The Daily Dish

Put a Stake in the Stakes

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In its latest policy misstep, the Trump Administration announced it was taking a 10-percent stake in Trilogy Metals, costing $35.6 million and coming along with warrants for an additional 7.5-percent stake. The idea is to improve "national security" by providing access to mineral deposits – especially gallium and germanium, the markets for which are dominated by China. Eakinomics will resist the usual histrionics, hair loss, and hypertension. Instead, let's review why this is a bad idea.

First, there are the purely economic dimensions:

- **It is an inefficient subsidy for access**. If the goal is access to minerals, the policy should be to pay for a long-term contract guaranteeing the purchase of the minerals. This will require a premium above the spot-market price, which is effectively the subsidy, but it would not distort any other supply decision. The equity purchase is a subsidy to one factor of production – capital – which reduces costs and increases production, but also skews the mix of capital, technology, and labor toward capital. A less-efficient firm emerges.
- **It suffers from adverse selection**. Which firms are willing to give up 10 percent of their ownership? Bad firms. They either lack managerial spine or are unable to raise money in private capital markets. Don't buy. Just say no.
- **It sets bad precedents**. Other firms cannot be sure they are safe from being nationalized or that they will not face unfair subsidized competition. This leads to reduced entry and underinvestment in some industries.
- **It distorts capital markets in a couple of ways**. First, it involuntarily exposes taxpayers to Trilogy Metals risk. If they wanted that risk, they could have bought it on their own. They face the cost of re-balancing their portfolios as a result. Notice that the administration will emphasize that the taxpayer will get a return ("It's a great deal"), but this is just the flip side of the increased involuntary risk. This approach also

provides an incentive for investors to target firms likely to benefit from government intrusion. These are not the economic fundamentals that one wants as the focus of capital allocation.

There are also political economy considerations.

- **Politicians meddle in business decisions**. The Trump Administration has already used its "golden share" of Nippon Steel to force the company to keep an uneconomic plant running.
- **After the initial outlay, it is a hidden subsidy**. All of the subsidies should be on the budget and visible every year.
- **Politicians can never admit error, so the firms will never be allowed to fail**. The taxpayer will just keep pouring dollars down the drain and the politicians will provide protection against its competitors, Meanwhile the management will have no incentive or need to improve.
- **These are now technically state-owned enterprises (SOEs)**. SOEs are a recognized evil in global trading and face restrictions and retaliation. It is damaging to the nation's credibility for the administration to take these stakes while criticizing China's state subsidies.

Conservative economic policy used to be guided by a three-part test: 1) Can the private sector deliver this good or service efficiently? 2) Can the government provide this good or service? 3) Can the government provide this good or service *more* efficiently that the private sector? The test made sure the government was focused on the things at which it was uniquely effective. The administration discards these considerations as merely some strange fetish unique to economists. But disciplinary religion was never the point. The point was protecting the taxpayers from the economic and political fallout.