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Industrial Policy Is Back

Geopolitics is driving new interest in industrial policy.

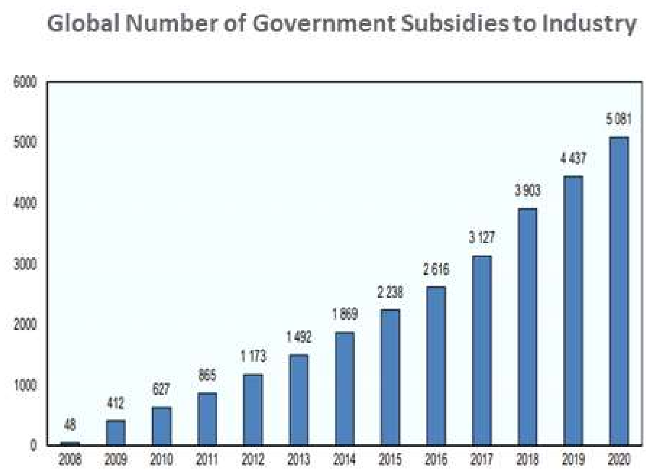
I recently re-watched the film *Ford v Ferrari*. The plot highlights a series of tradeoffs: individuality vs. conformity, engineering vs. marketing and risk vs. reward. It's well-written, and well-acted.

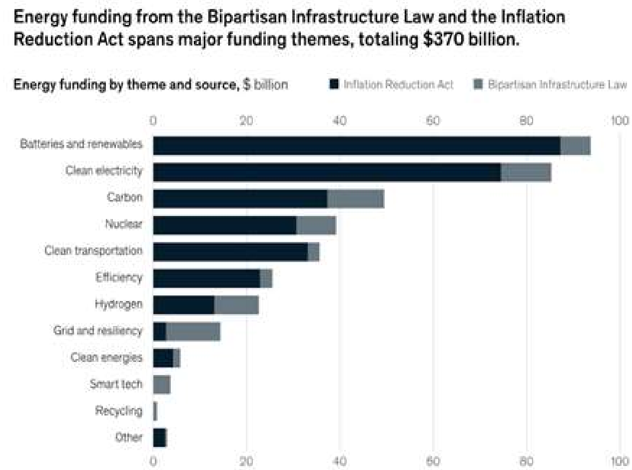
Another contrast that serves as a backstory is nationalism vs. globalism. When emissaries from Detroit attempt to purchase Ferrari, they run into state-sponsored obstacles that scuttle the deal. The bad feelings that emerge from the negotiations provide the fuel for the duel on the track.

In the decades that followed Ken Miles' run at LeMans in 1966, state-directed industrial policy and the promotion of domestic providers fell out of favor. But today, those practices are attracting renewed interest, reshaping the world economy.

Stagnation during the 1970s prompted a re-evaluation of government involvement in economies. Markets came to be seen as better allocators of capital, and they promoted an efficiency that often eluded state-run enterprises. Having national champions across all industries was seen as unnecessary: the 1980s management guru Peter Drucker urged firms to "Do what you do best and outsource the rest."

Trade pacts and policies were crafted with this mantra in mind. The General Agreement on Tariffs and Trade, adopted after World War II, frowned on countries that owned, subsidized or favored domestic producers. The World Trade Organization (WTO) took over in 1995, and served as a governing body to adjudicate grievances on this front. Trade liberalization and privatization were often required of nations receiving financial assistance from the International Monetary Fund in the 1980s and 1990s.





Sources: OECD, McKinsey

China's managed capitalism has been a source of stress for a number of years. Its entry to the WTO in 2002 was contingent on reduced subsidies for state-owned enterprises and increased market access for foreign providers. China's lack of follow-through on these pledges has been the subject of a range of grievances filed with the WTO's dispute settlement panel.

The 2008 financial crisis shook belief in market mechanisms and produced calls for greater government involvement in the economy. Regulation rose, and economists began to question the accepted wisdom that governing best was governing least. Among the more influential was Mariana Mazzucato, whose 2011 book ***The Entrepreneurial State*** argued that the public sector is often underappreciated as a promoter of innovation.

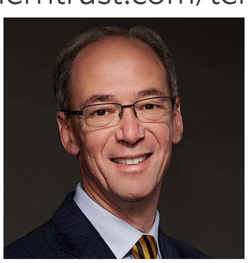
Mazzucato cited the examples of the internet and GPS, foundational innovations that were developed under the auspices of government agencies. Without them, many breakthroughs in computing and communication would not have been possible. While pharma companies pour substantial resources into drug research, new medications are often developed with grants and support from public health authorities.

States can take a long-term, strategic, not-for-profit view that might be more difficult for public companies to sustain. Governments are typically responsible for infrastructure, which is essential to industrial development. On this front, the applications of public/private partnerships (PPPs) have advanced significantly over the past two decades. This model attempts to capitalize on the best that both sides have to offer, while delivering economies to taxpayers and returns to investors.

Governments around the world are presently leading the way in promoting energy transition, creating more secure supply chains, and supporting the application of artificial intelligence. As an example, legislation passed in the United States during the past two years offers incentives to broaden the market for electric vehicles, produce energy from alternative sources and improve broadband access across the country. This week's executive order prohibiting U.S. firms from investing in Chinese providers of advanced computing is the latest step in the battle for primacy in that space.

Critics of industrial policy highlight three main concerns. First, government sponsorship of industry is anti-competitive, favoring some providers over others. The U.S. Inflation Reduction Act favors American producers of EVs over those from overseas, which prompted threats of retaliation from the European Union. Secondly, governments are still bureaucracies that aren't known for being nimble. And finally, governments change periodically, and politics can often usurp economics in decision-making. Regime shifts can create roadblocks, detours, or U-turns in the journey to economic progress.

Fifty years ago, Ford Motor Company was one of the largest bureaucracies on the face of the earth. And yet, it was able to develop the GT40 that had great success on a global stage. Proponents of industrial policy are hoping for similar results.



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