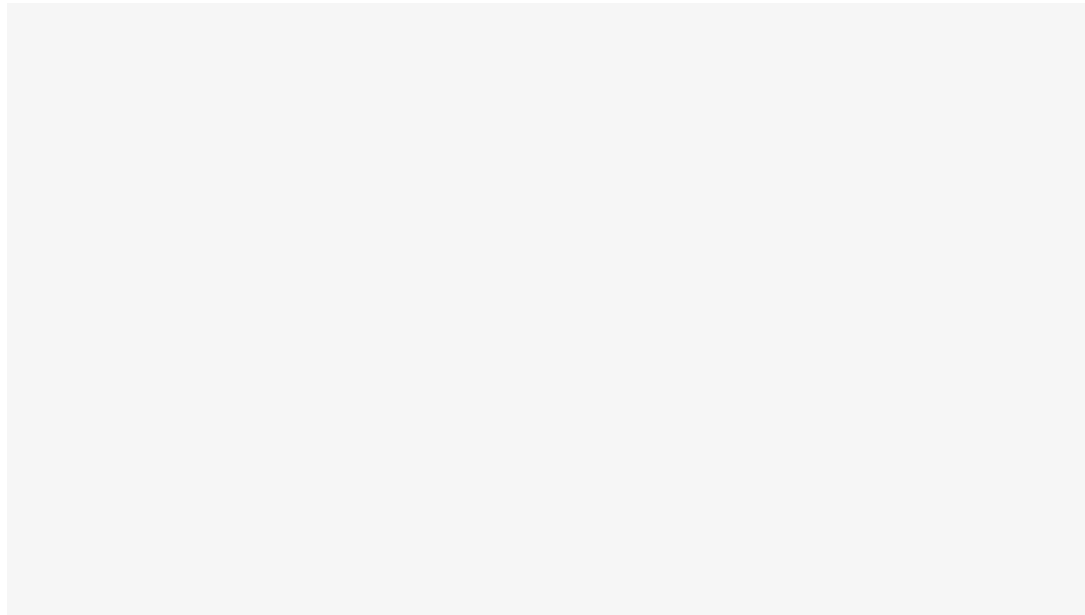


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Spiral of mistakes: Why industrial policy is destined to fail

By Rainer Zitelmann

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Industrial policy is doomed to fail for the same reason as the planned **economy**. This is one of the theses explored in the book by esteemed Chinese economist Zhang Weiyong, a professor at Peking University.

Zhang is widely recognized as **China's** leading advocate of **free-market** principles and played a significant role in shaping Chinese ruler Deng Xiaoping's economic policies in the late 1980s and 1990s. However, Zhang's influence has waned in recent years as China has shifted toward a more state-driven industrial policy.

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In his newly released book, *Re-Understanding Entrepreneurship*, published by Cambridge University Press, Zhang criticizes Chinese and American industrial policies. These have, he writes, both influenced each other, leading to a spiral of mistakes: “Partly in response to China’s industrial policies, the American government has also introduced industrial policy in past decades in one way or another. Examples include the legislative passage of the CHIPS and Science Act and the Inflation Reduction Act overseen by President Biden.”

If Western politicians believed that China’s economic success was the result of state economic management or industrial policy, this was a misinterpretation of China’s success, Zhang explains. A working paper from the World Economic Forum published five years ago stated that “China’s private sector ... is now serving as the main driver of China’s economic growth. The combination of numbers 60/70/80/90 are frequently used to describe the private sector’s contribution to the Chinese economy: they contribute 60% of China’s GDP, and are responsible for 70% of innovation, 80% of urban employment and provide 90% of new jobs. Private wealth is also responsible for 70% of investment and 90% of exports.”

Since the 1980s, China has experienced many industrial policy failures but very few successes. According to Zhang, the country’s successes were not because of, but despite, state intervention in the economy.

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The reason why industrial policy routinely fails is the misguided belief that politicians and civil servants have a better understanding of the most promising innovations of the future than millions of entrepreneurs and consumers. According to Zhang, it is a big mistake to assume that governments can predict the future correctly.

Innovations do not come about through state planning but through entrepreneurship. The role of the entrepreneur is not properly understood by politicians or classical economics. Innovations do not stem from scientific market studies but rather from the implicit knowledge (also known as intuition) of entrepreneurs. When entrepreneurs make mistakes, which happens often enough, they are penalized in the competitive market.

The problem with state industrial policy is that although it may yield short-term successes, it fails in the long run. When failures arise, they are often not corrected, leading politicians to continue their misguided strategies.

This cycle of intervention and failure was referred to as the intervention spiral by the economist Ludwig von Mises. Zhang aptly summarizes this phenomenon when he states, “Government officials and experts, however, are generally unwilling to acknowledge their own mistakes because mistakes expose their own ignorance. One way to conceal mistakes is to provide more support to failed projects. The result is one mistake after another!”

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It is often only with hindsight that the failure of industrial policy comes to light, as exemplified by Japan, which was, in the past, hailed as a resounding success and a model for countries such as China and the United States. However, more recent studies have shown that the 20 most successful Japanese industries received hardly any support, while the seven most unsuccessful industries received the most state support.

Politicians in the U.S. and China are currently drawing inspiration from each other's worst policies, as Zhang shows: U.S. industrial policy under Biden "provokes the Chinese government to be more stubborn in its industrial policy. So, the industrial policy of different countries can re-accelerate each other."

Another problem is that when industrial policy fails, this is often concealed by a process of "self-justification." One example is the promotion of electric vehicles: "If the government uses legislation to prohibit the use of gasoline-powered vehicles and only allows electric vehicles by 2030, for example, then the elimination of gasoline-powered vehicles will be a decisive victory for electric vehicles. However, this does not prove that an industrial policy to encourage electric vehicles is correct."

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Government policy could well eliminate technology with more potential. The potential for progress in gasoline-powered vehicles is still tremendous. The market, not politicians, should decide whether innovative combustion engines or electric vehicles prevail.

It is an irony of history that an economics professor from Peking University, guided by the teachings of Ludwig von Mises and Friedrich August von Hayek, has to explain the principles of capitalist economics and entrepreneurship to the U.S.

Rainer Zitelmann is the author of [The Power of Capitalism](#), [In Defense of Capitalism](#), and [How Nations Escape Poverty](#).

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