Economic Institutions and Policies in the US and the EU: Convergence or Divergence?[1]

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1. Introduction

Once upon a time, there were national varieties of capitalism. There were a German (or Rhineland) model, a Gallic model, a Scandinavian model, a British model, etc.., as well as, outside Europe, a Japanese model or a Korean model. Some of these models were more distant from the US model of a modern market economy and some were closer, but each was specific. As recently as a quarter of a century ago, the common belief in academic as well as business and policy communities was that these idiosyncrasies were here to stay.

This belief was based on the view that Transatlantic differences were primarily rooted in dissimilarities in the functioning of capital markets, as regards, for example, corporate ownership and governance structures; financing patterns; the regulatory framework; and relationships between states and markets. Goods markets and labour markets were part of the picture, but less essential. This is why the emphasis was put on alternative models or varieties of *capitalism*. In the view of this school of thought, complementarity between key features of those patterns, as well as between them and social ones made the model self-reinforcing and led to the belief that it would survive the transformations of the world economy.

This was a wrong hypothesis. Over the last 25 years a major change has taken place in Europe as a consequence of globalisation and European integration. The latter has proceeded through (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. References to a French or a German model of capitalism nowadays are generally made in a normative way, to blame procrastination or rearguard manoeuvres in coping with change.

However, significant differences remain in the social models. In spite of rhetoric references to the “European social model” – and of an obvious distance between Europe and the US -, several varieties of it continue to coexist within the EU. Furthermore, not much convergence can be observed between, say, the costly but efficient social institutions of the Nordic countries and the much less developed welfare state of the UK.

This persistence is sometimes taken as a basis to claim that the varieties of capitalism have survived the transformations induced by globalisation – that only the focus of differentiation

has changed. In fact, authors starting from very different conceptual backgrounds such as Bruno Amable (2003), Peter Hall and David Soskice (2001), or Raghuram Rajan and Luigi Zingales (2003), seem to converge to consider that national varieties of capitalism still exist. Hence, a first, methodological issue: Can different forms of capitalism of the kind we have outlined remain in an area of globalisation? Can these differences be rooted in capital markets institutions? Can, alternatively, the persistence of specific 'social models' form the basis of lasting differentiation? Is there a role for the broader macroeconomic policy framework?

The second issue we intend to investigate is an empirical as well as a political one: Assuming national models fade away, is European integration leading to the emergence of a genuinely European type of market economy or to convergence on the US model? Over the last quarter of a century, 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 emergence of the 'new economy', the gyrations of fiscal policy in the 1990s and the early 2000s and the emergence of a new monetary policy philosophy under the chairmanship of Alan Greenspan. The question is whether this double move is leading towards convergence or renewed divergence of the EU and US. 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 and (at least in theory) prudent macroeconomic management. But this is a rather superficial characterisation. The real question is whether the two sides are converging towards the same model of market economy, where the differences that remain are rooted and whether they can be expected to recede.

The paper is organised as follows: section 2 surveys the literature on alternative models of market economies; section 3 reviews what the transformations of France and Germany over the last two decades imply for this analysis; section 4 discusses the way European integration transformed microeconomic institutions and policies in the EU; section 5 deals with macroeconomic policy; section 6 addresses the social dimension; section 7 concludes.

2. A retrospective on the "varieties of capitalism"

Andrew Shonfield's seminal 1965 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-dependent trajectories? Are there pressures toward greater

institutional and policy convergence? And even if there are, are there also continuing and new sources of diversity?”

Throughout the 1980s and the 1990s, a significant body of research has been devoted to characterising the different versions of capitalist economies. To quote just a few authors, Aglietta (1976) and Boyer (1986) proposed the concept of *régulation* (which does not translate into regulation but rather designates a consistent and self-reinforcing set of rules, institutions and practices) to distinguish between different types of market economies across time or space. Zysman (1983) introduced the distinction between ‘market-led’, ‘bank-led’ and ‘state-led’ financial systems. Albert (1991) contrasted the US type of market-led capitalism and the German-based *Rhineland* model. Cohen (1992) studied French social-colbertism. Crouch and Streek (1996) discussed whether European capitalisms would eventually converge on the US type or would follow distinctive paths. More recently, Hall and Soskice (2001) proposed a framework for analysing of *varieties of capitalism.*

This line of research has given rise to both an academic and a policy debate. The academic discussion has been devoted to the reason for, and the characterisation of, the core features of national varieties of capitalism. The policy discussion has been centred on the assessment of European integration and on the possible emergence of a European model that would not simply replicate the US model of a market economy.

As Dani Rodrik (2001) put it, there is now widespread agreement to consider that “first-order economic principles [such as] protection of property rights, market-based competition, appropriate incentives, sound money, and so on, do not map into unique policy packages”. Even from an efficiency standpoint, this indeterminate mapping leaves room for alternative institutional arrangements, especially in the presence of institutional complementarity as emphasised by Amable (2003). Furthermore, growth economics suggests that the nature of the efficient arrangements may depend on the degree of development: institutions that are growth-enhancing in a catching-up phase may become dysfunctional as the economy approaches the technology frontier (Acemoglu, Aghion and Zilibotti 2002). The issue, thus, is not whether differences may exist, but where they are rooted and how they can withstand the effects of markets integration.

Proponents of the variety of capitalisms approach frequently address the functioning of markets for goods, capital and labour, macroeconomic policy behaviour, and redistributional issues, all of which are regarded as being interconnected. However, the main focus of this line

of research has been on the institutions that determine the functioning of the market for capital.

This focus is very clear in early work such as John Zysman's *Government, Markets and Growth* (1983), which provides an analytic framework for investigating the role of governments in financial systems and the impact of institutions on growth patterns. Zysman starts from a simple question: how is the financing of the economy organised in industrialised countries and how does it impact 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. The US and Britain exemplify the 'market-led' 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 – which implies the release of information on an ongoing basis. 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 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, as if allocation were too important a function to be left to market forces. Finally, Zysman sees 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 raises 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. Thus, there was no normative implication in his approach.

The approach of Soskice and Hall (2001) is in some respects similar. They intend to "bring firms back into the centre of the analysis of comparative capitalism" and put the emphasis on the relationship firms establish internally (with their own employees) or externally (with suppliers, clients, shareholders, etc..). Consistent with this emphasis, they distinguish between "liberal market economies" in which "firms coordinate their activities primarily via

hierarchies and competitive market arrangements" and "coordinated market economies" in which they "depend more heavily on non-market relationship to coordinate their endeavours with other actors".

This latter distinction comes close to that of Rajan and Zingales (2003), although the purpose of these authors is normative rather than positive. Rajan and Zingales distinguish between "relationship capitalism", by which they designate the system of managed competition that emerged in the developed economies after World War II in which the role of markets in allocating resources was contained, and "arms-length capitalism", in which financial markets drive investment choices. While Rajan and Zingales put the emphasis on financial systems, they underline the resemblance between relationship capitalism, Rhenish capitalism, and bank-based system.

Although authors frequently come from different backgrounds and are only loosely related, and although their normative preferences certainly differ, that body of research thus converges on the key features that distinguish varieties of capitalism. Those are:

(i) The pattern of corporate ownership and control;

(ii) The financing of corporations;

(iii) The degree of competition in goods and services markets and the regulation of entry, and;

(iv) The role of the state in allocating resources.

3. Europe's transformations and the (partial) demise of national models

The events of the last decades lead to question the permanence of national varieties of capitalism. France and Germany, which were not long ago consider archetypal of different kind of varieties, have both – though to an unequal extent - undergone deep transformations as a consequence of globalisation and European integration. They therefore provide appropriate test cases.

France's exit from the state-led mode

In the second half of the 1970s, reactions to the oil shocks and the growth slowdown 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 control over the allocation of capital to the state. However, the government soon realised that it was politically untenable to assume full responsibility for the level of capital

reallocation 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 by the newly elected government of Jacques Chirac.

As a consequence of these transformations, French capitalism no longer resembles Zysman's model of it. Except in a few sectors such as utilities and defence industry, virtually all the channels that made effective state guidance possible have been eliminated. But it does not resembles either what the privatisers of the 1980s had imagined: the ownership structure created on the occasion of 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. When the privatisation process was launched, the government tried 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 achieved in the privatisation process through allocating blocks of shares (known as *noyaux durs* – hard cores) to selected corporate shareholders. Thereby, the major companies were given reciprocal control. 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. Gradually, most of them got rid of the control blocks they had been given.

The result of this move was a dramatic increase in the share of non residents in the capital of French companies. According to the Banque de France, foreign shareholders accounted for 29% of the capital of all French companies in 2002. This is still a smaller proportion than in

the UK where it reaches 37%, but a significantly higher one than in Japan (18%), Germany (15%) or the US (11%)[2]. As Table 1 illustrates, in spite of the size discrepancy between the two economies, at end-2003 equity investment by non-resident exceeded the level reached in Germany.

Table 1: Non-resident Protfolio Equity Investment in Major Economies at end-2003

Millions of US dollars

Investment in: / Investment from:		United States	United Kingdom	Major euro area countries	Other	**Total value of investment**
1	United States	....	174,064	415,786	346,451	**1,274,037**
2	United Kingdom	420,684	--	176,787	76,205	**894,006**
3	Luxembourg	6,026	17,995	354,938	94,329	**622,798**
4	Japan	255,496	71,342	84,988	27,864	**493,777**
5	France	130,761	44,941	118,891	35,135	**410,089**
6	Germany	103,239	29,223	102,214	38,821	**326,663**
7	Netherlands	115,792	31,916	101,878	27,330	**320,700**
Total value of investment		**2,080,302**	**664,067**	**1,896,729**	**840,721**	**6,910,332**

Source : IMF, Coordinated Portfolio Investment Survey

Furthermore, the share of non residents is much higher in the capital of listed companies, for which it reaches 38%[3]. Former national champions like Total, Saint-Gobain, or CapGemini are now truly global companies, whose foreign shareholders account for about 60% of total capital[4]. Other such as Péchiney or AGF have been taken over by foreign companies.

Wide-ranging liberalisation and large scale privatisation against the background of weak institutional investors have thus brought French-style capitalism to an abrupt end. This does not mean that resistance to liberalisation has disappeared, nor that the state does not intervene in the markets. In 1997-2002, the socialist government of Lionel Jospin launched several industrial policy initiatives in the aerospace, telecom and banking sectors. From 2002 on, right-wing Prime minister Jean-Pierre Raffarin embarked on a series of rescue initiatives to avoid the disappearance of flagship companies such as France Télécom or Alstom and advocated the promotion of 'industrial champions' (including by lending support to the 2004

[2] Data for other countries are for the year 2000. The French figure for that year was 27%, a bit lower than in 2002.
[3] 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)
[4] Although we do not have precise figures, only estimates (except for Total).

takeover of Aventis, a Franco-German pharma company, by Sanofi, a French one) and in 2005, his successor Dominique de Villepin promoted "economic patriotism" and explicitly defined a series of sectors where foreign takeover were officially unwelcome.

What the evolution that has taken place means, however, is that the state has effectively been deprived from the instruments it could rely on to bolster its industrial policy initiatives. Ministers can still intervene to support an ailing company and promote negotiations with its creditors. This is however virtually the only initiative they can take – under the surveillance of the European Commission which has the powers to order companies to reimburse illegal state aids. In fact, even in very publicized cases like the Sanofi-Aventis battle, the only tool the French ministers used was political pressure because they had no other legal or financial instrument at their disposal. Rajan and Zingales may be right when they point out the resilience of relationship capitalism, however the resistance of incumbents could not prevent the foreign takeover of companies such as Pechiney and AGF.

Germany's partial exit from the bank-led model

Changes have been less pronounced in Germany, as illustrated by a series of events such as the obstruction to a European Commission-initiated takeover directive by German members of the European Parliament, by Chancellor's Schröder 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. In 2005, SPD general secretary Franz Munteferring even compared foreign investors to locusts, thereby illustrating once again the German reluctance to accept the dominance of financial market in the ownership and the control of companies.

Research by Marco Becht and colleagues confirms that as recently as in the mid-1990s, Germany was still very far from having converged on the British or American type of ownership structure. According to Becht and Böhmer (2003), a single blockholder controlled more than 25% of the voting rights in 82% of the German corporations. In more than half of the companies, the largest shareholder controlled 52% of the voting rights against 20% in France, 10% in the UK and less than 5% in the US (Becht and Röell, 2003). It would thus seem that unlike the French model, the Rhineland model is alive and well.

Nevertheless, the transformation of German capitalism is underway, as illustrated by a series of transformation such as the successful hostile takeover of Mannesmann by Vodaphone in 2000 (in spite of strong and vocal opposition by the unions and the Chancellor), the merger of

Allianz and Dresdner Bank and the transformation of Deutsche Bank into a global investment bank. Even that last dyke, national bank ownership has ceased to be a taboo, as illustrated by the 2005 merger of Hypovereinsbank and Unicredito. Less anecdotally, the 2000 change in the tax law (effective 2001) that scrapped the taxation of capital gains on the sale of share by companies was widely regarded as signalling the end of the traditional long-term bank holdings of industrial shares, as banks and other financial intermediaries became free to unwind their long-established capital links with companies without paying a tax penalty.

Italy's eventual opening of the financial sector

In Italy, resistance to the transformation of the local variety of capitalism was epitomised by the stubborn but eventually unsuccessful attempt by Governor Fazio to oppose the takeover of Italian by foreign banks. In the name of "itialianity", the governor tried in 2004-2005 to make use of his discretionary powers to prevent foreign takeovers and to promote instead local solutions. However, evidence that in the process he had departed from the neutrality that is to be expected from a central bank governor eventually forced him to resign. Only a few weeks later, the takeover of Banca Nazionale del Lavoro by French bank BNP-Paribas was announced. It is widely expected that the policy of the governor appointed in early 2006, Mario Draghi, will distinguish himself from the protective attitude of its predecessor.

France, Germany so far to a lesser extent, Italy, and more generally continental Europe are thus moving away from the collection of country-specific models they were[5]. 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.

4. The European regulatory framework: an airlock or a shelter?

The two major forces behind the decline of national varieties of capitalism have been globalisation and European integration. However, the European microeconomic regulation framework that has been gradually replacing national frameworks could be regarded as a building block or a stumbling block in a process of convergence towards the US model. While European integration contributes to the dismantling of pre-existing national regulatory framework, it can either play the role of an 'airlock compartment' that allows to gradually adjust to the pressure of globalisation or, alternatively, a 'shelter' under which a genuinely

[5] Another illustration of the change is the fact that Governor Fazio's manoeuvres to avoid the takeover of Italian banks by foreign banks have ended up in creating embarrassment for the Italian authorities.

European variety of capitalism could develop and replace national ones, while remaining different from that of the US.

In order to shed light on this issue, we start by recalling the policy process that led to the replacement of national policy frameworks by a European one. We then look at a series of quantitative indicators in order to grasp the extent of the transformation that has affected European economies. Finally, we examine specific policies.

Integration through liberalisation rather than common policies: The logic of the last decades

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). Against the background of discussions on 'US economic decline' and 'eurosclerosis' a debate developed between, on the one hand, the proponents of active intervention 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, American pundits such as Clyde Prestowitz, Robert Reich, Lester Thurow or 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 targeted industrial policies a zone of decreasing – if not negative - returns.

During the following two decades, the EU 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 proactive policies.

In the early 1980s, Europe was suffering from stagflation, exchange crises and industrial restructuring, EC integration was stalled and the Community machinery was overwhelmed by difficulties. National governments were frequently tempted by purely national, if not isolationist, solutions.. 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 this challenge

through what was meant to be a two-track strategy: the launching of the Single market programme and a series of projects tailored to prop up technological development.

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, but it received new impetus. 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 integrationist policies into a single mobilising project, Europe 1992[6]. 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 thus relied 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 (such as Esprit, Eurêka, etc..) devoted to the promotion of new technologies. Instead of choosing between free-market and interventionist policies, European reformers were aiming at a combination.

In retrospect, Europe's successful implementation of its liberalisation agenda strongly contrasts with the very limited success of its industrial policy initiatives. Two decades 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. Change has certainly been slow in some areas, such as services and public utilities. Furthermore, enlargement raises new issues as the single market involves countries of very dissimilar development levels. In Spring 2005, the row over the Bolkestein directive aiming at a liberalisation of services markets was an illustration of this new tension[7]. Nevertheless, liberalisation has made inroads

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[6] 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.

[7] In Spring 2005, a Commission proposal to introduce a framework law for the liberalisation of the service sector was fiercely attacked by French politicians as it would have provided a more effective instrument to foster intra-EU competition in previously sheltered sectors. In the campaign before the referendum on the draft constitution,

into previously highly regulated sectors, state aids in individual member states have been cut down and competition policy has gained strength.

In contrast, 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[8]. Most of the projects initiated in the 1980s have subsequently 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 belong to the remit of the Union.

Europe's behaviour in the allocation of third generation mobile telephone licenses provides an interesting case. The starting point was the EU success with the second generation. Early adoption of a common European standard, the GSM, had been a success and had facilitated the development of equipment manufacturing and services. Although this had not been the product of an explicit industrial policy, Europe had *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 relying on 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 technological visibility. Europeans were wary enough not to embark on an explicit industrial policy, 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 without having demonstrated that industry would be able to deliver on the technology's potential. In the event, it was not – at least within the envisaged time frame[9].

A clear imbalance thus now exists between the former two arms, liberalisation and industrial policy. Those who find little merit in industrial policies may regard this contrast as just another illustration of their intrinsic inefficiency. There is some truth in this view, but it must

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the "Polish plumber" came to epitomise the fear of "social dumping" in the services market. At the insistence of president Chirac and other heads of state, the directive project was temporarily withdrawn.

[8] When the first *Esprit* Programme was launched in 1984, the dominant view was that Europe had to catch up with the US in the information technology sphere through producing computers and electronic components. Eight years after the launching of the programme, in 1992, the results were mediocre: the EC was still buying three times as much as it sold to the US.

[9] Furthermore, member states proceeded in an uncoordinated way as the Council had decided that the allocation of licences could be left to the member states. 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 to sell the licences in a beauty contest. As a result, the price of licences varied between 630 euro per user to 43 euros per user (Cohen and Mougeot, 2001).

be observed that integration within the Single market has not brought visible supply-side effects either. 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)[10]. Unlike the US, the EU preference for liberalisation policies can thus not been explained by the success they had.

The failure of European active intervention partially results from the permanent conflict between interventionist and free-market leaning states within the EC, but equally from the Union's idiosyncratic disregard of industrial policy. Three factors explain the continuing European commitment to the removal of internal barriers and its near-abandonment of industrial policy:

- The first is that liberalisation has become identified with European integration. The removal of intra-European barriers 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 support the creation of a single market for railways or energy even though they may have reservations on the accompanying liberalisation agenda.
- The second reason can be found in the decision mechanisms. Since the 1950s, European integration has proceeded in two different modes: 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. As a decision mechanism, the first mode is certainly more efficient than the second. The strength of liberalisation is that it proceeded through the first mode, while a weakness of industrial policy is that it relies on the second.

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[10] 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

- 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 strength of liberalisation may thus progress through a series of quasi-judicial decisions that do not require explicit political decisions. Industrial policy instead constantly requires discretionary decisions for which the EU governance system is ill-equipped.

European integration in the micro field thus primarily provides a framework for regulation. An implication of the prominence of overall liberalisation over concrete initiatives is that the specifically European character of the policy may be less pronounced. Before turning to the investigation of specific cases, we briefly look at what the quantitative indicators may tell us.

A quantitative assessment

The degree to which policy responsibility has been transferred to the European level is hard to measure. A comprehensive attempt at a quantitative assessment has been made by Alesina, Angeloni and Schuknecht (2002) but while their indicators give an overall picture of the development of EU legislative activity (Figure 1), they do not provide a reliable measure of the degree to which effective responsibility has been transferred to Brussels in various sectors.

Indicators developed by the IMF (2004) for the measurement of structural reform provide complementary indications. Their purpose is to provide a consistent measure of the degree of liberalisation of goods, labour and capital markets. Although similar in intention to those of the OECD, they have the advantage of being available year by year, which helps in the assessment of the effect of European integration[11].

[11] We are grateful to Xavier Debrun from the IMF for having provided us the data and to Karine Serfaty for research assistance.

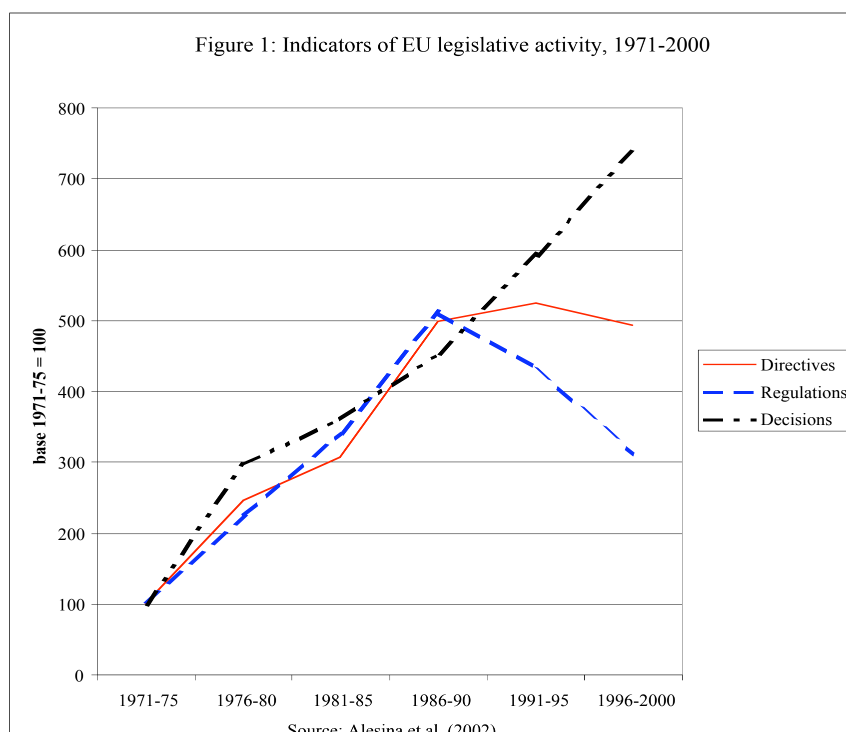


Figure 1: Indicators of EU legislative activity, 1971-2000

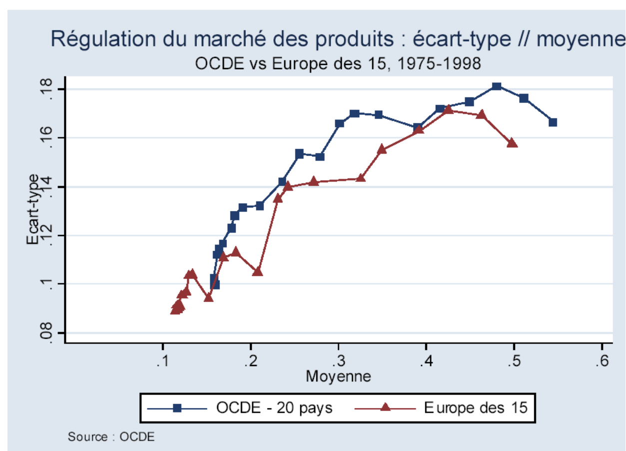
Source: Alesina et al. (2002)

Figure 2 plots for each of the three markets – goods, capital and labour – the mean and the standard deviation of the liberalisation indicator for both the EU-15 and 20 OECD members (including all the EU 15). Three features stand out:

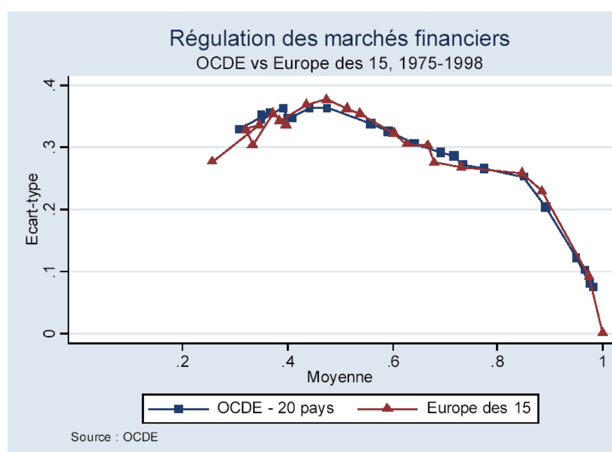
- First, markets differ in both the degree of liberalisation and the dispersion of individual country performance. For capital markets, liberalisation and convergence are complete. For goods, and even more for labour, liberalisation is incomplete and convergence is partial.
- Second, the dispersion of country indicators is the highest for goods markets. This suggests that the move towards liberalisation takes place at different speed in different countries, thereby initially increasing dispersion (before it eventually recedes as convergence takes place). This pattern was also observed for capital markets in the 1980s and the early 1990s, before convergence took place.
- Third, there is virtually no difference in the degree of liberalisation or the dispersion of performance between the EU and the OECD. This means the inclusion of the US, Japan and other non-EU countries does not alter the observed pattern. In other words, membership in the EU does not lead to an observable difference in behaviour.

Figure 2: Indicators of market regulation and liberalisation, 1975-1998

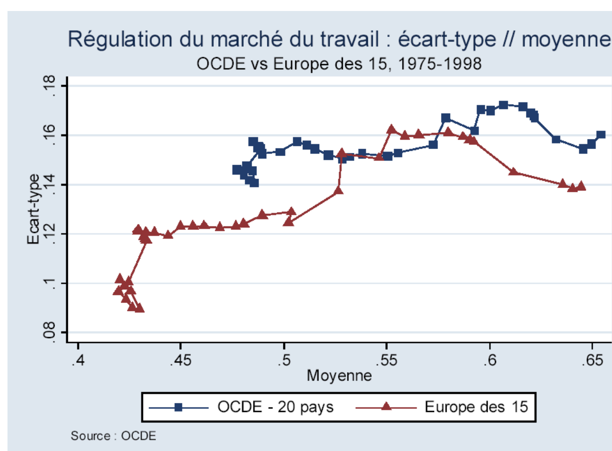
a) Goods markets



b) Capital markets



c) Labour markets



Explanatory Note: For each country, the indicator takes values between 0 (no liberalisation) and 1 (complete liberalisation). The graph plots the mean of the indicator for the EU-15 or the OECD-20 (X-axis) against the standard deviation of the same indicator (Y-axis).

Quantitative evidence thus suggests a limited EU effect on liberalisation and convergence. It lends support to the ‘airlock’ rather than the ‘shelter’ view of European integration. But the indicators are admittedly very crude and potentially misleading. Thus, we have to look at more direct evidence of the effects of integration.

The Enron test

The corporate scandals of the early 2000s provided a test of the EU’s willingness and ability to promote a specific variety of capitalism. Before the Enron affair broke out, convergence on the US model of corporate governance was slowly taking place as a consequence of three forces: first, European companies contemplating a listing on the NYSE were increasingly adopting US governance and disclosure rules; second, new accounting standards were being elaborated by the *International Accounting Standards Board (IASB)*; third, national governments and private organisations were slowly adopting new regulatory frameworks.

The Enron affair and those who emerged simultaneously raised the question of the future of the convergence process. Detractors of the US corporate governance and control model were quick to take the occasion to express distrust in its market-based philosophy and to renew calls for a truly European approach to the issue. Furthermore, the US Congress reacted swiftly by passing the Sarbanes-Oxley legislation, which addressed perceived fault lines in the US system and take no account of European demands. This could have been a factor of divergence. As in the interwar period, when the stock market crash was accompanied by increasingly powerful distrust in the markets and the emergence of a much more regulated capitalism, the event could have been for the US and the EU the occasion of moving apart.

In the event, the US congress took the lead in the definition and the design of appropriate measures and most Europeans decided to follow suit through the passing of similar legislations. Instead of pulling apart Europe and the US, the corporate scandals in effect accelerated European convergence on the US model.

The same can be said of the accounting standards. Although the process had been initiated before the US corporate scandals, the Enron / WorldCom affairs drew attention to the issue and gave increased resonance to discussions that would otherwise have remained at a technical level. Here again the outcome of the process was not written in advance. The Europeans had chosen to delegate to the IASB the preparation of new accounting standards, hoping that the US would join and that truly international standards would in this way

emerge. In fact, US accounting concepts frequently prevailed (especially as regards the fair value accounting) and the Europeans ended up adopting standards that certainly do not reflect a European idiosyncrasy.

Summing up

The question we started with was whether European integration could give rise to the emergence of a specific European variety of capitalism. A first conclusion from the observation is that this cannot be expected from proactive industrial policies. 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, the EU has has moved away from a discretionary approach and increasingly puts emphasis on developing and enforcing rules of the game, thereby gradually adopting a more resolutely pro-market stance. .

The question, thus, is whether the European legislative and regulatory framework is likely to shape a specific variety of firm behaviour. There are certainly many aspects of EU legislation that can hardly be found elsewhere. But the overall assessment is that the EU-wide regulatory framework is more of the ‘airlock’ type than of the ‘shelter’ type. More precisely, under present circumstances the strong forces that lead to harmonising regulatory frameworks – free capital movements and the emergence of truly multinational companies – are not likely to be significantly countered by legislative initiatives. Thus, the micro regulation framework is unlikely to provide the shelter for developing a European model of capitalism.

How does this compare to the other side of the Atlantic? US policy 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 and neither the executive nor Congress refrain from exercising political judgement when deemed appropriate. In 2005, the rejection on purely political grounds of the takeover of an oil company, UNOCAL, by Chinese company CNOOC once again illustrated this feature of US attitude. The US government remains responsive to political pressures, while the EU increasingly defines itself by the set of rules it has committed to abide by. Because it regards 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 recent 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 political setting implies that the administration remains responsive to the electorate's and the special interest groups' concerns.

5. Macroeconomic policy

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).

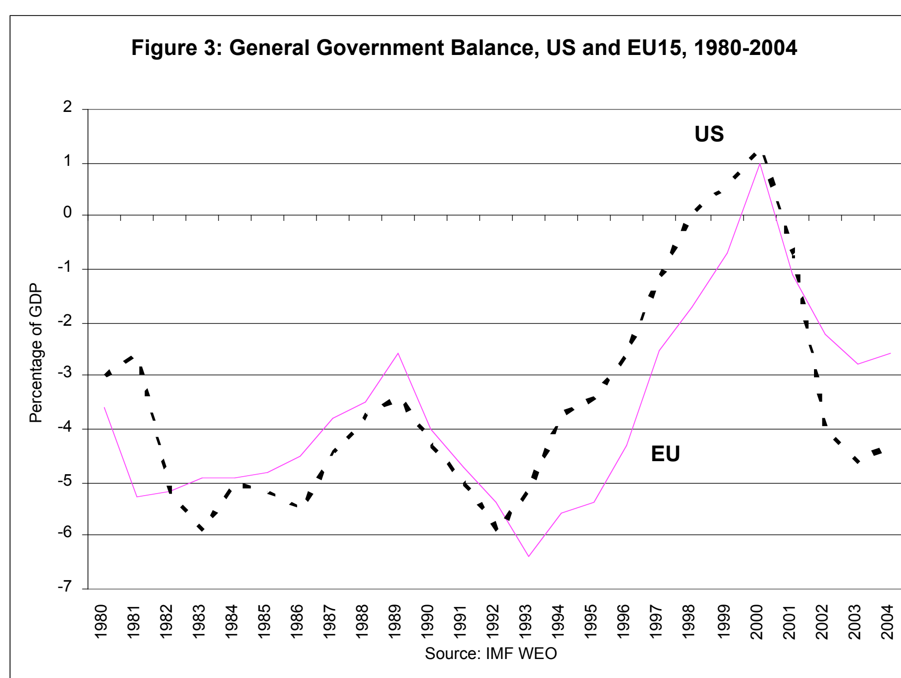
Since the 1970s, the US has not experienced a discrete change in the way financial markets operate; it has not introduced any legal redefinition of the objectives of economic policy; its major economic policy institutions have remained virtually untouched; and the exchange rate regime has not been redefined. This high degree of continuity has certainly not precluded significant changes in the development of financial markets. Nor has it prevented an evolution in the approach to 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 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 euro area countries where the central bank was not fully independent from government have reformed their monetary institution and responsibility for monetary policy 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.

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. 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.

- Although the stated objective of monetary policy is not identical, price stability is a common goal. Differences in monetary policy reaction functions have been studied extensively in the literature. In their research on 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 had been in fact 'remarkably similar'. More recent studies (Artus and Wyplosz, 2002) suggest that the same can be said of the ECB.
- More surprisingly, there is also evidence of fiscal policy convergence. Figure 3 depicts the evolution of the general government balance in the US the EU. By and large, the evolution has also been remarkably similar. While the short term volatility in the deficit has been greater in the US, especially in recent years, the timing of the major reversals is similar.



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 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 has been 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 implicit policy rule of the Federal Reserve under Alan Greenspan has been ironically described as "study all the data carefully, and then set interest rates at the right level" (Mankiw, 2002), which is an accurate description of discretionary 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 initially adopted a quantitative definition (inflation below 2% over the medium term) and a strategy partially relying on a quantitative objective for M3[12].

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. In its first years, it overlooked the evolution of M3 after having observed that this aggregate had almost always exceeded its growth target by a considerable margin. Furthermore, the ECB has kept its eye on the medium term and consistently allowed inflation to exceed the 2% threshold, provided expectations remained contained. In May 2003, the ECB governing council eventually adapted its monetary strategy: the objective was modified (inflation should now be below 2% but close to 2%) and the monetary aggregate was downgraded from being one of the two pillars of the strategy to an indicator status.

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[12] ECB Council decision of 13 October 1998.

But its response to the slowdown of the early 2000s was much less aggressive than that of the Federal Reserve, although growth in the euro area remained deceptive long after the US economy had picked up. At a deeper level, the ECB and the Fed have developed quite different philosophies on the role of a central bank in a world of uncertainty. ECB officials lose no opportunity 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". By contrast, Alan Greenspan (2004) insists that in an environment of uncertainty "the conduct of monetary policy in the United States has come to involve, at its core, crucial elements of risk management" and that "policy practitioners operating under a risk-management paradigm may, at times, be led to undertake actions intended to provide insurance against especially adverse outcomes". From the same premise – that the world is uncertain – the two central banks thus draw opposite conclusions as regards the role of monetary policy.

Differences in the approach to fiscal policy are also significant. In the US, there have been discussions on a balanced-budget rule but, so far, Congress remains free to vote whatever budget is deemed appropriate. And this freedom is being used: according to the OECD, the US cyclically-adjusted deficit as a percentage of GDP moved from a 1.1% surplus in 2000 to a 4.3% deficit in 2004.

In Europe, 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. Constraints on national fiscal policy have continuously hardened from the early 1990s, when the treaty was negotiated, to the early 2000s, where the Stability pact began to be enforced. 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 and Growth Pact of 1997 states that "member states commit themselves to respect the medium term budgetary objective of positions close to balance or in surplus"[14].

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[13] Testimony before the Committee on Economic and Financial Affairs of the European Parliament, quoted in Artus and Wyplosz (2002).

[14] Resolution of the European Council on the Stability and Growth Pact of 17 June 1997.

A look at the data suggests that since the launch of the euro, constraints have effectively beaten. In the 1998-2004 period (the same as for the US), the aggregate cyclically-adjusted deficit of the euro area fluctuated between 1.3% and 2.6% of GDP. The amplitude of fiscal gyrations has therefore been four times smaller than in the US.

However, the jury is out as regards the implications of the 2005 reform of the Stability Pact. While emphasising the rules, this reform has introduced significantly more recourse to economic judgement in the assessment of the fiscal situation of the member states. In a way, the EU has taken a step away from a mechanical rules system and towards a constrained discretion regime – in effect narrowing the gap that had widened with the US.

Inertia vs. responsiveness

Another, related characteristic of EU economic policy is 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 the time of writing) 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 pointed out that internal procedures make the European central bank a 'slow institution' (Gros et al., 2000, 2001, Alesina et al. 2001). The same can be said of the Eurogroup in which the euro area'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 coordinated 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 unanimity. Amendments to secondary legislation require almost 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 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 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 of 1935 to the Keynesian inspiration of the Employment Act of 1946 and the Humphrey-Hawkins Act of 1978 as well as neo-Ricardian, monetarist and supply-side influences.

The outlook

A major issue 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 and that all the essential tenets of the system are in place. Another one emphasises that the EU is still on a learning curve and that it is too early to say whether some form of collective governance can be expected to emerge.

If the first view is correct, the euro area can be expected to follow a medium-term-oriented, non activist monetary policy and a fiscal policy that limits itself to letting the automatic stabilisers move freely, with very little aim at discretionary action, at least for the euro area as a whole[15]. In such a system, there would be built-in stabilisers, but neither monetary nor fiscal policy would take responsibility for the overall management of the economic cycle. The policy mix would be the *ex post* result of decisions taken by individual actors in accordance with predefined rules.

Assessing such systems *per se* is not the purpose of this paper. Here, our focus is on a comparison with the US and on implications for EU-US relations. While some US policymakers 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. As to the relationship between the EU and the US, one may speculate that US governments would generally be happy with a Europe that follows a rules-based approach to macroeconomic policy and leaves to the US the task of being the world's Stackelberg leader. However, circumstances could also arise in which the US would expect Europe to undertake

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[15] This could be different for individual member states that could rely on discretionary fiscal policy to counteract asymmetric developments.
[16] Nor should there be one, would say many scholars, because coordination and discretionary action could prove counter-productive (Alesina et al., 2001).

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.

According to the second view, an alternative scenario would be for the participants in the euro to develop institutions that would equip the area with an ability to make policy choices, including through discretionary decisions. When the Eurogroup was created in 1998 its (frequently but not exclusively French) promoters wanted it to be able to undertake policy coordination and for that purpose expected it to become a kind of collective executive body (Jacquet and Pisani-Ferry, 2000, von Hagen and Mundschenk, 2001). Further proposals have been made to assign to the Eurogroup or a euro area council the responsibility of making decisions that apply only to the euro area countries or to entrust the group with a capacity to vote by qualified majority on economic policy guidelines for the whole area (Lamy and Pisani-Ferry, 2002, Coeuré and Pisani-Ferry, 2004). The logic of these proposals is that the Eurogroup should, in some circumstances, be able to make decisions for the area as a whole even though implementation would be left to the national governments. If this approach prevails, the functioning of the euro area will move somewhat closer to the US model.

The jury is still out. A majority of member states certainly favours the status quo, but two recently introduced changes indicate that the euro area policy system has not yet reached its equilibrium. First, the rotating Eurogroup presidency has been replaced by a fixed presidency. Although decision procedures remain unchanged, the adoption of a fixed presidency is a victory for the advocates of a more visible and more active Eurogroup. Second, the reform of the Stability Pact has introduced a dose of economic judgement in what was initially regarded as a purely rules-based system. Before deciding sanctions, ministers now have to exercise judgement as regards the origins of a deficit, the economic situation, or the nature of the expenditures.

For the longer run, 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 XIXth century gold standard, seek to depoliticise macroeconomic management 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 XXth 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 with the goal of price stability and a scrupulous respect of the central bank's independence. But they correspond to two different policy philosophies.

Summing up

For the macro field, the upshot of our analysis is that if anything, Europe has become more distant from the US. This assertion needs to be qualified, as differentiation takes place against the background of convergence on some basic macroeconomic and institutional principles – stable prices, an independent central bank, fiscal sustainability, etc.. It may also be less long-lasting than suggested by the present policy setting. Nevertheless, the reasons to believe that even if it evolves, Europe will remain more inclined than the US towards a rules-based, non-activist, and rather inertial policy philosophy have roots in the Union's constitutional set-up, especially in the lesser role of the political process and the need to achieve consensus to amend the treaties.

6. The social dimension

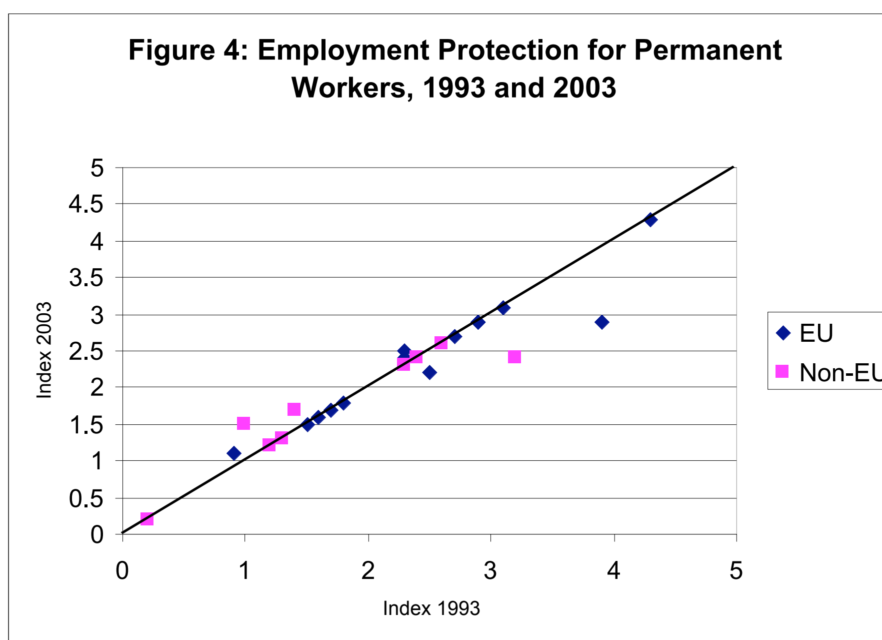
The 'varieties of capitalism' approach regarded corporate ownership, control, financing and competition as well as competition and relationship with the state as the main factors behind international differentiation. For the reasons we have explained, we doubt this can still be the case in an area of globalisation – although we recognise that convergence is far from complete and is bound to take time.

Our discussion on macroeconomic policy leads to single out some factors of differentiation that may prove durable. But we recognise that even significantly different macroeconomic policy philosophies are unlikely to give rise to sharp differentiations. Assuming that US macroeconomic policymakers will remain more willing than their EU counterparts to take on the role of insurers vis-à-vis the private sector, and that this may in turn reinforce the European private sector's relative risk-aversion in comparison to that of its US counterpart, this is unlikely to create a deep divide between the two sides of the Atlantic.

There is however a domain where very little convergence can be observed either across the Atlantic or even within Europe. It is the social sphere. Contrary to early expectations, global integration has not led to convergence in the level of social insurance spending or in the delineation of the relative responsibilities of states and markets in the provision of social services such as old-age insurance and health care. Neither have the principles underlying unemployment insurance and welfare assistance converged. Finally, labour market institutions remain world apart. Gøsta Esping-Andersen's (1990) notion of several worlds of welfare capitalism remains accurate. Furthermore, research into the motives for the differences

between the US and Europe have emphasised permanent factors such as the nature of political institutions and the ethnic composition of the population (Alesina and Glaeser,2004).

In a similar vein, convergence within Europe is hardly noticeable in spite of talks of a European social model. Labour market institutions remain extremely diverse and do not exhibit more pronounced convergence than within the OECD as a whole, as illustrated by Figure 4 taken from Pisani-Ferry (2005). While Blanchard and Giavazzi (2003) have pointed out that deregulation in the goods markets should over time translate into reform of the labour markets, the evidence so far is that the process is at best a slow one. The so called “European employment strategy” and the “Lisbon strategy adopted in 2000 to coordinate economic and especially labour market reforms have not delivered the expected results and they have been looked at with increasing scepticism.



There is even less convergence in the fields of pensions, health care and welfare, which are very much in the realm of national states. In fact, except for very basic provisions regarding working conditions or gender equality at work, European harmonisation has not extended to social policies, which remain of the responsibility of national governments or social partners within countries. Boeri (2002) and Sapir (2005) can thus underline the persistence of no less than four social models within the EU15 involving different degrees of efficiency and different trade-offs between efficiency and equity: A continental one (Germany, France), a

Nordic one (Scandinavia, Netherlands), an Anglo-saxon one (UK, Ireland) and a Mediterranean one (Italy, Spain).

A fundamental reason for this persistence is that labour mobility within the EU remains extremely low. In spite of the treaty provisions according to which the movements of persons is (together with those of goods, services and capital) one of the "four freedoms" that form the very basis of the Single Market, the untold consensus in the EU has for long been that mobility should remain as low as possible. Table 2 shows that in most of the EU-15 member states, and all large ones, residents from other EU countries represent a small fraction of the population. Furthermore, only in three countries (Britain, Ireland and Sweden) has the accession of the new member states from Central and Eastern Europe been accompanied by the liberalisation of migrations. The twelve other member of the former EU-15 have made use of the possibility of keeping temporary restrictions for up to seven years.

Table 2 : EU10 and EU15 nationals as percentage of destination country's working age population aged 15-64

Country of Destination	Nationality	
	EU10[1]	EU15[1]
Belgium	0.2	2.7
Czech Republic	1.0	0.1
Denmark	0.1	0.2
Germany	0.2 / 0.9[2]	1.0
Estonia	0.0	0.1
Greece	0.1	:
Spain	0.0	0.1
France	0.0	0.0
Ireland	1.9	:
Italy	0.1	:
Latvia	0.0	0.0
Lithuania	0.0	0.0
Hungary	0.0	0.0
Malta	0.1	0.8
Netherlands	0.2	:
Austria	0.7 / 1.2[2]	:
Poland	0.0	0.0
Portugal	0.0	0.0
Slovenia	0.0	0.0
Slovakia	0.0	0.0
Finland	0.0	0.0
Sweden	0.1	0.0
United Kingdom	0.4	:

[1] EU10 = New member states.
EU15 = Old member states.
[2] First figure refers to foreign workers stock and second to work Permits.

Source: European Commission Report on the Functioning of Transitional arrangements on the Accession Treaty, 2006. Data sources differ from country to country.

In addition, the 2004 proposal by the Commission to introduce a "home country principle" according to which providers of cross-border services would be subject to the legislation of their home country instead of that of the country where the service is being provided met fierce opposition in several member states, especially France where this proposal played a role in the rejection of the referendum on the European constitution. Although the issue involved many technical arguments, the main reason for popular rejection was, again, the fear that it would undermine the (French) social model. Similar reactions have been observed in other member states such as Belgium or Germany, as well as in Scandinavian countries.

More precisely, a distinction should be drawn between labour market regulations where some pressure towards convergence does exist and the redistribution and social insurance sphere where national models do not exhibit any convergence. The revised Lisbon strategy presented by the European Commission in 2005 puts emphasis on employment rate convergence and is underpinned by an ongoing benchmarking of national labour market policies. While wage negotiation patterns, unemployment insurance systems and employment protection regimes still differ to a very large extent from country to country, it can be argued that there is a trend towards convergence. Health care, pensions, and welfare systems however remain disconnected, as well as tax and redistributions systems.

It can even be speculated that against the background of different national preferences, one-dimensional convergence in the governance and the financing of the corporate sector contributes to maintain and even to increase divergence in the social models. For example, differences in collective risk aversion could in the past result in companies insuring their employees to a different degree against economic risks, yet in the context of global capitalism those differences are more likely to surface in public social insurance institutions.

Differences in some of the basic tenets of the social contract are thus likely to persist across the Atlantic and may even widen as US and European collective preferences regarding, for example, the degree of redistribution through taxes and transfers, or the degree of protection against economic risks that is provided by the social safety net seem to be more distant than they were in the 1970s. Within Europe, convergence is at best a very slow process driven by policy learning rather than mandated harmonisation, explicit coordination or market pressure. As pointed out by Sapir (2005), it may lead the least efficient systems to reform themselves, therefore implying convergence in the efficiency dimension, but there is no reason to believe that convergence will extend to the equity dimension.

It is therefore in national preferences and their influences on the social institutions, rather than the nature of capitalism, that the most profound differences between developed economies are today located. This has led Amable (2003) to claim that diversity of capitalism is alive and well.

We do not agree. A situation where the rules and institutions governing capital, goods and services market regulation are to a very large extent common (either within Europe between Europe and the US) while rules and institutions governing redistribution, social insurance and even labour markets remain diverse would bear little relationship with the one that gave rise to the varieties of capitalism school of thought. While it was an appropriate characterisation until the 1980s, today we regard "diversity of capitalism" as a misnomer which can only conceal the depth of the changes that have taken place. We prefer, instead, to speak of the coexistence and relationship between a global capitalism and diverse social institutions.

This is not a semantic issue. From an analytical standpoint, whether different varieties of capitalism coexist and how global capitalisms adapts to societies characterised by differing social contracts are two different issues. To confuse them does not help tackling the research challenges.

7. Conclusions

In this paper, we have examined how differences between the European and American economic systems and policies have evolved over the last quarter century. 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. Temporary exceptions apart, 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 European regulatory framework. The US has not undergone similar transformations.

3. European integration could be regarded as providing a kind of 'airlock' compartment for the adaptation of European economic regimes to globalisation or as offering a 'shelter' for the emergence of a genuinely European variety of capitalism. In spite of (failed) attempts

at developing European industrial policies, the evidence suggests that in the micro field, Europe has played the former rather than the latter role.

4. In the macro field, convergence is less pronounced. Although the end goals of US and EU macro policies are similar, differences are apparent in the definition of the role of macroeconomic policy, the degree of activism and the degree of inertia of principles, rules and institutions. Those differences are likely to be durable.

5. 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. 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.

6. 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.

7. 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. 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.

8. Labour markets, and to an even higher degree 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. The EU has thus produced bounded convergence, and here lies the true specificity of the European model.

9. This, however, should not justify to continue to speak of a persistence of diversity in the models of capitalism. We prefer, instead, to speak of the coexistence and relationship between a global capitalism and diverse social institutions

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