Economic Competition & International Trade: From Decoupling to Industrial Policy

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The outsized economic might of the United States has for so long been the envy of the world that much of Washington's policymaking takes for granted its continuation. This is unwise. America's strategic competitors are working tirelessly to build economies that rival or surpass our own. With their growing economic strength comes greater influence in the global order, which they use in turn to facilitate further growth. To preempt a troubling erosion of American power and influence, American policymakers should adopt a mindset that consistently puts the strength and dynamism of our national economy at the center of policy deliberations. The effects of employing such an approach may not be immediate, but the consequences of not doing so would be both dire and long-lasting.

A clear-eyed assessment of U.S. economic competitiveness and the policies intended to promote it would render a mixed verdict. The United States is home to the world's premier educational and research institutions as well as the world's deepest and most liquid capital markets. Innovation and entrepreneurship remain vibrant here, and many of the world's most successful companies are born and based here. If current trends hold, the U.S. economy will more rapidly regain the ground lost during the pandemic than will most other advanced economies. On the other hand, the U.S. manufacturing base has been shrinking. The United States is reliant on supply chains controlled by competitor countries, as the pandemic revealed, and red tape and regulatory uncertainty discourage capital investment. One could identify any number of other warning signs.

At the same time, American policymakers are rightly focused on China's steady accumulation of economic power. In Washington, no topic in foreign affairs received more well-deserved attention over the past four years than America's economic competition with Beijing. While commentators were marveling at China's remarkable growth rates and its expanding international clout, Trump administration officials and others were pointing out that China's rise was fueled in part by deviations from legal rules and market norms that the rest of the world's economic powerhouses generally observed. Over time, a bipartisan consensus coalesced around the conclusion that, contrary to the predictions of prior decades, China was not evolving toward being a "responsible stakeholder" in the international economic order. Along with that consensus came the widely expressed sentiment that the United States must do more to ensure continued economic vitality if it is to sustain the broad-based prosperity that a strong U.S. economy provides.

This situation has sparked innumerable studies on how to shore up American economic competitiveness. Policy prescriptions have consistently focused on a handful of important points. Public funding for research and development (R&D) should be increased, as should incentives for private R&D spending. The United States should pursue policies that create incentives for capital investment. To develop a workforce fit for the future, the United States should redouble its commitment to education in science, technology, engineering, and mathematics, and we should admit more high-skilled immigrants. These widely supported policy changes and others along the same lines are well elaborated in study after study—and yet action to execute on them is slow, inconsistent, and at times wholly absent. Why?

The answer, at least in part, is that success in the ongoing global economic competition—far from being a central objective of U.S. policymaking—is often a secondary goal, or even an afterthought. If the United States is to retain its preeminence in the international economic arena, that must change. Support for U.S. economic competitiveness is not fundamentally a discrete set of policy proposals. It must be an integrated policymaking mandate.

Refocusing Policymaking

Policymakers should consider expected effects on American economic strength in *all* policymaking. Too many policies formulated in Washington are informed solely by near-term domestic political considerations and immediate consequences for favored constituencies, with no thought to how those policies will enhance or degrade America's competitive position in years to come. Many laws and policies that are not directed to economic competitiveness nonetheless have consequences for it through increased fiscal stress and tax burdens, gradual accretion of regulatory encumbrances, and effects on labor markets. The variables are endless.

Take, for example, what the Biden administration calls its American Rescue Plan, a multi-trillion-dollar stimulus package enacted when the U.S. economy was already on track for a robust post-pandemic recovery and economic indicators were favorable. Former Treasury Secretary Larry Summers called this spending “excessive stimulus driven by political considerations” and “a consequential policy error.” As Secretary Summers described, support for this “rescue” was motivated by domestic political positioning, not policy objectives. Most opposition was based in policy objections, but even these tended to be domestically focused. Yet the package is likely to have harmful effects on U.S. global competitiveness. Employers and economists alike believe its generous benefits are delaying workers’ return to the workforce, its $1.9 trillion price tag will necessitate an increased future tax burden on domestic economic activity, and its size has sparked concerns about the return of inflation. Each of these effects chips away at American competitiveness. In addition, the size of the package appears to have suppressed congressional appetite for ambitious spending on infrastructure and R&D, which could directly enhance American competitiveness.

In adopting a competitiveness-focused mindset, policymakers must recognize that their goal should be protecting the U.S. business environment, not individual businesses. As a matter of political reality, it is perhaps understandable that politicians focus on the latter at the expense of the former, but that road leads to sclerosis and stagnation, not dynamism and innovation. Much of what passes for industrial policy is designed to protect the economy as it exists today. Protecting sectors and companies in a static state is not a recipe for a vibrant, healthy economy. On the contrary, it is a recipe for inert industries that watch helplessly as China and other competitors pass them by. The U.S. economy, including its manufacturing sector, must evolve to meet the needs of the moment.

The same focus on American competitiveness should inform the U.S. approach to regulation. Regulatory clarity and continuity attract investment and empower innovation. In general, alternating Democratic and Republican administrations seesaw between layering on and relieving regulatory burdens on American businesses. For a particular area of economic activity, the optimal level and shape of regulation can fairly be debated. Nonetheless, there can be no question that steadily increasing regulatory burdens will diminish American businesses’ global competitiveness, adding substantial compliance costs, trapping innovation in layers of red tape, and interposing lengthy delays between project conceptualization and realization.

The seesawing between greater and lesser regulation itself undermines American competitiveness because it generates uncertainty regarding applicable regulatory requirements as businesses make investment decisions on years- and decades-long time frames. Regulators proposing new rules—even those that would be desirable in the abstract—rarely account for the high costs of uncertainty inherent in a regulatory regime that is in constant flux. This is not to say that no new regulations should be promulgated, but neither should regulators continue to ignore the harms to American competitiveness caused by the shifting sands of continually changing regulations. The same is true of the lamentable practice of "regulation by enforcement"—formulating new rules not through proper rulemaking channels but by bringing post hoc enforcement actions. This practice, legally dubious but nonetheless widespread, undercuts certainty in the regulatory environment. In all they do, regulators should consider the likely consequences of their actions for American competitiveness.

Leading Internationally

It is not only the domestic legal and regulatory environment that should concern American policymakers. The global operating environment for American businesses is in many respects dictated by international standards set multilaterally. These standards span the whole breadth of economic activity, both international and domestic. They cover intellectual property protections, rules governing trade in goods and services, technical standards for countless products, telecommunications protocols, financial stability measures governing financial institutions, rules coordinating international air travel and sea transport—the list goes on. Countries vie for influence in the various international bodies that set these economic standards, trying to shape the rules in ways that benefit their domestic industries. In this effort, both success and failure are self-reinforcing. Economic success provides influence in setting the standards. Setting those standards so that they are conducive to a nation's economic interests in turn fosters further economic success. Because the United States and like-minded countries founded many of these standard-setting bodies, this virtuous cycle has for decades benefited the United States and its friends.

This self-perpetuating scenario explains why the Chinese government has quietly been making a steady, well-planned effort to secure greater influence in international standard-setting bodies. Over the past decade, the Chinese government has worked to install Chinese officials in leadership roles in these bodies as well as in the various other multilateral economic organizations. In the past few years, policymakers in the United States became acutely aware of

China's ambitions and began to push back, rallying like-minded countries to preserve the influence of market economies in setting global standards. This played out most notably in the selection of a Singaporean candidate to head the World Intellectual Property Organization, despite a muscular Chinese campaign for the post.

It is in the U.S. national interest to continue proactively seeking and exercising leadership in standard-setting bodies and other multilateral economic entities such as the G7, G20, Organisation for Economic Co-operation and Development, and Financial Stability Board. Moreover, where formal U.S. leadership is not viable—leadership posts in many of these bodies rotate among members—the United States should work to promote leaders from like-minded market economies, such as our G7 partners, Australia, and South Korea.

Fortunately, in the recent past, the United States has succeeded in maintaining leadership in many important international economic bodies. During the Trump administration, U.S. officials sought and secured the top posts at the Financial Stability Board and the Financial Action Task Force as well as the vice-chair position at the International Organization of Securities Commissions. The United States presided over the G7 during that body's consequential pandemic response efforts in 2020. Americans now lead the World Bank (which is traditionally led by an American) and the Inter-American Development Bank (which is not). To be sure, there were times when U.S. policy positions ran contrary to those of other countries, but leadership in international organizations should not be confused with acquiescence to positions that contravene fundamental American interests. Future administrations should continue to seek and exercise leadership in multilateral economic bodies, while never hesitating to stand up for American interests in those bodies.

Standing up for American interests will be especially important in the formulation of international rules and norms for data governance. As Matthew Slaughter and David McCormick have argued, control over data governance, including standards for cross-border data transfers, will have significant ramifications for future economic and political power. The EU has staked out an aggressive position on these matters, which critics assert to be a protectionist response to the international prominence of U.S. technology companies. China is developing its own model, founded on authoritarian precepts. Both approaches would impose substantial impediments to cross-border data flows. The United States needs to work with like-minded countries toward the adoption of international data governance standards that are consistent with American interests.

Strengths and Challenges

An examination of American economic policymaking reveals bright spots that can serve as models for other initiatives. For example, the United States has thoroughly reformed its screening mechanism for foreign direct investment, the Committee on Foreign Investment in the United States (CFIUS), to make it more capable of identifying and addressing investment that would harm national security while at the same time preserving the open investment climate that serves as an engine of growth. The bill prescribing these reforms enjoyed broad bipartisan support. The reformed CFIUS investment screening mechanism is a product of thoughtful balancing of competing considerations—protecting national security and attracting foreign capital—to achieve a result that furthers American competitiveness. Moreover, American policymakers recognized that many partner countries also face threats from malign investment and that a unified front against such exploitation would benefit all market economies. Between 2018 and 2021, the U.S. Treasury Department, which leads the CFIUS process, worked with dozens of countries to help them build out their own investment screening mechanisms.

Similarly, the United States has shown itself capable of rapid, decisive action to advance American interests, including its economic interests. Operation Warp Speed's success in facilitating vaccine development and distribution is a historic success that accelerated the recovery from COVID-19's depths, both in the United States and around the world.

The United States has also demonstrated that it can galvanize like-minded countries to set rules of the road on issues of common concern. U.S. leadership spurred rapid, widespread international adoption of the Clean Network initiative, which built a community of countries committed to including only equipment from trusted communications providers in their national telecommunications networks.

Compare these rapid, effective, consequential initiatives to the plodding pace at which necessary approvals for capital investments or innovations in regulated industries can be secured. Surely the United States can, without sacrificing analytic rigor, speed up consideration of these matters to give U.S. investors and entrepreneurs confidence that the projects they propose will not be trapped indefinitely in continuous loops of regulatory decision-making.

For example, the United States needs to internalize a commitment to responsible regulatory agility in financial innovation. Worldwide, the financial sector is experiencing rapid and thoroughgoing digitization.

While that trend presents risks that innovators and regulators must address, it also promises substantial benefits in terms of the speed, cost, efficiency, and inclusiveness of financial services. Many of the most dynamic, most innovative financial companies in the world are U.S.-based. To harness the potential that digitization and American financial innovators can offer, U.S. policymakers need to work rapidly toward providing clarity and certainty regarding the regulatory regime applicable to new financial technologies, including digital assets. The dangers of failing to do so are that these technologies could come to maturity elsewhere, the United States could become an importer of financial technologies, and other countries' decisions regarding regulatory treatment could become more influential than our own.

U.S. policymakers must also take urgent action with regard to international supply chains. With manufacturing declining as a share of economic activity in all advanced economies, it is unrealistic to believe that most manufacturing of goods consumed in the United States will be re-shored to American factories. Nor it is realistic to believe that the United States and China will fully decouple, severing all trade or financial interconnection. Nonetheless, the current U.S. supply chain configuration imperils national security and compromises American economic power. For critical goods, the United States cannot tolerate dependence on undiversified supply chains controlled by strategic competitors. To prevent substantial vulnerability in semiconductors, telecommunications equipment, advanced batteries, and rare-earth minerals essential to cutting-edge technologies, the United States must have assured supplies of these vital inputs. As the COVID-19 pandemic demonstrated, the United States must have an ironclad access to medical goods, including domestic production capacity for the most critical items. U.S. policymakers must immediately work to ensure that the United States either has the capacity to produce these items itself or that it has a guaranteed ability to procure them from our closest allies without interference by strategic competitors.

In all these matters, there are no quick fixes. But there is also no excuse for failing to move rapidly to re-center American policymaking on enhancing and ensuring U.S. competitiveness in the global economy. We must treat the pursuit of economic strength and dynamism not as an afterthought but as a mandate.