■ Industrial Power

Financing for Critical Industries

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SUMMARY

American techno-industrial strength cannot be restored without fundamental changes to how we finance industrial innovation and scale-up production. The existing policy paradigm does not provide sufficient incentives for investment in critical industries, which has resulted in the erosion of the defense industrial base, fragile supply chains, and unsustainable macroeconomic imbalances. An American sovereign wealth fund can fill this critical gap by using public funds to activate private investment.

PROBLEM

For decades, corporate and financial market incentives favored the separation of "techno" and "industrial." Business models such as "designed in California, made in China" divorced intellectual property rents from capital- and labor-intensive parts of the value chain. Software was "eating the world" because the highest-margin revenue streams could now be harvested without return-eroding investments in hardware and physical infrastructure. On top of that, foreign subsidies and industrial policies made cap-

ital-intensive sectors less attractive domestically and more attractive abroad. Today, the definition of "tech" itself is usually applied only to businesses with low marginal costs of expansion. Although policymakers often assumed that lofty valuations demonstrated US "tech" dominance, in reality, American companies were dominating a narrow, asset-light approach to innovation while our techno-industrial prowess—from Intel to Boeing to GE to the Detroit automakers and beyond—steadily declined. The result of this decline is not only our deteriorating capability to produce submarines, artillery shells, and other military materiel in sufficient quantities. This trend also contributes to increasingly fragile and inflation-prone commercial supply chains, as well as the erosion of quality middle-class jobs, inflated asset prices, and the macroeconomic imbalances and financial precarity witnessed since 2000.

Restoring America's techno-industrial leadership therefore requires fundamental changes to investor incentives. Making America great again requires making investments in critical capital-intensive sectors attractive again. While efforts to address this challenge encompass everything from environmental permitting reform to trade policy to tax policy, these will not be enough without one of the most important approaches to investment promotion: government-supported financing.

According to conventional economic theory, industrial policy investment vehicles will always be inefficient, value-destructive, and a drag on growth because they interfere with market-driven capital allocation. If private-sector actors require government support or prodding to make an investment, the theory goes, then it must be a poor investment, even if necessary for non-economic reasons such as defense.

These models assume, however, a form of economic rationality in which firms operate to maximize profits. In reality, firms operate to maximize shareholder value. The two may occasionally overlap, but they are not identical. As a result, firms often maintain hurdle rates well in excess of their cost of capital, and pursue financial engineering strategies instead of capital investment. This behavior is often eminently rational for maximizing short-term equity valuation. The net result is chronic national underinvestment, particularly in capital-intensive sectors where foreign industrial and trade policies drive down domestically produced returns. This is one reason why the relationship between financial returns and productivity breakthroughs has always been more tenuous than standard models would predict, and why smart industrial strategy can spur economic development by dislodging financial rentierism.

Government investment promotion can therefore enable investments whose returns, while below high private-sector hurdle rates, are still positive. These investments, in turn, can form the basis of new companies, technologies, and industries, as the many historical examples of successful industrial policies attest, from Korean autos to Taiwanese semiconductors to early Silicon Valley.

Tax incentives and deregulation, while certainly needed in some areas, will not be enough to bridge the gap between investor hurdle rates and the capital-intensive realities of critical techno-industrial sectors, particularly those facing foreign-subsidized competition. Proactive state investment plays an important role in these areas, and a development-oriented sovereign wealth fund is the most effective way to structure it.

SOLUTION

A Sovereign Wealth Fund

Channeling private capital into America's critical techno-industrial sectors will require more robust government investment authorities. President Trump has ordered the Secretaries of Treasury and Commerce to offer a plan for the creation of a US sovereign wealth fund, a bipartisan idea also explored by the Biden administration and previously by now-Republican Senator David McCormick (R-PA). Such a fund could be the key investment engine of American techno-industrial revival.

President Trump's executive order of February 3, 2025 stated that the purposes of a sovereign wealth fund should include "establish[ing] economic security for future generations, and promot[ing] United States economic and strategic leadership internationally." Neither of these purposes can be met unless the financing deficits confronting critical industries are addressed. The order also directs the Treasury and Commerce Departments to investigate the necessary legal considerations, including whether legislation is needed.

Fortunately, the legislative structure for such a fund—and, realistically, Congress will have to appropriate funds for a vehicle of any size to take shape—has already been outlined by Vice President Vance during his time in the Senate. In 2024 Senator Vance was about to cosponsor a bipartisan bill to establish the Industrial Finance Corporation of the United States (IFCUS). (Vance became the vice-presidential nominee shortly before the bill was introduced). IFCUS would be a development bank focused on critical, capital-intensive industries, such as the defense industrial base, advanced manufacturing, energy, and biotech production.

The administration should recommend that Congress establish a sovereign wealth fund as a government-owned investment vehicle, along the lines of the IFCUS model, to support:

1. Robust and resilient supply chains in critical sectors and industries
2. US manufacturing and the economic development it drives
3. Domestic commercialization of advanced technologies
4. Small- and medium-sized manufacturers, especially in critical sectors
5. Critical industries facing systematic underinvestment or unfair trade and industrial policies from other nations

This kind of sovereign wealth fund could leverage $50 billion in capital to generate hundreds of billions of dollars of private-sector financing. Following the ICFUS model, its tools should include the ability to issue and guarantee loans, issue bonds, take equity stakes, acquire assets, establish investment facilities and enterprise funds, and securitize its investments.

A key advantage of a development bank, or sovereign wealth fund, for techno-industrial policy is its budgetary efficiency. Unlike government grants (as in the CHIPS Act), a $50 billion appropriation to a development fund would be leveraged to produce a much larger multiple of deployable assets. Moreover, the fund would earn returns on its loans and investments, which could be redeployed without requiring future appro-

priations. Additionally, unlike a onetime grant program (such as CHIPS), the fund's permanent, portfolio structure allows for greater experimentation, adaptation, and customizability in financing models.

It is worth noting that the US currently has not one but two development banks for foreign investments: the International Development Finance Corporation and the Export-Import Bank of the United States. Entrepreneurs looking to build factories often find it easier to raise US government funds to build abroad than at home. The Trump administration's proposed sovereign wealth fund would correct this policy omission.

The US government also maintains a raft of programs aimed at de-risking early-stage technologies across multiple departments. But these agencies have very limited resources to support scale-up production, even as foreign subsidies target precisely this area. Too often, then, US government-supported technology companies end up locating production abroad. At precisely the moment when these companies could begin hiring employees, generating tax revenue, and producing at scale, they must shift production out of the US for lack of financing. Because of our failure to finance scale-up production, existing US technology investments often function to subsidize rivals, who reap the rewards of US R&D and often use their production capabilities to seize intellectual property leadership as well. This story has played out across critical sectors, from semiconductors, to batteries, to nuclear technologies and beyond. A sovereign wealth fund to invest in scale-up development is a critical missing piece in the US techno-industrial ecosystem.

JUSTIFICATION

The combination of a development-oriented sovereign wealth fund with good tax policy (and along with the other proposals outlined in this collection) could supercharge investment in America's techno-industrial future. The timing for the Trump administration is also propitious. The pressure to compete in AI has driven software companies to undertake previously unthinkable capital expenditures. Firms like Microsoft, Google, and Meta, whose business models defined the "fissured economy" of asset-light services separated from physical investments, are now investing in vertically integrated energy generation and securing hardware supply chains. At the same time, novel combinations of private equity, private credit, and insurance structures open new avenues for financing capital-intensive projects. Apollo Global Management, for instance, led multiple investments in chip manufacturing, in some cases in tandem with CHIPS Act funding. This model has also been proven internationally. The European Investment Bank achieved a 15:1 ratio of private to public capital deployment in its "Juncker Plan."

During the last several decades, Americans found a way to financially engineer seemingly everything except for investments in critical techno-industrial capabilities. Today, that may be changing, and prudent, proactive government investments offer a unique opportunity to finally mobilize the private capital needed for techno-industrial revival. ■

FURTHER RESOURCES

- American Compass, "A Domestic Development Bank: Financing American Industrial Development," 2023
- David Adler, "Financing Advanced Manufacturing: Why VCs Aren't the Answer," *American Affairs*, 2019
- David Adler and William B. Bonvillian, "America's Advanced Manufacturing Problem—and How to Fix It," *American Affairs*, Fall 2023.
- David McCormick, *Superpower in Peril: A Battle Plan to Renew America*, Center Street, 2023, 2019
- Senator Marco Rubio, "American Investment in the 21st Century," 2019

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