MARCUS NOLAND

Executive Vice President and Director of Studies at the Peterson Institute for International Economics

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I will now turn to Marcus.

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I think we have reached the point in the morning where everything has been said, but not by me. When I received the invitation to participate in this panel, I eagerly accepted, viewing the opportunity as a great honor. When I looked at the composition of the panel, I saw that we had so much talent regarding macroeconomic and financial matters that I thought I would focus on microeconomic issues as a compliment.

I believe we are in the midst of a transformation of international trade and investment relations, driven by the revival of industrial policy in major economic centers. Compared to the previous international trade regime, this system will be more complex and considerably less transparent. It will be vulnerable to political capture by special interest groups, and will possibly be accompanied by overall reductions in economic efficiency, and will give rise to international tensions.

How did we get here? There are two principal drivers. The first, which I hope all of us can agree on, is global warming and the need to adopt policies to internalize externalities that the market will not do on its own. The second is more controversial; the geopolitical justification. I think the best intellectual rationale for this was actually provided by the Canadian deputy prime minister and finance minister, Chrystia Freeland, who argues that in essence, the west got lucky during the cold war. The Soviet Union self-isolated, so the west was free to construct a liberal, open order, in which there was no contradiction between engaging in trade and investment relations, everyone prospering together, and military security. In contrast, in the present, China has embraced the global economy. This creates tension between economic integration on one hand and military security concerns on the other. That is the intellectual justification for what was called de-coupling. President Von Der Leyen of the European Commission more politely termed this “de-risking”.

In the case of the United States, these two concerns have been met by two sorts of policy thrusts. In the case of the geopolitical objectives, the concern centers on semiconductor chips. The two main policies have been the Chips Act in the United States, and then a set of export controls aimed at restricting export of chips and manufacturing equipment to countries of concern; namely China and Russia. In the case of climate change, the thrust has been through two large pieces of legislation: the Infrastructure Investment Jobs Act and the Inflation Reduction Act (IRA). On these points, I will focus on electric vehicles and batteries. In both cases, the policies are complex. They are not entirely transparent, and make considerable demands on government policy and ability to implement effectively. Additionally, they have caused heartburn in partner countries.

The Chips Act allocates slightly over USD 50 Billion in subsidies for production and research and development over the next four years. It prioritizes supply-chain security, that is to say, chips currently made in Taiwan. It is open to both domestic and foreign firms, and particularly firms from Taiwan and Korea, and excludes China and Russia. Companies receiving that funding cannot build new capacity in China for 10 years.

The export patrols aim to deter high-end production in China, meaning the policy is dependent on third-party cooperation. In this case, the US government got lucky in that there were some choke-points in the semiconductor industry that required minimal cooperation from third-parties in order to implement. However, there is no guarantee this will be the case in the future with industries of very different industrial structure. Think, for example, of biotech. The US is not alone; Europe has its own Chips Act, and Japan has adopted a similar set of re-shoring or friend-shoring incentives, and is providing subsidies for an American firm, Micron Technology, to build a plant in Hiroshima.

While the US is leading the charge, it is not alone. With respect to climate change, I will focus on electric vehicles, as this is where much of the current trade action is. The US legislation creates consumer incentives, builds out the charging infrastructure, and encourages domestic production. The way it did so was by having strong domestic preferences, which caused problems with our partners. One thing to bear in mind concerning this legislation is that the IRA is 1000 pages long. The congress did not know every detail of what it was voting for when it enacted it, and it has all sorts of unintended consequences. One of these was to make those consumer incentives apply to American-built automobiles, but not those from Korea or the EU who, understandably, became upset. A certain enterprising bureaucrat at the department of treasury, who probably deserves some sort of Nobel prize in applied economics, discovered that there was a provision written for trucks, which are normally leased, which if reinterpreted, could be applied to cars, and that the Koreans and Europeans could continue to export to the US and benefit from consumer subsidies.

Likewise, the legislation incentivized use of non-Chinese minerals in the production of the batteries for those cars, and due to our vision that essentially endorses production and free-trade partners, it has created a strange phenomenon in Washington where Korean firms who build the batteries are lobbying the US government to conclude free trade agreements with Indonesia, Philippines, Argentina, and other potential supply sources. It appears akin to a software-patch, so to speak, and it would not be surprising if the congress went back and revisited some of these provisions, if the congress could actually act, that is, which, given the dysfunction, remains an open question.

Implementation is complex, depending significantly on administrative regulations. It is not transparent, and remaining informed is costly. This non-transparency creates opportunities for political capture by special interest. Europe has its own Chip Act, and it also has the Carbon Border Adjustment Mechanism (CBAM), which is going to create problems as well.

More broadly, the EU is tackling these problems with an emphasis on taxes. The US is emphasizing subsidies and tax provisions, and there is a need to reconcile these differing approaches to commonly shared goals. To me, there is a valid question on whether the US government is currently constituted as up to the task of implementing a policy as complex as this one.

Jean-Claude Trichet

We usually go for a new round of remarks to be made, in order to criticize or compliment what other members of the panel have said.