# A "GOOD" INDUSTRIAL POLICY IS IMPOSSIBLE: WITH AN APPLICATION TO AB5 AND CONTRACTORS

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## INTRODUCTION

Industrial "policy" in capitalism is automatic and self-correcting, animated by the logic of profit and loss.[1] But the "market failure"[2] rationale for government direction of resources and provision of goods and services rests on the claim that the profit test cannot provide public goods, discipline natural monopolies, solve problems of asymmetric information, or internalize social externalities. Progressive political operatives would go much further, arguing that the direction of the economy requires a "hand on the tiller," with the conscious and intentional direction of investment to ensure that growth occurs in the areas of maximum social benefit and efficiency.[3]

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[1] Marshall and Marshall is the earliest, clearest mathematically complete argument for this position. In a competitive system, profits should be transitory, but the signal given by profits (or losses, which should also be transitory) is essential for the system to function effectively. *See* MARY P. MARSHALL AND ALFRED MARSHALL, THE ECONOMICS OF INDUSTRY, (MacMillan & Co. ed. 1881). Mises argued not only that profit and loss was the best industrial policy, but that no other politically selected "policy" was even feasible. *See* LUDWIG VON MISES, *Profit and Loss* in PLANNING FOR FREEDOM (Libertarian Press ed. 1952); *see also* Walter Block et al., *No Policy is Good Policy: A Radical Proposal for U.S. Industrial Policy*, 17 GLENDALE LAW REV. 47 (1999). Smith and Cannan sought to give moral authorization to profit, and commercial society, precisely so the system could carry out this function. *See* ADAM SMITH AND EDWIN CANNAN, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (Ixia Press ed. 2019) (1776).

[2] For foundations, s*ee generally* A.C. PIGOU, THE ECONOMICS OF WELFARE 331 (4th ed. 1932); Francis M. Bator, *The Anatomy of a Market Failure*, 72 THE QUARTERLY J. ECON. 351, 357 (1958). For modern syntheses, *see* A. W. Brian Simpson, *Coase v. Pigou Reexamined*, 25 J. LEGAL STUDIES 53 (1996); J. O. LEDYARD, *Market Failure* in THE NEW PALGRAVE DICTIONARY OF ECONOMICS (S. N. Durlauf & L. E. Blume eds., 2nd ed. 2008); Roger E. Backhouse & Steven G. Medema, *Economists and the Analysis of Government Failure: Fallacies in the Chicago and Virginia Interpretations of Cambridge Welfare Economics*, 36 CAMBRIDGE J. ECON. 981, 982 (2012) (quoting James M. Buchanan, *Politics, Policy, and the Pigovian Margins*, 29 ECONOMICA 17 (1962)); Iain Marciano and Steven G. Medema, *Market Failure in Context*, 47 HISTORY OF POLITICAL ECONOMY 1 (2015).

[3] Describing in detail the enthusiasm for industrial plans in the Roosevelt administration. *See* IRA C. MAGAZINER AND ROBERT B. REICH, MINDING AMERICA'S BUSINESS (Harcourt, Brace, and Jovanovic ed. 1982); *see generally* A. BADGER, FDR: THE FIRST HUNDRED DAYS, (Hill and Wang ed. 2008); AMITY SHLAES, THE FORGOTTEN MAN: A NEW HISTORY OF THE GREAT DEPRESSION, (Harper ed. 2008).

The "public choice"[4] counterargument to claims that market failure and social suboptimality are sufficient conditions for state action were spelled out in the 1960s; the argument was later incorporated into and elaborated on by the "law and economics" tradition.[5] The counterargument centers on two problems:

- *Information*—knowledge of the relative scarcity of resources is not possessed by anyone, and without prices, such knowledge literally does not even exist.
- *Incentives*—public officials act on their own goals, and according to their own purposes, rather than automatically acting in the public interest, even if the public interest were known by all.

More simply, the so-called "public choice objection" argues that while emergent market orders organized by the profit test fail to implement conceptually ideal social outcomes, the alternative of top-down planned industrial policies cannot reliably do better and may do much worse, either because (1) government officials cannot access the dispersed knowledge that would be required, or (2) because the incentives and collective action costs that face state actors prevent the implementation of the ideal policy if it could be identified.[6]

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4 Originally, the critique of market failures focused on public goods and externalities. *See* PETER J. BOETTKE AND JAMES M. BUCHANAN, *The Rebirth of Political Economy* in ECONOMICS AND ITS DISCONTENTS: TWENTIETH CENTURY DISSENTING ECONOMISTS 21-39 (Richard P.F. Holt, Steven Pressman ed. 1998); R.H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960); R.A. Epstein, *Law and Economics: Its Glorious Past and Cloudy Future*, 64 THE UNIV. OF CHICAGO L. REV. 1167 (1997). More recently, the process of state implementation itself has been highlighted. *E.g.*, CLIFFORD WINSTON, MARKET FAILURE VS. GOVERNMENT FAILURE, (Brookings Institution ed. 2006); William R. Keech & Michael C. Munger, *The Anatomy of Government Failure*, 164 PUBLIC CHOICE 1 (2015). For a recent review of "behavioral public choice" *see* W. Kip Viscusi and Ted Gayer, *Behavioral Public Choice: The Behavioral Paradox of Government Policy*, 38 HARV. J.L. & PUB. POL'Y 973 (2015).

5 *See* DANIEL FARBER AND PHILIP FRICKEY, LAW AND PUBLIC CHOICE, (University of Chicago Press ed. 1991). For the origins of law and economics in industrial planning, *see* HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (Free Press ed. 1966).

6 George Stigler summarized the argument this way:

For some, market failures serve as a rationale for public intervention. However, the fact that self-interested market behavior does not always produce felicitous social consequences is not sufficient reason to draw this conclusion. It is necessary to assess public performance under comparable conditions, and hence to analyze self-interested political behavior in the institutional structures of the public sector. Our approach emphasizes this institutional structure--warts and all--and thereby provides specific cautionary warnings about optimistic reliance on political institutions to improve upon market performance. We may tell the society to jump out of the market frying pan, but we have no basis for predicting whether it will land in the fire or a luxurious bed.

GEORGE STIGLER, *The Economists' Traditional Theory of the Economic Functions of the State* in THE CITIZEN AND THE STATE: ESSAYS ON REGULATION 103 (University of Chicago Press ed. 1975). Francis Fukuyama noted that:

An industrial policy worked in Taiwan only because the state was able to shield its planning technocrats from political pressures so that they could reinforce the market and make decisions according to criteria of efficiency—in other words, worked because Taiwan was not governed democratically. An American

Historically, both Public Choice and Law and Economics critiques of industrial policies have focused on the first category of objection, that state officials and bureaucrats have no access to the dispersed and unorganized knowledge that would be required to make accurate assessments of "winners" and "losers," directing resources toward the good industries, and then politely but firmly ushering the soon-to-be (in the minds of experts) obsolescent industries off the stage.[7]

Surprisingly, or so I will argue in this paper, the main internal concern of the advocates for interventionist industrial policy has been a forthright admission that political incentives in a democracy make "good" industrial policy difficult to implement or maintain. The key feature, a necessary condition for success, *according to the advocates themselves*, is that *industrial plans be insulated from democratic and political influences, precisely because* industrial planners openly concede that *the Public Choice objections are correct*.[8] A close reading of the interventionist literature reveals that the incentive problem is the key obstacle standing in the way of successful industrial policy because "helpful" government action will be distorted and coopted by political power, and the public interest will be given short shrift.[9] My method is to grant, for the sake of argument, the "perfect information" assumption made by the dirigistes to focus on the incentive problem.

Analytically, there are three categories of industrial policy:

(1) The pattern of investment and economic growth resulting from "the profit and loss test," which is simply the "industrial plan" of unfettered capitalism

(2) The pattern of investment and economic growth resulting from "political capitalism," or cronyism, the result of allowing powerful political interests and rent-seeking to direct taxes and subsidies toward industries

(3) The pattern of investment and economic growth envisioned by advocates of a socially optimal industrial plan, assuming an omniscient despot

For the sake of argument, I grant that the benevolent despot solution to the "knowledge problem;" all participants actually know the three outcomes

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industrial policy is much less likely to improve its economic competitiveness, precisely because America is more democratic than Taiwan or the Asian NIEs. The planning process would quickly fall prey to pressures from Congress either to protect inefficient industries or to promote ones favored by special interests.

FRANCIS FUKUYAMA, THE END OF HISTORY AND THE LAST MAN 125 (Free Press ed. 1992).

7 *See* DON LAVOIE, NATIONAL ECONOMIC PLANNING: WHAT IS LEFT? 123 (Mercatus Center ed. 2016).

8 PIGOU, *supra* note 2, at 331.

9 Dani Rodrik, *Green Industrial Policy*, 30 OXFORD REV. ECON. POL'Y 469, 472 (2014).

(profit test, political outcomes, optimal plan) and the path that leads to them.[10] The point is not that this is true (it isn't), but rather that even granting an absurd premise is insufficient to rescue comprehensive industrial plans from the ash heap of policy history, at least in a liberal democracy.[11]

My conclusion is that, in a democracy, a "good" (i.e., socially optimal) industrial policy is impossible, even supposing (counterfactually) that planners had all the information required to identify the appropriate policies. The form of the argument, then, is to accept the premise of the proponents of industrial policies—good policies fail the political viability test—and use it to show that no good industrial policy can be produced or sustained in a democracy. The problem is government failure, not market failure.[12]

The paper's outline is as follows. Section I is a review of the arguments for industrial policy and "public choice" information and incentive objections to politically-selected activist intervention in the economy. Section II is a more technical argument for why "good" industrial policy is impossible. Section III considers the case of the management of "contractors" and "employees" in California under Assembly Bill 5. The final section offers some conclusions.

## I. THE PROFIT TEST AND POLITICAL INDUSTRIAL POLICY

### *1. Overview of the Naïve Argument for Industrial Policy*

An "industrial policy" is the set of government actions that encourage or directly subsidize the expansion of some economic sectors.[13] The motivation of such state actions can range from a narrow focus on "balancing" economic growth to a broader focus on the economy-wide expansion (in the case of general education subsidies) to an even broader rejiggering of market outcomes to achieve social objectives of environmental protection, empowering labor, or redistributing wealth to achieve notions of social justice.[14]

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10 Boettke, *supra* note 4, at 21-39 (describing this as the "thermostat" model of public policy, where all is required is to use experts to select the optimal level of budget or policy—in this case, industrial policy of taxes, subsidies, and regulations to select winners and losers—and then enter the setting into a machine, where it will be implemented perfectly and without cost).

11 This does raise the question of whether an industrial plan might be viable in an a relatively small, highly authoritarian state such as Singapore. That is beyond the scope of this paper, though *see* Denis Binder, *The Deceptive Allure of Singapore's Urban Planning to Urban Planners in America*, 3 J. COMPAR. URBAN L. & POL'Y 155 (2019).

12 *See* William R. Keech & Michael C. Munger, *The Anatomy of Government Failure*, 164 PUBLIC CHOICE 1, 2 (2015).

13 Robert B. Reich, *Why the U.S. Needs an Industrial Policy*, HARV. BUS. REV., Jan.-Feb. 1982, at 74, https://hbr.org/1982/01/why-the-us-needs-an-industrial-policy.

14 Dani Rodrik, *Industrial Policy: Don't Ask Why, Ask How*, 1 MIDDLE E. DEV. J. 1, 2–21 (2014).

The benchmark "industrial policy," in a market system at least, is the *profit test*.[15] If an entrepreneur negotiates voluntary contracts with owners of materials, capital, and labor, each of those input suppliers is better off as a result of the exchange. If the entrepreneur sells the resulting product in voluntary exchanges with buyers of the product, then each of those consumers is better off as a result of the exchange. The sum of those benefits—seller surplus to suppliers and consumer surplus to buyers of the product—is the social benefit resulting from the entrepreneurial mediation of the firm. Without that firm, each seller would be worse off because they would have sold to the next best buyer; each consumer would be worse off because they would have paid more or bought something else that was not as desirable.

But the entrepreneur requires a signal that gives information about whether the activity is valuable and gives an incentive that it should be abandoned, cut back, continued, or expanded. The signals of profit and loss provide both of these data in a way that is decentralized and requires no centralized management.[16] If the sum of the revenues from consumers exceeds the sum of the costs of the contracts paid out to suppliers, this is a profit, and the activity should be continued or expanded; if not, that's a loss, and the activity should be cut back or suspended entirely. Without externalities or artificial market power, non-negative profits are a necessary and sufficient condition for the social justification of the activity. The correct industrial policy is then simply ensuring conditions in which entrepreneurial intermediation is encouraged: a stable money supply, predictable and consistent tax and regulatory policies, and a judicial system for defining, exchanging, and adjudicating disputes over property rights.

In fairness, the caveats in the "correct industrial policy" story above are not innocuous. Externalities can render profits neither *necessary* (in the positive case) nor *sufficient* (in the negative case) to indicate that an activity is socially desirable. Market power can create artificial protections of profits from entry or competition, implying that the social impact is not positive but may be a (possibly unjust) transfer from suppliers or consumers to firm owners. It is just this kind of "yes, but…" argument that is the foundation of the "market failure" approach to justifying an active industrial policy that substantially changes the outcomes observed under the profit test alone.[17] Markets are not perfect, the argument goes, so the state should act. As has been pointed out in the public choice response, this is not a logically coherent

[15] Mises, *supra* note 1, at 7.

[16] There are defenders of markets who base the argument for capitalism on the natural property rights of the firm owners, claiming that the ownership of productive resources is a per se justification for protection of profits from state action or interference. That argument is interesting, but it has been explored elsewhere. For my purposes, the social welfare claim is sufficient; I take no position here on the stronger moral claim.

[17] Bator, *supra* note 2; Ledyard, *supra* note 2.

claim because the imperfection of markets does not imply the perfection, or even the relative superiority, of the state.[18]

In practical terms, the political pressure for an activist industrial policy goes far beyond market failures. Progressive activists think of industrial policy as a cure for the "failure" of the market to deliver the entire vector of outcomes that match the desires of political elites in every dimension. It is easy to see why the active direction of resources is seductive to political elites because observed economic outcomes could never be "ideal." It is tempting to want a little more of this and less of that; further, "more of everything, for everyone!" is hard to oppose. Of course, the record of industrial policies in actually delivering "more of everything, for everyone!" is not very hopeful, but promises and ostensible intent are powerful political tools. After all, if it didn't work, the only explanation is that we didn't spend enough! And even if the results are disappointing in this instance, doing something is still better than not trying at all, isn't it?

There is an opposing view; rather, there are two opposing views that are not mutually exclusive: the *information* objection and the *incentives* objection.[19] The information objection holds that the state, or experts appointed by the state, lack detailed information about resources, and local workings of particular production processes, to be able to select an industrial policy that would improve over the profit test. The strong form of this claim holds that no "better" allocation of resources exists, and anything done by the state that differs from the allocation chosen by the market system will be socially inferior. But it is not necessary to take a strong position for this argument to work; the fact that state actors are making top-down choices from a centralized vantage point ensures that "good" industrial policies—policies that improve on the profit test--are a set of measure zero, and the chances of stumbling onto an improvement are negligible.

The incentive objection does not deny the importance of the information problem but extends it. Suppose that state-appointed experts *could* identify an allocation of investments and subsidies that would improve on the profit test and implement that policy instantaneously. Then the political incentives would cause the replacement of that optimal policy in favor of another allocation that benefits those in power. In technical terms, the "win set" of the optimal policy is always non-empty, and in the real-world political incentives will prevent the implementation of the optimal policy in the first place.

It is tempting, particularly for those innocent of economic knowledge, to think that the argument for an active, directive "industrial policy" is straightforward: why not take what nature gives us and improve on it? We'll get our smartest, best people and make things better in short order. In 1982, Robert Reich summarized the argument in terms so plain that it would seem

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[18] Keech, *supra* note 12.

[19] Michael Munger*, 30 Years After the Nobel: James Buchanan's Political Philosophy*." REV OF AUSTRIAN ECON. 31, 6 (2018).

any rational person would agree. U.S. industrial policy should combine "supply side" measures to raise the level of investment and "investment policies" in infrastructure to raise the return on investment, to "smooth" employment losses in declining industries, and to subsidize the vigorous expansion of industries that would help the economy grow. Industrial policy "by balancing regional growth and by assisting workers forced to retrain or relocate, seeks to defuse the resistance to economic change likely to come from those who would be the hardest hit." [20]

Of course, the rationale behind the "profit test" for expansion and contraction is that profit and loss give accurate and granular feedback for each separate activity in the economy. The argument for *laissez-faire* is the fast, useful, and decentralized information about the *social* value of what is being created, and what resources would be better employed elsewhere. Joseph Schumpeter famously gave a more dynamic description of the animated profit test.

The opening up of new markets, foreign or domestic, and the organizational development from the craft shop to such concerns as U.S. Steel illustrate the same process of industrial mutation—if I may use that biological term—that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism.[21]

Industrial policy is conscious and explicitly intended to deny the essential fact about capitalism.[22] If anything, the idea of industrial policy, from mercantilism in the 18th century to "balance through finance" in the late 19th and early 20th centuries, predates the clear articulation of the profit test.

This story is told vividly by Glock.[23] After the Panic and Depression of 1873-1878, an energetic "new movement declared it the government's duty to keep all sectors of the economy in a grand balance with one another."[24] From the profit test/creative destruction perspective, the expansion of productivity and mechanization in farming meant that too much land, and far too much labor, was being devoted to an industry that had "mutated."[25] Resources *should* have been moving out of farming. In some countries,

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20 Robert B. Reich, *Why the U.S. Needs an Industrial Policy*, HARV. BUS. REV., Jan. 1982, at 74.

21 Joseph A. Schumpeter, Capitalism, Socialism & Democracy, 83 (George Allen & Unwin 3rd ed., 1981) (1942).

22 With thanks to Thomas Sowell, who said, "The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics." Thomas Sowell, *Is Reality Optional? And Other Essays*, HOOVER INST. (Nov. 1, 1993), https://www.hoover.org/research/reality-optional-and-other-essays. If creative destruction is the essential fact about capitalism, then industrial policy denies the essential fact about capitalism.

23 Judge Earl Glock, The Dead Pledge: The Origins of the Mortgage Market and Federal Bailouts, 1913-1939 (Devin Fergus, Louis Hyman, Bethany Moreton, and Julia Ott eds., 2021).

24 *Id.* at 1.

25 R.T. McMillan, *Effects of Mechanization on American Agriculture*, 70 SCIENTIFIC MONTHLY 23, 26 (1949).

particularly Stalinist Russia, this was achieved by massive programs of resettlement and starvation, wreaking enormous destruction and suffering.[26]

The same process of creative destruction in the U.S. was signaled by falling profits in the agricultural sector. But the industrial policy of the Progressive reformers, beginning in the 1890s and continuing to . . . well, the present day, was to "balance" the sectors by subsidizing agriculture and implicitly taxing the more productive sectors to raise funds.[27] The idea of using subsidies and government investments to assist under-performing sectors directly contradicts the logic of the profit test, but it has been a foundational trope of Progressive industrial policy.

But modern Progressive industrial policy is seen by its supporters as forward-looking and creative. It is not necessary for industrial policy to be perfect, after all, the politically-selected policy need only be an improvement over the status quo, where that status quo reflects market failure. It is at this point that the Public Choice counterargument can go astray, in my view, because Public Choice scholars have simply (and possibly tendentiously) reversed the burden of proof. The market failure paradigm alleges that market imperfections justify state action, but that is only true if state action improves the situation. Likewise, the Public Choice counterargument would seem to allege that any government failure justifies sticking with markets alone. Each of these two arguments is an oversimplification.[28]

The problem is that there are *three* alternatives to consider: the results produced by the profit test, the results produced by political processes in which rent-seeking is rampant, and the results produced by an expert-driven industrial plan *if that plan can be insulated from both market and political pressures*. In an earlier book, I claimed that these three broad categories—markets, politics, and experts—are the only alternative sources of legitimate authority in a liberal society.[29] Through constitutional, conventional, or other means, any liberal society divides the domain of choices into (1) individual choice or voluntary action (markets); (2) collective choice using voting or other "choosing in groups" institutions (politics); (3) technical, scientific, religious, or other top-down commands or direction (experts). My argument in that book was that in such a system of "separation of powers," policy will always be conflictual as these different authorities vie for dominance.

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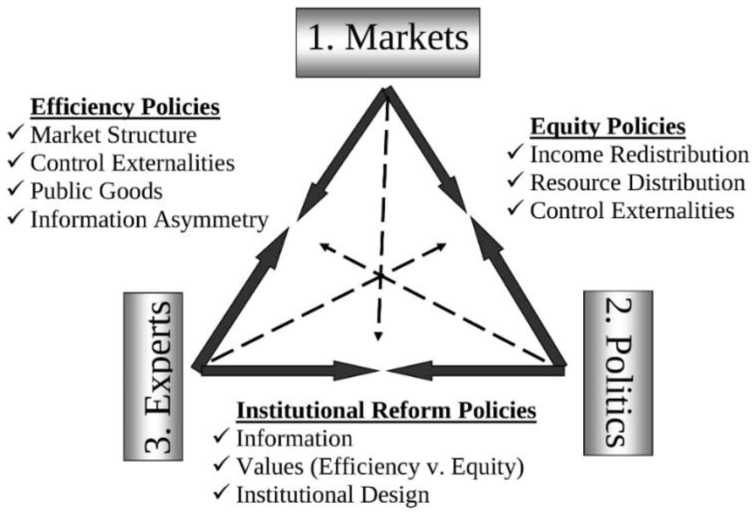
26 ROBERT CONQUEST, THE HARVEST OF SORROW: SOVIET COLLECTIVIZATION AND THE TERROR-FAMINE. (1987).

27 GLOCK, *supra* note 23, at 4

28 The author thanks Murat Mungan for suggestions that helped clarify the argument in this section.

29 The definition of legitimate is problematic, and sometimes seems circular. The use of the word in this context dates at least from Weber, who defined a state this way: "[A] state is a human community that (successfully) claims the monopoly of the *legitimate* use of physical force within a given territory." MAX WEBER, ESSAYS IN SOCIOLOGY 77 (H.H. Gerth, C. Wright Mills eds. & trans., 1946) (1921) (emphasis added)); *see generally* MICHAEL MUNGER, ANALYZING POLICY: CHOICES, CONFLICTS, AND PRACTICES (Stephen Dunn ed., 2000).

**Figure 1: The Policy Conflicts Among Three Sources of Legitimate Authority**




As the figure suggests, each binary "policy conflict" will also be influenced by the excluded power source. For our purposes, the key policy conflict segment—industrial policy—will be characterized by a debate between markets and experts (with politics exercising influence through budget authority and oversight by Congressional committees).[30] The "experts" could range from economics authorities, who seek to direct market structure and investment, to environmental scientists seeking to control pollution, to welfare specialists seeking to manipulate taxes and subsidies in ways that generate greater total welfare or social justice, since all of these goals (and more) have been mentioned as targets of industrial policy.

My claim is that advocates of industrial policy have set themselves a "to-do list," which goes something like this:

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[30] Gary W. Cox & Mathew D. McCubbins, *Bonding, Structure, and the Stability of Political Parties: Party Government in the House*, 19 LEG. STUDIES QUARTERLY 215, 216 (1994); Barry R. Weingast & William J. Marshall, *The Industrial organization of Congress: or, Why Legislatures, Like Firms, Are Not Organized as Markets*, 96 J. POL. ECON. 132, 144 (1988); Barry R. Weingast & Mark J. Moran, *Bureaucratic Discretion or Congressional Control? Regulatory Policymaking by the Federal Trade Commission*, 91 J. POL. ECON. 765, 770 (1983).

- Gain control of the technocratic authorities so that the "right people" head the relevant regulatory agencies
- Select the best policies to achieve a dog's breakfast of diverse social goals
- Exclude both politics and markets so that only correct-thinking technocrats have the standing to decide or even to make public statements about industrial policy.

Lest the reader dismiss my caricature as tendentious, consider a serious statement of the problem by one of its most vocal and competent advocates, the economist Dani Rodrik:

> The case against industrial policy comes in two forms. The first . . . is that governments do not have the information needed to make the right choices as to which firms or industries to support . . . The second . . . is that once governments are in the business of supporting this or that industry, they invite rent-seeking and political manipulation by well-connected firms and lobbyists. Industrial policy becomes driven by political rather than economic motives . . .
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> I contend . . . that the first [claim] is largely irrelevant, while the second—*about political influence—can be overcome with appropriate institutional design*. Good industrial policy does not rely on the government's omniscience or ability to pick winners. Mistakes are an inevitable and necessary part of a well-designed industrial policy program; in fact, too few mistakes are a sign of underperformance.[31]

To Rodrik's credit, he correctly identifies each of the two central arguments against technocratic industrial policy: information and incentives.[32] My charter in this paper is not to consider the information claim, which has been argued at length elsewhere.[33] The question is whether the incentives problem, the problem of creating a technocratic elite with absolute power over the economy and completely free from all political influence, "can be overcome with appropriate institutional design."[34]

Progressive economists emphasize the precariousness of capitalist growth and the tendency shown by market systems toward cronyism. The "market failure" model is then deployed to justify state action, which really comes to the claim that capitalism will work better if it is planned and directed by a technocratic elite of the right background and mindset. If this technocratic elite could just be released from the strictures of democratic accountability, growth would skyrocket, poverty would disappear, and all the roads would run downhill in both directions. The problem is democracy; those who favor "good" industrial policy must somehow explain how their

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31 Rodrik, *supra* note 9, at 472 (emphasis added).

32 *Id.*

33 Bruce Caldwell, *Hayek and Socialism*, 35 J. ECON. LITERATURE 1856 (1997); Pedro Bento, *Competition as a Discovery Procedure: Schumpeter Meets Hayek in a Model of Innovation*, 6 AM. ECON. JOURNAL MACROECONOMICS 124 (2014). *See generally* Friedrich Hayek, *The Use of Knowledge in Society,* 35 AM. ECON. REV. 519 (1945).

34 Rodrik*, supra* note 9, at 472.

"experts" will be able to prevent the *third source of power—politics*—from wresting control over the process of direction.

It is always a delight for political scientists to hear economists dismiss problems of fundamental constitutional reform as a problem of "appropriate institutional design," so it is worth something to keep analysts like Rodrik around.[35] But only for amusement value. There is no "we" at all, much less a "we" who agree on appropriate institutional reforms that will elevate unaccountable technocrats to the role of dictator. Ginsburg put it this way: "[Planning agencies] would work closely with representatives of business and labor, minorities and women, consumers and environmentalists, regional and community organizations, and other groups which have a vital interest in the successful functioning of our economy."[36] As Don Lavoie asked about this view, "In other words, representatives of the very same special interests who now struggle for government favor will still do so under national planning. Why these representatives are expected to reflect the democratic will of the people any better than they do now is not explained."[37]

To be fair, it is common for advocates of industrial policy to include a throw-away line caveating their optimism that, for some reason, *this time* politics will be different. Carnoy and Shearer simply assert that it is obvious that the authority that makes and enforces plans "should be the government—our democratically elected legislature and executive."[38] But then, in what should be a whiplash-inducing turn, Carnoy and Shearer (rightly) warn that "This is one of the many dilemmas we face: how to move the government to restrict corporate power instead of aiding abetting it." [39] So the reason that industrial policy is needed is precisely that "the government is heavily influenced (if not controlled) by" economic interests. But the mechanism by which corporations are to be controlled is . . . just the political process that is producing the Pareto inferior industrial policy in the first place.

Of course, it is at least conceivable that a particular, ephemeral coalition of interests might select a "good" industrial policy at a point in time. But there is, by definition, no mechanism for locking in such a design once it is arrived at. The reason this is a problem is that there is a tension between the de facto distribution of power and rents and the de jure selection of institutions to try to "correct" that distribution. As Cox, North, and Weingast point out, there is no means of making credible commitments to secure the rents now controlled by the existing configurations of political elites.[40] Cox and his co-authors advance what they call the "proportionality theorem,"

35 *Id.*

36 WOODROW GINSBURG, AN ECONOMIC RECOVERY PLAN 8 (Americans for Democratic Action ed. 1982).

37 Lavoie, *supra* note 7.

38 Martin Carnoy & Derek Shearer, Economic Democracy: The Challenge of the 1980s 5 (5th ed. 1980).

39 *Id.*

40 Gary W. Cox, Douglass C. North & Barry R. Weingast, *The Violence Trap: A Political-Economic Approach to the Problems of Development*, 34 J. OF PUB. FIN.& PUB. CHOICE 3, 9 (2019).

which holds that institutions that enforce differences between de facto power and de jure rules are fatally unstable and cannot be expected to survive.[41]

Reformers assume will current "owners" of politically enforced assets will simply consent to have their valuable rent extraction rackets dismantled. In terms of the triangle in Figure 1, Rodrik's dismissive claim that all we need is "appropriate institutional design" assumes that political actors are altruistic and that market rent-holders are passive.[42] Without these assumptions, one cannot arrive at the docile acceptance of the vector of sectoral policies calculated by the shamans of industrial planning.

### *2. The Public Choice Response*

Public Choice originated in the late 1950s and early 1960s partly in response to this superficial and unreflective assertion that state action should be thought of as the implementation of ideal plans by an omniscient, omnipotent dictator. The Public Choice counterargument followed the Austrian economics line in the "calculation debate."[43] The problem is that, far from being omniscient, the state would lack essential basic information because it would not have access to prices formulated in a competitive discovery process. If the state proposes to abandon the profit test and manage prices, then the required *information* would never be available to policymakers, and so the policy that would be selected, while different from the set of outcomes observed under markets, could not possibly be the ideal outcome.[44]

Soon, Public Choice developed a parallel critique, focused on the perverse *incentives* created by concentrated political power. Elected officials pursuing their own policy and reelection goals could not be expected to select the socially optimal policy, and in fact, the more likely result of imbuing state actors with the power to "pick winners and losers" would be the corrupt practice simply of rewarding supporters (in exchange for votes, promises of future employment, or other benefits) and punishing opponents and dissenters. Worse, collective action problems meant that a pluralist system—far from solving the problem—would generate political impulses that would

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41 *Id.* at 6.

42 Rodrik, *supra* note 9, at 472.

43 Boettke, *supra* note 4, at 21-39; Peter J. Boettke & Edward J. Lopez, *Austrian Economics and Public Choice*, 15 REV. OF AUSTRIAN ECON. 111, n.4 (2002).

44 F. A. Hayek, *The Use of Knowledge in Society*, 35 AMERICAN ECONOMIC REVIEW 519 (1945); JAMES M. BUCHANAN, COST AND CHOICE: AN INQUIRY IN ECONOMIC THEORY (Liberty Fund ed. 1999) (1969); James M. Buchanan, *Market Failure And Political Failure*, 8 THE CATO JOURNAL 1 (1988); F. A. HAYEK, *Competition as a Discovery Procedure* in NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS (University of Chicago Press 1969); WILLIAM NISKANEN, BUREAUCRACY AND REPRESENTATIVE GOVERNMENT (Aldine Atherton Press ed. 1971); FRIEDRICH A. HAYEK, LAW, LEGISLATION, AND LIBERTY (1973); James M. Buchanan & Viktor Vanberg, *The Market as a Creative Process*, 7 ECON. AND PHIL. 167 (1991).

actually *benefit* powerful organized interests at the expense of the mass public.[45]

One key way that this agenda control by elites was found to work was (in the U.S., at least) the interaction between partisan control of the legislative process and the committee system.[46] The process of self-selection among committees based on conformity of regulatory and budgetary jurisdictions with district-specific electoral goals has been exhaustively documented empirically.[47] Together, these two objections to the information problems and the incentive problems of political solutions were seen by many Public Choice scholars as having put "paid" to the notion of political improvement on market outcomes.

*But this view is mistaken*; looking through the history of advocacy for industrial plans, in fact, one finds something that the standard Public Choice narrative might not lead one to expect. The central justification for many industrial policy analysts is not the failures of *markets and capitalism* but in *politics*! Further, Progressive proponents of industrial plans fully recognize (in their lucid moments) the difficulty in obtaining accurate and timely information. The central conundrum in industrial planning is precisely the Public Choice objection: *even if planners knew what to do, politics would prevent them from doing it*.[48] The barrier to "good" industrial policy is that concentrations of economic power can acquire political influence and power; worse, political authorities actually welcome this expansion of power because politicians themselves benefit electorally or through the promise of future employment.

Rodrik's warning about "political influence" is thus not a throw-away line or an aside;[49] in fact, for every Ginsburg or Carnoy and Shearer who think democracy can be fixed, there other advocates who see the suppression of politics is seen by some planning advocates as the main *advantage* of industrial plans.[50] As an illustration, it is useful to go back to the same era of the early 1980s and consider several passages from one of the stalwarts of the Progressive industrial plan movement, Robert Reich.[51]

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45 Schattschneider famously said that in "the pluralist heaven... the heavenly chorus sings with a strong upper-class accent." E.E. SCHATTSCHNEIDER, THE SEMISOVEREIGN PEOPLE: A REALIST'S VIEW OF DEMOCRACY IN AMERICA 35 (1960); MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION 35 (1965).

46 Marshall, *supra* note 30; Cox, *supra* note 30.

47 Kevin B. Grier & Michael C. Munger, *Comparing Interest Group PAC Contributions to House and Senate Incumbents 1980-1986*, 55 J. OF POL. 615 (1993); Eleanor Neff Powell & Justin Grimmer, *Money in Exile*, 78 J. OF POL. 974 (2016).

48 If one allows that the two assumptions, information and incentives, can be treated as separable. Buchanan is skeptical of this claim, since the problems are in fact created by the same institutions of political failure. James M. Buchanan, *Market Failure And Political Failure*, 8 THE CATO JOURNAL 1 (1988).

49 Rodrik, *supra* note 9, at 472.

50 Ginsburg, *supra* note 36; Carnoy, *supra note 38*.

51 Reich, *supra* note 20, at 76.

Reich decries the lack of any rational (by which he means social optimality) basis for the set of policies that fix taxes, subsidies for research, and trade protection:

> [The pattern of subsidies and trade protection] are largely the result of special interest pressure and not of a coherent industrial policy, they have no rhyme or reason…. [These] subsidies have for the most part channeled capital toward industries…that are sheltered from international trade…industries such as footwear and apparel that depend on low-wage labor; and industries such as ship building that have no advantage over foreign competitors. In effect, these programs have taken capital away from emerging industries or growing segments of established industries—semiconductors, say, or specialty steel—with a real chance to obtain a competitive edge in world markets and increase the real wages of U.S. workers.[52]

Frankly, this is Public Choice 101, at least to this point. Instead of a forward-looking policy and plan for development, the politically-influenced industrial policy will seek to "balance" growth and the costs of creative destruction. The problem for Reich is that this is not a side effect of industrial policy but as Glock showed has always been the essence of Progressive doctrine, trying to ease the transition for those displaced by economic change.[53]

To his credit, Reich then goes on to explain why "politics" and "public good" are rarely coincident:

> This perverse result is largely a function of politics. Established industries usually gain political power as communities and regions become dependent on them for jobs, tax support, and the purchase of locally produced goods and services. This power often translates—with the help of mayors, governors, congressional representatives, and White House political operatives—into special government subsidies. Emerging industries, of course, lack such power.[54]

Again, it's hard to argue with Reich's logic. In fact—and I already said it was surprising—there is a strong tradition of sensitivity to Public Choice concerns among Progressive economic planning advocates. The "market failure" program, in which the failure of markets to select Pareto optimal allocations of resources is taken as grounds for state action, is usually thought of as the core of the rationale for industrial policy. One of the founders of the market failure approach, Bator, explicitly recognized the work done earlier by theorists who had raised questions about the capacity of decentralized price mechanisms to signal the relative scarcities and full social costs (or benefits) of particular transactions accurately.[55]

He highlights, in particular, the contributions of A. C. Pigou. Bator points out that the harmony of marginal cost pricing with efficiency is broken: the cost is different from marginal cost as perceived by the seller

52 Reich, *supra* note 20, at 76.
53 Glock, *supra* note 23.
54 Reich, *supra* note 20.
55 Bator, *supra* note 2, at 357.

(buyer), and so marginal cost pricing was not Pareto efficient.[56] The difference between marginal social cost and prices accounting only for private costs would need to be corrected by some industrial plan, including, at a minimum, a system of taxes and subsidies.[57] And this is hardly a misreading of Pigou, who, after all, had said:

> In any industry, where there is reason to believe that the free play of self-interest will cause an amount of resources to be invested different from the amount that is required in the best interest of the national dividend, there is a *prima facie* case for public intervention.'[58]

This passage later led R. H. Coase and others to call the market failure approach "naïve."[59] But Backhouse and Medema point out that it would behoove critics to attend to what Pigou meant by *prima facie*.[60] He had been quite clear about it twenty years earlier, in 1912:

> The case . . . cannot become more than a *prima facie* one, until we have considered the qualifications, which governmental agencies may be expected to possess for intervening advantageously in this class of matter…
>
> *It is not sufficient to contrast the imperfect adjustments of unfettered private enterprise with the best adjustments that economists in their studies can imagine. For we cannot expect that any State authority will attain, or even whole-heartedly seek, that ideal. Such authorities are liable alike to ignorance, to sectional pressure, and to personal corruption by private interest. A loud-voiced part of their constituents, if organized for votes, may easily outweigh the whole.*[61]

Later, in State Action and Laissez-Faire, Pigou again sounded a note of caution:

> In order to decide whether or not State action is practically desirable, it is not enough to know that a form and degree of it can be conceived, which, if carried through effectively, would benefit the community. We have further to inquire how far, in the particular country in which

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56 *Id.*

57 *Id.*

58 PIGOU, *supra* note 2, at 331; R.H. Coase, *The Lighthouse in Economics*, 3 J. OF LAW & ECON. 357, 357–60, 372–76 (1974).

59 Roger E. Backhouse & Steven G. Medema, *Economists and the Analysis of Government Failure: Fallacies in the Chicago and Virginia Interpretations of Cambridge Welfare Economics*, 36 CAMBRIDGE J. ECON. 981 (2012). Backhouse and Medema identify the criticism of the "Cambridge" school, but since the Marshall-Pigou synthesis of welfare economics is essentially the mainstream view we will not make this distinction. However, Backhouse and Medema give useful examples of what they see as a caricaturing of the "Cambridge" view, in Buchanan. *Id.* at 982 (quoting James M. Buchanan, *Politics, Policy, and the Pigovian Margins*, 29 ECONOMICA 17 (1962)); R.H. Coase, *The Problem of Social Cost*, 3 J.LAW & ECON. 1, 28-42 (1960).

60 Backhouse and Medema, *supra* note 59, at 982.

61 Backhouse and Medema, *supra* note 59, at 984 (quoting A.C. PIGOU, THE ECONOMICS OF WELFARE 331, 247-48 (4th ed. 1932) (1912)).

> we are interested, and the particular time that concerns us, the government is qualified to select the right form and degree of State action and to carry it through effectively.[62]

Far from naïve, this is a nuanced and careful case for intervention, recognizing the potential for *government* failure on the grounds of inaccurate information, inconsistent incentives, and majoritarian dysfunction.[63] These are all themes that were later raised by Public Choice scholars in protest against the naïve Pigouvian view, of course, but it seems unfair to claim that Pigou himself was unaware of the problems. In fact, Pigou should be seen as ur-texts of the Public Choice movement.[64]

Another insight on this subject comes from John Kenneth Galbraith, who made a pithy—and, given his place in the pantheon of planning advocates, surprising—observation about the contrast between markets and politics. It goes like this: "In economics, the majority is always wrong."[65] When it comes to innovation, there is a fundamental difference between market innovation, which happens at the margin, and political innovation, which by definition must persuade the median voter to have any effect on policy.[66]

As Munger argued, this means that the personal computer would simply not exist if it had been left up to majorities, since for nearly a decade, only a small margin of relatively wealthy enthusiasts subsidized the development of something that all the technocrats, even those in computer firms such as DEC or IBM, considered to be useless.[67] Consequently, there is an entirely different burden of proof in innovations, depending on whether they must appeal to marginal investors and consumers based only on the profit test or whether a single policy, based on the (frankly uninformed) views of the median voter will pick winners and losers. Worse, the political process not only fails the information test since the median voter is simply not qualified to make such choices, but also the incentive test since politics will be dominated by the concentrated power of existing industrial and labor organizations. There is no hope for innovation if politics is in charge.

Rather than denying this consequence of applying the Public Choice apparatus, modern industrial policy advocates embrace it and follow the logic through to its institutional implication: *politics must be removed from the process*. Reich gives the (plausible) argument for why this is true:

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62 *Id.*; A.C. PIGOU, *State Action and Laissez-Faire* in ECONOMICS IN PRACTICE: SIX LECTURES ON CURRENT ISSUES 107 (Macmillan and Co. ed. 1935).

63 Backhouse and Medema, *supra* note 59, at 985; Keech, *supra* note 12.

64 PIGOU, *supra* note 2; PIGOU, *supra* note 62.

65 This "quotation" is widely attributed, but I cannot find a direct source in anything Galbraith wrote or said. An example of the attribution is Foroohar (2019). Rana Foroohar, *Old Economists Can Teach Us New Tricks*, THE FINANCIAL TIMES (Jun. 2, 2019), https://www.ft.com/content/ece567f4-83c1-11e9-b592-5fe435b57a3b.

66 MICHAEL C. MUNGER & KEVIN M. MUNGER, CHOOSING IN GROUPS 86 (2015).

67 Michael Munger, *Two Steves and One Soichiro: Why Politicians Can't Judge Innovation*, ECONLIB (Oct. 2, 2006), https://www.econlib.org/library/Columns/y2006/Mungercollectivism.html.

> So long as these [subsidies, favorable tax policies, and trade protections] are one way or another hidden from public view, there can be no public debate about their wisdom or consequences. It is the claim of industrial policy, therefore, that the only alternative to formulating an explicit program for improving the nation's competitive performance is to cede effective responsibility for policy to groups with back-door political influence.[68]

Of course, this only follows if it must be true that there will be subsidies, favorable tax policies, and trade protections on offer in the first place. The reason politics is corruptible is that politicians have put themselves in the business of selling off policy to the highest bidder. The "profit test" version of an industrial plan would require a constitutional straitjacket, constraining subsidies and differential tax rates to zero. The configuration of political rent-seeking we now observe in the industrial economy is not what happens when the profit test is used but rather is what happens when corporate interests are allowed, and in many cases actively invited, to go shopping for artificial rents. Once rents are for sale, it is no great leap to predict that they will go to the highest bidder.

In short, advocates of rational industrial policy are quite right to decry the political capture of these rents and the corruption of the process. The problem is that their solution, preserving all the rents and, in fact, adding dramatically to the politically distributed boodle while removing the power of economic interests to command those rents, smacks of fantasy.

### 3. *Intervention in Economics but Not in Politics: Is it Possible?*

I claimed above that Pigou should be an ur-text of Public Choice. But Pigou thought that what we now call the "Public Choice Problem"—information and incentives—though difficult, could be solved. The claim of the Cambridge industrial policy scholars was always that, unlike markets, governments could "learn" through *institutional* innovation, whereas markets can only "learn" *product* innovation through the profit test. In this view, good industrial policy is the consequence of informed analysis and correct (public-spirited) motivations. Just as Rodrik said, then, the difference does not come down to perfection; pro-intervention welfare economists never believed the government was perfect.[69] Instead, the difference lies in the difference in the prospects for learning and guided improvement.[70] As Backhouse and Medema put it, this difference is important:

> What emerges, then, is that the difference between the Cambridge welfare economists and their modern counterparts at Chicago and Virginia was not that the former was guilty of committing the 'nirvana fallacy' or that they were naive about political processes. *Political processes were as central to the policy conclusions of the Cambridge welfare economists as they are to modern public choice theory and the literature on law and economics—indeed,*

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68 Reich, *supra* note 20, at 76.

69 Rodrik*, supra* note 9, at 469, 472.

70 *Id.* at 485.

> *because they did not see government as a homogenous entity, it was even more important for them to examine such processes than it is for modern economists who work with a simplified conception of government* . . . The rational choice approach, with its assumption of stable preferences, is central here, for it effectively rules out the evolutionary view of human improvement that was central to the Cambridge vision.[71]

So, the best version of the industrial policy argument should be taken seriously. It does *not* assume the perfection of the state, and proponents are not ignorant of basic Chicago "capture" theories of regulation. Nor do proponents deny Public Choice problems of incentives. If anything, the Cambridge welfare/planning school was out in front of recognizing and highlighting these problems. In fact, "politics and democracy" is precisely the *problem* that a technocratically controlled industrial policy was supposed to solve.

In the next section, I discuss the problem of "cronyism" and the challenges it presents to "good" industrial policy. There are two core claims to be addressed: first, rational political actors will never choose a "good" industrial policy. Second, rational political actors will likewise never a set of institutions that would lead to the selection or stability of such a policy if it exists. I will argue that combining these two conclusions implies that "good industrial policy" is impossible.

## II. THE IMPOSSIBILITY OF "GOOD" INDUSTRIAL POLICY

### *1. Capitalism is Not Sustainable*

In a recent book, I concluded that "pure" capitalism is not sustainable in a democracy.[72] This conclusion has been summarized as "doing Public Choice on Public Choice" because it starts with the standard public assumptions of self-interested politicians, self-interested corporate elites, and poorly informed voters subject to problems of voluntary ignorance and collective action problems. Under these conditions, at some point in the process of maturing as a firm or industry, the marginal rate of return for the pursuit of honest profit must fall below the first-dollar return of lobbying and rent-seeking.

The arguments for capitalism, as Klein argues, give a powerful justification for the "pursuit of honest profits."[73] But there is nothing in the logic of self-interest that will restrict rational actors from pursuing the legal but immoral course of securing rents, subsidies, and artificial protections

71 Backhouse and Medema, *supra* note 59, at 993.

72 *See generally* MICHAEL C. MUNGER, TOMORROW 3.0: TRANSACTION COSTS AND THE SHARING ECONOMY 20 (2018).

73 DAN KLEIN, KNOWLEDGE AND COORDINATION: A LIBERAL INTERPRETATION 258 (2012).

from competition. Saying "that's not real capitalism!" misses the point. *The point is that real capitalism is not sustainable in a democracy*.

To summarize, my argument had three stages: *First*, at a given firm, a manager with ethical values might refuse to undertake legal but unscrupulous (in terms of capitalist morality) resort to rent-seeking. But given that there is a competitive market for managers, it should be easy to find someone not so encumbered by morality. Given that rent-seeking is more profitable than honest competition, there is a tendency toward cronyism. The only check on this legal but immoral impulse to annex the coercive powers of the state for private gain is moral character, which is just what Public Choice tells us that we cannot invoke as a solution.[74] Logically, sauce for the goose—we can't assume benevolence by state officials—is sauce for the gander—we can't make capitalism sustainable by assuming benevolent CEOs.

Still, moral action is *possible*, let's grant that. Suppose that the firm holds out, retaining the morally scrupulous manager. The *second* problem is the market for mergers and acquisitions: The firm's capital is underperforming compared to the legal return it could be earning if it were engaging in corrupt, exploitative rent-seeking and lobbying for special favors. But by definition, this means that an outside raider could borrow against the increased post-acquisition return and tender a takeover offer. Stockholders might be willing to support the scrupulous manager in principle, but cash-on-the-table tender at 20% over the current price would likely get their attention. The firm is acquired, rent-seeking commences, and cronyism triumphs. Good people are not enough, just as Public Choice predicts.

Of course, even the stockholders *might* hold out and refuse to sell their shares at the higher price. What then? The previous two steps have assumed that the state and its elected and appointed officials are passive bystanders. But this is not true; in fact, much of the impetus for rent-seeking is extractive, as was clear in the aftermath of the Great Recession, where banks were pressured to accept TARP funds.[75] So the *third* problem is that in a democracy, the state is free to design and redesign institutions to the benefit of the ruling elites. It is possible that such reforms will be consistent with "the public good," but that would be only an accidental coincidence. It is in the self-interest of elected officials and bureaucrats to attract or—if necessary—coerce private interests into a state of dependence).[76] This allows control and affords many choke points where permission or licenses can be held up until state officials can extract favors and submission.

74 Randall Holcombe, *Make Economics Policy Relevant: Depose the Omniscient Benevolent Dictator*, 17 INDEP. REV. 165 (2012); Milton Friedman, *Make It Politically Profitable For the Wrong People To Do the Right Thing*, YOUTUBE (2013) https://www.youtube.com/watch?v=MEVI3bmN8TI.

75 *See* Fred McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUDIES 101, 102–105 (1987).

76 Holcombe, *supra* note 74, at 169.

My conclusion was that the long-term pursuit of "honest profits,"[77] the sine qua non of capitalism, is not possible in a democracy.[78] The rational self-interest of elites who recognize that they can manipulate the fundamental "rules of the game" to their benefit will distort and corrupt capitalism into cronyism.[79]

### 2. *Good Industrial Policy is Not Sustainable, Either*

The first-level critique of the viability of industrial policy to solve problems of market failures is well-known.[80] The critiques take the form of highlighting the "knowledge problem" [81] and connect those difficulties with the incentive problems the Public Choice show is created by a powerful state.[82] According to this view, if there is a tendency toward cronyism, it *is the fault of the state*, not of markets, because the distortion of the workings of markets violates the information and incentive justifications for using markets in the first place. Capitalism, without state meddling, is a stable and self-sustaining position.

My claim is that this is not true in a democracy if politicians are self-interested. This is not "self-interest properly understood" or some other legerdemain designed to eliminate the Prisoner's Dilemma problem through changing the payoffs. The Nash strategy of "defect to cronyism" is the dominant play for any individuals, even though it makes the system worse off. Blaming democracy for the problem of "selling rents" may be accurate, but unless the critic is willing to say, "And therefore, no democracy!" and propose an alternative then we are stuck with democracy and elections, with all the problems that come with them.

The reason I have developed the argument this way is to show that Reich, Rodrik, and advocates of industrial policy are not confused about this problem. They fully understand—as I argued in the previous section—that "politics" in Figure 1 will not select the ideal industrial policy (again,

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77 *See* DAN KLEIN, KNOWLEDGE AND COORDINATION: A LIBERAL INTERPRETATION 15–16 (Oxford University Press ed. 2011); s*ee generally* VERNON SMITH & BART WILSON, HUMANOMICS: MORAL SENTIMENTS AND THE WEALTH OF NATIONS FOR THE TWENTY-FIRST CENTURY 10 (Cambridge University Press 2019).

78 Smith & Wilson, *supra* note 77.

79 *See* Douglass North, *Economic Performance Through Time*, 84 AM. ECON. REV. 359, 361 (1994).

80 *See* Walter Block, *Crony Capitalism versus Pure Capitalism*, 23 INDEP. REV. 379, 381–82 (1994); *see* Scott Lincicome, Industrial Policy: A Bad Idea Is Back, CATO POLICY REPORT (July 2021), https://www.cato.org/policy-report/july/august-2021/industrial-policy-bad-idea-back.

81 LUDWIG VON MISES, SOCIALISM: AN ECONOMIC AND SOCIOLOGICAL ANALYSIS 98–111 (J. Kahane trans., 2d ed. 1969); Hayek, *supra* note 44, at 519–521.

82 It is misleading to conflate the Misesian and Hayekian views in this way, because Mises thought the problem was the absence of private property, and Hayek thought it was the absence of the discovery process of generating prices in a competitive environment. But for present purposes the conflation will just have to do. *See* Joseph T. Salerno, *Ludwig von Mises as Social Rationalist*, 4 REV. OF AUSTRIAN ECON. 26, 31–37 (1990).

assuming that such a thing exists and can be discovered). And "discovered" is the right word: proponents of industrial policy never imagine that there is sufficient information *ex ante* simply to identify and implement the ideal industrial policy. Their claim is that public-spirited technocrats can discover, through earnest trial and error updating of expanding success, and eliminating failing, programs an outcome that is better than would be observed under the market system.[83]

The core of the argument is that "good" industrial policy is not *difficult*; it is literally *impossible*. Either a "good" policy will fail to pass in the first place, or a good policy will not be sustainable if, by lucky accident, it is implemented. The reasons were outlined long ago in the Public Choice literature, but apparently, the argument must be spelled out again. First, elected officials are far from passive and have shown themselves perfectly capable of rewriting rules and "reforming" bureaucracy for their own benefit, even if this is harmful to the "public good."[84]

Second, if legislators would not vote for the "right" policy if it is presented as part of an agenda where a politically preferable alternative is available, they would not vote for creating an independent body that will select the right policy because the *implied agenda inherits the properties of the original choice*.[85]

To fix ideas, let us make some assumptions. I understand these assumptions are not innocuous, but they allow us to focus on the subject of this essay rather than a more general consideration of epistemology and collective action.

(1) There exists an allocation $P_m$ of all of society's resources that would be the known result of allowing *market* processes to follow their course.

(2) There exists an allocation $P_p$ of resources that would be the known result of *politically* motivated taxes and subsidies to play out through legislation in a democracy.

(3) There exists an optimal allocation $P_I$ of resources that would be the predictable result of an *industrial* policy that solves the market failure problems of $P_m$ but is immune to the Public Choice problems of $P_p$.

83 The idea of "trial and error" in industrial policy and economic planning dates to Oskar Lange, *On the Economic Theory of Socialism: Part One* 4 REV. ECON. STUDIES 53, 60–68 (1936).

84 Moran, *supra* note 30, at 792 (discussing how officials can benefit from writing the rules); *see* MORRIS FIORINA, CONGRESS: KEYSTONE OF THE WASHINGTON ESTABLISHMENT 48, 52 (Yale University Press 2nd ed., 1989); *see* M. MCCUBBINS, R. NOLL, & B. WEINGAST, *Political Economy of Law* in HANDBOOK OF LAW AND ECONOMICS: VOLUME 2 1687, 1687–1689 (A. Mitchell Polinsky & Stephen Shavel, eds., 2007).

85 See William Riker, *Implications from the Disequilibrium of Majority Rule for the Study of Institutions*, 74 AM. POL. SCI. REV. 432, 444 (1980) (discussing legislators creating issues that benefit themselves); *see* Brian Humes, *Majority Rule Outcomes and the Choice of Germaneness Rules*, 75 PUB. CHOICE, 301, 304 (discussing legislators choosing between two different sets of rules).

(4) From the perspective of the functioning of the economy and ignoring problems of liberty and takings of property rights, it is agreed that:

$$P_I \succcurlyeq P_M \succcurlyeq P_P \quad (1)$$ [86]

and

$$P_I \neq P_M \neq P_P \quad (2)$$

Where "$\succcurlyeq$" means "at least as good as" for the society.

In words, the technocratic ideal industrial policy, the market outcome, and the political outcome are all materially different from each other (hence (2)), and socially it is understood and agreed that the technocratic ideal is best, and the market outcomes are worse. But market outcomes are still better than political cronyism, where the state acts to exaggerate and protect inequalities in market power.

Now, one might object that the particular ordering $P_I \succcurlyeq P_M \succcurlyeq P_P$ is incorrect or that the very idea of a social ordering is incoherent because of the Arrow problem.[87] But I wanted to give the fairest and clearest case in favor of the industrial policy, and the argument so far makes clear why this ordering best embodies the logic of that claim. Proponents of industrial policy are fully cognizant (following Pigou and the Cambridge School economists who later moved their intellectual headquarters to the American Cambridge, housed at Harvard and MIT) that politics will supply sub-optimal solutions to market failures.

Cronyism ($P_p$), in this view, is the logical implication of developing a politically-directed industrial policy: concentrated economic power will always win rent-seeking contests. Having a "policy" of auctioning rents is worse than enforced government inaction ($P_M$), where the power to pick winners and losers is constitutionally or legislatively taken off the table. In other words, Pigou, Reich, Rodrik, et al. agree with the Public Choice critique and incorporate it into their analysis: political processes are no better and are likely worse than market processes.

The *disagreement* is about the existence and sustainability of a third possibility: $P_I$, or "Ideal industrial planning by technocrats." To make things simpler, we stipulate that:

(a) $P_I$ exists

[86] There is nothing very important about the $P_M \succcurlyeq P_P$ part of this assumed social ordering. Note that there is no claim that the ordering holds in matters of pure public goods, or legitimate market failures. The only claim is that political meddling in markets, by fostering rent-seeking, results in concentrated market power and corruption, *in commerce*.

[87] *See generally* KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (1951); *see* RUSSELL HARDIN, MORALITY WITHIN THE LIMITS OF REASON 112–197 (1988); *see* Sean Ingham, *Why Arrow's Theorem Matters for Political Theory Even If Preference Cycles Never Occur*, 179 PUB. CHOICE 97, 2–5 (2019) (discussing social ordering); *see* Munger, *supra* note 66, at 140-142.

(b) $P_I$ can be reliably identified given information that can be obtained by technocrats, using trial and error, if technocrats are given a free hand to experiment with taxes, subsidies, and different forms of property rights [88]

These claims are debatable, but allow me to focus on three provable results:

Proposition I: Even if $P_I$ exists and could be identified *ex ante*, it will not be selected in a democracy.

Proposition II: If for some reason $P_I$ is selected, it is not an equilibrium and so will not survive in a democracy. The only way this conclusion is wrong is if PI = $P_P$, in which case industrial policy is worse than the laissez faire market outcome $P_M$.

Proposition III: Suppose that $P_I$ is a structure-induced equilibrium (SIE) of some institutional rules $S_I$. For example, structure $S_I$ might be a setting where technocrats are insulated from majoritarian influence. In other words, $S_I$ produces $P_I$ as an SIE. Then $S_I$ would never be adopted by a legislature if the status quo structure $S_P$ produces $P_P$ as an SIE.

It is useful to sketch a proof of the propositions:

*Proof of Proposition I:* There are two cases:

a. A majority rule equilibrium (MRE) exists, and it is $P_P$. (No outcome other than $P_P$ can by an MRE, by assumption (1) above).

b. No majority rule equilibrium exists.

In case (a), $P_P$ will be chosen over $P_I$

In case (b), some arbitrary stopping rule will result in an outcome, but it is unlikely to be $P_I$, unless legislative leaders are irrational or incompetent at agenda control.

88 As noted above, the advocates of industrial planning do not claim that state planners would have, or could have, full ex ante information about the economy or ideal policy. Their "discovery process" is informed experimentation, or "evidence-based" policy. Further, there is no claim by advocates that there is a unique "best" industrial policy, or that experimentation would discover it if there were. I am "solving" all that by simply positing the existence of a "best" industrial policy and assuming it is known. If this is not true, the case for industrial policy is even weaker. Of course, I am trying to show it is impossible in the first place, and so that's not really relevant. *See* Rodrik, *supra* note 14, at 2–21.

*Proof of Proposition II:* Suppose that there is no Condorcet winner in the set of policy choices, and that for some reason $P_I$ is selected by some agenda and becomes the status quo. Assuming that any member of the majority whose preferences hold that $P_P \succcurlyeq P_I$ has proposal power, then $P_P$ will be proposed, and will defeat $P_I$ and become the new status quo. Consequently, $P_I$ is not sustainable even if it were briefly the status quo, without institutions that declare $P_P$ out of order.

*Proof of Proposition III:* $P_P$ is majority preferred to $P_I$. Rational anticipation of professional politicians means they can forecast that a vote for $S_P$ results in policy $P_P$ and vote for $S_I$ results in policy $P_I$. As the work building on "structure-induced equilibrium" demonstrates, assuming that the preferences being expressed are on the ultimate results, not intrinsic preferences over procedure, it must be true that $S_P$ is majority preferred to $S_I$. To put it another way, $S_I$ is not an institutional equilibrium.[89]

The following section presents the case of a recent attempt at a particular kind of industrial policy, imposing a definition of the legal framework of labor contracts. My claim is that state technocrats chose a $P_I$ they believed to be ideal but were immediately overwhelmed by $P_P$, leaving a situation where things would have been better off at $P_M$.

## III. CALIFORNIA AND AB5: CONTRACTORS VS. EMPLOYEES

The conclusion of the previous section granted the dubious preference that "good" industrial policy exists and is known by technocrats. But (again following proponents of industrial policy) that "good" policy is different from the outcome of majoritarian political processes, filtered through a system where lobbying and influence affect outcomes. I claimed three things followed this logic:

(1) good industrial policy will likely never be chosen in the first place

(2) if for some reason, the good industrial policy is chosen, it is not stable and will be replaced quickly

(3) if supporters try to change the structure of the institution to prevent a majority-based replacement of the good policy, the proposal for that institutional change will fail to command a majority because members understand that a vote for the new institutional arrangement is a vote for a less-preferred policy.

89 *See* Riker, *supra* note 85, at 444 (discussing legislators creating issues that benefit themselves); K. Shepsle, *Studying Institutions: Some Lessons from the Rational Choice Approach*, 1 J. THEORETICAL POL. 131 (1989).

The institutional problem is this: Legislatures prefer a policy other than the socially best policy for political reasons. But then, that same legislature's members can anticipate the consequences of institutional reforms that would result in that less-preferred policy. Thus, good industrial policy is not an equilibrium, and institutions that would force the selection of good industrial policy cannot be implemented by legislative majorities.

This appears actually to have happened in California in 2019 and 2020.[90] For many kinds of "jobs," there are two distinct modes of employment: the *employee* and the *contractor*. The employee is someone who is entangled in a longer-term relationship. A contractor is different, at least conceptually. The Latin verb *contraho* is "to draw different things together"; a *contractor* is someone who draws together, in their own person or activity, their own tools or skills for a relatively brief time.

The "test" for whether a worker was an employee or contractor had long been a matter of tax classification because the position in the hard binary had substantial implications for whether the employer was responsible for withholding payroll taxes, paying Social Security, and other matters of state and federal law.[91] This analytical distinction is blurred in practice, however, particularly in many parts of the new sharing economy.[92]

Unsurprisingly, given the importance of the sharing economy and new Silicon Valley "unicorns" in developing "gigs" as employment relations, combined with an atmosphere of pro-intervention political progressivism, the issue was most truly joined in California.[93] In 2018, the California Supreme Court sought to establish relatively clear guidelines on the classification based on the "ABC" or three-pronged test.

> Unless the hiring entity establishes (A) that the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact, (B) that the worker performs work that is outside the usual course of the hiring entity's business, and (C) that the worker is customarily engaged in an independently established trade, occupation, or business, *the worker should be considered an employee and the hiring business an employer under the suffer or permit to work standard in wage orders*; the hiring entity's failure to prove *any one of these three prerequisites will be sufficient in itself to establish that the worker is an included employee*, rather than an excluded independent contractor, for purposes of the wage order.[94]

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[90] Kate Conger, *Uber and Lyft Drivers in California Will Remain Contractors*. NEW YORK TIMES. November 4, 2020. https://www.nytimes.com/2020/11/04/technology/california-uber-lyft-prop-22.html.

[91] 26 U.S.C. § 3509.

[92] *See* Munger, *supra* note 72, at 54; *see* ELIZABETH TIPPET, *Employee Classification in the Sharing Economy* in CAMBRIDGE HANDBOOK OF THE LAW OF THE SHARING ECONOMY 291–95 (N.M. Davidson, et al. eds., 2018); *see* ADAM DAVIDSON, THE PASSION ECONOMY 258-59 (2020).

[93] *See* Davidson, *supra* note 92, at 258-259.

[94] Dynamex Operations W. v. Superior Ct., 416 P.3d 1, 32-33 (2018) (emphasis added).

The California Assembly, believing (plausibly) that the matter should be codified in legislation rather than relying on "guidance" from a court decision, passed Assembly Bill 5 (AB5). Part of the Bill text reads:

> The court cited the harm to misclassified workers who were with significant workplace protections, its unfairness to employers who must compete with companies that misclassify . . . and misclassification to avoid obligations such as payment of payroll taxes, social security, unemployment, and disability insurance . . . The misclassification of workers as independent contractors has been a significant factor in the erosion of the middle class and the rise in income inequality, nothing in this act is intended to diminish the flexibility of employees to work part time or intermittent schedules or to work for multiple companies.[95]

The goal was apparently to reverse the "erosion" of the middle class while recognizing that the flexibility of contract work for many people was attractive and could even be part of the essential definition of the work relation, as in the case of a plumber or free-lance writer.

One might question whether there has, in fact, been a substantial "erosion" of the middle class.[96] Even if there is, one might question whether the sharing economy is a "significant factor" in that erosion. But, as in the previous section, I am willing to stipulate that the policy in question was actually $P_I$, the ideal industrial planning solution.

The law codifies the three-prong test, establishing a strong presumption that all workers are employees. Since the prongs are not actually as clear in real-world work relations as they seem on paper, this presumption puts a substantial burden on prospective employers. If 'I'm trying to start a company, and I'm trying to decide if I'm going to have employees or contractors, the presumption is heavily in favor of the relationship being an employment relationship; this relationship (particularly in California) entails expensive benefits, restrictions on the nature of work, substantial paperwork, and compliance requirements.

The prospective contractor must be free from the control and direction of the hiring entity. The task has to be outside the usual course of the hiring entity's business. And the prospective contractor has to be customarily engaged in an independently established trade occupation or business of the same nature. In response to AB5, Uber and other sharing economy firms in California either cut back operations or defied the law.[97] Given the nature of "gigs," this was perfectly predictable: the opposite of "contractor" is not "employee," it's "unemployed." The law's protections were inconsistent with the distribution of economic bargaining power, and the creation of value, in the economy.

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95 Assemb. B. 5, 2019–2020 Leg., Reg. Sess. (Cal. 2019) (enacted).

96 James Heckman & Rasmus Landersø, *Lessons for Americans from Denmark about inequality and social mobility*, 77 LAB. ECON. 13-4 (forthcoming 2022).

97 Eli Rosenberg, *Can California Rein in Tech's Gig Platforms? A Primer on the Bold State Law That Will Try*, WASH. POST (Jan. 14, 2020), https://www.washingtonpost.com/business/2020/01/14/can-california-reign-techs-gig-platforms-primer-bold-state-law-that-will-try/.

The ideal industrial plan for the California Assembly seems to have been based on their notion of the just distribution of income between companies and employees. AB5 was implemented to rebalance the difference in power by preventing companies from exploiting workers by classifying them as contractors.[98] There seemed to have been three premises for the members of the Assembly who passed AB5:

- The corporations in question were huge amounts of money and should give more of that "surplus" to the workers.
- The business model could clearly withstand being forced to have workers serve full-time and receive benefits.
- The workers, who were now contractors, would want to be reclassified as employees. More specifically, most workers now employed by sharing economy firms would prefer to have defined hours, be forced to work 40 hours per week, and be subject to direct and constant control by supervisors.

Remember, I am trying to credit the proposed industrial policy as being socially ideal. By this, I mean that the legislature thought it could simply change the rules and remake the industry by issuing commands. However, each of the three bulleted premises listed above is problematic. First, Uber, particularly but not solely, was losing very substantial amounts of money, even under the existing model.[99] Second, much of the sharing economy is based on "two-sided markets" or platforms, where the notion of employment is simply misplaced, to begin with.[100] Third, this legislation surprisingly resulted in many, and perhaps most, of the workers from whom the legislature expected to garner political gratitude being upset, even angry, in response to being denied contractor status.[101]

The main sponsor of AB5, Rep. Lorena Gonzalez, was honestly surprised that there was even another view; she clearly expected something along the lines of "this is an ideal industrial policy, thanks!" But a substantial portion of the affected workforce was offended by Rep. Gonzalez's apparent lack of knowledge of how that part of the economy worked.[102] There were

98 Samantha J. Prince, *The AB5 Experiment - Should States Adopt California's Worker Classification Law?*, 11 AM. UNIV. BUS. L. REV. 49, 49-52 (2021).

99 Mike Issac, *How Uber Got Lost*, N.Y. TIMES (Aug. 29, 2019), https://www.nytimes.com/2019/08/23/business/how-uber-got-lost.html.

100 Michael C. Munger, The Sharing Economy: Its Pitfalls and Promises 98-99 (2021). Many observers claimed that the point of AB5 was partly to "protect" taxi drivers from Uber, and in fact many taxi drivers were ardent supporters. Bizarrely, very few taxi drivers in California were, or are, employees. Almost all are contractors. *See* Carolyn Said, *California's Gig Law Targets Uber and Lyft*, S.F. CHRON., 2019.

101 Augusta Saraiva & Ngai Yeung, *California Throws 70,000 Truckers in Gig-work Legal Limbo, Risking Supply Chains*, BLOOMBERG (July 8, 2022), https://www.bloomberg.com/news/articles/2022-07-08/california-truckers-in-gig-work-law-limbo-risking-supply-chains.

102 According to a story in the San Francisco Examiner:

lawsuits seeking either to nullify or seek an exemption from the Bill, which were all filed by workers the Bill was supposed to "help," including free-lance journalists, writers, truckers, delivery drivers, and others.[103]

The protests against the restrictiveness of the law and its negative impact on the ability of workers to contract for flexible hours and conditions led to the filing of Proposition 22, which, even by the standards of referendum-mad California, was unusual.[104] The Proposition was effectively a substitute bill—more than 6,000 words, in fact—replacing or augmenting much of the language of AB5. There was considerable monetary spending by both supporting and opposing parties, but most of the spending was done by the supporting party, with millions spent by Uber, Lyft, and other sharing economy giants.

In a frankly cynical attempt to derail the Proposition, the Assembly passed AB2257, which legislated many of the changes that Prop. 22 would have required by referendum. In particular, AB2257 exempted several broad classes of workers, including free-lance writers, photographers, translators, musicians, and several categories of service contractors, from the strictures of AB5.[105] The new bill was passed in September 2020, two months before the referendum vote.

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One person asked Gonzalez to address the concerns that freelance workers have that there would be "a shortage of good jobs" in California once the law goes into effect, as employers look for workers in other states. Vox media, publisher of the sports blog network SB Nation, has announced that it would break with its California freelancers because of the law.

"These were never good jobs. No one has ever suggested that, even freelancers. We will continue to work on this next year," Gonzalez wrote in response.

"Wow, you really suck at this," another person wrote in response.

There were other exchanges:

Gonzalez got into a testy exchange with one Twitter user, who wrote that people won't be able to have "2-3 side hustles" anymore because of AB 5.

"They shouldn't f——- have to. And until you or anyone else that wants to b—— about AB5 puts out cognizant policy proposals to curb this chaos, you can keep your criticism anonymous. Good God," Gonzalez wrote, later adding that the account she was responding to belongs to somebody who works in the Legislature.

Gonzalez has invited people to offer suggestions for changing the law.

"Advocate for ongoing work," she wrote. "But stop saying this is a bad bill. It's not. It's a great structural reform we've needed since the 1940s. I'm not going to repeal it. We will continue to refine it. But educate yourself."

Remarkably, it seems literally never to have occurred to Gonzalez or AB5's other supporters to ask the affected workers what they thought of it.

Tribune News Services, *Gonzalez gets profane in Twitter battle with AB5 critics*, S.F. EXAM'R, Dec. 24, 2019.

[103] Rosenberg, *supra* note 97.

[104] Prop. 22, 2020 (Cal. 2020) (enacted); Erin Mulvaney & Maeve Allsup, *Millions at Stake for Gig Companies as Prop. 22's Reach Debated*, BLOOMBERG L. (July 1, 2021), https://news.bloomberglaw.com/daily-labor-report/millions-at-stake-for-gig-companies-as-prop-22s-reach-debated.

[105] Assemb. B. 2257, 2021–2022 Leg., Reg. Sess. (Cal. 2022).

But, Proposition 22 still passed easily, with 58 % of the vote.[106] This could be read simply as a victory for the large corporations that spent heavily on advertising, messaging on social media, and paid staff; this is certainly the way the supporters of AB5 depicted it.[107] But, there were also large and self-organized groups of contractor/workers themselves who canvassed neighborhoods and worked at precincts handing out literature in support of Prof 22 and against AB5.[108]

One view of this process is to argue that planners, and their attempt to modify the relative power positions of participants in the economy, will have to experiment. Trial and error necessarily implies *error*, after all. It is the ability to learn from errors that was the hallmark of the Cambridge-bred optimism about technocratic "learning." But that view is mistaken, or, at least, it is not entirely correct.

To see why remember that the premise of the "new" industrial planning advocates is actually the same as the old planning advocates: political outcomes are the *problem*. These advocates have never claimed that political "discovery" through voters, filtered through democracy or representative assemblies, is the solution. Their solution is to *insulate* the industrial plan from any ability to interfere by corporations or, for that matter, by labor.

The example of AB5 / AB2257 / Proposition 22 is distinctly important because it shows that trial and error cannot solve the information problem faced by industrial planners. Either (a) the plan, for the "good of all," is insulated from democratic pressure to such an extent that it will result in a legal insurrection to reform the rules and thus violate the Cox, North, Weingast "proportionality theorem," or (b) it is not insulated from democratic pressure and politics will quickly block its passage.[109] The only workaround, which is institutional reform to prevent effective challenge, will be vetoed by political elites because they can forecast that the outcome is less preferred than the status-quo institutions.

## CONCLUSION

The quote at the outset of this paper, from Francis Fukuyama, raises an important point. I have fleshed out a more extensive version of an argument that accepts Fukuyama's claim as true. The debate over industrial policy has pitted political leaders who wish to use public resources to reward their friends and harm their enemies against Public Choice scholars who deploy an argument based on the self-interest of politicians and the lack of

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106 Kate Conger, *Uber and Lyft Drivers in California Will Remain Contractors*, N.Y. TIMES (Nov. 9, 2020), https://www.nytimes.com/2020/11/04/technology/california-uber-lyft-prop-22.html.

107 Rosenberg, *supra* note 97.

108 Conger, *supra* note 106.

109 Gary Cox et al., *The Violence Trap: A Political-Economic Approach to the Problems of Development*, 34 J. OF PUB. FIN. & PUB. CHOICE 3, 3-9 (2019).

information required to make valid judgments about winners and losers. My argument in this paper is that it is not the best version of the argument for an industrial policy and opponents of industrial policy need to credit supporters who have a more sophisticated and better-informed view than the naïve political argument.

Proponents of industrial policy are fully aware that politics, at least democratic politics with elections in which organized groups can be pivotal, is a problem. In fact, for many supporters, politics may be the most important problem. As Robert Reich put it, "It is the claim of industrial policy… that *the only alternative to formulating an explicit program* for improving the nation's competitive performance is to cede effective responsibility for policy to groups with back-door political influence."[110]

So, advocates of industrial policy do not see their program working *in spite of politics*; their claim is that their policy will be implemented *instead of* politics. All that will be necessary, according to the (typical) view of Rodrik, will be to select an "appropriate institutional design."[111] All we need to do is get the rules right, and the results will be a good industrial plan, better than the results we would obtain under market processes alone. But it is understood, and often explicit, that getting the rules right will require the suspension of democratic accountability.

It is thus an open secret, understood by both proponents such as Reich and Rodrik and opponents such as Fukuyama, that a necessary, but not sufficient, condition for "good" industrial plans is an authoritarian state. Authoritarian states might choose good or bad industrial policies, of course, but only an authoritarian state can sustain what planning advocates consider to be a good industrial policy.

The contribution of the present paper is to examine more closely the actual intellectual history of the idea of industrial policy. That examination demonstrates that, far from ignoring what would later come to be known as the "Public Choice objection," the problems of political sustainability were the central concern for industrial planners. If anything, advocates for industrial plans, from Pigou onward, were *primarily* concerned with controlling politics, even more than markets.

Nonetheless, Public Choice and Constitutional Political Economy have taught an important lesson, one that planning advocates have either missed or ignored: it is impossible to sustain a "good" industrial policy in a democracy. The problem is not a simple choice of "appropriate institutional design," unless by appropriate institutional design one means the suspension of democracy and due process. I have demonstrated that political actors (1) will never vote for a "good" industrial policy; (2) will always overturn a "good" industrial policy if by chance one is selected; and (3) will vote against institutional rules that would select and protect a "good" industrial policy. This last point, in particular, is important: legislators can look down the

110 Reich, *supra* note 20, at 76 (emphasis added).
111 Rodrik, *supra* note 14, at 1-29.

agenda tree and see that the rules being voted on today will result in outcomes over which they have preferences in the future.

All of this grants a dubious premise, of course: I have simply assumed, for the sake of argument, that the "knowledge problem" does not obtain here. I have granted that the trial and error, or economic expertise, claims of proponents are correct. The point is not that the assumption is correct; rather, even if one grants the heroic assumption that the information problem can be solved in its entirety, the incentives problem of political equilibrium cannot be solved as long as we accept the constraint that we are guaranteed by Article IV, Section 4's stipulation of "a Republican Form of Government."[112]

112 U.S. CONST. art. IV, § 4.