Industrial Policy and Global Cooperation in the Context of Major Power Competition

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Abstract: *Recently, the China Finance 40 Forum and the China Center for International Economic Exchanges jointly hosted the 6th Bund Summit, where a closed-door seminar was held on Industrial Policy, Trade Conflict and Global Cooperation.*

International experts noted that trade has always been a sensitive issue in the United States. When facing strong competitors such as China, politicians tend to politicize trade issues by exploiting the public's misunderstandings about trade. Regarding China's industrial policy, the main concern in the U.S. is that subsidies to certain industries might crowd out resources from other sectors, posing risks of inefficiency and market distortion. European experts stated that the current geopolitical environment makes industrial policies discriminatory, and Europe and other countries might actually benefit from major powers' trade conflicts.

Industrial policy can lead to both positive and negative spillover effects. It might promote reasonable policy objectives and drive competition and technological progress, but excessive or inappropriate industrial policies can also lead to resource misallocation and loss of social welfare. The experts agreed that countries should learn from history to protect the global trade system. WTO reform needs to be depoliticized to some extent, emphasizing dialogue and cooperation; industrial policies should avoid market distortions and the increase of trade barriers; in the context of insufficient carbon tax efforts, countries can substitute tariff policies by subsidizing new energy vehicles.

I. Global Trade and Industrial Policy Under Geopolitical Conflicts

Charlene Barshefsky, the former U.S. Trade Ambassador and Chair of Parkside Global Advisors in the United States, mentioned that trade has always been a sensitive issue in the U.S., especially after the North American Free Trade Agreement (NAFTA). The losses from trade are often highly concentrated, such as job losses in certain industries, while the benefits of trade are highly dispersed across the economy, making it difficult for individuals to directly feel the benefits of trade. People are more likely to blame their economic hardships on trade rather than on technological progress or productivity improvements. When facing strong competitors like China, the U.S. has taken a more conservative and protectionist stance politically, such as erecting barriers and restricting trade. Politicians often exploit public misunderstandings about trade to politicize trade issues, turning trade into a "flypaper" to which all grievances are attached. People are persuaded to believe that trade is the culprit and that a particular country is the root of the problem, while overlooking the real causes of job losses, namely advancements in technology and productivity.

Wei Shangjin, a tenured professor at Columbia University, pointed out that the concept of industrial policy was actually laid by the United States, tracing back to Alexander Hamilton, the first U.S. Secretary of the Treasury. Successive U.S. presidents have actively used subsidies, tariffs, and restrictive policy tools to guide economic structural changes. A major concern for the U.S. regarding China's industrial policies is that China combines American industrial policy ideas with the Chinese governmental system, which may be somewhat extreme, posing risks of inefficiency and market distortion. For instance, China's shipbuilding industrial policy has transformed the country from a minor ship-producing nation 20 years ago to the world's largest commercial shipbuilder and exporter, a tremendous success story. However, from an economic opportunity cost perspective, to develop its shipbuilding industry, China has invested heavily in resources, potentially suppressing many other industries and economic sectors. The same is true for China's policies supporting innovation. Although the number of Chinese patents has grown rapidly, this does not necessarily indicate real innovative output.

Daniel Gros, Director of the Institute for European Policymaking at Bocconi University in Italy, believes that under the current geopolitical environment, many trade policies often exhibit discrimination, and countries like Europe may benefit from this process. For example, imposing tariffs on Chinese new energy vehicles instead of taxing cars from all countries equally. In this sense, trade policies motivated by geopolitical reasons are more costly for all countries choosing to implement such policies, as this leads to trade diversion. Other countries and regions in the world often benefit from trade wars between major powers, including but not limited to Europe or Vietnam.

II. Positive and Negative Spillover Effects of Industrial Policy

Industrial policy has been controversial since its inception, potentially bringing both positive and negative spillover effects. On one hand, industrial policy may promote reasonable policy objectives and drive competition and technological progress. On the other hand, excessive or inappropriate industrial policies can lead to resource misallocation and loss of social welfare.

Takehiko Nakao, advisor at Sumitomo Corporation and chairman of the Center for International Economy and Strategy, mentioned that certain industrial policies could foster technological advancement and competition, resulting in positive spillover effects. Due to the low marginal costs in technology companies and the semiconductor industry, significant economies of scale are present. Once a company gains a certain market share, a "winner-takes-all" scenario could form. Thus, promoting the development of certain industries to compete internationally is understandable. However, the overuse of industrial policies, especially in protecting domestic industries and manufacturers, is inappropriate, although some workers may need attention and support.

Annabel Gonzalez, Deputy Managing Director of the Inter-American Development Bank and former Deputy Director-General of the World Trade Organization, believes that subsidies, as an important tool of industrial policy, have had positive effects in supporting the development of necessary areas, but they also increase fiscal pressure and crowd out resources for other urgent needs. For example, on the environmental level, years of subsidies for fisheries, fossil fuels, and agriculture have damaged biodiversity and the climate. For non-subsidized economies, subsidies can distort trade and investment, increasing feelings of unfairness, especially when developed countries use subsidies to create a competitive environment favorable to themselves. This situation also triggers a "subsidy race" and protectionism risks among nations. Other countries might take countermeasures to offset the negative spillover effects of subsidies from other countries, leading to increased costs, triggering anti-dumping measures, or escalating trade disputes, further impacting global trade and investment. These frictions and barriers may actually undermine the original goals of the subsidies, such as green subsidies causing frictions that could slow down or increase the cost of emission reduction processes.

III. Policy Recommendations

International experts unanimously believe that the exchange of trade and ideas is a fundamental element of global development. Despite the political difficulties of handling trade issues, nations should learn from history to protect the global trade system. Leaders from the United States, China, and other countries have significant responsibilities in maintaining the trade system. Countries should accurately assess national security threats and avoid increasing trade barriers by expanding the concept of national security, which could undermine the global trade system.

Gonzalez noted that the reform of the World Trade Organization needs to be depoliticized to some extent, emphasizing dialogue and cooperation, and a deeper understanding of the key issues faced, especially how to balance green subsidies and trade rules appropriately. Current trade frictions face core issues, such as the lack of specific rules for subsidies to state-owned enterprises and the market distortions they may cause, especially in non-market economies. At the same time, large-scale subsidy policies in developed countries prevent many developing countries from participating in this "subsidy competition" due to a lack of fiscal space, forcing them to be mere observers. If there is a desire to integrate developing countries into the global trade system, their concerns must be addressed and resolved. Therefore, subsidy agreements need to be scrutinized and monitored from multiple perspectives. Additionally, the European Union could also initiate dialogues on industrial policy within the WTO framework. Although drafting new rules may be challenging, there is much foundational work that can be undertaken to lay the groundwork for future goals.

Jeffrey Schott, a senior fellow at the Peterson Institute for International Economics, believes that the key issue in today’s industrial policies and energy transition is how to achieve necessary economic and environmental goals while avoiding market distortions and the increase of trade barriers. Currently, national security is closely linked with economic security, and many policies aim to protect nations from economic threats. This security consideration encourages countries to use non-fiscal means to protect their interests. Nations should summarize and reflect on historical lessons, formulating rules and policies that align with global interests through effective dialogue and cooperation. Reflecting on the past, during the first and second oil crises, the International Energy Agency (IEA) was established, and a strategic oil reserve plan was formulated. Today, similar measures can be taken in other areas to reduce the risk of economic coercion.

Wei Shangjin believes that in the context of insufficient carbon tax collection, countries could provide subsidies for new energy vehicles as an alternative to tariff policies to more effectively address climate change, accelerate the green transition, and reduce damage to global cooperation. The policies of the United States, European Union, and Canada imposing additional tariffs on Chinese electric vehicles are unwise and detrimental to both climate change and international cooperation. These tariffs slow down the transition from traditional vehicles to electric vehicles, increase the cost of living, and damage future cooperation opportunities. As many countries are reluctant to raise carbon costs to socially optimal levels, global carbon tax efforts remain insufficient, and nations are looking for suboptimal alternatives to fill this gap. If there are concerns about China's dominant position in the electric vehicle sector, the EU, U.S., and Canada should provide more subsidies for domestic production. This approach not only accelerates the green transition but is also more efficient than imposing tariffs.