Economic Policy in the US and the EU: Convergence or Divergence?

Élie Cohen (*) and Jean Pisani-Ferry(**)

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* CNRS-Sciences Po and Conseil d’analyse économique, Paris.
** Université Paris-Dauphine and Conseil d’analyse économique, 35, rue Saint Dominique, F 75007 Paris. E-mail j.pisani-ferry@cae.pm.gouv.fr
1. Introduction

A quarter of a century ago, the EU member states were still characterised by country-specific patterns of government – economy relations. In areas such as industrial policy, competition or macro-economic policy there was a German (or Rhineland) model, a Gallic model, a British model, etc., as well as, outside Europe, a Japanese model. Some of these models (e.g. the French one) were rather distant from the US model of a modern market economy and some were closer, but there was a strong belief in academic as well as business and policy communities that these idiosyncrasies were more or less permanent.

This was a wrong hypothesis. Over the last 25 years a major change has taken place in Europe as a consequence of (i) the extension of EU-wide economic legislation within the framework of the Single Market, (ii) the delegation of some major policy functions such as, competition policy and monetary policy to EU institutions, and (iii) softer forms of intra-EU convergence through harmonisation and peer pressure in fields such as privatisation and fiscal policy. No one talks of a French or a German model of capitalism anymore, except to blame procrastination or rearguard manoeuvres in the adaptation to the new regime. A truly European model seems to be emerging.

At the same time, US economic policy has experienced significant changes in both the micro and the macro fields, as a consequence of the deregulation of the 1980s, the move to a fiscal surplus in the 1990s and the emergence of a new monetary policy philosophy under the chairmanship of Alan Greenspan.

The question to be investigated is whether this double move is leading towards convergence or divergence of the EU and US models. From a distant point of view, there is obviously convergence since both sides of the Atlantic are now characterised by limited government intervention in the markets, a high degree of price stability and sound public finance. But this is a rather superficial characterisation. The real question is whether the two sides are converging towards the same model of market economy, and what are the potential consequences of this evolution.

To answer that question, section 2 reviews how the different varieties of capitalism were regarded a one or two decades ago; section 3 discusses the transformation of macroeconomic policy; section 4 deals with what we call competitiveness policy issues, i.e. industrial policy, liberalisation and competition policy; section 5 briefly outlines some tentative conclusions.
2. Background: What happened to the national varieties of capitalism?

Shonfield’s seminal study of the interaction between politics and economics in core capitalist countries after the Second World War initiated a series of debates on the convergent or divergent character of the dynamics at work in advanced market democracies. According to Kitshelt et al. (1999), the main issues were “to what extent capitalist countries are maintaining their path dependant trajectories? Are there pressures toward greater institutional and policy convergence? And even if there are, are there also continuing and new sources of diversity?” As recently as 10 or 20 years ago, there was indeed both an academic and a policy debate on the issue. A significant body of research was devoted to characterising the different varieties of capitalism – contrasting in particular the US type of market-led capitalism and the German-based Rhineland model (Albert, 1991) or French social-colbertism (Cohen, 1992) – and to discussing whether they would eventually converge on the US type or would follow distinctive paths (Crouch and Streek, 1996).

The discussion encompassed macroeconomic policy behaviour, the functioning of markets for goods, capital and labour, and redistributional issues, all of which were frequently regarded as being strongly interconnected. For example, the degree of government control over resource allocation was deemed a key determinant of the effectiveness of monetary policy; patterns of industrial relations were considered a significant factor affecting nominal and/or real wage rigidity and thereby having an impact on aggregate macroeconomic behaviour and corresponding macroeconomic policy responses. Output volatility in the UK or inflation and France and Italy were regarded as significant stylised facts whose roots could be found in microeconomic structures and industrial relation patterns.

However, the main focus was on microeconomic issues such as the patterns of property rights and corporate control, the degree of financial intermediation, and the role of the financial markets. John Zysman’s (1983) description of different varieties of corporate control gives a useful starting point.

Zysman’s model

In Government, Markets and Growth, Zysman provides an analytic framework for investigating the role of governments in financial systems and the impact of institutions on growth patterns. He starts from a simple question: how is the financing of the economy

\footnote{Boyer (----) and Gordon (----) are good examples of this literature.}
organised in industrialised countries and how does it impact industrial performance? Answering this question requires that a clear link be established between financial organisation and industrial performance. Zysman’s model includes the organisation of financial markets, credit policies, business financing patterns and the exercise of property rights. This provides the basis for analysing national varieties of capitalism and for elaborating ideal types. Zysman distinguishes between ‘market-led’, ‘state-led’, and ‘bank-led’ financial systems.

The US and Britain provide the basis for the first type, where financial markets are the central institution channelling capital to the most profitable investments. Companies finance themselves on the market and must therefore convince shareholders, analysts, institutional investors and rating agencies. Thus, a focus on quarterly results with the corresponding short-term bias.

France and Japan are examples of the second, ‘state-led’ type. Through credit controls, specialised credit channels and interest rates subsidies, the state essentially substitutes itself for financial markets in the allocation of resources to the various sectors of the economy. In this type of capitalism, there is a market for goods and services (although it may be subject to state intervention), but hardly for factors of production. Allocation is too important a function to be left to market forces.

Zysman saw Germany’s system as ‘bank-led’ because funds are channelled to companies and investment projects through the banking system. The intimate relationship between a company and its bank is thus key to development and to capital accumulation. This arrangement favours long-term strategy over short-term results.

The variety of arrangements obviously raised the issue of their relative efficiency. To explain why such different institutional settings and economic regimes could lead to apparently similar performance, Zysman argued that differing institutional arrangements for coordinating economic activity all had their strengths and weaknesses, and that the market-led model was not universal. That conclusion was shared by Holligsworth and Boyer (1998).

Events however soon led to question the permanence of national varieties of capitalism.

Exit from the state-led model: France

Initial reactions to the oil shocks and the slowdown in growth seemed to confirm the view that each country would follow its own path. In the early 1980s, the socialist government of François Mitterrand nationalised the entire financial system, thereby giving the state almost
total control of the allocation of capital. However, the government soon realised that it was politically untenable to assume full responsibility for the level of capital reallocation that the period called for. Although it embarked on a hands-on approach to the restructuring of ailing sectors and companies, it was also quick to reverse its initial course and to move towards financial deregulation.

Starting in the mid-1980s, a series of reforms were introduced which amounted to a complete overhaul of the financial system. (State-owned) banks were despecialised, interest rate subsidies were reduced and eventually eliminated, credit controls were scrapped, administrative controls on direct inward and outward investment were eliminated, portfolio capital flows were freed, and government policy clearly encouraged disintermediation. Simultaneously, the traditional instruments of industrial policy (direct state aids and sectoral plans) were progressively eliminated. Finally, from 1986 onwards, previously nationalised banks and companies, including those which had been nationalised after World War II, were returned to the private sector.

As a consequence of these transformations, French capitalism no longer resembles Zysman’s model of it. Furthermore, the ownership structure created on the occasion of their privatisation has not passed the test of time. Due to the absence of pension funds and more generally to the weakness of institutional investors, the French financial market lacked agents that could exercise control over the newly privatised companies. The Balladur government that launched the privatisation process had hoped to overcome this difficulty by mimicking the German system and creating a network of cross-ownership between the major banks and insurance firms and the major non-financial companies. This was done in the privatisation process through allocating blocks of shares (known as noyaux durs – hard cores) to selected corporate shareholders. However, this artificially-created structure did not last for long as the companies strategic interest did not coincide with the role they had been given by the architects of the privatisation process.

The result was a dramatic increase in the share of non residents in the capital of French companies. According to Banque de France (2001) statistics, in year 2000 foreign shareholders accounted for 26% of the capital of companies. This is a smaller proportion than in the UK where it reaches 31%, but significantly higher than in Germany (21%) or the US (11%). Furthermore, the share of non residents is much higher in the capital of listed
companies, for which it reaches 37.5\%\(^2\). Former national champions like TotalFinaElf, Vivendi, Alstom or CapGemini are now truly international companies, whose foreign shareholders account for more than 60\% of total capital.

Wide-ranging liberalisation and large scale privatisation against the background of weak institutional investors have thus brought French-style capitalism to an abrupt end. Resistance to liberalisation does exist, but concentrates on issues relating to competition in the transport, postal service and electricity sectors, which are dominated by state-owned monopolies.

**(Partial) exit from the bank-led model: Germany**

Changes have been less pronounced in Germany, as illustrated by a series of recent events such as the (successful) obstruction to the takeover directive by German members of the European Parliament, by Chancellor’s Schröder active (but unsuccessful) involvement in the rescue of the Philip Holzman construction group and by his staunch defence of the special character of Volkswagen, or the opposition expressed by the Länder to the implementation of EU competition legislation in fields such as local services, transportation and banking. These three events (and other) illustrate a German reluctance to accept the dominance of financial market in the ownership and the control of companies.

Recent research by Marco Brecht and Colin Mayer (2001) confirms that Germany is still far from having converged on the British or American type of ownership structure. In more than half of the listed non-financial companies, a single block holder controls more than 50\% of the voting rights, while the median block holder controls only 20\% of the voting rights in France, 10\% in the UK and 5\% in the US\(^3\). It would thus seem that unlike the French model, the Rhineland model is alive and well.

However, questions abound on the future of the German model (Uterwede, 2002). The recent decision to eliminate the taxation of long term corporate capital gains has been widely interpreted as an incentive to untie long-standing ownership relationships, especially between banks and companies. The merger of Allianz and Dresdner Bank, the transformation of Deutsche Bank into a global investment bank and Vodaphone’s successful hostile take-over of Mannesman (in spite of strong and vocal opposition by the unions and the Chancellor) are indications that transformations are under way.

\(^2\) The figure is even more impressive if we narrow the scope to the CAC40 companies, for which foreign shareholders account for 50\% of total shareholders (*Les Échos, Audit de la France, 2002*)
France, Germany to a lesser extent, and more generally continental Europe are thus moving away from the collection of country-specific models they were. A large part of these transformations simply amount to the adoption of a market-based model of a modern economy, of which the US offers a powerful example. However, to conclude that European countries have simply converged on the US model would be premature. In what follows we investigate whether a truly European model is emerging.

3. Macroeconomic policy

Convergence

Over the last quarter century, the approach to and instruments of macroeconomic policy have changed on both sides of the Atlantic. The change, however, has been less in the US than in Europe, where the role of monetary and fiscal policy has been transformed by financial market liberalisation and the creation of Economic and Monetary Union (EMU).

Since the 1970s, the US has not experienced a major transformation in the way financial markets operate; it has not introduced any legal redefinition of the objectives of economic policy; its major economic policy institutions have remained virtually untouched; and in spite of the demise of the Bretton Woods system, the exchange rate regime has not been redefined. This high degree of continuity has certainly not precluded significant changes in the approach to both monetary and fiscal policy, as a consequence of both the succession of events and the economic policy controversies of the 1970s, the 1980s and the 1990s. But these strategic redefinitions have taken place against the background of a stable economic, legal and institutional framework.

Europe, by contrast, has undergone a complete overhaul of its economic policy system(s). First, financial markets regulations and restrictions to capital outflows which were widespread in the 1970s have been dismantled throughout the continent. Second, the objectives of economic policy and the corresponding assignment of instruments have been redefined. Third, all EU countries where the central bank was not fully independent from government have reformed their monetary institution. In addition, in the Euro area monetary authority has been transferred to the European Central Bank. Fourth, the exchange rate regimes have changed from fixed to floating, then to a floating-but-adjustable rates regime, and eventually either to floating (in non-euro countries) or to a full monetary union.

3 The same is actually true of other continental European countries such as Italy or Belgium (and to a lesser
In some respect, the European countries are certainly closer to the US now than they were a quarter of a century ago. When president Reagan and president Mitterrand both embarked on a fiscal reflation course in 1981, the US and the French economy responded in almost opposite ways, as could have been expected since one was a financially open economy with an independent, inflation-adverse central bank and the other was a financially closed economy whose central bank had to yield to government injunctions (Figure 1). Nowadays, both the financial environment and the monetary context of fiscal policy are broadly similar in Europe and the US. Unsurprisingly, a significant degree of convergence can be observed in the pattern of macroeconomic policy.

(Figure 1 – Economic Responses to Fiscal Reflation: United States and France, 1981-85)

Differences in monetary policy reaction functions have been studied extensively in the literature. In their study of the post-1979 period, Clarida, Gali and Geltler (1998) have shown that in spite of rhetorical differences, the actual behaviour of the Fed and the Bundesbank has been in fact ‘remarkably similar’. More recent studies (Artus and Wyplosz, 2002) suggest that the same can be said of the ECB.

Fiscal policy convergence is also impressive. Figure 2 and 3 depict the evolution of the general government balance and the public debt ratio in Europe and the US. By and large, the evolution has also been remarkably similar. While the short term volatility in the deficit is somewhat greater in the US, the timing of the major reversals is similar and changes are of a comparable magnitude. Even the debt ratio has followed a similar path.

(Figure 2: General Government Balance in the US and the EU, 1960-2001)

(Figure 3: General Government Debt Ratio in the US and the EU, 1960-2001)

There are however significant differences in the way macroeconomic policy is envisaged and implemented. First, quasi-constitutional constraints on economic policy are much more prevalent in Europe, which implies that the discretionary component of both monetary and fiscal policy is less prominent than in the US. Second, there is much more policy inertia in Europe, as Europeans have in a way ‘locked in’ the particular policy philosophy that characterised the late 1980s and early 1990s and are likely to stick to it while US policy is more likely to adapt to changing circumstances.
Rules vs. Discretion

In the US, the Federal reserve was given by Congress a broad and somewhat loosely defined mandate and the FOMC has consistently maintained a significant margin of discretion. In the words of Governor Laurence Meyer (2002), “while monetary policy can follow a rule-like behaviour, it can and should avoid the quarter-to-quarter commitment to a strict rule […] No one policy rule can anticipate the appropriate response to all possible circumstances before they arise”. The only implicit policy rule of the Federal Reserve under Alan Greenspan has been described as “study all the data carefully, and then set interest rates at the right level” (Mankiw, 2001), which is an accurate description of discretionarly behaviour.

The ECB is characterised both by a narrower mandate and a greater inclination towards rules. It was given by the Maastricht treaty the specific mandate of preserving price stability, for which its governing council has adopted a quantitative definition (inflation below 2% over the medium term)4. Furthermore, the ECB governing council has adopted a monetary policy strategy which is in part based on a quantitative target for the growth of M3 (ECB, 2000, Gali, 2001).

Since the ECB has taken charge of monetary policy in the Euro area, its actual behaviour suggests that it has in fact retained a margin of discretion. For example, it has allowed inflation to exceed its 2% target for 17 consecutive months5 after shocks to the price of oil and of agricultural products had resulted in a rise in inflation. But its response to the 2001-2002 slowdown was much less aggressive than that of the Federal Reserve, although growth in the Euro area was actually lower than in the US. Even on 12th September, 2001, Wim Duisenberg, ECB president, emphasised that “monetary policy is forward-looking and medium-term oriented, and we do not and should not react to very short-term indicators”6. ECB officials lose no occasion to emphasise that, in the words of the bank’s chief economist Otmar Issing (2002), “central banks must avoid becoming a source of additional uncertainty themselves when there is only limited knowledge about the economy and the behaviour of economic agents”. The European monetary institution has certainly more inclination towards fixed rules than its American counterpart.

5 From June 2000 to December 2001.
Differences in the approach to fiscal policy are at least as significant. In the US, there have been discussions on a balanced-budget rule, but so far, Congress remains free to vote whatever budget it deems appropriate. And this freedom is used: according to the OECD (2002), the US general government deficit moved from a 1.7% of GDP surplus in 2000 to a 1.1% deficit in 2002, essentially because of a deterioration in the structural balance (from a 1.3 percentage points surplus to a 0.7 percentage points deficit). Recent developments thus confirm that in spite of the steady improvement in the situation of public finance that was observed in the 1990s, the US fiscal policy stance can be subject to abrupt reversals.

Europe appears to be heading towards a different model. The responsibility for fiscal policy remains in the hands of national governments, but subject to the constraints of the ‘no-excessive deficit’ procedure of the treaty and of the Stability Pact. In fact, constraints on national fiscal policy have continuously hardened since the treaty was negotiated in the early 1990s. While the member states’ initial obligation was only to “avoid excessive deficits” (Art. 104 of the EU treaty), by which it was understood that, absent “exceptional circumstances”, they had to keep the general government deficit below a 3% of GDP threshold, subsequent legislation has tightened the limitations on fiscal discretion. The Stability pact of 1997 states that “member states commit themselves to respect the medium term budgetary objective of positions close to balance or in surplus”.

This commitment is now interpreted as an obligation to achieve and to maintain a balance in the cyclically-adjusted position of the general government. It is being enforced: eight of the twelve Euro zone member states complied with it in 2001 and when they met at the European Council in Barcelona in March 2002, all member states committed themselves to achieving it in 2004 at the latest. A caveat must certainly be added as the non-compliant states are by no means insignificant: they include Germany, France and Italy, which together account for more than ¾ of the zone’s GDP. The jury is therefore still out. But if the participants in the euro stick to the interpretation of the pact they have formally adhered to and act accordingly, the fiscal policy of the Euro zone will, for all practical purposes, be put on the automatic pilot. This is in fact regarded as a positive development by prominent European economists (Alesina et al., 2001).

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8 On 10 July 2001, the Ecofin Council stated that “the assessment of the appropriateness of the member states’ medium term objectives and the examination of their fulfilment have to take explicit account of the cyclical position and its effect on the budget”.

Inertia vs. responsiveness

Another, related characteristic of EU economic policy is that it exhibits a high degree of behavioural and institutional inertia. Behavioural inertia results from the fact that most policy decisions for the Euro area as a whole need to be taken collegially, which implies that they often require consensus-building and/or negotiations. This applies to the monetary policy decisions of the ECB, which are taken by a council consisting of six board members and (at present) twelve national central banks governors. Although information on the deliberations of that body is scarce (it does not publish minutes and generally does not vote), most ECB-watchers have the impression that internal procedures make the European central bank a ‘slow institution’ which does not succeed well in communicating its strategy and making it understood by market participants (Gros et al., 2000, 2001, Alesina et al. 2001). The same can be said of the Eurogroup in which the Euro zone’s finance ministers regularly gather to assess the economic situation and discuss policy coordination. Legal constraints notwithstanding, any discretionary decision to alter the policy stance is bound to require long negotiations between ministers even before it goes to the various parliaments. Quite apart from the member states’ commitment to fiscal discipline, this is a significant constraint on the implementation of a common fiscal policy.

Institutional inertia results from the fact that Europe’s institutions (such as the ECB) or rules (such as the price stability objective and the no-excessive deficit procedure) are enshrined in a treaty that can only be modified by unanimity⁹. Even amendments to secondary legislation (such as the Stability pact) may require as much consensus and political capital as a constitutional reform in a unitary state. Thus, it is likely that the set of rules and institutions that constitutes the EU economic policy system will exhibit a high degree of stability. Moreover, those rules and institutions were all defined within a short time span, between the late 1980s to the late 1990s. As a consequence, they embody the policy thinking of a period in which industrialised countries were just emerging from high inflation and still struggling with high public deficits and rising public debt ratios. This explains the very high priority given to credibility and discipline. In a way, the EU has ‘locked in’ the policy philosophy of that decade and has made it a permanent inspiration of its policy system.

This contrasts with the US, whose policy rules and institutions result from a sedimentation of influences, from the early Federal Reserve Act of 1913 and the post-depression Banking Act

⁹ pending the recently created Convention in charge of institutional reform of the EU.

*Does it matter?*

The major question regarding the future is whether the policy system of the Euro area has reached an equilibrium or whether it can be expected to undergo further significant transformations. One view holds that the major choices have been made, that Europe’s system is essentially in place, and that the objectives set out by the Council provide a fair image of the future. If this view is correct, Europe can be expected to follow a medium-term-oriented, non activist, monetary policy and a fiscal policy that is limited to letting the automatic stabilisers move freely, with very little aim at discretionary action, at least for the Euro area as a whole. In such a system, there would be built-in stabilisers, but neither monetary nor fiscal policy would be responsible for the overall management of the economic cycle (in more technical terms, no institution would play the role of a Stackelberg leader). There would be no attempt to define and implement a policy mix for the Euro zone. Nor should there be one, because coordination and discretionary action could prove counter-productive (Alesina et al., 2001). Instead, the policy mix would be the *ex post* result of decisions taken by individual actors in accordance with predefined rules.

Assessing such a system *per se* is not the purpose of this paper. Here, our question is whether such an evolution would lead to US-EU divergence and whether such a divergence could give rise to transatlantic tensions. The best answer to the first question is most probably positive. While some US policy makers find merit in the idea predefined rules, little in the country’s political institutions or traditions suggests that it could go very far in this direction. The answer to the second question is probably ‘no, most of the time’, because the US government would generally be happy with a Europe that follows a rules-based approach to macroeconomic policy and that leaves it the task of being the world’s Stackelberg leader. However, circumstances could also arise in which the US would expect Europe to undertake discretionary action, either in connection with the exchange rate of the euro vis-à-vis the dollar, or in response to common shocks affecting both the US and Europe.

An alternative scenario would be for the participants in the euro to develop institutions that would equip them with an ability to take discretionary action. The Eurogroup was created in

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10 This could be different for individual member states that could rely on discretionary fiscal policy to counteract asymmetric developments.
1998 for that purpose. In the eyes of its (frequently but not exclusively French) promoters, it should be able to undertake policy coordination and for that purpose it should become a kind of collective executive body (Jacquet and Pisani-Ferry, 2000, von Hagen and Mundschenk, 2001). Former Finance minister Strauss-Kahn (2000) thus proposes to give the Eurogroup “a formal and executive decision-making capacity in those areas pertaining to macro-economic policy, or alternatively, to allow the Ecofin’s euro members to meet in separate session in order to decide on co-ordinated action”. In a similar vein, Lamy and Pisani-Ferry (2002) propose to replace the Eurogroup’s rotating presidency by a president designated for a fixed period and confirmed by the European Parliament and to entrust it with a capacity to vote by qualified majority on economic policy guidelines for the Euro zone. The logic of these proposals is that the Eurogroup should be able to decide on a fiscal policy stance for the zone as a whole, at least in some circumstances, even though implementation would be left to the national governments.

If this approach prevails, the functioning of the Euro zone will move somewhat closer to the US model. A remaining difference will still be that the European federal budget is unlikely to be assigned any significant macroeconomic role\textsuperscript{11}; but if coordination becomes more effective, the notion of a Euro area macroeconomic policy will nevertheless emerge. This could, paradoxically, lead to more rivalry with the US, especially if internal coordination results in a more assertive Europe that would create a unified external representation in the international economic and financial fora\textsuperscript{12} and attempt to play a macroeconomic role in the world economy. But more discretionary decision-making in Europe could also be more able to play an active, cooperative role in dealing with common shocks or crises.

To put it differently, Europe continues to hesitate between two views of monetary integration, which Maastricht tried to reconcile. On the one hand, there are those who, in a spirit that reminds that of the XIX\textsuperscript{th} century gold standard, seek to depoliticise the management of the currency and economic policy as a whole, and to ensure that economic policy abides by a set of fixed rules. On the other hand, there are those who, in the tradition of the XX\textsuperscript{th} century, regard fiscal and monetary policy as key instruments that have to be used for minimising the adjustments imposed on society by external shocks. These two views are both compatible

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\textsuperscript{11} This does not exclude that additional policy functions would be transferred to the EU budget. But transfers are unlikely to be significant enough to give the EU budget a meaningful macroeconomic role.

\textsuperscript{12} Those who advocate stronger intra-European coordination also frequently call for a common external representation. For example, French PM Jospin (2001) advocates a common representation at the IMF board.
with the goal of price stability and a scrupulous respect of the central bank’s independence. But they correspond to two different policy philosophies.

4. Competitiveness Policies

Competitiveness is a catchword for a series of policies dealing with the supply side. We use it here to encompass traditional sectoral industrial policies as well as more horizontal policies, including those dealing with innovation, R&D and infrastructure, and the promotion of competition. The concept is controversial, and we therefore use it as a general term, broad enough to cover a range of ideas (we also refer to a period of time in which there was less agreement than there is now on how and when governments have to intervene in the economy).\(^{13}\)

In the early 1980s, Europe and the US were both discussing the virtues of competitiveness policies. This discussion was motivated by the continuous erosion of the market share of European and US producers vis-à-vis those of Japan and emerging Asia (Dertouzos, Lester and Solow, 1989). There was talk of ‘US economic decline’ and ‘eurosclerosis’. There was also a debate between, on the one hand, the proponents of active competitiveness policies relying on industrial policy, strategic trade policy and a soft stance towards national champions in competition policy decisions and, on the other hand, the advocates of free-market solutions such as liberalisation, deregulation, and privatisation.

In this context, several American scholars or writers (such as Clyde Prestowitz, Robert Reich, Lester Thurow, Laura Tyson) depicted Japan and European countries as examples of successful competitiveness policy strategies. Europeans, however, had the feeling that their traditional approaches had reached their limits and that targeted industrial policies had reached a zone of decreasing – if not negative - returns. During the following two decades, Europe was in fact not able to renew its interventionist toolkit and essentially relied on liberalisation while the US, which had already started the deregulation of several sectors in the 1970s, kept a more balanced approach between liberalisation and active competition policies. Europe, thus, emulated a stylised US model, while the US itself retained a pragmatic approach.

\(^{13}\) On the competitiveness policy debate in the US and in Europe, see Cohen and Lorenzi (2000) and the references therein.
Industrial policy in the US

In spite of the pundits, no US government really endorsed industrial policy. Ronald Reagan’s administration strongly opposed it, on the ground that it could only create distortions and result a waste of public money. If anything, government intervention in the markets was considered a potential handicap, even in the presence of market failures. Government failures, it was argued, were bound to exceed market failures. Not only were governments unable to pick the winning sectors and companies, they were also vulnerable to capture by specific lobbies. The political economy approach also highlighted the risk that they would follow their own, politically-determined agenda. A large body of literature originating in the work of Stigler and Buchanan was supporting these views. The actual behaviour of the Reagan and Bush administrations was however less clear-cut. Intervention took place, especially through trade policy initiatives such as the ill-named Voluntary Export Restraints  

The Clinton administration initially endorsed a more proactive approach. It was sympathetic to the idea that the US was suffering from a relative economic decline and that government intervention was needed to counter both the overall slowdown in productivity growth and the challenge created by Japanese advances in several sectors  

An ambitious public investment programme was designed, with the aim of contributing to a reversal of those tendencies  

In practice, the Clinton administration’s policy essentially relied on a more traditional macroeconomic approach. The elimination of the federal deficit and the resulting adoption of a stimulative stance by the Federal Reserve are generally considered key factors behind US expansion in the 1990s. Fears of an economic decline proved to be completely unfounded  

However, the Clinton administration consistently focused on creating conditions favourable to productivity growth.

In assessing competition policy cases, the US government has been willing to consider potential trade-offs between competition and innovation, instead of focusing on market power only. This happened in the Microsoft case. Confronted with the same problem, the European

14 Under the VER agreement the Reagan administration monitored car imports from Japan in a very bureaucratic way.
15 The MIT Commission on Industrial Productivity provided a sharp analysis of the reasons of the American industrial decline and a toolkit for an improvement of the American performance in industry (Dezourtos, Lester aand Solow, 1989).
16 Before his election, President Clinton had expressed interest for the thesis developed by Laura Tyson (1992) and the strategic trade policies approach, which advocated active policy initiatives in sectors like electronic components, telecom equipment, or the car industry.
Commission prohibited the integration of content providers and infrastructure providers in digital TV (MSG case). This difference in attitude was also apparent in two mergers cases – Worldcom-Sprint and GE-Honeywell – which were fully approved by American competition authorities on the ground that there was no evidence that they would harm the interests of consumers and were rejected by the European commission on the ground that they would create dominant positions.

_Europe’s response to eurosclerosis_

In the early 1980s, Europe was suffering from a deep europessimism crisis. In the eyes of many industrialists, stagflation, exchange crises and painful industrial restructuring signalled that the future was bleak. Governments were frequently tempted by purely national, if not isolationist, solutions. EC integration was stalled and the Community machinery was overwhelmed by current difficulties. Most if not all political energy was devoted to restructuring ailing sectors, negotiating adjustments to the Common Agricultural Policy, managing the consequences of monetary disturbances or quarrelling about budgetary contributions. The EC was able to liquidate, but unable to build for the future.

Europeans responded to the competitive challenge by a series of projects tailored to prop up technological development and with the launching of the Single market project.

This response had been prepared by a several initiatives. The European commission vice-president in charge of industrial restructuring, Étienne Davignon, had encouraged the creation of a lobby of European industrialists that was advocating bolder reforms and increased integration. The idea that Europe’s weakness was in large part due to the fragmentation of its internal market was thus making progress. The Single market itself was not a new project, as the Commission had prepared a programme of 300 directives that were deemed necessary to go beyond the abolition of internal tariffs and to complete the integration of markets for goods, services and capital. Among the member states, Germany and France, the traditional pillars of European integration, were looking for a new momentum, and the UK under Mrs. Thatcher was keen on dismantling regulations and barriers.

Jacques Delors was the political entrepreneur who succeeded in blending a demand for economic efficiency, a demand for political impetus, and the EC’s traditional supply of

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17 Nevertheless, Clinton like Reagan and Bush strove to force the opening of the Japanese market through the ‘Structural Impediments Initiative’.
integrationist policies into a single mobilising project, Europe 1992$^{18}$. The resulting Single European Act was a balanced compromise between liberalisation (with the removal of physical, technical and tax barriers to economic integration), integration (with the adoption of qualified majority voting for a series of decisions) and political assertion (with the launching of new common policies and the addition to the EC budget of a significant redistributive component). The economic agenda for bolstering European competitiveness was relying on a liberalisation arm through the removal of trade and non-trade barriers and an industrial policy arm through the adoption of a series of programmes (Esprit, Eurêka, Brite, Race, Euram…) devoted to the promotion of new technologies. Instead of choosing between free-market and interventionist policies, European reformers thus aimed to combine them.

**Ex post assessment: interventionist failure, successful liberalisation**

In retrospect, Europe’s successful implementation of its liberalisation agenda strongly contrasts with the very limited success of its industrial policy initiatives.

Almost twenty years after the adoption of the Europe 1992 objective, the integrationist programme initiated in the mid-1980s through the liberalisation arm has by and large been implemented. The Single market is widely considered a success, and rightly so. Progress has been slower than expected in some areas, such as financial markets and services, and there is significant resistance to change in utilities and more generally in public services, but the achievements are very significant and the momentum towards liberalisation and integration continues. The only question that is being debated is whether the same logic will soon extend to new sectors such as education and health care services or pensions. At the same time, state aids in individual member states are being cut down and competition policy, which has gained strength, explicitly overlooks industrial policy objectives.

However, little remains of the industrial policy arm. Attempts to rejuvenate the European economy through the promotion of common, forward-looking projects have had at best limited success and have certainly not been sufficient to overcome a deteriorating competitive position. When the first Esprit Programme was launched in 1984 on the basis of the work of a joint Commission-industry group chaired by Messrs. Davignon and Guilenhammar$^{19}$, the

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$^{18}$ It is significant that Jacques Delors, by his own confession, only set in motion the process of liberalisation having found that no other direction for relaunching European integration would have gained the support of the Member States.

$^{19}$ Then the CEO of Volvo.
dominant view was that Europe had to catch up with the US in the information technology sphere. Special and urgent efforts were required in the production of computers and electronic components. Eight years after the launching of the programme, in 1992, the results were mediocre: in spite of the R&D programmes and the cooperative joint ventures between European firms that were supposed to improve the competitive position of European firms, the EC was still buying three times as much as it sold to the USA. For Japan the proportion was of one to fourteen and for the Asian NICS it was one to ten²⁰.

Furthermore, most of the projects initiated in the 1980s have either been abandoned or redirected towards the promotion of research. The few successes there are, in sectors such as aerospace, rely on special or bilateral agreements and do not fall within the realm of the Community. Eurêka, an intergovernmental cooperative programme, has had some initial success and its bottom-up method was generally appreciated, but it has de facto been abandoned.

This failure partially results from the intrinsic conflict between interventionist and free-market leaning states within the EC, but even more from the Community’s idiosyncratic disregard of industrial policy. In only one occasion, the Europeans took industrial policy seriously, when they initiated the Eurêka 95 programme on HDTV. But here they failed to deliver any kind of substantial achievement. Eurêka was a bottom-up programme based on industry initiatives, sponsored by an ad-hoc committee and supported mainly by national governments (and in a limited way by the European Commission). The HDTV program was very ambitious: the aims were to stimulate the creation of a European industry through cooperative research, common standards, and incentives for the production of innovative media programs. Five years after the beginning of the cooperative research project, the European community scaled back its financial efforts, the media industry rejected the common standards (D2MAC:HDTV), and the consumer electronics industry suffered a severe crisis (Cohen, 1996).

A clear imbalance thus now exists between the former two arms. It is visible in the definition of the policy objectives, in the decision rules and in the implementation mechanisms. Those who find little merit to industrial policies may regard this contrast as just another illustration of their intrinsic inefficiency. There is some truth in this view, but it must be observed that integration within the Single market has not brought visible supply-side effects either.

²⁰ European Information technology observatory 93 EITO Publisher 1993 p 30
Europe’s still lags behind the US in terms of innovation and productivity growth, and if anything, the gap has increased in the period in which the growth effects of the 1992 programme were supposed to materialise (Emerson et al, 1988, Baldwin, 1989)\textsuperscript{21}. Unlike the US, the preference for liberalisation policies can thus not been explained by the success they had in countering the relative decline of the European economy.

Three factors may explain the continuing European commitment to the removal of internal barriers and its near-abandonment of industrial policy initiatives.

The first reason is that liberalisation has become identified with European integration. As the removal of intra-European barriers (or negative integration, as it is called in the European jargon) implies dismantling national protections and regulations, it is by nature a liberalisation policy. But it can be pursued on the basis of its integrationist merits only. In effect, the alliance that Jacques Delors had built to promote the Single market programme brought together Eurosceptic Margaret Thatcher (on liberalisation grounds) and free-market sceptic François Mitterrand (on integrationist grounds). The same applies today as pro-Europeans frequently support the creation of a single market for railways or energy even though they have reservations on the accompanying liberalisation agenda.

The second reason can be found in the fact that European integration has proceeded in two different modes since the 1950s: a deep, supranational mode and a shallow, intergovernmental mode. Under the supranational mode, European countries have created common institutions and a genuine Community law enforced by the Community's own courts. Under the intergovernmental mode, national governments have agreed to coordinate their national policies, but these policies are executed by national institutions under national law and remain determined to a large extent by national policymakers. The paradigm of decision-making under the supranational mode - though not always practised - is decision by (qualified) majority, while the paradigm of intergovernmentalism –here again with some exceptions - is unanimity. The strength of liberalisation is that is has proceeded through the first mode, while a weakness of industrial policy is that it relies on the second.

The third reason is that the implementation of the liberalisation agenda relies on powerful lock-in mechanisms which, once in place, do not require additional political impetus. The

\textsuperscript{21} Recent surveys such as Gros (2001) do not provide evidence of an increase in European productivity growth that would even partially match what has been observed in the US
strength of liberalisation may thus progress through a series of quasi-judicial decisions that do not require explicit political decisions.

Two examples: competition policy and public services

Competition policy provides a telling example of the logic at work. In 1989, the role of the Commission in the control of industrial concentration was significantly enhanced by a new Council regulation. At that time, there was a discussion on how industrial policy concerns could be taken into account in competition policy decisions. However, the Commission jurisprudence has consistently refused to consider potential trade-offs between competition and industrial policy concerns. Over the years, the predominance of concerns relating strictly to the competitive functioning of markets has been confirmed by a series of cases. A recent illustration was the decision to block the Schneider-Legrand merger, regardless of the potential impact of this decision on Europe’s competitive position in the electrical equipment sector. Furthermore, the Commission relies on a stricter definition of threats to the competitive operation of markets than the US Department of Justice: it takes into account the potential effects of concentration rather than only its actual effects and frequently considers that to assess the potential effect of a merger, the relevant markets are the national ones rather than the European one.

Public utilities provide another illustration. The founding fathers of Europe gave the European Commission was given the mission of ensuring the free movement of goods and services in the European area. It has thus become the arbiter of competition, state aids and exclusive rights affairs. Art. 86 (ex. Art. 90) of the treaty in particular gives the Commission the power to determine whether public monopolies that provide services of general interest conform the general rules of the EC. In the eyes of the signatories of the Treaty of Rome, it was intended to protect public services and until the end-1980s, the Commission exercised restraint in the use of its powers under Art. 86. Things however began to change with the emergence of competition between public monopolies and private entities. Being itself free from the influence of national compromises, the European commission then started to question received wisdom. Why was it deemed necessary to grant a monopoly status to a company that

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22 Recent examples are the Tetra-Sidel, Legrand-Schneider, Volvo-Scania and GE-Honeywell cases.
23 Art. 86 states that “Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in [this] Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. It gives the Commission the role to “ensure the
provides service of general interest? Why was it considered natural that state-owned companies provide public services is made by? Was there a sound rationale for allowing a public company to provide both public and non-public services without a strict separation of accounts? Did (German) federalism require that local public banks be granted special financial privileges? Although the Commission frequently preferred to compromise rather than to go to the European court of justice, its pressure contributed to a significant liberalisation of public services.

*Europe’s gamble on 3G telecommunications*

Europe’s behaviour in the allocation of third generation mobile telephone licenses provides another interesting case because the creation of an entirely new market for telecommunication services was bound to involve public authorities. The starting point was Europe’s success with the second generation. Early adoption of a common European standard, the GSM, facilitated the development of services and progress of European manufacturers in the production of the corresponding equipment. Although it did not happen as a consequence of an explicit industrial policy, Europe *de facto* succeeded in taking the lead in the development of mobile telecommunications (Cohen and Mougeot, 2001, Didier and Lorenzi, 2002).

The European Commission’s attempt to reiterate this success led in 1998 to the adoption by the Council of a similar approach for 3G mobile telecommunications. However, an ambitious timetable for the development of new services was adopted in spite of a lack of visibility about the technology’s potential. Europeans were wary enough not to embark on an explicit industrial policy strategy, but they could not resist the temptation to stimulate the emergence of a sector in which they could pretend being more advanced than the US and possibly Japan. The result was that the new project was launched in spite of the absence of convincing studies demonstrating that industry was able to deliver on the technology’s potential.

Furthermore, member states proceeded in an uncoordinated way. In 1998, the Council decided that the allocation of licences could be left to the member states. No serious attempt was made at determining whether a fully decentralised approach was preferable to some form of coordination. Some member states such as Finland and Sweden chose to give away the licenses for free, while others such as the UK and Germany opted for an auction procedure explicitly aiming at maximising public revenue and others again decided to sell the licences to

*application of the provisions of this Article and [...] where necessary, address appropriate directives or decisions to Member States*.
the winners of a beauty contest. As a result (and because of the time lags between the first and the last decisions), excluding the countries in which they were allocated for free, the price of licences varied between 630 euro per user in the UK to 43 euros per user in Belgium (Cohen and Mougeot, 2001). Questions now abound about the viability of the telecom companies who have paid a high price for acquiring licences on the basis of inflated revenue expectations. The irony is that those states who have pocketed the receipts from auction sales may well be the indirect recipients of transfers from shareholders (and possibly governments) from other member states.

What this case illustrates is that Europe’s policy can be hostage of the conflicting influences of its technological ambitions and of the member states budgetary interests.

Does it matter?

During the last two decades, the US and Europe have both embarked on ambitious supply-side policies whose main focus was on liberalisation and deregulation. For Europe, or at least several member states, this was a very significant departure from the traditional industrial policy approach and a step in the direction of the US model.

Europe’s initial attempt to balance this initiative by a more discretionary, sector-oriented or project-oriented approach did not pass the test of time. Technology projects have been abandoned, the cooperative approach to R&D has not delivered the results that were expected and event in the recent 3G telecommunication case, where it could build on a previous success, the EU initiatives do not appear to be successful. Due to a combination of factors, ranging from the internal weaknesses of the industrial policy approach to the identification between liberalisation and integration and the implementation of liberalisation through a series of powerful mechanisms, Europe has moved very rapidly from a traditionally proactive stance in industrial affairs to a resolutely free-market stance.

There are probably deep reasons behind this move. Quite apart from the intrinsic efficiency or inefficiency of the industrial policy approach, the same ingredients can be found in most cases: Europeans do not agree among themselves on the merits of industrial policy initiatives; industrial and technological objectives tend to be blurred with distributional objectives (especially in direction of the poorer member states); decisions are handicapped by the variety of conflicting interests; implementation is too often chaotic.

As a consequence, it is logical that Europe moves away from a discretionary approach to supply-side policies and increasingly puts emphasis on developing and enforcing rules of the
game. It is no accident that the completion of the Single market has been Europe’s major and most successful economic reform initiative of the last decades.

The US retains by contrast a larger margin for discretion. Although it has also moved away from industrial policy, instruments are still in place: the defence and research budgets are far more considerable than those of the EU and they are being used. At a more fundamental level, the US government remains responsive to pressures and incentives to act, while the EU increasingly defines itself by the set of rules it has committed to abide by. The recent US decision of granting protection to domestic steel producers and the EU response were both characteristic in this respect. The US decision was almost explicitly motivated by electoral concerns and it was not supported by any kind of convincing economic justification. In its response, the EU was careful to emphasise that it would strictly conform the rules of the World Trade Organisation. In this affair, the US was thus all discretion while EU was all rules.

Similar postures can be expected for the future. Because it itself a ‘Community of law’ and has developed a rules-based culture, the EU is likely to behave increasingly as the champion of rules in international economic relations. As integration proceeds and competences are transferred to the EU level, more and more domains can be expected to be managed on the basis of a core set of principles. While the development of a more political and a more democratic Europe could be expected to counteract this tendency, the upcoming enlargement is going to reinforce it. The US, by contrast, is only slowly moving in the direction of a rules-based approach, because its domestic institutions favour that the administration remains responsive to the electorate’s and the special interest groups’ concerns.

5. Conclusion

In this paper, we have examined how differences between Europe and the US in the approach to and the instruments of economic policy have evolved over the last twenty years. Our main conclusions are as follows:

1. There has been a considerable degree of convergence of Europe towards the US model of a market economy. With the possible and most probably temporary exception of Germany, little remains of the traditional models of capitalism that were not so long ago considered permanent characteristics of the major European countries.

2. European integration has been a major driving force of this convergence process. Both in the macro- and the microeconomic fields, it has led to a near-complete transformation of
the rules and institutions governing European economic policy. US economic policy has not undergone similar transformations.

3. Europe’s convergence towards a model characterised by a stability-oriented monetary policy, non-activist, sustainability-oriented fiscal policies, free competition in products and capital markets, and a very limited role for targeted government intervention is both a product of trends affecting the world economy and of idiosyncratic developments. The focus on macroeconomic rectitude and market liberalisation was at least favoured by the dynamic of European integration.

4. European integration has generally increased the weight of common rules and reduced the scope for discretionary economic policy decisions. This can be observed both in the micro and in the macro fields. A difference is thus emerging between a rules-based Europe and the US, where discretion remains a major characteristic of economic policy.

5. European rules are generally enshrined in treaty or treaty-like legal texts whose revision requires unanimity or supermajority. There is thus an element of inertia in Europe which is absent in the US. Furthermore, European rules and principles have generally been defined within a short period of time and for that reason they tend to lock-in a policy philosophy characteristic of the 1980s and the 1990s. Factors of inertia do exist in the US, but they are probably less powerful.

6. Cooperation between a Europe that abides by rules and a US in which policy choices retain a distinctive discretionary character could result in the US taking the role of a Stackelberg leader while Europe would essentially follow its rules. However it could also leads to divergence and conflict, as exemplified by the recent trade dispute about US steel protection. The EU is likely to behave increasingly as the champion of rules in international economic relations, and this may lead to enduring divergence with the US.

7. It should be reminded that a large part of the remaining differences between Europe and the US are outside the scope of this paper. Labour markets, redistribution and social insurance, pensions, and the provision of public services in education and health care are key areas in which virtually no convergence can be observed, and which have not (not yet, at least) been affected by European integration. Consumer protection is another area in which differences are apparent, probably because collective preferences (vis-à-vis environmental or sanitary risks) have not converged. Here lies the true specificity of the European model.
References


Figure 1a: The Reagan Experiment

Figure 1b: The Mitterrand Experiment
Figure 2: General government balance, 1960-2001

Source: OECD

Figure 3: General Government Gross Debt (OECD definition)

Source: OECD