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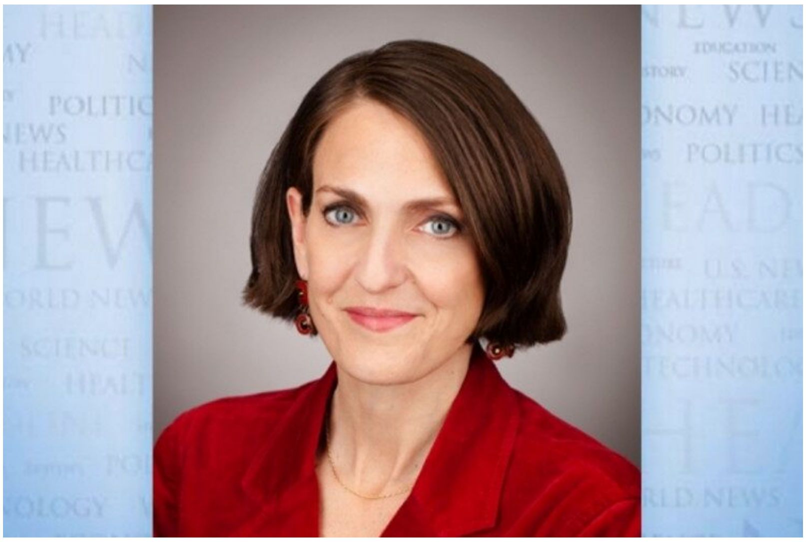
What to Expect From Washington's Latest Industrial Policy


Veronique de Rugy

Industrial policy is making a comeback. For those of you under the age of 50, this is just another term for corporate welfare — a lovely name for the unlovely practice of a government granting subsidies, protective tariffs and other privileges to politically influential industries or companies. It's often done in the name of some lofty goal such as strengthening national security or ensuring that America is a leader in the "industries of the future." But the outcome is always the same: wasteful, unfair, unsuccessful and unjustified. Oh, and it invariably grows the budget deficit.

The latest form of industrial policy is Congress's CHIPS Act of 2022, a bill meant to subsidize the semiconductor industry by channeling taxpayer money to build up domestic production capacity and combat feared Chinese computer-chip supremacy.

This chapter began with the disruption caused by lockdowns to global supply chains. Unsurprisingly, that led to a series of semiconductor shortages aggravated by a surge in demand for automobiles. Automakers wrongly assumed that the original drop in demand would persist, canceled orders for semiconductors, and then could not keep up with the buying public.

Now, Congress is responding to this *temporary* chip shortage with $52 billion in subsidies and $24 billion in tax credits mostly directed at semiconductor industry beggars.

Never mind that chip firms have already expanded production without subsidies. In fact, two years into negotiating this bill, it's obvious that it has little to do with any alleged structural deficiencies in the semiconductor market. For instance, the initial chip subsidy proposal had a $16 billion price tag. Since then, the industry has announced its own investments totaling over $800 billion, with $80 billion committed for near-term investment in U.S.-based fabrication facilities. Yet somehow, the bill more than tripled in price to target a problem that's already being solved.

What about the argument that China is subsidizing its chip producers and thus threatening our technological leadership? Yes, China subsidizes its chip industry, but this doesn't guarantee their subsidies will work. If U.S. politicians could for a moment stop treating every Chinese action as a threat, they would see that the Chinese semiconductor industry is both quantitatively and qualitatively weak. In fact, many of the companies subsidized would go under without the government's help. That's hardly the sign of a vibrant industry. These subsidies are more like life support than super-vitamins.

China not only imports somewhere around 84% of its chips, but its civilian sector is dominated by those made in America. Chinese-made chips are used mostly by the military; these chips are absent from nearly all the high-value industry segments. In other words, Beijing's efforts to create a powerful chip industry have failed for two decades. We can safely assume that this failure will continue for decades to come.

By contrast, the U.S. chip industry is extremely profitable. These firms invest massive amounts of money in R&D — 18 times the dollar amount of their Chinese-subsidized competitors. The result, as Stevens Institute of Technology professor George Calhoun writes, is that if the semiconductor industry "is de-constructed into its key segments, the picture is clear. There is no significant capacity or capability problem for the U.S., which is dominant in every segment of the industry" except one.

Furthermore, as my colleagues Weifeng Zhong and Christine McDaniel point out in a recent op-ed, believing that these subsidies will promote our national security by helping companies relocate production to the United States is rooted in faith rather than facts. Noting that "(o)nly 1 in 8 interventions change a company's location choice," they write:

> Any resulting new operations would still face deep-rooted issues hindering American manufacturing. Large-scale environmental assessments will be required, but over the years, the costs and delays have become excessive. Recent trends promoting or requiring unionized workers for federal contracts, combined with the current labor shortage, will hinder chipmakers' ability to find talent and could exacerbate the cost of domestic production.

In other words, if you believe that moving most of our chip production onshore is important for national security reasons, you should labor for regulatory reforms rather than subsidies.

It's easy for politicians to talk about industrial policy in terms of sweeping national goals. But in the real world, what these policies do is add to our deficit, fuel more inflation, waste resources, breed unfairness and hinder growth.

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