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The U.S. Should Oppose the EU's Turn Toward Industrial Policy

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KEY TAKEAWAYS

Unfortunately, the EU is moving toward the adoption of industrial policy, which, while aimed primarily at China, is also motivated by resentment of the U.S.

Industrial policy is the wrong tool for addressing the problems posed by China's rise. This approach will damage the EU's economy and transatlantic relations.

The U.S. must vigorously oppose the EU's turn toward industrial policy and emphasize the need for more economic growth, not an EU policy based on resentment.

Industrial policy refers to the belief that government, not the free market, should shape or control the manufacturing sector of the economy. This control can be exercised in many ways, from directly playing favorites among competing firms to helping companies that are making investments in supposedly strategic portions of the economy. Purportedly, industrial policy can solve problems—from slow growth to the failure of particular industries to become as large as expected—that the free market cannot address or does not acknowledge.

In practice, the track record of industrial policy is exceptionally poor. It is based on a fallacy: that government bureaucrats are wise enough to make good investments while avoiding bad ones. But the fallacy of industrial policy has not stopped influential voices in Europe from making the case that what the European Union needs in order to compete more effectively with China and the United States is a new industrial policy that focuses on creating so-called European champions.

This is bad economics and bad politics. No matter how poorly Europe is doing at creating world-leading large firms, the answer for the EU is not to use government to bring them artificially into existence. This approach inevitably involves discrimination against foreign investors, including investors from the U.S. If the EU goes down this road, it will open itself up to mutually damaging retaliations by other major economies, and it will create unnecessary political tensions inside and outside Europe. The U.S. must vigorously oppose the EU turn toward industrial policy and back the free market, which works best for nations on both sides of the Atlantic.

The Relative Decline in the Size of Europe's Firms

It is easy to forget that most firms in every advanced nation are small, and that large firms are therefore not the only—or even the best—source of economic growth, employment, or innovation. Large firms attract attention, disproportionately so, precisely because they are large, not because they are necessarily efficient.

It is therefore not inherently significant that, over the past decade, Europe's share of the world's largest firms has declined. According to *The Economist*, in 2006, 17 of the world's 50 largest firms were European; by 2016, that number had fallen to seven.[1] More important, at least in the eyes of policymakers, is the fact that many of the largest American firms—such as **G**oogle, **A**pple, **F**acebook, and **A**mazon, the so-called GAFA firms—have exceptional public visibility.

The many factors behind the rise of these firms, and the disappearance of their European counterparts—such as Nokia—lie beyond the scope of this *Issue Brief*. But the fundamental reason why there are not more very large European firms is that, for the past decade, Europe has grown slowly and even stagnated. If Europe wants more big firms, this is the problem it must address: It is not possible to create industrial giants with economic policies fit for midgets.

The Pressure for European Industrial Policy

Industrial policy is becoming fashionable in the EU because European policymakers fear that their firms are falling behind their competitors in the United States and China in scale and success, and that these non-EU firms will set the terms of the global marketplace in ways that will fundamentally and permanently damage Europe's interests.

The truth behind this fear is at best exaggerated: History is replete with major firms, from Kodak to General Motors to Nokia, which were thought to have the power to remain forever dominant, but which rapidly proved to be susceptible to competition.[2] Supposedly, this time is different, either because of the Internet, or because some of the new firms are Chinese and receive government support in ways that purportedly make them immune to the normal changes of corporate fortune.

The rise of China does pose serious questions for public policy. But if industrial policy does not work because policymakers lack the ability to pick winners, it makes no sense to seek to pick winners as a response to hidden Chinese subsidies. A bad policy response to China's rise is worse than no policy response at all; and industrial policy is a bad policy response.

That fact has not stopped influential European voices from demanding that the EU adopt an industrial policy of its own. As one outlet put it, "Industrial policy is back in vogue."[3] The pressure began in September 2018, when Annegret Kramp-Karrenbauer, the chair of the German Christian Democratic Union (CDU), announced a "real paradigm shift" in industrial policy,[4] an initiative that was followed in December 2018 when 19 EU member nations backed a call to update "the EU's antitrust rules in order to facilitate the emergence of European industrial giants able to face 'fierce competition' from the US and China."[5]

In February 2019 came the announcement by CDU economics minister Peter Altmaier of a "National Industrial Strategy 2030."[6] This was followed almost immediately by the release of a Franco–German "Manifesto for a European Industrial Policy Fit for the 21st Century."[7] Not coincidentally, the European Commission shortly thereafter announced that it would block a merger between Siemens, a German firm, and Alstom, a French one, on the grounds that this would be bad for competition.[8]

In the following months, pressure built for the adoption of an EU industrial policy. In March came the EU's decision to reserve 35 percent of its research budget for clean energy innovation. The same month saw a decision by the European Council (a meeting of EU political leaders) that called on the European Commission to "present, by the end of 2019, a long-term vision for the EU's industrial future, with concrete measures to implement it."[9]

The European Commission responded to this pressure by presenting, at the end of April, an approach to a new "modern" industrial policy that would "build on the single market and focus on strategic value chains," adding that the EU "should develop new tools" to combat state-supported companies that distort the internal market's level playing field.[10] For his part, Altmaier agreed that new policy cannot be made "just at member state level. It must be conceived at European level and it has to be the European Commission that organises and guides the debate."[11]

The advocates of industrial policy have not had it all their own way. The European Commission is clearly torn between protecting its power over member states because of its control of competition policy—which is used to limit the power of potential monopolies—and seizing control of industrial policy while risking giving nations back the power to create monopolies.[12] With only 19 of the EU's 27 member nations (not including Britain) supporting the December declaration, it is clear that there are widespread concerns over the idea of seeking to use government or EU power to create European champions.[13] Finally, in spite of the leading role that the German government has played in creating the pressure for a European industrial policy, the reaction of German industry has been skeptical, if not hostile.[14]

But it seems unlikely that these critics will be able to prevent the EU from adopting an industrial policy, at least in certain areas. Support is already consolidating around backing an industrial policy in three areas: (1) battery cell production in Europe, (2) so-called disruptive innovation, and (3) artificial intelligence.[15] It is likely that, whether the EU's industrial policy is expressed as a gesture toward environmental concerns or whether it takes the form of fears about U.S. and Chinese dominance, it will assume at least partial reality in the coming years.

Key Next Steps for the United States

Much of the discussion of any EU industrial policy will be framed as a battle over EU competition policy. Simply put, it will be argued that the EU needs to relax its approach to competition policy to allow bigger, and potentially monopolistic, EU firms to grow through mergers so that they can compete on size with their international rivals.

This framing of the issue is partial at best, tendentious at worst. As analysts have pointed out, the EU actually rejects very few mergers. The problem is that European governments, in particular the French government, protect their own national champions at the cost of wider European competition and the creation of larger European firms through the mechanisms of the market.[16] In short, what Europe needs is not a weaker competition policy,[17] but governments that pursue pro-growth policies that allow firms to grow, and competition policies at the national level that allow even larger firms to come into existence across Europe.

The deeper irony of the EU's praise for the creation of European industrial champions is that Europe has led the world in imposing discriminatory taxes on large U.S. firms, in particular on the GAFA firms, which it clearly perceives as U.S. technology champions.[18] The European stance on large firms is riddled with hypocrisy: When these firms are American, they are bad and deserve to be taxed, but if they were to be European, they would be praised and welcomed. The U.S. should make it crystal clear to the EU that this argument is completely reversible, and that it could easily be used to justify the imposition of U.S. taxes on large European firms. These taxes are undesirable in Europe and would be equally undesirable in the U.S., but if Europe persists in taxing U.S. firms simply because they are large and American, the political pressure for retaliation will only grow. The way to prevent that from happening is for Europe to abandon its hypocritical policies.

To respond to the rising EU enthusiasm for industrial policy, the U.S. should:

- **Call out all EU rhetoric and policy based on treating the U.S. as an adversary**. While the primary target of the EU's emerging industrial policy is the People's Republic of China, and another target is the sovereignty of the nation states of the EU itself, it is impossible to ignore the fact that skepticism about, or actual hostility to, the U.S. and its world-leading firms has created some of the impetus behind this policy.[19] The U.S. should identify and protest every example of EU rhetoric and policy that treats the U.S. as an adversary, and, in particular, every occasion on which the U.S. is treated like or equated with the People's Republic of China.

- **Offer support to industrial and national opponents of the EU's competition policy**. While the EU's emerging industrial policy clearly has considerable support, it also has opponents. The U.S. should support this opposition by making a principled argument to them about the inevitable failure of industrial policy, and the practical argument that any industrial policy at the EU level will have to be based on discrimination against foreign industries and investors, including those from the United States. This discrimination will likely lead to a U.S. reaction that will damage U.S–European relations in general and European industrial interests in particular.

- **Pursue, aggressively, multilateral remedies for European discrimination against U.S. firms and investors**. It is deeply troubling that much of the EU's enthusiasm for industrial policy is framed as a celebration of the commercial success of Airbus,[20] as the aerospace giant has repeatedly been found guilty by the World Trade Organization (WTO) of receiving prohibited EU subsidies. If Airbus is the model for the EU's industrial policy, the future of U.S.–European relations will be increasingly shaped by disputes like those over Airbus's subsidies. But if this is the path the EU wishes to take, the U.S. should respond by aggressively filing WTO complaints every time an EU policy gives rise to a creditable case that the EU is unjustly favoring its own firms or investors.

What the U.S. Should Do

The EU's enthusiasm for industrial policy has met opposition in Europe, but it is likely that, at least in some sectors, this opposition will be unable to prevent the emergence of an EU industrial policy. While aimed primarily at China, this policy must also discriminate against the United States. Industrial policies are bad economics, and as such, an EU industrial policy is a bad way to confront the genuine problems posed by the rise of China. Europe does not need an industrial policy that seeks and fails to pick winners and losers. It needs policies that promote higher levels of economic growth. The U.S. must vigorously oppose the EU's turn toward industrial policy, which it can do most effectively if it avoids adopting instruments like Buy American policies, which are outliers of an American industrial policy that will be just as economically ineffective and politically damaging as its EU counterpart.[21]

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