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INDUSTRIAL POLICY: SON OF CENTRAL PLANNING

INTRODUCTION

Proponents of industrial policy insist that their policies have nothing to do with centralized, comprehensive planning--which, they all agree, is both economically inefficient and politically dangerous.[1] While central planning requires the complete mobilization of a nation's economy under the control of a single decision-making agency, proponents of industrial policy claim that their approach asks only that an "investment-guiding" agency be permitted some measure of influence over an otherwise unguided capitalistic economy. It is hard to find an article supporting industrial policy which does not contain an explicit disclaimer that it is not a form of economic planning. Thus criticisms of centralized planning routinely are dismissed as entirely irrelevant to the case of industrial policy. Yet it is clear the criticism cannot be dismissed. Analysis of the logic of the proposal demonstrates that industrial policy and central planning are fundamentally indistinguishable. Indeed, today's industrial policy proposals are the son of yesterday's central planning schemes.

One can, of course, always define "industrial policy" in so innocuous a manner as to imply that every economy, by definition,

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1 See Robert B. Reich, "An Industrial Policy of the Right," The Public Interest, Fall 1983, p. 17. Reich admits that some "perplexing" political problems are raised by industrial policy such as, "How can we insulate it from the predations of narrow interest groups and the vagaries of partisan politics while ensuring that it is democratically accountable?" He denies, however, that there are any economic problems with industrial policy. While the author would agree that serious political problems plague industrial policy, this paper will restrict itself to describing an economic problem which Reich and other proponents of industrial policy have ignored.

has one.[2] In a recent issue of The Public Interest, one industrial policy advocate, Harvard economist Robert B. Reich, points out that "no tax, credit, or subsidy program, however neutral in appearance, is neutral in competitive effect." Thus, he concludes, "the United States has an industrial policy. It always has and always will."[3] What America lacks, says Reich, is not an industrial policy, *per se*, but an explicit one.[4]

Critics of economic planning, however, argue that the main reason government policymakers do not know how to guide economic development intelligently is that the problem exceeds the intellectual powers of the human mind to undertake deliberately or explicitly. When Reich and other industrial policy advocates ask for a more "coherent industrial policy"[5] they are aiming at the same goal as the 19th-century socialists and Marxists who wanted to bring the economy under the "conscious control" of a central planning agency. Both seek to subject the market economy--which is otherwise "anarchic" (as Marx put it) or "of the 'do-it-yourself' variety" (according to Reich)--to the deliberate control of a single organization. What distinguishes moderates like Reich from radicals like Marx and Engels is not their ultimate goals but their means. Both groups strive for a form of national economic planning; it is just the degree of comprehensiveness of this planning that differentiates them.

INDUSTRIAL POLICY AND CENTRAL PLANNING

Industrial policy advocates are much less extreme in their policy formulations than most advocates of central planning. Nevertheless, the critique of centralized or comprehensive planning that emerged in the classic "socialist calculation debate" of the 1930s[6] is also relevant to the more modest proposals aired

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2 *Ibid*., p. 7. Similarly, more forthright advocates of national economic planning usually try to dispel any fears by asserting that all economic systems must be "planned" in some sense.

3 *Ibid*., pp. 7-8. See also Amitai Etzioni, *An Immodest Agenda: Rebuilding America Before the Twenty-First Century* (New York: McGraw Hill, 1983), pp. 312-316.

4 Robert B. Reich, *The Next American Frontier* (New York: Times Books, 1983), p. 274.

5 Reich, "An Industrial Policy of the Right," p. 16.

6 The basic argument against central planning was articulated by Ludwig von Mises in 1922, *Socialism* (Indianapolis, Ind.: Liberty Press, 1981) and F. A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), pp. 119-208. Also see Trygve J. B. Hoff, *Economic Calculation in the Socialist Society* (Indianapolis: Liberty Press, 1981); Peter Murrell, "Did the Theory of Market Socialism Answer the Challenge of Ludwig von Mises? A Reinterpretation of the Socialist Controversy," *History of Political Economy*, 15:1; Karen Vaughn, "Economic Calculation Under Socialism: The Austrian Contribution," *Economic Inquiry*, Summer 1980; and Don Lavoie, *Rivalry and Central Planning: the Socialist Calculation Debate Reconsidered* (New York: Cambridge University Press, forthcoming).

today for a national industrial policy. Essentially the problem with comprehensive planning is not so much that it is comprehensive--indeed, this is the only sensible way to try to control an economy--but simply that it is planning. It proposes, in other words, to make a single agency responsible for deliberately controlling a process that can only be driven effectively by the competitive interactions of thousands of separate and often contending plans. Industrial policy still represents an attempt to plan an economy, without doing so comprehensively. As such the proposal still fails to resolve the difficulty raised by economists over fifty years ago.

What is worse, industrial policy represents an attempt to accomplish an end--the rational formulation of priorities for a nation's investment decisions--without supplying the means necessary for that end--the gathering of comprehensive knowledge about the detailed interconnections of the economic system, and the power to alter these details. This means that one can confidently expect the initial policy measures of the investment-guiding agency to fail and to require serious modifications. The nature of these modifications will depend on the policymakers' diagnosis of the failure. But since the advocates of industrial policy seem to presume that whatever degree of order an economic system attains must be due to deliberate coordinating policies of government, rather than to spontaneous competitive forces, it seems likely that their diagnosis would be that they lack sufficient central power and control over the economy. So while industrial policy may not be a form of central planning, as such, it could well be a big step in that direction.

The Nature of the Planning Agency

The crucial issue is not what industrial policy advocates would like to be the result of their proposals, but what economic analysis indicates would tend to result from the institutional structure implied in those proposals. What economic forces would an investment-guiding agency set in motion? It would depend in great measure on the intentions of those in charge of the agency. These would shape the policymakers' reactions to the unanticipated difficulties encountered by their initial measures.

Most advocates of industrial policy do not want to invest a central government with coercive powers so immense and detailed that they would seriously obstruct the workings of the market economy. But they do most earnestly want to give a national investment guiding agency enough power to decide deliberately and intelligently which industries to encourage and assist, and which to discourage and phase out.

How much power is enough to accomplish this task?

The Nature of the Market Process

Economic analysis shows that the complex workings of a market economy are driven by the mutually influenced choices of the millions of human minds that compose it. The factors that weigh on these choices, and the considerations that these minds find relevant, together make up the structure of information that brings a measure of coordination to the market process. As the classic debate over socialism showed, centralized planning runs into serious economic difficulties because it cannot hope to marshal the vast amounts of detailed knowledge that inform decentralized decision-making in the market. The market represents what Nobel Laureate F. A. Hayek calls a "telecommunication mechanism," a device for communicating information through money prices which permits those who engage in profit/loss calculations with them to effectively act on more information than any single mind or organization could ever master.

The market process may be compared with the process by which new knowledge is discovered within the scientific community. In both cases the effective generation of knowledge is made possible by virtue of the independent theorizing and experimentation of rivals who disagree on the best ways of doing things. The criticism of national economic planning is not fundamentally different from the case for academic freedom. Attempts by government to influence either scientific or market discovery processes are apt to sabotage them.

It is the mutually coordinated use of detailed information by individual decisionmakers that makes the market system work. Industrial policy advocates insist that they (unlike advocates of comprehensive planning) wish to do nothing to hamper the market process or to override its detailed functioning, but only desire to steer it in general ways--in other words, to shape it in the aggregate, not in its particulars. They do not aspire to tell the businessman in the machine-tool industry how he should organize his factory, but only to decide explicitly whether the machine-tool industry as a whole should receive more investment monies than, say, the fast-food industry.

Such a plausible and seemingly reasonable retreat from comprehensive or detailed planning to noncomprehensive or aggregative planning is, however, fundamentally illusory. Once control over detail is abandoned so must be control as such, except in the sense that the basic legal "rules of the game," within which economic choices are made, can and should be established. But aggregative industrial planning is more akin to throwing a wrench into a piece of machinery than it is to controlling anything.[7]

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7 See F. A. Hayek, Law, Legislation and Liberty, Vol. 1, Rules and Order (Chicago: University of Chicago Press, 1973) for his distinction between law and legislation.

WHY CENTRAL PLANNING MUST FAIL

What is "Planning"

A comprehensive planning agency, if it could exist in a modern economy, should not be confused with the more mundane and partial "planning" undertaken by any sensible person trying to achieve certain goals. The purpose of central planning is to plot and ensure the consequences of the agency's own actions. If the agency were successful, unintended consequences could be dispensed with and mankind could truly become master of its own future development. But if this ambitious goal proved unattainable, as most advocates of industrial policy now admit it is, what then can be said of comprehensive or aggregative planning? How does it differ from the partial planning of individual businessmen? Surely neither can pretend to be able to anticipate the remote consequences (both in time and place) of the limited variables it controls. In each case the attempt by any one decisionmaker to solve one problem may unintentionally lead to the creation of new problems for other decisionmakers.

The main characteristic that distinguishes planning done by a government from planning undertaken by others is that the former can employ coercion to help achieve its purposes. Nongovernment planners have to employ persuasion, such as offering something valuable in exchange, to get others to cooperate. This coercive advantage does not, however, guarantee that the goals promoted by the government planners will be accomplished. By definition, noncomprehensive planning seeks to control only part of the economic system, and hence those parts which it does not control are free to react in their own ways to government policies. These reactions and the further rippling consequences they engender cannot be fully anticipated by aggregative planners, and thus undesirable and unplanned results may follow in the wake of their policies. Indeed, why should aggregative planners be expected to be any better informed about the remote consequences of their coercion-backed plans than those who use persuasion?

The Impossibility of Complete Knowledge

Essentially, then, the problem with aggregative planning is a direct corollary of the flaws associated with comprehensive planning. The latter is impossible, because no single hierarchical agency could attain a level of intelligence to rival that which emergences socially from the competitive process. While aggregative planning, unlike comprehensive planning, is not an impossibility (indeed the world has seen little else this century), the same lack of knowledge on the part of any single person or organization which makes it impossible for comprehensive planning to replace the market also makes it irrational for an investment-guiding agency to try merely to "guide" the market. If the planning agency is necessarily less knowledgeable than the system which it is trying to guide--and even worse, if its actions must result in further undesired consequences in the working of that system--then what is going on is not deliberate planning at all, but rather blind interference by some agents with the plans of others.

Since industrial policy advocates want to plan aggregates rather than detailed specifics, for this reason alone it could be argued that their coercion-backed plans will necessarily be less informed. Details are the stuff of economic decision-making. Understanding how an economy works involves paying attention to the circumstances, meaning, and consequences of the individual human actions that make up an economic order. Aggregates are irrelevant in that they are simply constructs of economic theorists. They have no meaning to human actors and play no role in their choices.

One of the most eloquent critics of centralized planning, Michael Polanyi, has illustrated this point by the use of an analogy with a chess team playing a hundred games of chess. If what really counts for effective decision-making in economics and chess playing is the detailed and contextual knowledge of the individuals involved, then any attempt to control an economy or a chess team according to broad aggregate categories must necessarily drop that context and muddle the details.

> It is as if the manager of a team of chess players were go find out from each individual player what his next move was going to be and would then sum up the result by saying: "The plan of my team is to advance 45 pawns by one place, move 20 bishops by an average of 3 places, 15 castles by an average of four places, etc." He could pretend to have a plan for his team, but actually he would be only announcing a nonsensical summary of an aggregate of plans.[8]

If the chess team captain were actually to try to get his players to carry out his plan they would be led to make decisions, such as "advance a pawn," irrespective of the only context in which such decisions can be at all meaningful. Can there be any doubt that a chess team subjected to such interference would play exceedingly bad chess?

Contemporary advocates of industrial policy freely admit that the national investment guiding agency would not endeavor to obtain comprehensive detailed knowledge of the working details of the American economy. They seem to believe that this admission insulates them from the criticisms of central planning. But if the planners cannot obtain such detailed knowledge and are forced to formulate their plans in terms of broad aggregates, they would be

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8 See Michael Polanyi, The Logic of Liberty (Chicago: University of Chicago Press, 1951), p. 134.

trying to mould people's actions in general directions, without knowing either the goals of each individual or even what actions he is taking. Making such planning directives vague and general, instead of detailed, in other words, does not in the least answer the challenge posed by the economists' critique of planning. If the planners do not know the details, then they do not know what they need to know to justify the imposition of their choices over those they are trying to direct.

The Uselessness of Economic Aggregates

No one in the real economy weighs the value of aggregated constructs of particular goods. They directly assess individual goods in particular combinations and thus it is only on this particular level that the causal movement of economic phenomena can be adequately explained or controlled. Changes in an aggregate, whether as large as "GNP" or as small as "electronic components and accessories," are purely accidental by-products of individual human actions undertaken with respect to particular goods. Thus it is no more rational for an economy to be guided by general directives such as "invest more in computer technology" than it would be for a chess player to be guided by a directive to "advance a pawn." The appropriate responses of either decisionmaker would have to be to ask which specific investment or pawn move is desired, and why, and how it might fit into the overall strategy. However if the director could answer those questions he would not need subordinates at all. He could be the society's investor or the whole chess team himself.

The Problem of Infinite Choices

It is true, of course, that there are important differences between the conduct of Polanyi's hundred games of chess and the running of a modern, technologically advanced economy. But if the main differences are examined it would seem that they tend to strengthen rather than weaken the force of Polanyi's argument.

For example, the possible moves available to a chess player in any particular context are finite and could be listed by anyone who knows the rules. The possible choices of an economic decisionmaker, by contrast, are unbounded. His inability to list all his options is due not only to their sheer number but also to the fact that complete surprises are possible. Even given an infinite amount of time, some possibilities might never occur to him. Under such conditions of radical uncertainty,[10] the decisionmaker is forced all the more to rely on habitual modes of behavior established by a process of evolutionary selection in a profit

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10 See Ronald H. Heiner, "The Origin of Predictable Behavior," American Economic Review, 83, 4, 1983; and Richard R. Nelson and Sidney G. Winter, Evolutionary Theory of Economic Change (Cambridge, Mass.: Harvard University Press, 1982).

and loss environment. His choices are not straightforward calculations. They are of necessity based on tacit hunches. Such hunches do play an important role in chess as well, but it is at least conceivable that chess could be played by examining every possible contingency and computing the best move.[11] This possibility is not even remote in the case of economic decision-making.

The Interaction of Decision-Making

A more significant difference between decision-making in a chess team and in an economy is the fact that chess team players are only rivals of single opposing players and need not coordinate their activities with one another. Each game can be viewed in isolation, and thus the combined intelligence of all the players on one team is only a function of their average intelligence. But in the case of economies the overall intelligence of the system is greatly enhanced by the process of mutual interaction--the method of adjustment of each participant to the signals supplied by his fellows. In other words, whereas for the chess team captain to plan his teammates' moves he need only know all of their strategies in each of their specific games, for the economic planner to direct the economy would require that he know all the individual decisionmakers' strategies and also that he know something none of them know: how their competitive pulling and tugging will affect one another's choices.

The Superiority of Free Competition

It is this central problem that comprises the fundamental economic argument against all forms of national economic planning, whether comprehensive like Marx's or aggregative like Reich's. Competition is, as F. A. Hayek put it, a "discovery procedure."[12] It is a process that generates and conveys more knowledge than any of its participating contenders can possibly know. If planners could know in advance what they learn by permitting competitive forces to operate, they would not rely on them in the first place. Economic rivals frustrate each other's plans, but also provide information to guide them by virtue of their contrary tugs on prices. When one producer outbids another for some scarce factor of production, for instance, the excluded buyer has learned to use more efficient factors. No single rival, including government, can know what information market rivalry will discover without "playing out" the competitive process. Thus no single

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11 In fact modern researchers in the field of artificial intelligence have found it necessary to program computers to play chess by means of general "rules of thumb" learned from the experience of playing hundreds of games, rather than by the "brute force" method of trying to examine all possible moves.

12 See F. A. Hayek, New Studies in Philosophy, Politics, Economics and the History of Ideas (Chicago, University of Chicago Press, 1978), pp. 179-190.

organization has sufficient knowledge either to replace (Marx) or interfere with (Reich) this competitive process.

This competitive process can only discover new knowledge effectively so long as the contenders are free to experiment with the production methods they imagine will be successful. If, however, some production methods are chosen by an agency armed with the coercive powers of government, and some aggregate categories of industries are promoted at the expense of others, this cannot help but distort the workings of the discovery process. While industrial policy advocates have shown some awareness of the problems concerning special interest politics that are posed by an investment-guiding agency, they seem completely unaware of the economic difficulties caused by tampering with the competitive discovery process.

CONCLUSION

It is true, of course, that in a sense every nation has an "industrial policy." The sum of the actions of a government as Reich points out, cannot be neutral "so long as government has a role to play in the economy." The modern economy is undoubtedly quite heavily influenced by government policies, from defense spending to welfare measures, from antitrust laws to regulatory activities. The proponents of industrial policy seem to draw from this undeniable fact that the U.S. already has some sort of industrial policy. The much more contentious conclusion they draw from this observation is that America needs more conscious and coherent industrial policies. In light of the inherent deficiencies of central planning, however, it might be argued that the U.S. should instead try to reduce current government interference with the competitive process to the absolute minimum consistent with other political goals.

A society cannot avoid deciding on the general "rules of the game," that is, the system of laws and property rights within which economic competition takes place. But the central purpose of such laws should be to permit individuals to freely contend with one another for the consumer's dollar, without special access to government largesse. Such an "industrial policy" would indeed be unguided and implicit. Its winners and losers would emerge spontaneously from a process that no single agency could predict, much less control. Contemporary proponents of industrial policy see this as a defect. It should, however, be viewed as a virtue. If no agent knows better than the unconscious social process of market competition how to rationally allocate resources, then it would seem best, not only politically but also economically, to leave that process alone.

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