10–15 yr of founding." As a result, the authors conclude that the program did not achieve one of its primary goals (i.e., to generate "an increased likelihood of success (measured in different ways) for ARPA-E startups compared to similar companies").[130] The authors found that awardees did obtain more patents than un-subsidized competitors, but could not rule out that this "success" was due to ARPA-E "encouraging awardees to patent" or choosing "to fund companies with a higher propensity to patent."[131] Finally, the authors—

> …also examined the impact of funding from other government sources. They found that run-of-the-mill Department of Energy funding from the Office of Energy Efficiency and Renewable Energy had no impact on either patenting or follow-on funding. Meanwhile, Small Business Innovation Research awardees patented at a lower rate than the average firm.[132]

The ARPA-E program was therefore the best of the bunch. However, the bar is low, and success is *still* no better than what the market could produce. As one supporter of ARPA-E put it, "one would hope to see stronger evidence of the impact of ARPA-E support not only on follow-on funding, but also on product introductions, sales and other downstream commercialization variables over a longer time span."[133] Alas, no such evidence exists.

What "Problem" Will Industrial Policy Solve?

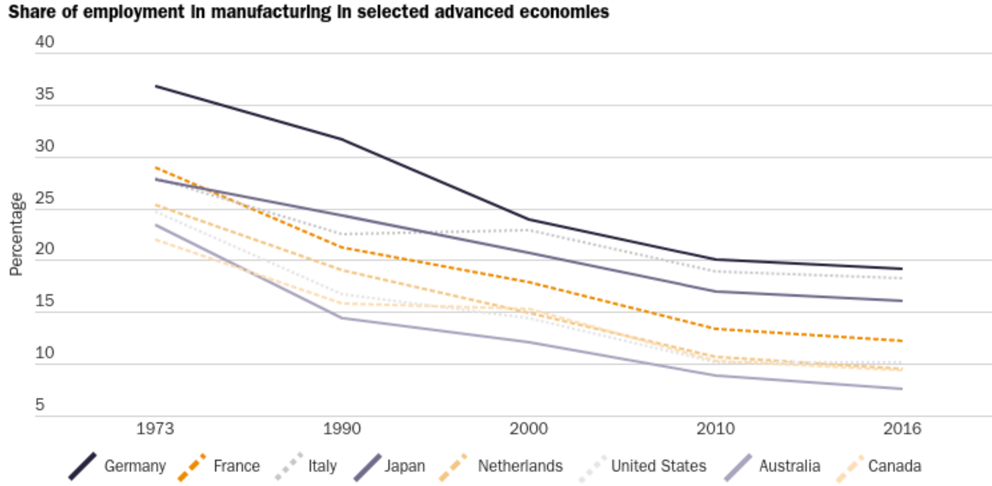
Industrial policy advocates also routinely fail to demonstrate the existence of the specific economic problem that their proposed policies will solve. Evidence shows that the most common problems – without which new industrial policy would not be necessary – are much less serious than advocates claim or cannot be fixed with industrial policy. This includes allegations of widespread U.S. "deindustrialization," declining manufacturing jobs and business investment, the erosion of middle class living standards, and the destruction of American communities.

"Deindustrialization"?

The supposed "deindustrialization" of the United States does not justify new U.S. industrial policies. As explained in Lincicome's January 2021 Cato Institute policy analysis, there is little merit to the common argument that the U.S. industrial base has been dismantled by decades of free market "fundamentalism" and industrial policy inaction.[134] Both declining U.S. manufacturing jobs (Figure 1) and the sector's shrinking share of GDP (Figure 2) primarily reflect long-term global trends shared by most industrialized nations and disconnected from specific federal economic policies, whether "free market" or "interventionist."

Figure 1

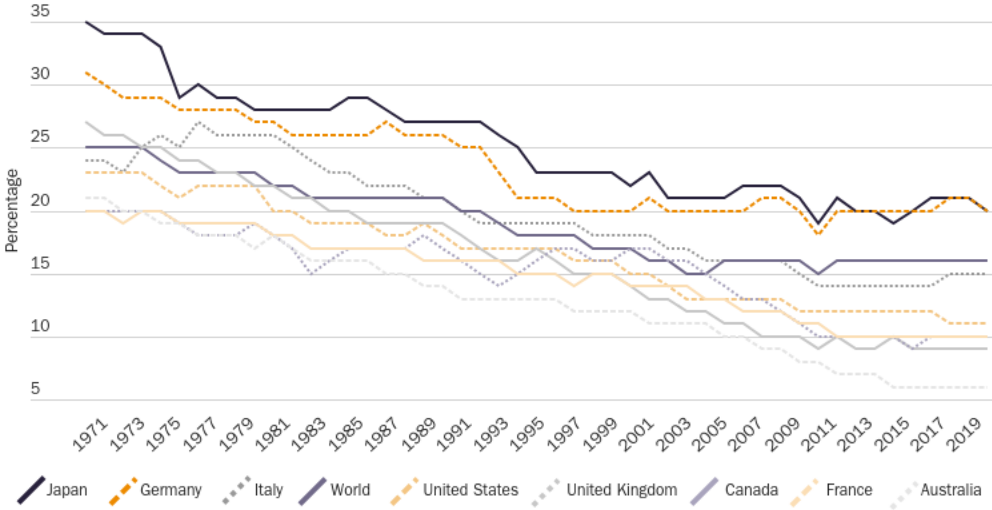
Share of employment in manufacturing in selected advanced economies



Source: Robert Z. Lawrence, "Recent US Manufacturing Employment: The Exception That Proves the Rule," Peterson Institute for International Economics Working Paper no. 17-12, November 2017.

Figure 2

Manufacturing share of gross domestic product in selected advanced economies

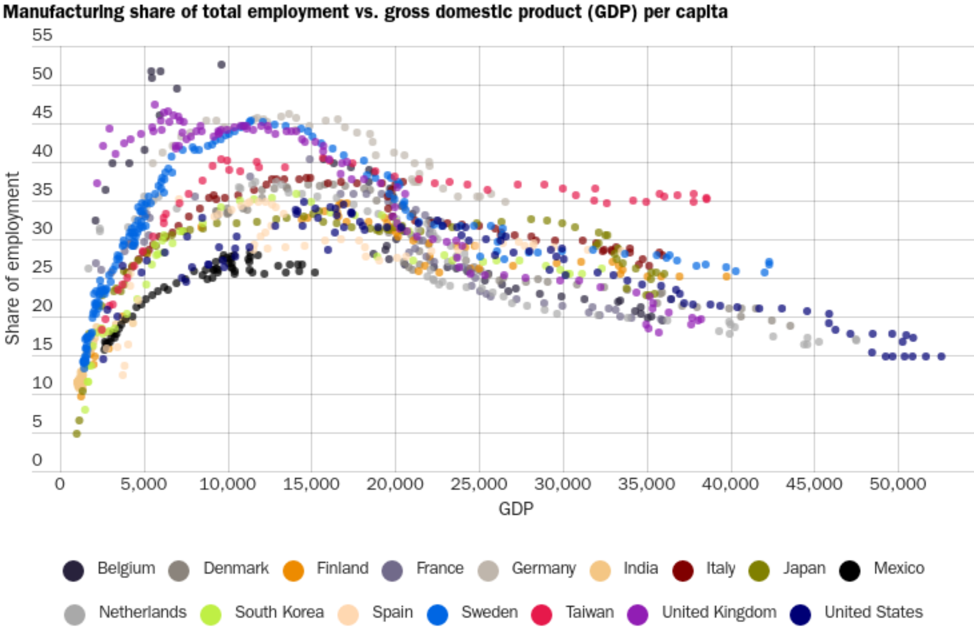


Source: United Nations data, https://unstats.un.org/unsd/snaama/Downloads.

Overall, as Figures 3 and 4 show, the historical trends in U.S. manufacturing jobs and GDP share are a standard story of economic development that all countries eventually experience as they get richer:

Figure 3

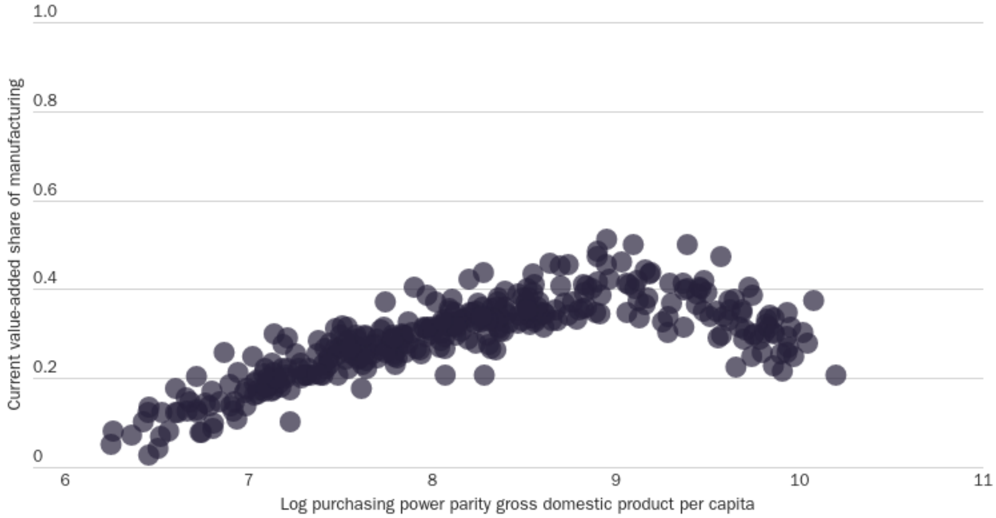
Manufacturing share of total employment vs. gross domestic product (GDP) per capita



Source: "GDP per Head vs Share of Industry in Employment, 1801 to 2015," Our World in Data, https://ourworldindata.org/grapher/gdp-vs-manufacturing-employment?time=1801..2015.

Figure 4

Manufacturing share vs. per capita income (country panels)



Source: Francisco J. Buera and Joseph P. Kaboski, "Scale and the Origins of Structural Change," *Journal of Economic Theory* 147, no. 2 (March 2012).

Given that these long-term, systemic trends were experienced in countries (e.g., Japan and Germany) with both trade surpluses and active, comprehensive industrial policies, there is little to suggest that new U.S. industrial policies would change the same trends in the United States.

Furthermore, Table 1 and Figures 5 through 7 show that the U.S. manufacturing sector remains among the most productive in the world and has expanded since the 1990s—continuing earlier period trends in output, investment (capital expenditures and R&D), and financial performance:

Table 1

Top manufacturing countries, 2018 (millions of dollars, unless otherwise noted)

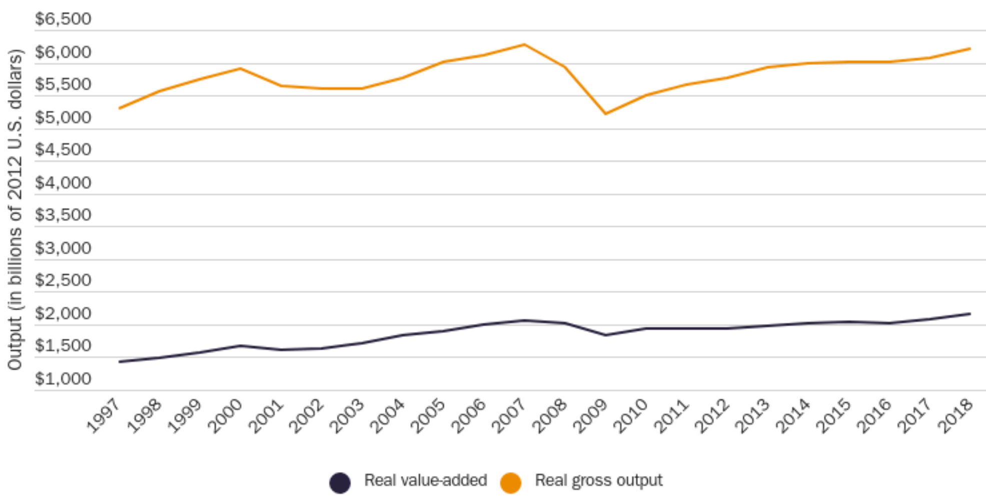
Country	Manufacturing value-added	Merchandise exports	Manufactures exports	FDI inflows (total)	FDI inflows (manufacturing)	Manufacturing value-added per worker (dollars)
China	$3,884,451	$2,486,695	$2,318,153	$138,305	n/a	$29,188
United States	$2,300,398	$1,663,982	$1,176,498	$253,561	$166,889	$177,127
Japan	$959,243	$738,143	$641,106	$9,858	$13,242	$92,448
Germany	$746,485	$1,560,539	$1,364,575	$73,570	$12,826*	$96,632
South Korea	$427,724	$604,860	$528,991	$12,183	$5,245	$94,841
India	$409,087	$324,778	$223,265	$42,156	n/a	$7,169
Italy	$289,160	$549,527	$452,134	$32,886	$8,481	$73,292
United Kingdom	$279,298	$486,439	$468,817	$65,299	$4,058*	$108,223
France	$260,321	$581,774	$462,086	$38,185	$20,128	$100,938
Mexico	$214,789	$450,685	$362,608	$34,745	$16,318	$29,931

Sources: United Nations Conference on Trade and Development; World Trade Organization; Conference Board; Organisation for Economic Co-operation and Development; and author's calculations.

Notes: FDI = foreign direct investment. Gross domestic product value-added figures were provided in 2015 dollars and have not been adjusted. All other figures are in 2018 dollars. Organisation for Economic Co-operation and Development data were not provided for "n/a" countries. Germany FDI inflows (manufacturing) is 2017, and UK FDI (manufacturing) is 2015 (the latest data available).

Figure 5

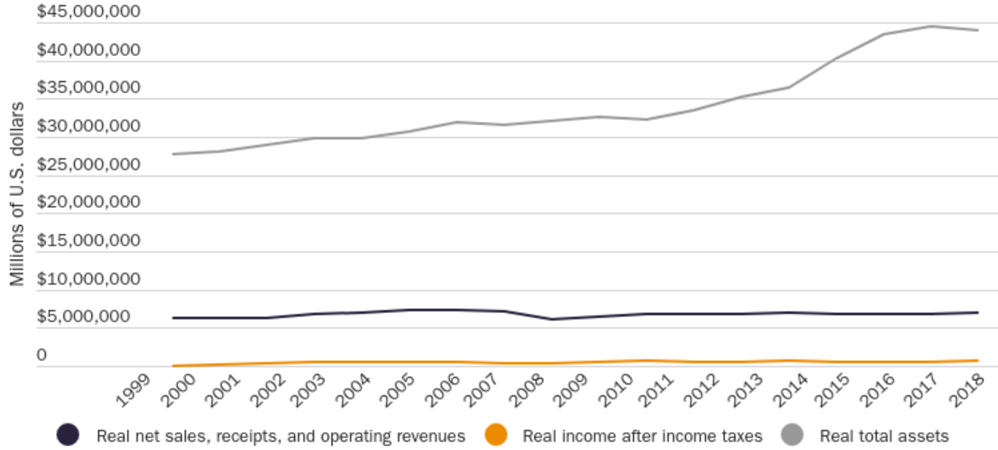
U.S. manufacturing output and value-added, 1997–2018



Source: "GDP-by-Industry," Bureau of Economic Analysis, updated December 10, 2020, https://apps.bea.gov/iTable/index_industry_gdpIndy.cfm.

Figure 6

U.S. manufacturing sector financial performance, 2001–2018

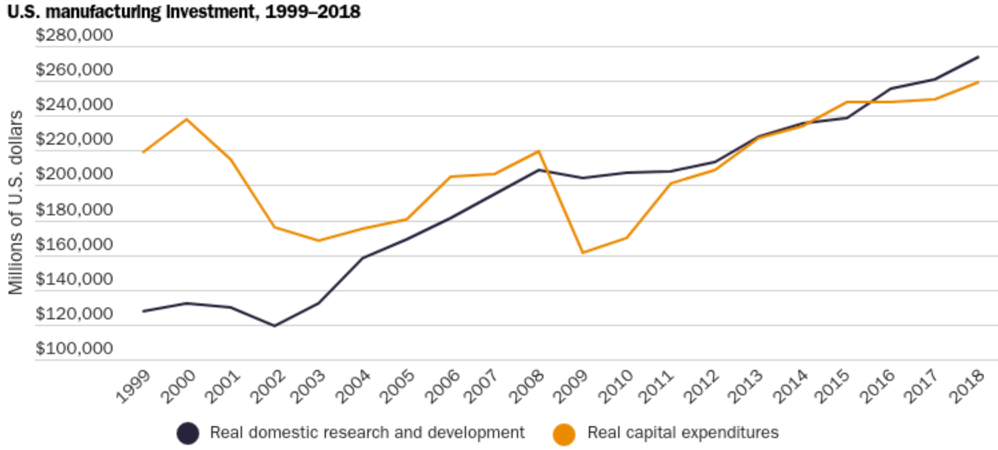


Source: "Quarterly Financial Report (QFR): Manufacturing, Mining, Trade, and Selected Service Industries," U.S. Census Bureau, https://www.census.gov/econ/qfr/.

Deflator: "Table 1.1.9. Implicit Price Deflators for Gross Domestic Product," National Income and Products Accounts, National Data, Bureau of Economic Analysis, https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=3&isuri=1&1921=survey&1903=13#reqid=19&step=3&isuri=1&1921=survey&1903=13.

Figure 7

U.S. manufacturing investment, 1999–2018



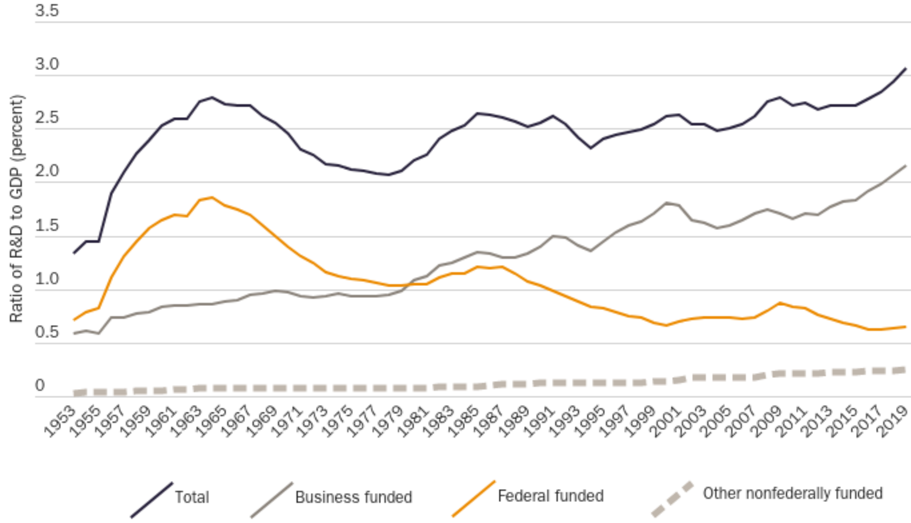
Sources: "Research and Development: U.S. Trends and International Comparisons," Science and Engineering Indicators, National Science Board, https://ncses.nsf.gov/pubs/nsb20203/u-s-business-r-d; and "2019 Annual Capital Expenditures Survey Tables," U.S. Census Bureau, December 16, 2020, https://www.census.gov/data/tables/2019/econ/aces/2019-aces-summary.html.

Deflator: "Table 1.1.9. Implicit Price Deflators for Gross Domestic Product," National Income and Product Accounts, National Data, Bureau of Economic Analysis, https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=3&isuri=1&1921=survey&1903=13#reqid=19&step=3&isuri=1&1921=survey&1903=13.

As shown in Table 2 and Figures 8 and 9, moreover, the R&D spending trends for the U.S. manufacturing sector generally track those of the nation overall, which hit all-time highs in R&D spending as a share of GDP and inflation-adjusted dollars spent:

Figure 8

U.S. R&D expenditures as share of GDP (1954-2018)



Notes: Data for 2019 are estimates; some of these data may later be revised. The gross domestic product (GDP) data used reflect the Bureau of Economic Analysis's comprehensive revisions of the National Income and Product Accounts of August 2020.
Source: National Center for Science and Engineering Statistics, National Patterns of R&D Resources (annual series).

Table 2

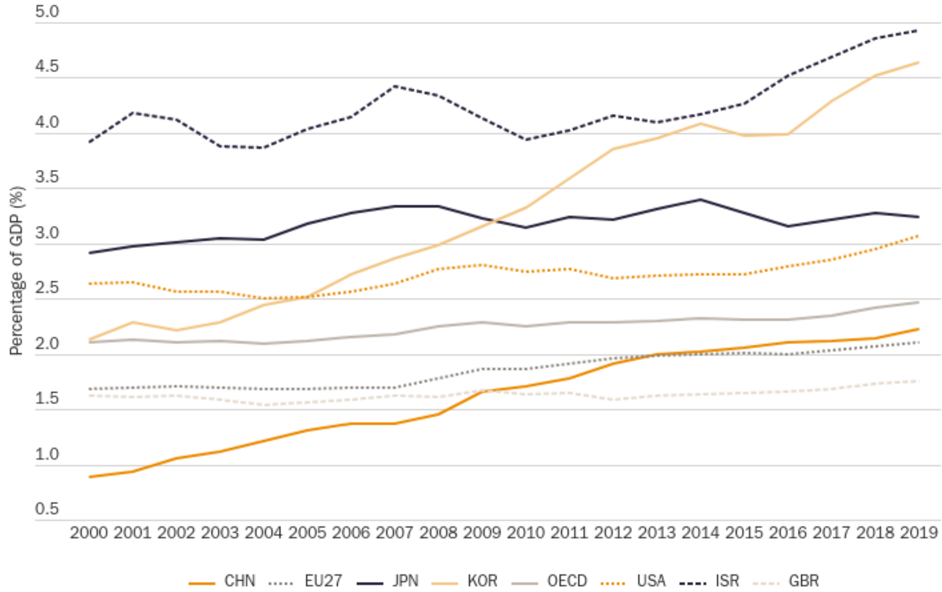
U.S. R&D expenditures by type of work, selected years (2000-2018) (Constant 2012 dollar billions)

	All R&D	Basic research	Applied research	Experimental development
2000	343.2	53.8	72.4	217
2010	423.1	79.4	82.3	261.4
2011	434.4	74.9	83.5	276.0
2012	433.7	73.8	86.9	273.1
2013	446.4	77.7	86.7	282.0
2014	459.3	79.8	88.6	290.9
2015	472.6	80.5	93.0	299.1
2016	493.5	85.1	101.0	307.3
2017	515.5	86.7	103.0	325.6
2018	549.5	91.7	105.5	352.3
2019a	584.4	96.1	111.2	377.1

Note a: Data for 2019 are estimates and will later be revised.
Source: National Center for Science and Engineering Statistics, National Patterns of R&D Resources (annual series).

Figure 9

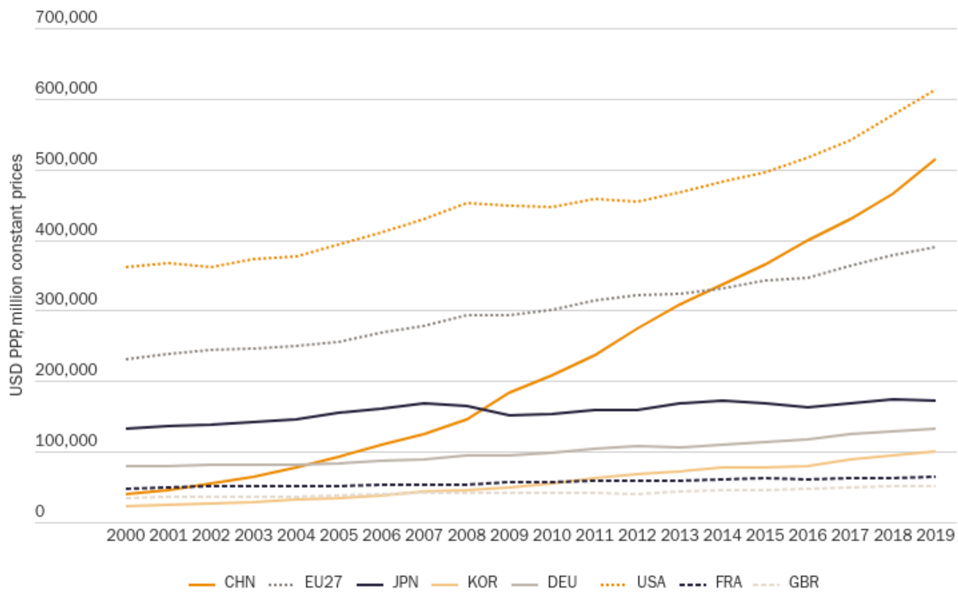
R&D Intensity: Gross domestic expenditure on R&D as a percentage of GDP, 2000-19



Source: OECD Main Science and Technology Indicators Database

Figure 10

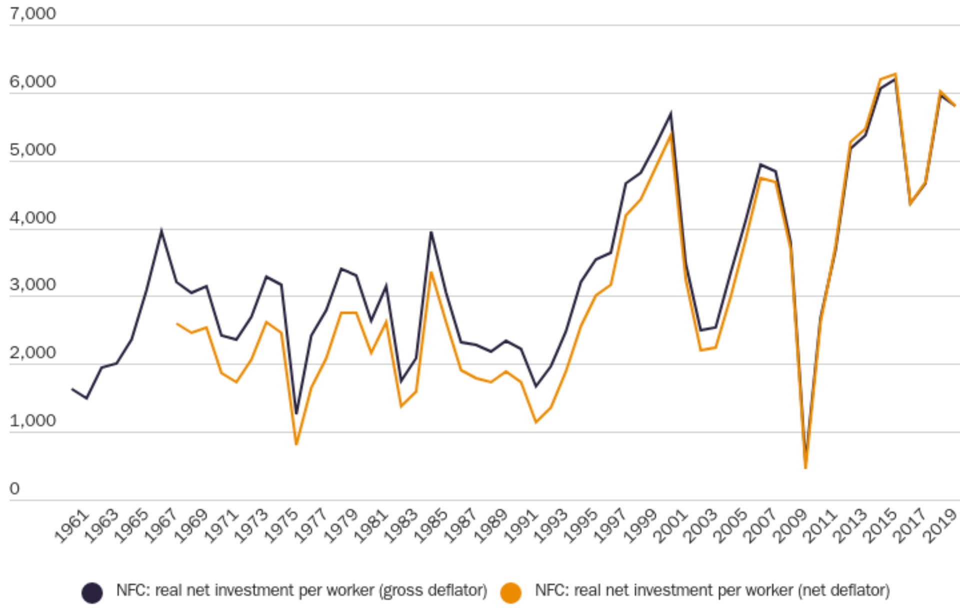
Gross domestic expenditure on R&D, 2000-19



Source: OECD Main Science and Technology Indicators Database

As documented by economist Donald Schneider, moreover, numerous experts have concluded that overall *net* investment in the U.S. nonfinancial corporate sector (i.e., new investment minus depreciation) has not declined in real terms and, as shown in Figure 11, reached an all-time high on a per-worker basis in the mid-2010s, leveling off thereafter:

Figure 11
Real net investment in the U.S. non-financial corporate sector ($), 1961-2019

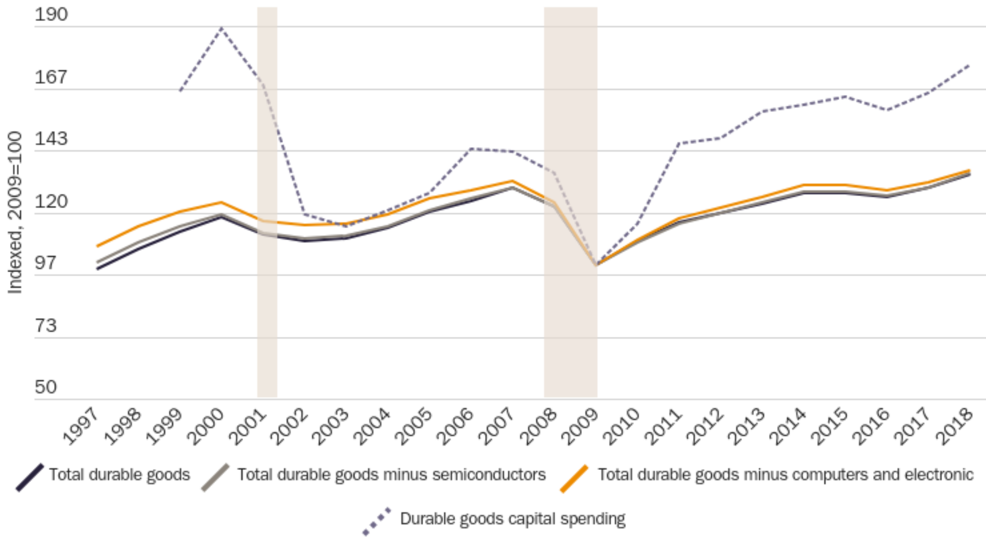


Source: Donald Schneider, Cornerstone Macro, using Bureau of Economic Analysis data

Research from University of Houston economist Dietz Vollrath, Schneider adds that a causal connection between total U.S. business investment and economic growth disappears after accounting for slowing population growth – surely not something industrial policy can fix.[135]

These topline data underscore that any new American industrial policy would require targeting specific industries (e.g., semiconductors) to change the sector's composition, *not* the horizontal tax or educational policies that some advocates claim to be "industrial policy." And while some manufacturing industries have undoubtedly declined over the last several decades, these changes usually reflect fundamental shifts in U.S. and global markets – driven by trade, technology, changing consumer habits, and other trends – as opposed to a "weak" manufacturing sector. The declines also have been offset by gains in other industries, particularly durable goods industries (see Figure 12), such as transportation and aerospace, and high-value nondurable goods industries like chemicals and energy (Table 3):

Figure 12
Real U.S. durable goods manufacturing output and investment



Sources: "Gross Output by Industry," Bureau of Economic Analysis, September 30, 2020, https://www.bea.gov/data/industries/gross-output-by-industry#:~:text=What%20is%20Gross%20Output%20by,inputs%20not%20counted%20in%20GDP); and "Annual Capital Expenditures: 2017," U.S. Census Bureau, March 13, 2019, https://www.census.gov/library/publications/2019/econ/2017-aces-summary.html.
Deflator: "Table 1.1.9. Implicit Price Deflators for Gross Domestic Product," National Income and Product Accounts, National Data, Bureau of Economic Analysis, https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=3&isuri=1&1921=survey&1903=13#reqid=19&step=3&isuri=1&1921=survey&1903=13.

Table 3
Change in U.S. nondurable goods manufacturing output, total and select industries

Industry	Percentage change in real value-added (1997–2018)	Percentage change in real gross output (1997–2018)
Total nondurable goods	0.2%	3.53%
Food and beverage and tobacco products	8.3%	12.5%
Food manufacturing	45.6%	27.9%
Beverage manufacturing	86.2%	22.2%
Tobacco product manufacturing	−72.7%	−70.1%
Textile mills and textile product mills	−38.9%	−51.5%
Apparel and leather and allied products	−65.4%	−81.6%
Paper products	−36.3%	−22.4%
Printing and related support activities	5.6%	−30.1%
Petroleum and coal products	13.0%	21.5%
Chemical products	14.2%	4.9%
Nondurable goods (excluding textiles, apparel, paper, printing, tobacco)	22.9%	10.3%

Source: "GDP-by-Industry," Bureau of Economic Analysis, updated December 10, 2020, https://apps.bea.gov/iTable/index_industry_gdpIndy.cfm.

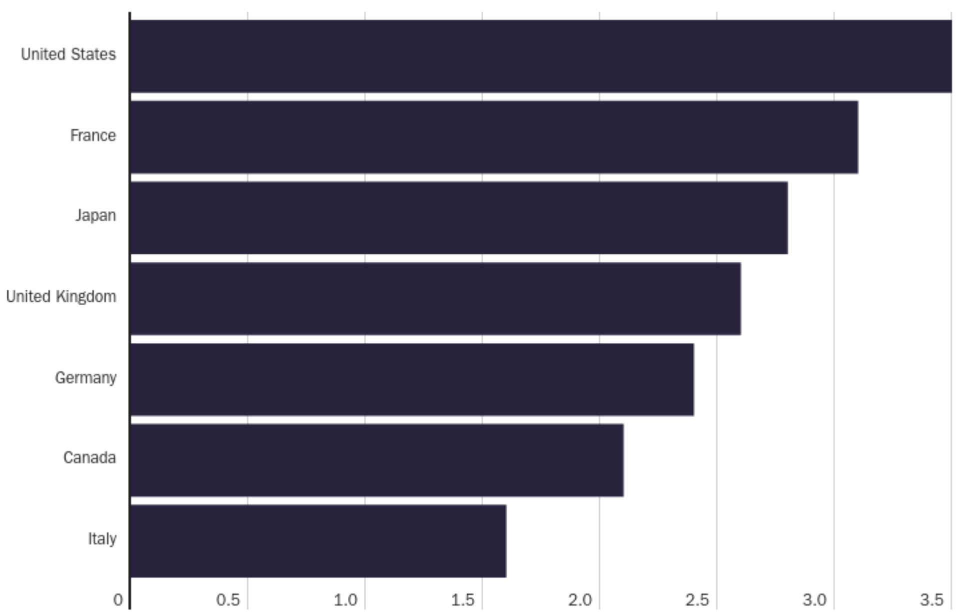
These and other U.S. manufacturing data reveal a flexible and dynamic sector that is generally responsive to free market forces – forces that are important for the health of the U.S. economy overall, not merely the manufacturing sector. Furthermore, the offshoring or automating of low-wage, low-skill industries in the apparel, furniture, and other manufacturing industries – while undoubtedly difficult for the workers directly affected – is an important part of a healthy, dynamic economy and an essential part of U.S. economic development, moving resources from less- to more-productive domestic enterprises. This is true regardless of whether said enterprises are in manufacturing or other sectors.

Manufacturing Jobs

Manufacturing jobs also cannot justify a new U.S. industrial policy push. As noted in the previous section, it is highly questionable to assume that the significant decline in factory jobs in the 1990s and 2000s could have been reversed via industrial policy because those same trends were happening in all industrialized nations, including those with robust industrial policies. U.S. policy could in theory produce a one-time increase in overall manufacturing employment, but the long-term downward trend would continue. Furthermore, as shown in Table 1 above and Figure 13 below, U.S. manufacturing workers continue to be among the most productive in the world, even accounting for a slowdown since the Great Recession:

Figure 13

Real value added per hour worked in manufacturing, annual percent change (1990-2018)



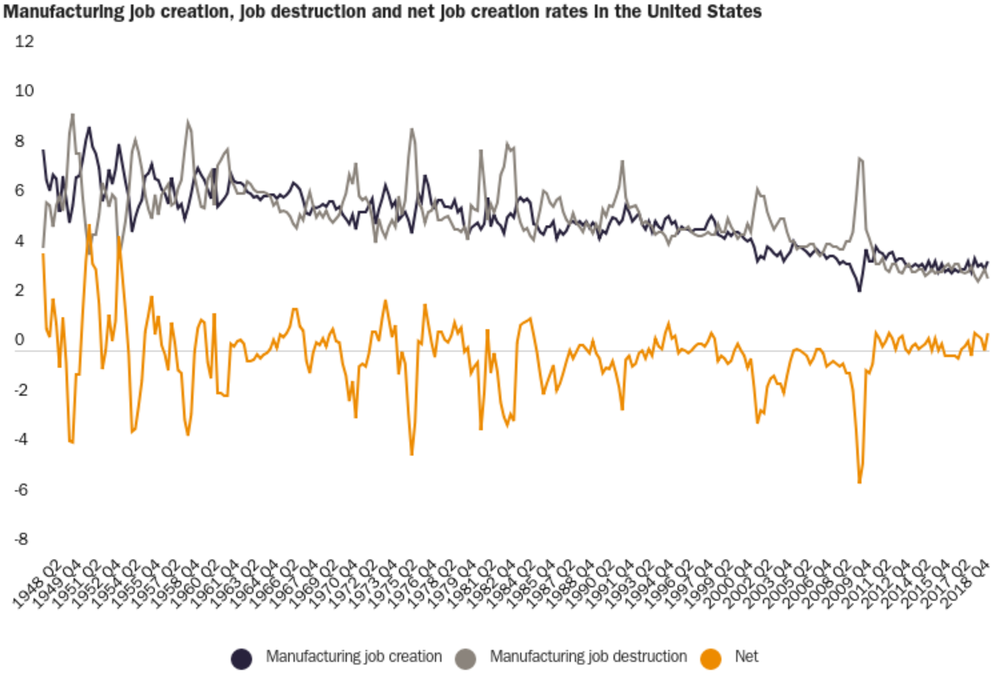
Source: The Conference Board International Labor Comparison program, January 2020

However, altering the composition of the 165-million-person American workforce to include an additional one or two million U.S. manufacturing jobs would not necessarily be better for the workforce or for the U.S. economy overall because manufacturing jobs are not – contrary to the conventional wisdom – sufficiently special or economically beneficial as to warrant government industrial policy interventions (even assuming that such interventions would be successful).

As the Cato Institute's Ryan Bourne documented in 2019[136], manufacturing jobs are not significantly more stable or secure than jobs in other sectors – especially for low-skilled workers whose manufacturing jobs have been disappearing for decades and are most exposed to automation and trade. As shown in Figure 14, for example, annual job creation in manufacturing has been low since the 1960s, and there was net job destruction from the 1960s through 2010:

Figure 14

Manufacturing job creation, job destruction and net job creation rates in the United States



Source: NBER and BLS.

Although manufacturing jobs have increased since the Great Recession, the Bureau of Labor Statistics projects that the sector will resume its long-term trend of shedding manufacturing jobs (444,800 of them, to be exact) over the next decade due to international competition and productivity-enhancing technologies.[137] On the latter issue, for example, the number of man-hours required to produce a ton of steel in the United States dropped from 10 in 1980 to approximately 1.5 today. The *newest* steel plants, however, need even fewer workers – one Austrian mill needs only 14 employees to make 500,000 tons of steel wire per year.[138] Because demand for steel is finite, steel industry employment will thus continue to decline as productivity continues to climb.

Indeed, as Bourne notes, U.S. manufacturing jobs tend to be highly productive (due in part to the aforementioned R&D expenditures), but this benefit has a downside: it caps industrial employment. For example, U.S. manufacturing gained almost 1 million jobs between 2010 and 2018, outpacing job growth Germany, Japan, and China in the process. However, over the same period, real manufacturing value-added per worker and per hour worked in the United States increased by only 0.3 percent per year and 0.1 percent per year, respectively, as compared to 5.6 percent and 5.7 percent per year between 2000 and 2008—a time of significant manufacturing *job loss* in the United States.[139] In other words, American workers were improving their ability to produce manufactured goods at a much more rapid pace during the height of manufacturing dis-employment than during the subsequent period of re-employment. Thus, the goal of promoting high-productivity, high innovation industries that need fewer workers (and higher skilled ones when they do) conflicts with the goal of supporting numerous comfortable, stable, secure jobs. An industrial policy that seeks to achieve the latter objective – for example by "re-shoring" jobs in the textile and apparel or consumer electronics industries – would inevitably sacrifice the former.

There is also little to indicate that boosting nominal manufacturing employment would solve sagging U.S. labor force participation, even among less-educated male workers. For starters, the U.S. labor force participation rate hit 63.4% in January 2020 – lower than its 2000 peak but at approximately level as in June 1979 when U.S. manufacturing jobs were at an all-time high in nominal terms. The prime-age (25-54) employment to population ratio, by contrast, was far higher in January 2020 (80.5%) than it was in 1979.[140] Only male prime-age employment was lower from 1979 to January 2020, but the decline (-8.2%) was relatively small compared to the concurrent drop in manufacturing jobs (-34.6%). Thus, even the connection between male prime-age employment and nominal manufacturing jobs is weak today, and there is no reason to think that targeted policies to *boost manufacturing jobs* – as opposed to broad macroeconomic policies that produce a strong labor market generally – will fix sagging labor force participation.

In fact, male labor force participation problems might reflect not a worsening manufacturing job market but instead reduced job seeking by men. Research by Scott Winship, for example, finds that most prime-age men not in the labor force (or inactive) reported that they were disabled, while another third were retired, enrolled in school or training, or taking care of a family member.[141] Just one in ten prime-age men not in the labor force fell outside of these categories, while about one-quarter of them said they wanted a job. Leaving aside what may be driving these trends, nothing here supports an *industrial policy solution* – whether it targeted routine, labor-intensive jobs or higher-skill, "grey collar" jobs that require advanced training. Indeed, even in late 2018, when both the U.S. labor market and manufacturing sector were booming, there were approximately 500,000 manufacturing job openings (a 3.9 percent openings rate) – the highest levels ever recorded, dating back to 2000.[142]

Finally, wages and incomes – in and out of manufacturing – do not justify new industrial policies. Contrary to the conventional wisdom, middle-class compensation has not been stagnant, nor has significant "wage polarization" occurred, over the last several decades.[143] Economist Michael Strain finds, for example, that median production and supervisory wages have increased by more than 30 percent since the early 1990s, and total personal compensation – wages, benefits (an increasing portion of pay), taxes, and transfers – is up 61 percent. Instead, "stagnation" occurred in the late 1970s and 1980s – long before the largest declines in U.S.

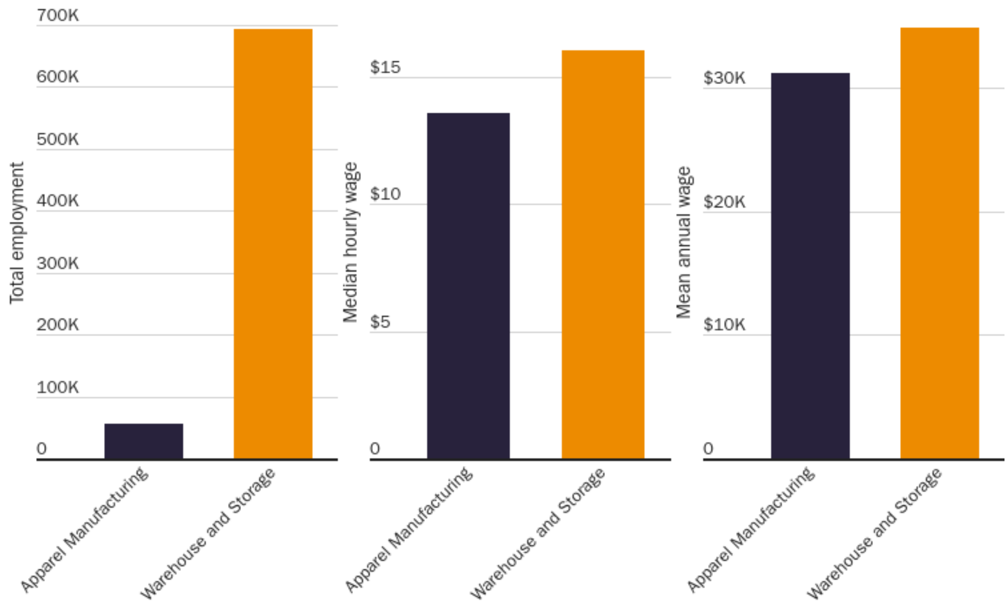
manufacturing jobs and the advent of modern "globalization" (and the last time the United States became enamored with industrial policy). In general, most Americans *are* getting richer over time, though they may be doing so in different jobs.[144] Among them are e-commerce warehouse jobs, which have increased substantially and are increasingly well-compensated. In fact, the average hourly pay for "blue collar" and administrative jobs in the warehousing industry now exceeds pay for those same jobs in both manufacturing and the private sector overall (Table 4), and it now pays more to transport and deliver the proverbial "cheap t-shirt" than it does to make it (Figure 15).

Table 4
2019 U.S. average hourly pay (dollars)

	Warehousing	Manufacturing	Private sector
All occupations	19.77	26.09	25.2
Management Occupations	52.65	65.11	60.26
Business and financial operations	31.99	36.92	37.92
Computer and mathematical occupations	33.56	49.38	45.88
Office and Administrative Support	19.62	20.91	19.46
Installation, Maintenance, and Repair	24.82	25.98	23.95
Transportation and material moving occupations	17.96	17.58	18.01
Laborers and material movers	16.19	15.78	14.64
Packers and Packagers, Hand	15.01	13.94	13.3

Source: U.S. Bureau of Statistics, Occupational Employment and Wage Statistics

Figure 15
Apparel Manufacturing Jobs vs. Warehousing Jobs (2020)



Source: U.S. Bureau of Labor Statistics.
Note: Apparel jobs are in "production occupations" (51-000); warehousing jobs are in "laborers and material movers" (code 53-7060)

The growth of these and other well-paying U.S. services jobs underscores that the manufacturing "wage premium" today is today small, if it exists at all. According to a December 2019 report by the Bureau of Labor Statistics, for example, by the end of 2018 "average hourly earnings of production and nonsupervisory workers in the total private sector had surpassed those of their counterparts in the relatively high-paying durable goods portion of manufacturing" (nondurables pay was even lower).[145] As shown in Table 5 below, moreover, many "blue collar" services jobs in the United States not only have grown faster than manufacturing jobs since 1990 but also have higher hourly earnings and faster wage growth. Most of these jobs are also expected to increase in number in the future.

Table 5

Employment and average hourly earnings of production and nonsupervisory workers in selected industries (1990 vs. 2018)

	1990		2018		Annualized percent change, 1990 to 2018	
Industry	Employment	Average hourly earnings	Employment	Average hourly earnings	Employment	Average hourly earnings
Total private	73,721,000	$10.20	104,319,000	$22.71	1.2%	2.9%
Manufacturing	12,669,000	10.78	8,899,000	21.54	-1.3	2.5
Durable goods	7,397,000	11.40	5,463,000	22.51	-1.1	2.5
Wood products	451,500	8.82	319,000	17.88	-1.2	2.6
Nonmetallic mineral products	413,200	11.11	309,900	21.41	-1.0	2.4
Primary metals	525,100	12.97	293,600	23.31	-2.1	2.1
Fabricated metal products	1,190,100	10.64	1,084,900	20.55	-0.3	2.4
Machinery	938,900	11.73	718,200	23.06	-1.0	2.4
Computer and electronic parts	980,200	10.89	613,100	25.09	-1.7	3.0
Electrical equipment and appliances	465,200	10.00	260,500	20.59	-2.0	2.6
Transportation equipment	1,473,400	14.44	1,188,300	26.32	-0.8	2.2
Motor vehicles and parts	869,500	15.00	778,700	22.77	-0.4	1.5
Furniture and related products	475,200	8.53	291,500	17.86	-1.7	2.7
Miscellaneous durable goods	484,200	8.87	384,100	19.14	-0.8	2.8
Nondurable goods	5,272,000	9.87	3,436,000	19.96	-1.5	2.5
Food manufacturing	1,165,000	9.04	1,271,500	17.49	0.3	2.4
Textile mills	417,900	8.17	87,700	16.46	-5.4	2.5
Textile product mills	194,900	7.37	85,600	15.31	-2.9	2.6
Apparel	805,200	6.22	80,900	15.32	-7.9	3.3
Paper and paper products	493,200	12.06	276,100	21.88	-2.1	2.2
Printing and related support activities	597,600	11.11	294,900	18.74	-2.5	1.9
Petroleum and coal products	97,500	17.00	77,400	40.32	-0.8	3.1
Chemicals	620,300	12.85	547,700	25.46	-0.4	2.5
Plastics and rubber products	646,700	9.76	548,100	18.49	-0.6	2.3
Miscellaneous nondurable goods	233,800	10.28	165,700	20.11	-1.2	2.4
Mining and logging	538,000	13.40	544,000	28.30	0.0	2.7
Construction	4,115,000	13.42	5,438,000	27.74	1.0	2.6
Wholesale trade	4,167,500	11.55	4,698,000	25.18	0.4	2.8
Retail trade	11,311,000	7.71	13,529,200	15.91	0.6	2.6
Transportation and warehousing	2,943,200	12.5	4,721,000	21.84	1.7	2.0
Utilities	584,900	16.14	444,700	36.77	-1.0	3.0
Information	1,866,000	13.4	2,278,000	31.93	0.7	3.1
Financial activities	4,973,000	9.98	6,637,000	26.94	1.0	3.6
Credit intermediation and related services	1,808,100	9.06	2,015,000	23.72	0.4	3.5
Real estate	849,100	8.71	1,255,800	21.69	1.4	3.3
Rental and leasing	415,000	8.49	458,400	20.45	0.4	3.2
Professional and business services	8,915,000	11.15	17,123,000	26.81	2.4	3.2
Professional and technical services	3,499,800	14.00	7,255,900	35.41	2.6	3.4
Management of companies and enterprises	1,279,900	11.11	1,540,200	28.86	0.7	3.5
Administrative and waste services	4,135,100	8.48	8,326,700	18.32	2.5	2.8
Education and health services	9,784,000	9.98	20,788,000	23.65	2.7	3.1
Healthcare	7,344,400	10.42	14,121,200	25.92	2.4	3.3
Social assistance	966,900	6.99	3,478,400	14.84	4.7	2.7
Leisure and hospitality	8,299,000	6.02	14,382,000	13.87	2.0	3.0
Other services	3,555,000	9.08	4,839,000	20.78	1.1	3.0

Source: U.S. Bureau of Labor Statistics.
Note: Numbers are not seasonally adjusted

BLS does report that manufacturing workers continue to have higher weekly earnings, but only because "workers in manufacturing have had to work more hours per week to make up for their relative weakness in hourly pay." The report adds that "employment has declined across virtually all of the component industries in manufacturing since 1990," and that "manufacturing hours show greater volatility from month to month."

In the face of these realities, manufacturers routinely report having difficulty attracting workers, even when offering higher wages – consistent with the aforementioned data on labor force participation and job openings. Prior to the pandemic, for example, finding workers was consistently the biggest problem that manufacturing employers reported to the Federal Reserve's *Beige Book* survey, and the Department of Defense explained in its 2019 *Industrial Capabilities* report that one of the defense industrial base's biggest needs was "increasing the prestige of manufacturing as a profession in order to inspire more prospective workers to choose it as a career."[146] Meanwhile, *Bloomberg* reported in 2019 that furniture manufacturers in trade-impacted Hickory, NC could not find local workers willing to do the "physically demanding, sometimes risky work" – even with $2,000 hiring bonuses, $35/hour wages, and a local unemployment rate of 4.3 percent.[147] The *Wall Street Journal* found a similar dynamic nationwide in January 2021: despite a red-hot sector and increasing wages, manufacturers reported difficulties in finding qualified workers – in part due to competition from the aforementioned warehousing jobs – and had resorted to waiving drug-use restrictions and tapping local jails' work-release programs.[148]

Finally, it is essential to note that the United States has been trying to increase manufacturing jobs for decades with little avail. As a 2013 Congressional Research Service report concluded about the state of American manufacturing, "Although Congress has established a wide variety of tax preferences, direct subsidies, import restraints, and other federal programs with the goal of retaining or recapturing manufacturing jobs, only a small proportion of US workers is now employed in factories."[149] This again indicates that, even if manufacturing jobs deserved to be saved, U.S. industrial policy would be unable to achieve that objective.

Perhaps for these reasons, even some industrial policy advocates have stopped citing manufacturing jobs as a core industrial policy objective.[150]

Living Standards

American living standards also cannot justify U.S. industrial policies. In terms of basic necessities like food, clothing and home goods, Americans today are absurdly rich as compared to only a few decades ago. According a 2016 report from Southern Methodist University, the share of American households with access to telephones or cell phones, electricity, air conditioning, home appliances, TVs, computers and other common household goods was at or approaching 100 percent.[151] Research from economist Bruce Sacrecdote found that the consumption gains for below-median income families to be particularly impressive: low-income consumption (adjusted for inflation) increased between 62 percent and 164 percent between 1960 to 2015, not fully accounting for improvements in quality (which in some cases, such as cars and homes, have also been substantial).[152] Accounting for these consumption improvements also dramatically narrows inequality, especially for single parents.[153]

The improving quality of life for low- and middle-income Americans has not been fueled by new debt but instead by a combination of higher incomes (discussed above) and lower prices. According to the Cato Institute's Marian Tupy, for example, the average amount of time that an unskilled American worker had to work to earn enough money to buy a long list of everyday items declined by 72 percent since the late 1970s, when manufacturing jobs were at their zenith.[154] That means that for the same amount of work that allowed an unskilled worker to purchase one item in 1979, he or she could buy 3.56 items in 2019 (on average). Tupy has found similarly impressive gains for food[155], helping to explain why food insecurity reached an all-time low before the pandemic hit.[156] (The United States' poverty rate also hit a record low in 2019[157], and one recent study found that only 2 percent of America was living in poverty as it was defined in 1963, when it was almost 20 percent.[158]

Of course, some consumption challenges remain, particularly in health care, higher education, and housing. However, each of these sectors is already highly subsidized, protected, and regulated, and new industrial policies targeting them – especially trendy "worker-centric" approaches – could just as easily raise prices and discourage innovation as the opposite. Market-oriented improvements to tax, trade, immigration, and regulatory policy are far more likely to improve these sectors – and thus American living standards – than any new industrial policies targeting them.

Communities

Finally, industrial policy would not solve the problems of certain struggling communities in the United States. To begin with, most American localities once centered around low-skill manufacturing have since moved on and are doing well today. A 2018 Brookings Institution report, for example, found that 115 of the 185 U.S. counties with a disproportionate share of manufacturing jobs in 1970 had "transitioned successfully" from manufacturing by 2016.[159] Forty of the remaining 70 "older industrial cities," moreover, exhibited "strong" or "emerging" economic performance. Overall, only 30 of 185 manufacturing communities were struggling. Anecdotal evidence reiterates these findings: towns, such as Greenville-Spartanburg, SC or Pittsburgh, PA, that once depended on low-skill manufacturing have since adapted and are now home to thriving companies and modern workforces. The contrast between these localities and those still reeling from decades-old shocks indicates that the latter's problem is not a lack of federal industrial policy, but instead local policies and these specific communities' inability to adjust to global economic forces *and* competition from other states.

Second, as the Peterson Institute's Adam Posen recently explained, "there are precious few examples of a government successfully reviving a community suffering from industrial decline."[160] He cites failed U.S. efforts to revive the Massachusetts textile towns of Lawrence and Lowell, and similar efforts in the Midwest. Then there are the continued struggles of former steel town Youngstown, Ohio: "A succession of presidents has promised—and failed—to turn around Youngstown, which, despite all the political attention and federal dollars lavished upon it, doesn't have a supermarket in the residential neighborhoods closest to downtown."[161]

Posen details similar failures to revive struggling communities or regions in Germany, Italy, Japan, the United Kingdom, and even China – "a country that has protected heavy industry on an unprecedented scale for years on end, has run substantial manufacturing trade surpluses, and has a government willing to restrict internal migration and locate industries by edict."[162]

Thus, leaving aside whether national economic policy should relieve states and towns of their responsibilities to create viable commercial centers, little evidence indicates that it can.

Do Other Countries' Industrial Policies Demand U.S. Industrial Policy?

Finally, the industrial policy experiences of other countries, particular China, cannot justify similar policies in the United States. Significant political and economic differences limit the extent to which these experiences can inform U.S. industrial policy efforts. Regardless, countries' industrial policy successes have been exaggerated, while numerous failures have been ignored. This includes China, which has commonly been cited to justify new U.S. industrial policy yet has a spotty industrial policy record and faces numerous economic challenges in the years ahead – some caused by its own industrial policy efforts.

The Perils of Cross-Country Comparison

In general, real or perceived industrial policy successes in other countries cannot inform whether similar results are possible in the United States or whether the federal government should adopt "industrial policy" broadly defined. As noted above, for example, reviews of the economics literature conclude that the empirical studies of industrial policy are limited and, of the few that have been published, primarily assess specific cases, industries, and policy episodes, and that these papers cannot therefore predict whether the analyzed cases would translate to the United States. As José Luis Ricón Fernández explained, "If there is one conclusion from the recent empirics of [industrial policy] it's that it's pretty much dependent on which industry, which country, in which period of development it is applied."[163]

This challenge is particularly significant for proposed U.S. industrial policies, given our political system and the special obstacles that industrial policies face here. As economist Nathan Lane explained in 2020 after reviewing the academic literature, "Without a doubt, future research must do more to understand the interaction between political economy and industrial policy. Because industrial policy is state policy, its success, scope, and efficacy is sensitive to institutional context."[164] He adds that, thus far, "surprisingly few empirical papers explore the political endogeneity of industrial policy, and that "the relationship between the success of industrial policy and regime type is still an open question." [165]

As noted above, the U.S. political system is particularly susceptible to public choice problems due to the short duration of many elected federal positions and our well-developed lobbying and interest group system. One would also need to consider the U.S.-specific laws and regulations, such as Buy American restrictions and NEPA, and the sheer size and diversity of the

U.S. economy (as opposed to, say, Israel) – both of which would further diminish assertions that industrial policy can "work" in the United States simply because specific programs worked in other countries.

Industrial policy successes abroad are also routinely exaggerated. Numerous analyses, for example, have punctured the myth that Japanese industrial policy was primarily responsible for the country's impressive growth and productivity in the 1970s and 1980s.[166] As the *Wall Street Journal* reported in 2002, Japan's own "Ministry of Finance admitted that the interventionist and protectionist policies of the Ministry of International Trade and Industry eroded the competitiveness of the industries the government had sought to support. 'The Japanese model was not the source of Japanese competitiveness but the cause of our failure.'"[167] Lach's 2003 assessment of much-heralded R&D subsidies for Israeli manufacturers found such funds did benefit small firms but had negative effects on large firms, and, because most subsidies went to the large firms, they generated statistically insignificant improvements in company-financed R&D.[168]

In his 2019 book, *Free Trade and Prosperity*, New York University's Arvind Panagariya shows that the supposed industrial policy success stories of Taiwan and South Korea, both of which experienced rapid, manufacturing-led economic growth in the mid to late 20th century, are less accurate than alleged:

- Taiwan's growth should be attributed to a general shift in trade policy away from import substitution towards trade and investment liberalization (particularly for industrial inputs), and to various domestic policies, such as political stability, labor market flexibility, macroeconomic stability, infrastructure expansion, and secondary education.[169] Government intervention, moreover, did not cause economic outcomes "to deviate significantly from what a neutral policy regime would have produced."

Instead, "sectors that showed the best performance on the export front were invariably labor intensive and were not subject to selective targeting" via industrial policy, and the public sector's share of manufacturing output declined significantly over the growth period examined.[170]

- The Korean government intervened more heavily in its economy, promoted exports, and maintained import restrictions in the 1950s through the 1970s. However, "calculations show that when the economy-wide implication of all interventions are considered, the policy regime exhibited a slight bias in favor of exports relative to what would have prevailed under free trade."[171] In other words, the overall industrial policy effects were modest. Moreover, the exported goods that grew rapidly during the 1960s – plywood, woven cotton fabrics, clothing, footwear, and wigs – were labor intensive and not subject to state targeting.[172] The Korean government also implemented domestic policies similar to those in Taiwan, and pushed industrial targeting in a "very small number of sectors." The government pursued greater targeting of heavy and chemical industry (HCI) between 1974 and 1982, but supported industries performed poorly during this period, with relatively low total factor productivity as compared to unsupported industries, and the nation's overall GDP growth rate was significantly below that achieved during the previous, less-interventionist period. Economic growth returned to this level and HCI industries' performance improved only after the government in 1983-95 ended the HCI drive, ceased promoting strategic industries, and liberalized both import restrictions and its financial sector.[173]

In both cases, Panagariya's evidence leaves those crediting industrial policy with Taiwan's and Korea's growth to argue not that government interventions boosted growth above that which a more liberalized regime would have produced, but instead that such benefits cannot be dismissed as implausible.[174] Such a standard is hardly a ringing endorsement of industrial policy, but even it is too kind, given that – as Panagariya also shows – the less interventionist Singapore, Hong Kong, and Taiwan grew faster than the more interventionist Korea.[175] Indeed, a 1991 analysis from Jaime de Melo and David Roland-Holst finds that Korea's industrial policies in the 1970s erected barriers to entry and allowed incumbent firms to exploit their policy-induced market power, and that additional liberalization would have increased national welfare by as much as 10 percent of GDP.[176]

Finally, industrial policy successes must be balanced against the numerous failures of such policies in countries around the world. This includes not only the U.S. policies noted in this paper, but also well-known debacles abroad, such as British aviation (e.g., the Concorde), computer, and automotive (e.g., British Leyland) efforts in the 1960s and 1970s; French "national champions" in computers and machine tools during the same period[177]; numerous European technology projects in the 1990s and 2000s[178]; Argentina's national smartphone initiative (and several other consumer electronics failures)[179]; Tunisia's "Ben Ali" firms (named after the country's leader, who owned most of the favored firms)[180]; India's Planning Commission and License Raj between the 1950s and early 1990s[181]; and numerous iterations of Brazilian automotive policy.[182] (Other, lesser-known industrial policy failures are also plentiful.[183])

The "China Threat"

The newfound push for American industrial policy has been motivated in large part by China, with U.S. advocates, including high-level officials in the Biden administration, citing China's growing economic and geopolitical power – both supposedly fueled by Chinese government industrial policy – as necessitating urgent federal government action.[184] China's recent and troubling embrace of illiberalism and expansionism, as well as pandemic-induced challenges to U.S. and global supply chains, have amplified these views and lead to a bipartisan push for American industrial policy to counter the "China threat."

However, while China's deepening authoritarianism surely warrants criticism and U.S. attention, the view of Chinese industrial policy as an urgent threat to the United States – one justifying a broad rejection of free markets and strong embrace of American industrial policy – is mostly misguided. Similar to its Asian neighbors, China's rapid growth since the 1980s can be largely attributed to market-based domestic reforms following decades of self-imposed poverty and its general liberalization of trade and investment policy, including its accession to the WTO, *not* industrial policy. Despite this "catch-up growth," moreover, China still lags the United States in both GDP per capita and many important industries. Chinese industrial policy may have helped some other industries, perhaps even overtaking Western competitors in the process, but the cost of doing so was enormous, and those policies have introduced systemic challenges that could hamper future growth. China also faces several other headwinds, financially and demographically, that could derail its ascension to the top of the global economic order.

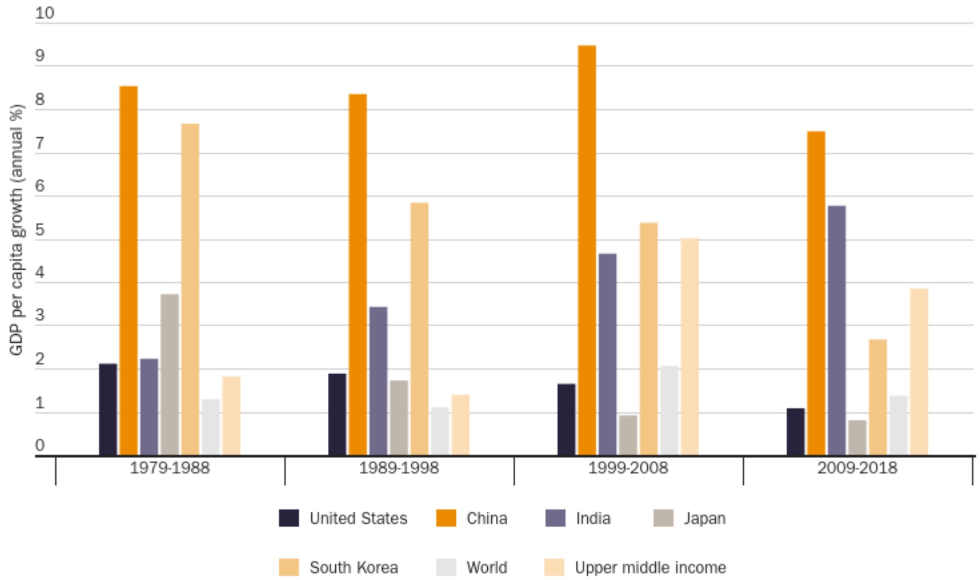
Combined, these facts rebut the all-too-common perception in the United States of China as an unstoppable economic juggernaut that – fueled by industrial policy – will inevitably overtake the United States unless we adopt similar policies here. U.S. industrial policy should be considered on the merits, not out of an overwrought fear of the "China Threat."

China's Rise and Subsequent Embrace of Industrial Policy

China's economic rise is undeniable. Growth in GDP per capita over the past four decades has been relatively steady, with a slight decline over the past decade (see Figure 16), at rates easily surpassing the United States and other countries. Furthermore, China's share of global trade grew from 3 percent in 1995 to 12 percent in 2018, and China is now the world's largest manufacturing nation, with growing high-tech and internet industries. Over the same period, China became the world's second largest economy and the largest trading partner of many economies' including the European Union.[185]

Figure 16

Growth in GDP per capita, select countries and periods



Source: The World Bank

Little of China's impressive historic growth, however, can be attributed the nation's industrial policies. Instead, China's economic out-performance began during its period of reform and opening up in 1978 (starting from a very low, communism-induced baseline), followed by its integration into the multilateral trading system—i.e., the World Trade Organization—in 2001 and the requisite structural and economic changes that said accession required. For example, a 2012 study by the University of Toronto's Xiaodong Zhu concluded that China's growth "has been driven by productivity growth rather than by capital investment," which can be attributed to "gradual and persistent institutional change and policy reforms that have reduced distortions and improved economic incentives."[186] Numerous other economists have found that most of China's export competitiveness stemmed from internal, market-based reforms—on property rights, privatization, price controls, trading rights, and import liberalization, for example – often in response to new WTO commitments.[187]

Along the same lines, Barry Naughton, an economist specializing in China and author of *The Rise of China's Industrial Policy*, explained that China's impressive pre-2010 economic growth did *not* result from the type of top-down industrial planning and state intervention that has become prevalent in China today:

> [T]here is a huge disconnect between the success that we attribute to the Chinese economy today and the orientation of Chinese policy today. China's emergence as an economic and technological super-power is due primarily to the policy package that it followed from 1978 through the first decade of the 21st century, that is, until about 2006-7. China's policy package today —that is, the policies that started tentatively after 2005 but were fully in place by 2008-2010— are radically different. Because of this, it is a mistake to attribute China's success to the policies China is currently following.[188]

By contrast, Naughton agreed with the aforementioned economists – and many others – that the "driving force of industrial development" in China was "market-oriented economic reform,"[189] with the government primarily relying on market forces and minimizing direct government interventions[190] and economic success particularly tied to China's WTO entry. "How much of that success could be attributed to industrial policy and planning?," Naughton asks, "The answer is simple: none."[191]

As Naughton notes, the Chinese industrial policies that American critics today target only began in 2006 when Beijing adopted plans focusing on innovation and seeking to match the industrial capabilities of advanced economies.[192] The 2008 global financial crisis amplified these efforts, with China by 2010 establishing innovation priorities for "strategic emerging industries" programs and desiring to surpass, not merely match, other nations. [193] Five years later, China adopted a new wave of industrial policies – focused on emerging and general-purpose technologies and supported by new public-private "industrial guidance funds" (IGFs) – to become a technological frontrunner.

Today, Chinese industrial policy covers a wide range of government actions, including direct investments, budgetary support, cheap loans, tax breaks, and regulatory preferences, and it is therefore difficult to estimate these initiatives' total price tag.[194] However, the IGFs offer some insights into the magnitude of China's industrial policy: by June 2020, IGFs had raised approximately 40% ($672 billion) of a targeted $1.55 trillion[195], the majority of which (61% or possibly higher) is dedicated to high technology and advanced manufacturing, with infrastructure, agriculture, and services also prioritized.[196]

Chinese Industrial Policy's Mixed Record

While American politicians and pundits often portray Chinese industrial policies as uniformly successful, the reality is much more complicated. Surely, not all Chinese industrial policies have been costly failures. The China State Grid Corporation, for example, developed ultra-high-voltage transmission projects and now is a world leader in the field.[197] Similar, industrial planning and subsidies have helped cultivate China's renewable energy sector, [198] which now leads the renewable energy output world-wide. China's industrial policy in steelmaking, high-speed rail, and machinery has also helped the nation become an economic power in those industries.[199]

However, Chinese industrial policy "successes" are matched by failures. Perhaps the most notable example is China's unsuccessful decades-long quest to be a global leader in semiconductors, an industry considered by U.S. industrial policy advocates as "too critical to fail."[200] Despite receiving billions of dollars in government funding and being prioritized in government policy documents, such as the Guidelines to Promote a National Integrated Circuit Industry, Made in China 2025, and the Technical Area Roadmap[201], China's domestic players still, by most expert accounts, decades behind the world's best producers.[202] Its share of the global installed capacity jumped from 1 percent in 2000 to 15 percent by 2020, but three-fourths of that capacity is owned by foreign multinationals.[203]

Government support also has not stopped six multibillion-dollar Chinese chip projects from failing over the past two years, and high-profile manufacturers, such as Wuhan Hongxin, Tacoma, and Dehuai, have dissolved or declared bankruptcy. [204] The ones that have survived are still two-to-three generations behind the United Sates (not to mention current industry leader TSMC)[205], and China's national champion, Semiconductor Manufacturing International Corporation (SMIC), is developing facilities to produce chips that "are five to six years behind the industry's leading edge at 10 percent of the volume of the world's leading firm." [206] By contrast, China's major advances have come in less technically-challenging and more labor-intensive "back-end manufacturing," and "fabless" design companies that "have low barriers to entry due to widely available off-the-shelf design tools."[207]

SMIC and other producers also remain heavily reliant on the United States and other countries for semiconductor manufacturing equipment; hence, why Chinese industrial policy is now focused on simply surviving U.S. sanctions, rather than leading the world.[208] According to a 2021 report in Nikkei—

> U.S. research firm IC Insights in January predicted that China's self-sufficiency ratio for semiconductors would be only 19.4% in 2025. This was a slight downward correction after the firm in 2020 predicted the ratio would rise to 20.7% by 2024. It also noted that over half of the ratio was accounted for by mainland China units of overseas manufacturers, such as Taiwan Semiconductor Manufacturing (TSMC), and South Korea's SK Hynix and Samsung Electronics, with the self-sufficiency ratio that involves only Chinese manufacturers estimated at around 10%.
>
> China's government under Xi had put large amounts of subsidies into semiconductor projects across the country until 2020, but the results of the funding were limited, with many projects failing. The government now seldom mentions the 70% self-sufficiency target laid out in its Made in China 2025 industrial policy.[209]

Indeed, industrial policy shoulders much of the blame for the current state of the Chinese semiconductor industry, which features rampant misallocation of resources, ineffective implementation, corruption, and a significant shortage of human capital[210], as well as heavy reliance on well-funded but uncompetitive SOEs.[211] Future success is also far from guaranteed. As Christopher Thomas from the Brookings Institution explained, "most segments of China's semiconductor industry remain behind its foreign competitors, and its efforts to catch up face major economic obstacles."[212]

The aforementioned IGFs, intended to combine government direction with private capital and market forces, also have proven unsuccessful thus far. In particular, they have not met their objective of attracting private investors and instead rely on state-owned entities for funding.[213]

Because of poor management and risk-assessment, moreover, many funds are underinvested, redundant, or wasted on illicit activities.[214] It is also unlikely that these investments, if they materialize, will be profitable because the government is targeting only a 5 percent rate of return in order to focus on "import substitution, acquiring intellectual property, and building a domestic industry" rather than profits.[215] Even these alternative goals, however, could prove to be wishful thinking, because "[p]ast experience indicates that new [general purpose] technologies take decades to spread through the economy, and their impact often comes in ways that were poorly anticipated at the beginning."[216]

Even where Chinese industrial policy has developed a competitive industry, its efforts in electric vehicles (EVs) show that the costs can be astronomical, successes modest, and future, market-based growth uncertain. The Chinese government started providing subsidies to the EV industry in 2009, aiming to develop quality domestic manufacturers and a domestic supply chain ecosystem.[217] These subsidies helped Chinese EVs to go from 10 percent global market share in 2011 to 53 percent in 2019, with 1.5 million EVs sold in China in 2018 alone.[218]

It is estimated, however, that the Chinese government spent nearly *$60 billion* cultivating its EV industry between 2009 and 2017, through a mixture of R&D grants, consumer subsidies, public procurement, and local protectionism. These subsidies may have created an EV market from scratch, but they also "sprouted a litany of problems that made Beijing worried that it was replicating the mistakes in the traditional auto industry." In particular--

> Instances of fraud and collusion were made public by a 2016 government investigation. In several instances, manufacturers received subsidies for vehicles that existed only on paper or that were equipped with batteries that didn't meet subsidy eligibility

> requirements. In some cases, vehicles were sold to companies related to the manufacturer so they could pocket the subsidies….
>
> The cost of subsidies may have been worthwhile if the irrational exuberance that accompanied this "let 100 EV firms bloom" period also led the way in technological superiority. Yet even as registered EV firms mushroomed to more than 400 by 2018, according to some estimates, only about 15% of them are actually manufacturing cars. The vast majority of these firms appears to have either not reached the production stage or have products of questionable quality.[219]

The Chinese government quickly curtailed EV subsidies and "launched a market-based program focused on raising quality and fuel efficiency and relying more on competition."[220] (It is far from certain that the U.S. political system could so quickly permit the same.) The EV sector, however, may not be sustainable in the absence of state interventions, as consumer subsidies alone accounted for one quarter of total EV sales. Indeed, EV sales in China declined by 20 percent in 2019 compared to one year prior, shortly after subsidies to private passenger EVs were terminated in June 2019.[221] Chinese EV companies still lag behind the world's leaders[222], and the United States' Tesla is venerated there.[223]

China's shipbuilding sector offers another example of industrial policy subsidies not commensurate with returns. According to a 2019 study from Panle Jia Barwick and colleagues, Chinese industrial policy generated more production and investment in the domestic shipbuilding industry, but it not only came at a very high cost but also generated "sizable distortions and led to increased industry fragmentation and idleness." The authors estimated that between 2006 and 2013 the Chinese government directed policy support totaling 550 billion yuan (approximately

$80 billion at the time) to the shipbuilding industry, but that these subsidies generated only 145 billion RMB ($21 billion) of net profit for domestic producers. Furthermore, a large share of the subsidies (230 billion RMB / $33 billion) went to global ship owners – of which Chinese shipping companies are a small share – via lower ship prices.[224]

Similar evidence of Chinese industrial policy problems can be found in the domestic aircraft and automotive manufacturing industries,[225] as well as 3G mobile technologies.[226] These and other examples call the overall economic benefits of China's recent embrace of industrial policy into question. Not only do projects' direct costs often outweigh their benefits (if there are any), but the broader costs imposed by China's industrial policies may actually hinder rather than accelerate China's economic development. In particular, China's industrial policies have been shown to create the following problems that hinder stable, long-term economic growth:

- **Resource misallocation.** According to a 2013 government audit, for example, the new energy sector generated 1.6 billion RMB (approximately $258 million) of misallocated funds between 2011 and 2012 alone.[227] A 2021 paper from Chong-En Bai and colleagues finds significant talent misallocation in China, with potential entrepreneurs instead attracted to the large state sector.[228] Given the extent of Chinese industrial policy activities since 2010 (not to mention the Chinese government's penchant for downplaying economic problems in official statistics), the total amount of resource misallocation – capital, labor, materials, equipment, and time – caused by such policies is likely substantial.
- **Corruption.** Corrupt behavior stems from the state's control over resources and financing, and is evident in Chinese sectors such as tobacco, banking, and infrastructure, in which state monopolies dominate.[229] In general, corruption is more prominent in counties with active industrial policies[230], and this is appears to be the

case in China too: according to Transparency International's Corruption Perceptions Index, China ranks 87th out of 180 countries, indicating a fairly high level of corruption.[231] Such corruption slows economic growth and development by thwarting competition, deterring investment,[232] exacerbating market distortions, and reducing tax revenue.

- **Investment bubbles.** Chinese industrial policies also have created investment bubbles and overcapacity in many targeted industries – bubbles that Beijing is now trying to deflate. As already noted, for example, both China's semiconductor and EV industries show signs of irrational exuberance and financially-stressed "paper companies" that will never be productive. The large-scale bankruptcies and business failures associated with Chinese industrial policies contribute to broader financial challenges in China, such as its growing debt load and share of non-performing commercial loans.
- **Overcapacity.** Meanwhile, the subsidized companies that survive may engage in duplicative projects or produce *too many* goods, resulting in overcapacity (where supply exceeds demand) that is evident in China's steel, cement, chemical fiber, aluminum, solar panel, and other industries.[233] This not only threatens China's economy, but also fuels tensions among China's trading partners and generates global economic distortions. Chinese government efforts to rein in overcapacity have thus far had limited success.

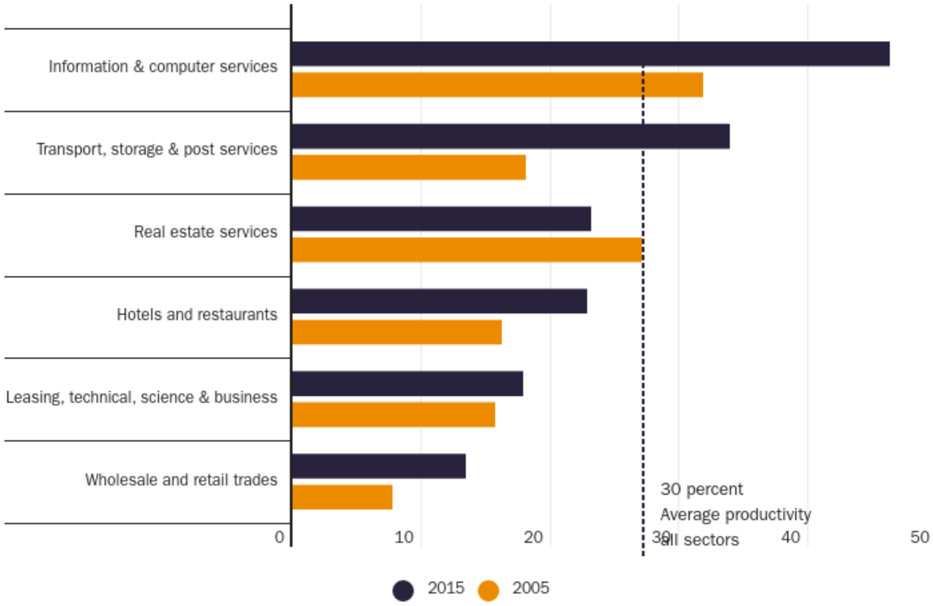
Finally, one must consider whether the United States *could* emulate Chinese industrial policy, even if doing so were desirable. China's industrial policy model is unique: the Chinese government controls a large share of the economy and therefore has an enormous amount of money at its disposal. As Naughton explains, this "puts limits on the degree to which industrial policies can impose costly distortions on the economy."[234] The U.S. system – thankfully – lacks such characteristics and would therefore suffer far more damage from "China-style" industrial policy interventions. As noted above, moreover, the United States also differs from China in that our political system is less tolerant of costly public failures, particularly in the commercial (as opposed to, say, national defense) arena. Popular backlash, which the U.S. system fortunately permits (again, unlike China), would be all but guaranteed.

China's Systemic Challenges

China also faces broader, systemic challenges that call its future global economic dominance into question. First, China is experiencing significant demographic headwinds that will only accelerate in the coming years. Despite relaxing its decades-long family planning policy, China continues to have a falling birth rate. Last year, its population rose to only 1.41 billion from 1.40 billion in 2019, with individuals over 60 now accounting for almost one fifth of the population.[235] An aging China creates pressures on its health care system and the overall economy.[236]

China could offset demographic concerns with rising productivity (it appears uninterested in immigration), but this factor is also lagging – likely due in part to Chinese industrial policy. According to a 2020 International Monetary Fund Report, China's average productivity rate is only a third of that in other developed economies – including Japan, Germany, and the United States.[237]

Figure 17
China productivity, percent of the global frontier level



Source: IMF People's Republic of China: Staff Report for the 2020 Article IV Consultation

A 2014 study published by Europe China Research and Advice Network corroborates the IMF's findings: although Chinese Global 500 firms grew from 3 in 1995 to 89 in 2013, these firms compared unfavorably to their western counterparts, with larger payrolls, less capital intensity (assets / employees), lower profitability, and less innovation capacities.[238]

It is an open question as to whether China will catch more productive developed economies. Productivity growth has stagnated in recent years, with average annual growth dropping from 3.5 percent between 2007 and 2012 to only 0.6 percent from 2012 to 2017.[239] Growth in Total Factor Productivity is now only a third of what it was before the Great Recession, a much sharper decline than other countries.[240] As noted by the *Wall Street Journal*, much of China's productivity slowdown is attributable to the government's "massive stimulus program to prop up economic growth" after the financial crisis, and has further deteriorated under President Xi Jinping.[241] Other contributors include recent government efforts to control private businesses, especially technology firms, and growing bureaucratization, which has confounded central government efforts to implement economic and social reforms that might boost national productivity.[242]

Inefficient SOEs are also a significant cause of China's productivity issues. Despite constituting a smaller share of China's economy today as compared to decades ago, "SOEs are dominant in key industries, including energy, aviation, finance, telecoms and transportation."[243] A 2021 Bruegel study similarly found that "China's competitive environment is generally poor," with Chinese SOEs generally in an "advantageous position" across most economic sectors.[244] However, even though SOEs benefit from privileged access to credit and other resources, they lag in productivity behind privately-owned counterparts by 20 percent.[245] As noted by Cato Institute adjunct scholar Terence Kealey, "as judged by the numbers of patents granted for every unit of investment in R&D, private companies in China are three times more efficient than are state-owned enterprises."[246]

Unfortunately, Chinese SOEs' economic prominence appears to be growing, with the government increasingly favoring these entities[247] while cracking down on private firms and entrepreneurs[248], and limiting foreign investment. As explained by China expert Nicholas Borst, much of SOEs' rise is attributable to Chinese industrial policy: "State-owned firms have been at the forefront of the Chinese government's drive to develop domestic sources of key technologies, such as semiconductors."[249]

Finally (and in part due to the aforementioned issues), China faces a growing debt burden that will, unless tamed, weigh on future growth. China's debt-to-GDP ratio reached approximately 280% in 2020 (295% if foreign debt is included), the majority of which is in the form of corporate bank loans. However, China's banks – long considered tools of Chinese industrial policy (via, for example, low-interest loans to preferred industries) – are showing signs of strain. In 2020, Chinese banks had a record high of $466.9 billion in non-performing assets –

a number that is expected to continue rising in the future.[250] According to the Bank of Finland, moreover, “China was already engaged in efforts to bail out small and medium-sized banks before covid-19 struck,” and stress tests released by People’s Bank of China in November showed that 10 of 30 banks – including all of China’s “systemically critical banks” would fail “even under the mildest stress scenario.”[251]

Chinese government debt may be more manageable (approximately 70 percent of GDP), but is expected to expand significantly in the coming years as the government funds a social safety net for its aging population.[252] (Certain Chinese industrial policy projects, such as high-speed rail, also contribute to China’s growing public debt burden.[253]) As the Bank of Finland analysis put it, “China’s piling on of debt has long raised concerns among observers of the Chinese economy because rapid descents into indebtedness in other countries have typically led to major economic collapse or severe banking crises.” While a crisis seems unlikely in the near term, such concerns are almost certain to weigh on future growth and other government initiatives.

It is possible that China can overcome these economic headwinds and others (e.g., environmental degradation, overseas project failures, restive populations, alienation of foreign firms, and increasing illiberalism[254]). It is undeniably a large economy with an increasingly educated population. But China’s economic challenges, caused in no small part by its relatively recent embrace of industrial policy, argue strongly against the implementation of U.S. industrial policy as a last-ditch effort to counter an unstoppable global hegemon.

Conclusion

Resurgent calls for American “industrial policy” suffer from several flaws. They depend on a malleable definition that prevents legitimate analysis, omit past industrial policy failures, and take credit – often absurdly – for innovations only tangentially related, at best, to government action. They ignore the many economic, political, and practical obstacles that have historically prevented U.S. industrial policies from producing market-beating outcomes. They claim, often without support, to solve problems – "deindustrialization" and declining American innovation; the disappearance of "good jobs"; the erosion of middle-class living standards; and the destruction of American communities – that are often exaggerated or most likely cannot be solved via industrial planning. And they erroneously use the experiences of other countries, particularly China, to justify new American industrial policy.

In reality, industrial policy – properly defined – has an extensive and underwhelming history in the United States, featuring high costs (seen and unseen), failed objectives, and political manipulation. Surely, not every U.S. industrial policy effort has ended in disaster, but facts here and abroad argue strongly against new government efforts to boost "critical" industries and workers and thereby fix alleged market failures. Such efforts warrant intense skepticism – skepticism that today is unfortunately in short supply.

[1] Claud E. Barfield and William A. Schambra, eds., *The Politics of Industrial Policy* (Washington: AEI Press, 1986), p.12. https://www.aei.org/wp-content/uploads/2014/07/-politics-of-industrial-policy_114213281403.pdf?x88519.

[2] Claud E. Barfield and William A. Schambra, eds., *The Politics of Industrial Policy* (Washington, AEI Press: 1986), p.266. https://www.aei.org/wp-content/uploads/2014/07/-politics-of-industrial-policy_114213281403.pdf?x88519.

[3] Claud E. Barfield and William A. Schambra, eds., *The Politics of Industrial Policy* (Washington, AEI Press: 1986), p.18. https://www.aei.org/wp-content/uploads/2014/07/-politics-of-industrial-policy_114213281403.pdf?x88519.

[4] Adam Thierer, "On Defining 'Industrial Policy'," *The Technology Liberation Front*, September 3, 2020, https://techliberation.com/2020/09/03/on-defining-industrial-policy/.

[5] Richard R. Nelson and Richard N. Langlois, "Industrial Innovation Policy: Lessons from American History," *Science* 219, no. 4586 (1983): 816, https://www.jstor.org/stable/1689818. "It is important to recognize that the efficacy of government procurement-related R&D depends on the knowledge advantage that comes from the government's position as a user and on the political legitimacy of its mission as justified on grounds other than spillover benefits. This conclusion thus does not extend to government procurement projects, the justification of which is the spillover itself or in which the procurement is intended to make a market for the technology. (The [failed] supersonic transport (SST) project remains the best case in point.)"

[6] Otis L. Graham, *Losing Time: The Industrial Policy Debate* (Cambridge, MA: Harvard University Press, 1992), pp. 65–66.

[7] Otis L. Graham, *Losing Time: The Industrial Policy Debate* (Cambridge, MA: Harvard University Press, 1992), pp. 65–66.

[8] Erik R. Pages, *Responding to Defense Dependence: Policy Ideas and the American Industrial Base* (Westport, CT: Prager, 1996), p. 21

[9] Uri Dadush, "Industrial Policy: A Guide for the Perplexed," Carnegie Endowment for International Peace Policy Brief 16/05, January 2016, https://carnegieendowment.org/2016/02/01/industrial-policy-guide-for-perplexed-pub-62660#:~:text=For%20the%20purpose%20of%20this,development%20of%20the%20wider%20economy.

[10] Arthur Herman, "America Needs an Industrial Policy," *American Affairs* 3, no. 4 (Winter 2019), https://americanaffairsjournal.org/2019/11/america-needs-an-industrial-policy/.

[11] Michael Munger, "Is it Time for an American Industrial Policy? (Finale)," Pairagraph, March 27, 2020, https://www.pairagraph.com/dialogue/747739cec52a4a908f36667ec2c9aa8c/4.

[12] Barry Naughton, *The Rise of China's Industrial Policy, 1978 To 2020* (Mexico City: National Autonomous University of Mexico, 2021), p. 19. "Industrial policy is any type of selective, targeted government intervention that attempts to alter the sectoral structure of production toward sectors that are expected to offer better growth than would occur in the (non-interventionist) market equilibrium."

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