https://www.wsj.com/articles/global-economy-economic-losers-fba30b53

The Economic Losers in the New World Order

Giant subsidies and rising protectionism are upending decades of free trade. Smaller countries, from the U.K. to Singapore, are getting left behind.

By Ed Ballard Follow *, Jason Douglas* Follow *and Jon Emont* Follow

Aug. 14, 2023 12:01 am ET

The world's biggest economies are offering huge subsidies in a cutthroat race to win the industries of the future. The losers: all the countries that can't pay up.

New tax credits for manufacturing batteries, solar-power equipment and other green technology are drawing a flood of capital to the U.S. The European Union is trying to respond with its own green-energy support package. Japan has announced plans for $150 billion of borrowing to finance a wave of investment in green technology. All of them are working to become less dependent on China, which has a big lead in areas including batteries and the minerals to make them.

Now, some smaller players are getting left behind. Many are nimble economies that were on the rise during decades of free trade, but are at a disadvantage in a new era of aggressive industrial policy. Industrialized nations such as the U.K. and Singapore lack the scale to compete against the biggest economic blocs in offering subsidies. Emerging markets such as Indonesia, which had hoped to use its natural resources to climb the economic ladder, are also threatened by the shift.

Intel has been offered $11 billion in subsidies from the German government to build two semiconductor plants, in what Prime Minister Olaf Scholz called the largest foreign direct investment in German history. The pledged government financing is substantially more than the annual budget of Singapore's Ministry of Trade and Industry.

"Let me tell you plainly: We cannot afford to outbid the big boys," deputy Prime Minister Lawrence Wong told supporters at a recent political rally.

Intel CEO Pat Gelsinger and German Chancellor Olaf Scholz signed an agreement in June for Intel to build two semiconductor plants in Germany. PHOTO: CHRIS EMIL JANSSEN/DDP/ZUMA PRESS

For many tech companies nurtured in the U.K., growth lies elsewhere. British battery-technology startup Nexeon, which developed its technology near Oxford, helped by government funding, raised over $200 million last year. Its first commercial factory will be in South Korea, likely followed by a plant in North America.

“But not the U.K., sadly,” said Scott Brown, Nexeon’s chief executive. Nexeon doesn’t see that changing without more government support for the battery industry.

AMTE Power, one of the U.K.’s few homegrown battery manufacturers, has said it may rethink plans to locate a proposed $200-million-plus factory in Scotland given the difference in subsidies on offer in the U.S. and Europe. Arrival, an electric-vehicle startup, said last year it wants to focus its manufacturing in the U.S. instead of the U.K, citing the tax breaks.

The U.S., which is offering $369 billion in incentives and funding for clean energy as part of the Inflation Reduction Act, is seeing a windfall of foreign investment. German carmaker BMW just broke ground for a new battery plant in South Carolina. South Korean firms Hyundai and LG announced a $4.3 billion battery plant in Georgia. Panasonic of Japan is building a plant in Kansas.

Workers prepare the site of a Panasonic EV battery plant near DeSoto, Kan. PHOTO: CHARLIE RIEDEL/ASSOCIATED PRESS

Unwinding globalization

The subsidy race marks a step away from the economic integration that for decades broke down barriers to trade and investment between countries.

Globalization transformed once-poor countries such as South Korea and Taiwan into high-tech, developed economies, lifting hundreds of millions of people out of poverty. Western consumers got an abundance of affordable consumer goods and a higher standard of living. Technological advances and new management ideas also moved more freely between countries, along with goods and financial resources.

The model also had steep costs. Once-thriving communities in the U.S. and Western Europe were hollowed out as manufacturing jobs moved to Asia or the former Soviet states. Environmental concerns mushroomed as the global economy consumed more natural resources. Some economies faced destabilizing bouts of capital flight as foreign money flooded in and out.

Unwinding that global integration—whether for reasons of national security, geopolitical rivalry or supply-chain anxieties—comes with its own problems, economists say. Especially at risk are smaller, developing economies that need access to global markets if they're to trade their way to greater prosperity.

"The world as a whole is becoming more inward and turning away from open trade and investment," said David Loevinger, a former U.S. Treasury official who is managing director for emerging markets at asset manager TCW Group. "Europe, the U.S. and China are in a subsidy competition and the losers in that competition are poorer economies with less fiscal resources."

The Western embrace of industrial policy could be especially painful for countries that had hoped to exploit the adoption of green technologies to turbocharge their own economic development.

A worker at a nickel processing facility operated by Harita in Indonesia. Indonesia hopes to parlay its nickel resources into a world-leading battery industry. PHOTO: ULET IFANSASTI FOR THE WALL STREET JOURNAL

Indonesia has ambitions to parlay its abundant nickel resources into a world-leading battery industry. But U.S. rules, put in place as part of the IRA, deny subsidies for EV batteries that contain large amounts of minerals from nations that are not American free-trade partners. Indonesia is among them.

"We have all the natural resources. We have the human resources. And we are a country that's a democracy," said Arsjad Rasjid, the head of the Indonesian Chamber of Commerce and Industry, in an interview. "Please don't shut us down."

The winners

As a leader in the subsidy race, the U.S. is experiencing an investment boom. The U.S. took in about 22% of global foreign direct investment last year, making it the world's top recipient, according to United Nations data. That is slightly lower than the 26% it received in 2021 when global investment bounced back after a lull during the pandemic, but significantly higher than the 13% it got in 2019. Spending on construction related to manufacturing rose 76% in May compared with a year earlier, to a seasonally-adjusted annual rate of $194 billion, Census Bureau data show.

In the U.K., Nexeon's funding underscores the power of the U.S. purse to skew the playing field. As well as the private capital it raised last year, Nexeon received two million pounds, worth about $2.55 million, from a U.K. government EV-industry fund.

Weeks later, two U.S. rivals, Sila Nanotechnologies and Group14 Technologies, both got $100 million from the Energy Department under a battery-industry funding program introduced in the 2021 infrastructure law. Like Nexeon, those companies are making silicon-based materials to be used in battery anodes to improve performance.

Workers at Wolfspeed, a semiconductor manufacturer in Durham, N.C., look on during remarks by U.S. President Joe Biden as part of his Investing in America Tour in March. PHOTO: MELISSA SUE GERRITS/GETTY IMAGES

"The economics of projects in the U.S. are just out of sight," said Guy Debelle, a former deputy governor of Australia's central bank and now director of Fortescue Future Industries, the green energy unit of West Australia miner Fortescue Metals. The company is scouting investment opportunities and currently sees the U.S. as the most likely location due to subsidies that could knock up to 60% off a project's price tag, said Debelle.

The European Union is preparing its own support package, relaxing limits on subsidies member countries can give industry. By 2030, the EU wants 40% of the key technologies needed for the green transition to be manufactured in the bloc, including solar equipment—a sector currently dominated by China—wind turbines and batteries.

The U.S. battery production pipeline, which measures capacity from projects in the works, has jumped 67% since the IRA was announced and now matches the size of Europe's, which grew by 26% over that period, according to estimates by Benchmark Minerals Intelligence, a U.K. based firm that gathers industry data.

The Brexit problem

The shift in global trade comes at a particularly awkward time for the U.K., which has been struggling to chart a new course in the global economy after leaving the European Union in 2020, which meant it no longer had easy access to its giant single market.

Brexit proponents said the U.K. could strike bilateral trade deals with other countries and double down on globalization. Since then, momentum for free trade has stalled and now appears to be in retreat.

"Back during the Brexit vote, nobody had any idea that we'd see a resurgence of industrial policy in the U.S.," said Gernot Wagner, a climate economist at Columbia Business School.

Now, the U.K. government is facing calls from all corners of the country's economy to respond to the interventionist turn in global economics with its own reinvigorated industrial strategy.

The U.K.'s auto sector got a boost recently when the owner of Jaguar Land Rover chose to build a new EV-battery plant there, but the overall scale of green subsidies lags far behind the U.S.

U.K. Finance Minister Jeremy Hunt is under pressure to introduce a reinvigorated industrial strategy in response to the interventionist turn in global economics. PHOTO: TAYFUN SALCI/ZUMA PRESS

Finance Minister Jeremy Hunt has promised to unveil the U.K.'s response this fall, but has downplayed expectations and said Britain will not "go toe-to-toe with our friends and allies in some distortive global subsidy race." He said the U.K. will look to target funding to areas where Britain has a clear competitive advantage.

New alliances

One solution for countries that can't compete is to draw rich trade partners closer and benefit from their industrial policies, as Canada and Mexico have done through their free-trade deal with the U.S., said Chad Bown, a trade expert and former World Bank official at the Peterson Institute for International Economics, a think tank in Washington, D.C. Indonesia's government is participating in the American-led Indo-Pacific Economic Framework for Prosperity, an economic pact that it hopes will improve market access for its minerals.

Last year, Investment Minister Bahlil Lahadalia said Indonesia would seek to form an OPEC-like cartel for nickel, a battery mineral whose production Indonesia dominates, as a response to protectionism by countries that make EVs. An OPEC-modeled organization would coordinate nickel production levels with other major exporters to ensure elevated prices.

Analysts doubt the plan, in part because other nickel producers don't want to alienate powerful trading partners such as the U.S. and China. Similar ideas for an OPEC-like organization of lithium producers have been floated by left-wing leaders in Latin America, but haven't been enacted.

Indonesia and Zimbabwe have put in place export restrictions on minerals such as nickel, bauxite and lithium, along with requirements that foreign companies build processing facilities in the country as a condition for exporting.

"I'm not a fan of these policies but they're clearly very popular," said Simon Evenett, a professor of international trade and economic development at the University of St. Gallen in Switzerland. "Clearly it will drive up prices and it will increase uncertainty and risk."

A view of a nickel processing complex operated by Harita in Indonesia. Indonesia and Zimbabwe have put in place export restrictions on nickel and other minerals. PHOTO: ULET IFANSASTI FOR THE WALL STREET JOURNAL