DOI: 10.2478/ie-2025-0051

Intereconomics, 2025, 60(5), 261-265
JEL: F02, F13, O25, Q56

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Beyond Trade Wars and Economic Nationalism – Towards a Cooperative Global Governance

Industrial policy has returned to the centre of global economic debate. Once dismissed as inefficient, government intervention is now seen as vital for addressing climate change, technological competition and supply chain vulnerabilities. Yet the rise in uncoordinated national strategies risks fuelling new trade conflicts and economic fragmentation. This article argues for a cooperative global framework that allows legitimate industrial policies while limiting harmful protectionism. It identifies three main policy areas – national security, industrial development and coordination for the net-zero transition – and discusses potential principles for transparent, time-limited and performance-based support. Establishing such rules could help reconcile national ambitions with international cooperation and preserve open markets wherever they are efficient.

The world is currently experiencing a period of highly confrontational policies driven by national interests and prolonged conflicts over trade and other forms of government interventions. These policies stand in stark contrast to the former global paradigm of free markets that for several decades had been characterised by extensive tariff cuts and a taboo against industrial policies and vertical government intervention.

While it has reached a new and openly aggressive dimension since the start of Donald Trump's second term in 2025, the trend towards government interventions aimed at protecting national interests or promoting strategically important industries had emerged as an international phenomenon long before this. This development has been underpinned by economic research identifying the downsides of a strongly market-driven globalisation: costly trade shock disruptions, overdependencies on the supply of critical goods from a limited number of countries, the need to support nascent industries and to foster the development of climate-friendly industries.

Given the long-standing trend, its deeper drivers and new research emphasising the effectiveness of industrial policies, the central question in the future will not be how to return to a free-market world, but rather how to design common global rules that accommodate national industrial policies within a cooperative framework. Such rules would help avoid arbitrary protectionist interventions or escalating conflicts in the form of tariff wars. Defining a coherent system of cooperative global governance and clear guidelines for industrial policies may even become the precondition for preserving free markets wherever they are efficient.

In the current context of escalating trade conflicts, thinking about reforming the global order may appear utopian. Nevertheless, beginning preparations for such governance now may help seize future opportunities. In this sense, this paper seeks to identify some of the main challenges ahead in building a new cooperative governance framework.

To develop such a framework, it is crucial to identify which types of government interventions could become broadly accepted and thus be recognised as legitimate, whether for economic or other reasons, on a consensual basis. Three major categories of industrial policy that appear to fit this description are the following:

Open Access funding provided by ZBW – Leibniz Information Centre for Economics.

* The content of this paper is based on discussions with Jonas Nahm of Johns Hopkins University and former Senior Economist for Industrial Strategy on the White House Council of Economic Advisers. It was also discussed in steering groups and at the Berlin Summit in June 2025 with Nancy Qian, Thiemo Fetzer and Guy Lalanne.

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- National security concerns involve measures aimed at defending national sovereignty and reducing dependencies of strategically important sectors;
- Development of the industrial base includes policies supporting the emergence of new industries or facilitating an upgrade within global value chains;
- Coordination problems require policies designed to accelerate the transition to a net-zero economy.

Clearly defining these cases will, in turn, allow for a better understanding of which instruments under which circumstances may be tolerated in a future global setting.

The new case for industrial policies

During much of the post-World War II period, industrial policies were widely discarded as inefficient and vulnerable to rent-seeking. This has profoundly changed in recent years. Industrial policies today have even become a defining feature of the global economy (Evenett et al., 2024). In addition, recent research takes a more positive stance, offering a more nuanced and contextual understanding of industrial policy (Juhász et al., 2023; Juhász & Lane, 2024).

Multiple pressures are accelerating this paradigmatic shift (Allan & Nahm, 2025): geopolitical competition with China, technological change demanding coordinated public-private responses, supply chain vulnerabilities exposed by global crises and recognition that complex challenges like climate transition require more than just market solutions. Given the apparent permanence of these challenges, governments are likely to continue actively shaping economic outcomes through targeted interventions.

The key challenge is to establish a global framework that reflects this new reality by allowing for national strategic objectives while ensuring a certain level of coordination to limit beggar-thy-neighbour policies. This task is particularly urgent for Europe, given the United States' retreat from multilateral cooperation and its imposition of tariffs even on allies. But it is also important for the global south, whose countries cannot compete in (green) industrial policy races as advanced economies seek to carve up global supply chains and markets.

Every international governance system faces a trade-off between global coordination and national sovereignty; in the end, it is a question of balance. What industrial policies are acceptable and on what terms? How can developing economies integrate into global supply chains while retaining policy space? The answers will determine whether current trends lead towards shared prosperity or further economic fragmentation.

The challenges of contemporary industrial policies

In recent years, advanced economies have embraced industrial policies that they once criticised, implementing large-scale subsidies and local content requirements to secure supply chains and maintain strategic control. While this shift was initially a response to China's policies, it complicates engagement with China (and others) on acceptable industrial policy standards: the very nations that championed free-market orthodoxy through international institutions now deploy interventionist tools they previously discouraged.

In part, this transformation reflects hard-learned lessons about market limitations. The 2008 financial crisis revealed the dangers of excessive deregulation, while the COVID-19 pandemic exposed critical supply chain vulnerabilities. Geopolitical tensions highlighted the strategic importance of technological sovereignty, particularly in semiconductors, clean energy and advanced manufacturing. A new awareness of strategic vulnerabilities triggered a fundamental rethinking of the state's economic role. Altogether, the perceived benefits of industrial policies appear to be growing.

At the same time, the perceived costs of industrial policies seem to be decreasing. The reason is that some of the long-standing criticisms of industrial policies, albeit still relevant, no longer deter policymakers as they once did. For example, the decline of competition and business dynamism in OECD countries over the past 20 years has mitigated the potential negative consequences of industrial policies. In addition, the green transition and threats to economic security potentially facilitate the identification of relevant critical sectors.

The shift towards more economic interventionism has created a complex new landscape: economic and security considerations now increasingly overlap. The United States' massive investments in semiconductor manufacturing through the CHIPS Act and Inflation Reduction Act, Europe's Green Deal Industrial Plan and similar initiatives worldwide reflect a growing consensus that strategic industries require government support to ensure national competitiveness and security.

Developing economies now face barriers to using the same industrial strategies that Western nations themselves deploy. The EU's successful WTO challenge to Indonesia's nickel export ban illustrates this asymmetry: advanced economies pursue aggressive economic nationalism while constraining similar efforts by developing nations. Indonesia's attempt to require domestic processing of nickel – a classic strategy for moving beyond raw material exports – faced international legal challenges despite being economically sound and developmentally beneficial. This double standard underscores the need to reform the current global economic governance system.

Building blocks for effective economic governance

Key principles for sustainable global industrial policy include transparency, clear objectives, non-discrimination and government support that is both time-limited and performance-linked. These basic elements must be woven into a more comprehensive framework that accounts for diverse national circumstances and development needs, and avoids beggar-thy-neighbour policies with negative spillovers.

Effective industrial policies should in principle aim to create positive-sum outcomes, where all participants gain from economic transformation. Well-designed interventions can expand global productive capacity, accelerate innovation and create new opportunities for participation in global value chains. This approach recognises that in an interconnected global economy, sustainable competitive advantages come from interventions that increase overall productivity rather than shut out potential competitors through tariff barriers or poach investment across borders through subsidy races.

Regardless of their development level, all countries must have genuine opportunities to pursue economic upgrading strategies. Different countries require different tools and timelines to achieve their development objectives. Advanced economies may focus on coordination challenges, frontier technologies and high-value services, while developing countries might prioritise industrial capacity building and skills development. Societies with longer-term horizons may target research and development, while those with shorter-term priorities may focus on producing upstream sectors that feed domestic downstream industries (Liu, 2019; Liu & Ma, 2023). No nation should remain permanently locked into narrow specialisations that expose them to volatile commodity prices or technological obsolescence. Instead, emphasis should be on joint ventures and investment that allow production in developing countries to move up the value chain. Particularly in the global south, countries must retain the ability to diversify their economies beyond extractive sectors and participate in higher-value economic activities. This is especially important for resource-dependent economies seeking to avoid the "resource curse" and build more resilient economic foundations.

Global governance of industrial policy should also extend to the service sector. Trade in services is increasingly vital to global economic integration and complements traditional goods trade and value chains. Beyond tourism and digital services, services can enable climate action through mechanisms such as ecosystem services markets, allowing countries to exchange certificates for carbon sequestration or other environmental benefits. Expanding trade to services enables economies with limited goods production capacity to integrate into global value chains, benefit from specialisation and contribute to shared decarbonisation goals. Ensuring transparency, trust in data and robust institutional frameworks is essential to deliver global "win–win" outcomes, supporting sustainable development and international cooperation.

Government interventions should enhance, rather than diminish, competition and innovation. Pro-competitive industrial policy supports emerging sectors with growth potential while avoiding indefinite protection of declining industries. Policies should include built-in mechanisms for evaluation, adjustment and removal, ensuring public resources generate measurable improvements in productivity, employment and technological capability.

Effective industrial policy also requires robust institutions for design, implementation and monitoring. Despite the resurgence of industrial policy, few nations currently possess such institutions. Governments must invest in building these capabilities to prevent resource misallocation or policy capture. These institutions ensure that interventions do not remain in place after firms achieve competitiveness and enforce sunset clauses when policies fail to build competitive firms. The central challenge is not picking winners but cutting off support to underperforming firms. Accordingly, government assistance should be linked to performance targets and include predetermined timelines for evaluation and phase-out, maintaining competitive pressures while providing temporary strategic support. Benchmarking creates accountability for both agencies and supported industries, with emphasis on emerging industries and technological advancements rather than declining sectors. The traditional rationale – addressing market failures – remains relevant but requires clear exit strategies to prevent long-term distortions.

A central challenge in governing the new wave of industrial policies is creating transparency and building an evidence base for fair scrutiny, policy learning and international comparison. While global reporting standards could help curb harmful practices and spillovers, their adoption depends on credible incentives for countries to comply. This requires investing in institutional capacity to evaluate policies systematically, learning by doing and drawing on international peer exchange. Two priorities stand out: first, conducting comparative evaluations of common instruments such as research and development tax credits, renewable subsidies or venture capital to understand what works in practice; and second, developing coherent strategies that combine complementary tools within robust governance frameworks.

Creating architecture for global coordination

Global coordination is essential in an era where national policies increasingly generate international spillovers. While the OECD has begun mapping industrial policies (Criscuolo et al., 2022), there is no dedicated global forum to establish transparency standards or supply chain resilience rules. This institutional vacuum creates risks of policy conflicts, inefficient duplication and exclusion of developing countries from emerging opportunities.

The lack of coordination mechanisms enables several problematic dynamics. Countries may pursue beggar-thy-neighbour policies that solve domestic problems by creating costs for others. Wealthy nations might engage in subsidy races that primarily benefit those with greater fiscal capacity while crowding out developing country opportunities. Without agreed standards, legitimate development strategies may be challenged as unfair trade practices. Addressing these challenges requires new approaches to international economic governance.

Rather than trying to eliminate all government intervention, the focus should be on establishing guidelines that distinguish between beneficial and harmful policies. This might include protocols for transparency and notification, criteria for evaluating policy impacts, and mechanisms for dialogue when conflicts arise. Defining permissible local content requirements and creating space for developing economies to participate in high-value segments of global supply chains are crucial to avoiding a subsidy war between major economies that would marginalise emerging markets. Local content policies have become popular tools for ensuring that public investments generate domestic benefits, but poorly designed requirements can reduce efficiency and exclude developing countries. Coordinated guidelines could help balance legitimate domestic objectives with international economic efficiency.

Navigating trade-offs

A balance must be struck between domestic economic goals and international cooperation, as well as between development needs and climate policy. These tensions reflect deeper challenges in managing interdependent systems where local actions have global consequences and where multiple objectives must be pursued simultaneously.

The relationship between development and environmental goals exemplifies these complexities. Developing countries worry that environmental standards might become new forms of protectionism that prevent their access to global markets. Simultaneously, climate urgency demands rapid industrial transformation worldwide. The solution requires designing green industrial policies that create opportunities rather than barriers for developing countries, potentially through technology transfer, capacity building and differentiated standards that recognise varying national circumstances.

Large-scale subsidies in advanced economies create challenges for resource-rich and resource-poor developing countries alike. For resource-rich nations, the challenge involves ensuring that natural wealth translates into broader economic development rather than perpetuating commodity dependence. When advanced economies subsidise mineral processing and clean energy manufacturing, they may crowd out potential investments in developing countries unless accompanied by collaborative arrangements. Resource-poor developing countries face different pressures as they compete for investment and market access without the fiscal resources to match wealthy country subsidies. Their strategy must focus on identifying comparative advantages through strategic investments in education, infrastructure and institutions that enable participation in global value chains.

Conclusion

In recent years, targeted intervention in particular sectors of the economy has become a prominent political phenomenon, driven by crises in traditional industrial regions, reactions to China's more aggressive policies and the urgency of tackling climate change. This has led to a fundamental political break with the former market-dominated paradigm, yet without a well-developed new framework. The growing number of conflicts arising from this uncoordinated shift towards nationalist industrial policies reflects the absence of a new set of rules to prevent arbitrariness and disputes. Given the high welfare losses that such a vacuum may produce, it is imperative to develop guidelines that could form the basis of a new global governance framework.

A more structured and principled discussion is needed – one that distinguishes between beneficial and harmful policies and ensures that industrial policy supports rather than undermines global economic stability. In this context, it is increasingly important to openly discuss, monitor and evaluate current industrial policies to identify what lessons can be learned. This evaluation can help identify cases in which industrial policies have proven legitimate and effective in serving broader objectives, be it climate action, national sovereignty or the development of new industries requiring (initial) government support.

To date, discussions of industrial policy have largely focused on responding to China's initiatives. This focus may impede productive dialogue: it politicises debates that ought to be grounded in economic analysis, creates false binaries between market and state approaches, and obscures the reality that all successful economies combine market mechanisms with strategic government action. Most importantly, it distracts from the development of universal principles that could guide policy evaluation regardless of national origin.

The ultimate objective is to create a system where industrial policy serves collective prosperity rather than narrow nationalism. This vision recognises that in an interconnected world, economic security and development are best achieved through cooperation rather than confrontation. Countries that successfully combine domestic strategic thinking with international collaboration will be best positioned to thrive in the emerging global economy.

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