

Cozen Currents: Industrial Policy is Back

The Cozen Lens

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After several decades in which industrial policy was out of fashion in Washington, a bipartisan consensus has emerged around the need for the US to have its own, largely to counter China.

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A rare point of agreement on Capitol Hill over the past two years was providing funding to create US jobs and to compete better with China, culminating in the CHIPS and Science Act.

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Some provisions that didn't make it into the final CHIPS and Science Act could make a reappearance during the lame duck session, but the outlook for significant congressional action on trade under divided government is dim. The focal point for trade is likely to shift towards the White House.

Industrial Policy is Back

Reviving Industrial Policy. As the US's strategic competition with China has evolved under Presidents Donald Trump and Joe Biden, a bipartisan consensus has emerged to support the adoption of a light industrial policy.

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This effort has been bolstered by industrial policy's political popularity, making it a relatively easy issue for members of both parties to get behind. While there can be disagreements over the specific details, generally speaking, it is seen as a means to support manufacturing jobs in the US and to be tough on China, two stances politicians are rushing to embrace.

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The messaging has been tricky at times as it has been important to ensure it is framed as becoming more competitive against China, rather than adopting China's strategy, which lawmakers and administrations have chided for years.

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To date, US industrial policy has focused heavily on microelectronics, specifically the semiconductor industry. However, there is increasing focus on other sectors and supply chains that could be vulnerable to exploitation by China, either through acquisition of sensitive technology or by providing China with leverage – i.e., because it is producing something vital that cannot be obtained quickly from another source. Components of clean energy supply chains, such as rare earth minerals, and critical pharmaceuticals and medical devices could be subjects of particular attention.

This Room is Only Big Enough for One of Us. To Trump, industrial policy was part of a paradigm shift in the US competition with China from “cooperation where possible and competition where necessary” toward a zero-sum confrontation based on his “America First” ideology.

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In practice, this meant focusing on balancing the trade deficit and embracing unilateral confrontation. Both the Section 301 tariffs and Phase I trade agreement were pursued because they were seen as advancing these goals.

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President Trump and then-US Trade Representative Ambassador Bob Lighthizer saw tariffs as a way to improve the US's negotiating leverage and position in the zero-sum competition with China.

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For the Trump administration, acting in conjunction with other countries was not necessary if taking action could be beneficial to the US or hurt China. Instead, the Trump administration sought to make the US the example, such as with restrictions on Huawei, and then encourage allies to follow.

Sticks and Carrots. Biden's approach to industrial policy is rooted in reducing US and allied reliance on China in critical supply chains and hindering China's ability to develop its advanced technology domestically.

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The Biden administration's recent export controls on semiconductors and the tools needed to manufacture them are being seen as yet another escalatory step in an economic war.

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What makes these unique from previous measures is that they are aimed broadly at the entire country rather than individual companies. Coupled with the CHIPS and Science Act's domestic subsidies to high-tech companies, this provides for a comprehensive industrial policy for semiconductors.

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The Biden administration has combined these initiatives with a new focus on working with allies to counter China. In addition to pushing allies to implement their own sanctions, the administration has sought to deepen engagements that connect allies to the US economically, such as through alignment of regulations and standards. A key element of this has been the Indo-Pacific Economic Framework, which does not include the tariff elimination found in a traditional free trade agreement, but which aims to encourage closer economic relationships between the US and its Indo-Pacific-based partners.

Congress CHIPS In

Industrial Policy is Popular with Populists. With the increasing rise of populism in both parties, members of Congress on both sides of the aisle are willing to fund programs to advance industrial policy.

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The CHIPS and Science Act passed with strong bipartisan votes in both chambers. In the House, 24 Republicans bucked their leadership who opposed the bill, in part due to inflation concerns. Many of these members were deeply invested in the bill's components and wanted to support subsidies that would lead to new jobs in their districts.

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In the Senate, 17 Republicans voted with Democrats to pass the bill, which underscores the popularity of the measure given the upper chamber's proclivity for gridlock these days. Senator John Cornyn (R-TX), who is seen as a potential successor to Senate GOP Leader Mitch McConnell (R-KY), was the sponsor of the semiconductor incentive provisions and took a prominent and public role in advancing the bill.

Spotlight on Semis. The implementation phase of the CHIPS Act is already underway with applications for the semiconductor fab subsidies scheduled to open as soon as February 2023.

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The most well known portion of the CHIPS Act is the \$52.7 billion that is appropriated over the next five years to support semiconductor manufacturing in the US. The largest portion of this is \$39 billion “in financial assistance to build, expand, or modernize domestic facilities and equipment for semiconductor fabrication, assembly, testing, advanced packaging, or research and development.” \$2 billion of the \$39 billion is to be set aside to support “mature nodes,” which is aimed at older chips used in automotive manufacturing. The set-aside was included following intense advocacy from auto manufacturers who have sought first-in-line access to chips.

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The Commerce Department released its strategy for the CHIPS for America fund in September. The strategy paper provides insights on priorities for reviewing applications, with Commerce explicitly stating that it is looking for projects that prioritize “broad economic gains, rather than outsize financial contributions to a single company,” adhere to standards and guidelines on components of information security, provide workforce solutions that enable stakeholders to work together, employ creative recruitment strategies and hire workers based on their acquired skills, and proactively work to include small businesses, minority-owned, veteran-owned and women-owned businesses, and businesses in rural areas.

What Else Hitched a Ride. The CHIPS and Science Act does more than just fund its namesake.

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The vast majority of the rest of the package provides expanded scientific research funding. The largest portion of this is \$102 billion over five years in authorizations to the National Science Foundation (NSF), Commerce Department, and National Institute of Standards and Technology, representing a \$52 billion increase over the existing baseline. \$81 billion will go to the NSF, including the largest increase over baseline of \$20 billion to create a new technology directorate at the NSF. The remaining \$61 billion going to the NSF will support its core activities.

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What should be noted about the above funds is that this legislation only authorizes the funds, but does not appropriate the money, meaning no money goes out the door until further appropriations legislation passes. Congress may choose to appropriate the funding as part of a year-end omnibus bill in the lame duck session.

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The only money other than the semiconductor support that is actually appropriated in the legislation is \$1.5 billion to support the development of open radio access network (Open RAN) technology. The goal of this funding is to support the development of competitive alternatives to 5G hardware and be able to build software-based wireless technologies.

What Comes Next?

Déjà Vu. It’s possible that some provisions left out of the final CHIPS and Science Act may come under consideration again during the lame duck session, including the controversial trade title.

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Noncontroversial components that were ultimately left on the cutting room floor could potentially be included in the FY23 National Defense Authorization Act (NDAA). As a must-pass bill, the NDAA offers an opportunity for other legislation to be attached as an amendment and become law. Generalized System of Preferences and Miscellaneous Tariff Bill renewal may be prime candidates to hitch a ride on the NDAA. These provisions enjoy support from the

business community and amid rising inflation; they could bring some costs down for businesses and consumers.

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The fate of other trade-related provisions is more uncertain. Lawmakers could try to revive an outbound investment screening mechanism as was previously proposed by Senators Bob Casey (D-PA) and John Cornyn (R-TX) or a change to the de minimis rule. There could also be a push, led by House Democrats, to reauthorize Trade Adjustment Assistance benefits. However, congressional Republicans have insisted any trade legislation reauthorize Trade Promotion Authority. It's unclear how much of a viable path forward these provisions have.

Trade Policy Under Divided Government. Republicans are likely to retake control of one or both chambers of Congress, resetting the political dynamics in Washington, DC next year.

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Democrats and Republicans will likely continue to have differences on trade policy beyond China in the 118th Congress, particularly as the 2024 presidential election inches closer. This creates doubts around major congressional action in areas such as renewal of the executive branch's Trade Promotion Authority.

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There's a strong likelihood of continued consensus between the parties about being tough on China, although there may be slight differing views on the best overall approach. Democrats and Republicans are likely to increase their focus on trying to outflank the other party. This dynamic could impede efforts to find common ground, standing in the way of legislative success or reducing congressional action to the lowest common denominator with support from both sides of the aisle. This was the case with the CHIPS and Science Act, which took over a year to pass Congress as a slimmed-down version of its original self.

Executive Action. With Congress expected to be largely stalled on the trade front, the White House is set to become the focal point on trade policy.

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The Biden administration will likely aim to deliver on trade in areas that don't require approval from Congress. Traditional free trade agreement negotiations don't fit that picture.

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Narrower initiatives will allow Biden to pursue a multilateral approach without the political baggage associated with free trade agreements and tariff elimination, and without needing to rely on Congress.

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Standards-setting and regulatory alignment will likely feature in negotiating initiatives, as these are areas on which the administration can secure commitments without needing congressional approval.

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Labor and the environment are also expected to feature prominently in the White House's trade agenda, including in negotiating initiatives with other countries and in enforcement activity.

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For example, the Biden administration has already brought five matters targeting facilities in Mexico under the US-Mexico-Canada Agreement's facility-specific Rapid Response Labor Mechanism.

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On China, the Biden administration is now undertaking a four-year review of section 301 duties imposed under Trump. Some observers have speculated that this could result in a focusing of the tariffs on strategic items, or in the opening of a new tariff-exclusion process. It remains to be seen what the administration will do. Finally, the administration may continue its aggressive use of export controls as a tool to impede China's rise and protect US technology interests.
