

Europe's competition policy – or extending the domain of integration

By [Sarah Guillou](#)

The principle of “fair competition” was set out in the general principles of the Preamble to the Treaty of the European Communities (TEC) in 1957, as was the commitment that the Member States will enact policies to ensure this fairness. Competition policy – overseen by the Competition Directorate – is the benchmark policy for market regulation, but also for industrial strategy and, more recently, for fiscal regulation.

The need for a competition policy flows directly out of Europe's project to establish a common market, and numerous attempts at industrial policy have come to grief on the altar of Articles 81 to 89 of the TEC (and now Articles 101 to 109 of the Treaty on the Functioning of the European Union), which establish the framework for competition. In practice, the two policies are clearly complementary in the European Union, and the space granted to the former develops thanks to the set of exceptions to the latter.

Competition as a general framework in the European Union

As a foundation of the common market, respect for and controls on market competition is a general principle underlying all European policy. More fundamentally, competition can be considered a *constitutional* principle of the European Union. It makes it possible to define the European space, the common space whose existence depends on controls on competition between States. Europe's competition law is therefore developed first of all to control economic competition between the States. The aim is to prevent the States from adopting policies that create benefits for companies in their own

territory and discriminate against companies from other States.

Within the European Commission, the Competition Directorate therefore has a significant role and responsibility. Supervision of competition is exercised through the control of mergers and cartels on the one hand, and the control of State aid on the other. To monitor cartels or any other abuse of a dominant position, competition law is exercised *ex post* to protect consumers and competitors from predatory behavior and abusive pricing. Control over concentration developed generally from the second half of the 1980s, in synch with the increase in the size of mergers and the opportunities for European rapprochements, which resulted from the success of the single market. Moreover, mergers and acquisitions are increasingly the subject of negotiations between the companies involved and the European Commission and conclude with a transfer of activity. For example, the acquisition of Alstom's energy division by General Electric in 2015 was accompanied by the sale of part of the gas turbine business to the Italian company Ansaldo Energia. This control has given the Commission an active role in the structuring of the market, which amounts to a super power, but since the 1990s, fewer than 1% of notifications concerning concentrations have led to a veto by the Commission.

European supervision of aid has been relatively continuous since it presupposes a permanent exercise of supervision of "undistorted competition" in the European area. It is a tool both to control any distortions of competition created by a Member State granting advantages to its companies and to fight against a race to "who grants most" in terms of subsidies. Thus, Article 87 (1) of the Treaty establishing the European Community states that State aid is considered to be incompatible with the common market, and Article 88 gives the Commission a mandate to monitor such aid. But Article 87 also specifies the criteria the Commission uses to investigate aid.

Business subsidies are subject to the Commission's authorization if they exceed 200,000 euros over three years and they are not included in the set of exemptions decided by the EU. The majority of aid investigated is authorized (almost 95%). As for France, the percentage of aid disallowed out of the amount granted is in line with the European average. There have of course been some noteworthy decisions, such as when EDF was required to repay 1.4 billion euros in 2015 following tax assistance dating back to 1997. But the Commission also recently allowed the French State to acquire an interest in the capital of PSA Peugeot Citroën (2015). Similarly, the Commission authorized the public-private partnership underpinning the construction of the Hinkley Point nuclear power plant in Great Britain.

Some recent developments in the exercise of this control should be noted. The regulation of State aid has been used to examine the provisions of tax agreements negotiated by companies with certain governments such as Ireland, Luxembourg and the Netherlands. By favouring some companies to the detriment of their competitors, these tax agreements create not only distortions in competition but also competition between States to attract the profits and jobs of the large multinationals. For example, in October 2016, the Commissioner for Competition, Margarethe Vestager, described the tax agreement that Apple had received in Ireland as unauthorized State aid, and accordingly required the Irish government to recover 13 billion euros from Apple. This use of the regulatory power over State aid constitutes a turning point in competition policy, in that it recalls that the object of competition policy is to ensure that competition between States does not go against the notion of "a common market."

Industrial policy is expressed in the exceptions to competition policy

Note that while competition policy is well defined at European level, there are many meanings of industrial policy in Europe,

almost as many as there are members. This makes it more difficult to find policy compromises prior to the definition of such a policy. Moreover, the institutional logic and the economic logic are not the same. As already noted, competition policy has a strong institutional anchorage, which is not the case with industrial policy. Even though the European Coal and Steel Community was at the origin of the European Community, industrial policy is not at the heart of the European project. Moreover, the economic logic is different: competition policy is defined with reference to space (the relevant market), whereas industrial policy can be understood only by integrating the life cycle of companies and industries, and therefore in reference to each country's industrial history. In a shared sense, industrial policy can be defined as policy that is aimed at orienting an economy's sectoral and / or technological specialization. It is therefore easy to grasp the dependence of industrial policy on national preferences. The tool favoured by the States to express this policy is aid to companies, whether directly or indirectly.

State aid is classified according to 15 objectives, ranging from "preservation of the heritage" to aid for "research and development and innovation". For the EU as a whole, the three categories that are largest as a percentage of total aid are: environmental protection (including aid for energy savings), regional aid, and aid for R&D and innovation. The amounts involved are far from negligible: in 2014, for example, 15 billion euros for France and 39 billion for Germany. A higher amount of aid in 2014 was due largely to an increase in aid for renewable energy as a result of the adoption in 2014 of revisions on the rules on this type of aid. Germany is the country that contributed the most to this increase. Support for renewable energies is indeed at the heart of its industrial policy.

European industrial policy develops as exemptions to the application of control on aid and hence to competition policy.

These exemptions are set out in the general regulations on exemptions by category. There are many Block Exemptions, which revolve around the following five themes: innovation and R&D, sustainable development, the competitiveness of EU industry, job creation, and social and regional cohesion. It can be seen in this set of exemptions that supervision is also the expression of Europe's policy choices on orienting public aid, and thence directing public resources towards uses that are in line with these choices. These choices are the result of a relative consensus on the future of the European economy which shapes industrial policy. The largest categories of aid are research and development and environmental protection. In a word, the European economy will be technological and sustainable. This is a policy of orientation and not a policy of resources, and it takes shape within the overarching framework of the policy on competition.

What future for Europe's competition policy?

It seems that, given the primacy of competition policy and its foundational role for Europe's union, competition policy is the conductor of microeconomic policy. It has, up to now, proved capable of adapting. Thus, in compliance with the European project, economic constraints and societal orientations have led to changes in the definition of exemptions on the control of aid, which have allowed for the expression of industrial policy. Similarly, it has seized upon the fiscal hyper-differentiation between certain States, which sharply contravened European integration and the common market.

Competition policy must not be weakened in authority or scale, but it must retain its capacity to adapt both to industrial orientations and to the deployments of Member States' strategies on competition with each other. It is also an essential counter-power to the growing strength of the multinationals, and governments must support it in this sense rather than becoming the mouthpieces of their national

champions.

François Hollande's five years in office: Stagnation or recovery?

By OFCE

The five-year term of French President Francois Hollande has been marked by serious economic difficulties, but also by some signs of improvement in the last year of his mandate. Overall, France experienced low growth from 2012 to 2014, mainly due to the fiscal consolidation policy, with moderate growth after that (see: [OFCE, Policy Brief, no2, September 5th, 2016](#)).

The scale of the fiscal shock at the start of Hollande's mandate, when the government underestimated the negative impact on growth, proved to be incompatible with a fall in unemployment during the first half of the mandate.

The effort to improve France's public finances involved a major fiscal adjustment, even though the target of a 3% public deficit was put off till the end of Hollande's term in office. According to the calculations of the European Commission, France's structural balance (i.e. the balance adjusted for cyclical effects) will have improved by 2.5 points over the 2012-2016 period. This effort did not however prevent the public debt from reaching a historic peak and from diverging significantly from the level in Germany.

Fiscal consolidation in France and in Europe had a marked negative impact, amounting to 0.8 point per year on average

between 2012 and 2017. The simultaneity of the austerity policies enacted in Europe amplified their recessionary impact by depressing domestic demand, but also external demand.

The economic policy of the governments led by Ayrault and Valls was initially marked by a significant period of rising taxation, on both companies and households, followed by a shift towards a supply policy in 2014. This policy, embodied in the Responsibility Pact and the CICE tax credit, is bearing fruit late in Hollande's term, as business margins improve, although household purchasing power and short-term growth have been hurt.

After a period marked by a significant downturn in business margins, they picked up over the first four years of the five-year term by the equivalent of 1 point in added value thanks to tax measures, and one additional point due to lower oil prices. The profit margin in industry even reached a level comparable to the historical records of the early 2000s.

Based on our forecasts for the five-year mandate as a whole, ILO-measured unemployment will have increased by about 100,000 people, despite the creation of 720,000 jobs, due to the lack of growth, combined with an increase in the labour force.

Wage moderation in Germany – at the origin of France's economic difficulties

*By Xavier Ragot, President of the OFCE, CNRS-PSE, together
with Mathilde Le Moigne, ENS*

If the future of the euro zone does indeed depend on political cooperation between France and Germany, then economic divergences between the two countries should be a cause for concern. These divergences need to be analysed, with particular attention to three specific areas: the unemployment rate, the trade balance and the public debt. Germany's unemployment rate is falling steadily; in June it was under the 5% mark, which represents almost full employment, whereas the French rate is over 10%. Germany's low unemployment rate does not however reflect strong consumption by German households, but rather the country's export capacity. While France continues to run a negative trade balance (importing more than it exports), Germany is now the world's leading exporter, ahead of China, with a trade surplus that will run close to 8% in 2015. As for the public deficit, it will be around 3.8% in France in 2015, while Germany is now generating a surplus. This has impressive consequences for the way the public debt is changing in the two countries. In 2010 they were similar, at around 80% of GDP, but in 2014 Germany's public debt fell below 75%, and is continuing to decline, while France's debt has continued to grow, and has now hit 97%. This kind of gap is unprecedented in recent times, and is fraught with mounting tension over the conduct of monetary policy.

This triple divergence is inevitably leading to differences in the political response, with respect to the population's ability to take in migrants and to the understanding of countries facing economic difficulties, such as Greece, but also with respect to the ability to cope with future economic crises. Economic divergence will become political divergence. The point is not to idealize the German situation, which is characterized by a large number of workers who have failed to benefit from the fruits of growth, as is shown in a recent study by France Stratégie, as well as by a rapid decline in population. This should not stop us from taking a hard look at the economic gap arising between the two countries.

What are the reasons for Germany's commercial success?

Many factors have been advanced to explain the divergence between the two neighbours: for some, it's a matter of the German strategy – outsourcing value chains, aggressive wage moderation, fostering competition between companies – and for others, French weaknesses: poor geographical and / or sectoral specialization, insufficient public support for exporters, and a lack of competition in certain sectors. Our [recent study](#) emphasizes the delayed impact of German wage moderation and suggests that this could explain almost half of the Franco-German divergence. To understand the mechanisms involved, it is necessary to distinguish between the sectors exposed to international competition and the sectors that are sheltered. The exposed sectors include industry, but also agriculture, including animal husbandry, which is currently in the news, and some services that can be traded. The sheltered sector includes transportation, real estate, retailing and a large part of personal services.

While unit labour costs in France have risen regularly and at similar levels in the two above-mentioned sectors, they have remained extraordinarily stable in Germany for nearly ten years. This wage moderation is the result of both poor management of German reunification, which tipped the balance of power during wage negotiations in favour of employers, and, to a much less extent, the introduction of the Hartz reforms in 2003-2005, which aimed to create low-paid work in the less competitive sectors (particularly the sheltered sector). The cost of German reunification is estimated at 900 billion euros, in terms of transfers from former West Germany, or slightly less than three times the Greek debt. Faced with this kind of challenge, the wage moderation initiated in 1993 represented a strategy for re-convergence between the two parts of Germany. In 2012, German nominal wages were 20% lower than French wages in the exposed (tradable) sector and 30% lower in the sheltered sector, compared to the 1993 levels. A

look at French and German margin levels shows that in the exposed sector, French exporters have made significant efforts by reducing their margins in order to maintain their price competitiveness. In the sheltered sector, French margins are on average 6% higher than German margins. The bulk of France's loss of price competitiveness is therefore a loss of cost competitiveness.

How much have these differences contributed to unemployment and the trade balance in the two countries? Our quantitative analysis shows that if German wage restraint had not taken place between 1993 and 2012, today's 8% gap in the trade balances would instead be 4.7% (2.2% of this being due solely to German wage moderation in the sheltered sector). Thus, Germany's wage moderation policy explains almost 40% of the difference in trade performance between the two countries. We also found that this wage moderation accounts for more than 2 points of France's unemployment.

The non-price competitiveness gap

This leaves nearly 60% of the difference in the trade balances still needing to be explained. Our study suggests that this difference is due to the quality of the goods produced, so-called non-price competitiveness. Between 1993 and 2012, the German quality-price ratio increased by around 19% compared with that of France, which has therefore more than offset the rise in German export prices relative to French prices. There is clearly a "quality" effect in this non-price competitiveness: Germany produces "high end", more innovative goods than France does in the same sectors. It is also possible to see an impact due to the outsourcing of some German production (nearly 52% of production volume in 2012) to countries where costs are lower: Germany today is a centre for design and assembly, which saves money on its intermediary costs, enabling it to invest more in brand strategies and efforts to move upscale.

This effect is nevertheless probably endogenous, that is to say, it flows in part from Germany's advantage in cost competitiveness. Low labour costs have enabled German exporters to maintain their margins in the face of external competition. The funds generated have led to investments which French companies have probably had to forego in order to maintain their price-competitiveness, thus losing the opportunity to catch up with German products in terms of non-price competitiveness over the longer term.

A positive way out and up

The root cause of the gap in economic performance between Germany and France lies in the nominal divergence observed between the two countries since the early 1990s. One way to reduce these differences would be to promote convergence in wages in Europe and in its labour markets more generally. Germany would need to allow wage inflation that was higher than in the periphery countries, thereby dealing with the increase in social inequalities in Germany, while France must not fall into the trap of competitive deflation, which would destroy its domestic demand, while keeping wage movements under control. In this respect, the report of the five Presidents presented by the European Commission on 22 June 2015 proposes the establishment of national competitiveness authorities, which hopefully would allow greater cooperation on social welfare and employment.

The difference in wages between France and Germany has profound implications in terms of economic thought. The increased trade integration that followed the introduction of the euro led not to a convergence but to a divergence in labour markets. It is then up to each State to once again bring about convergence of the economies while supporting economic activity. This State intervention in the economy is more complex than the simple Keynesian framework for the management of aggregate demand, and now involves the convergence of labour markets. Heretofore, Europe's response

has been systematic cuts in labour costs, while what is really needed is to increase wages in surplus countries, such as Germany, for example by using the minimum wage as a tool. All this, it is true, is economics. The politics begins when we realize that only long-term cooperation can bring about a convergence in national interests.

The promotion of renewable energy innovation: when State intervention and competition go hand in hand

by [Lionel Nesta](#) and [Francesco Vona](#)[1]

In contrast with the common belief that competition demands no State intervention, innovation policy and competition complement each other. This is the main conclusion of our investigation concerning innovation in the realm of renewable energy (RE)[2], summarized in the [OFCE Briefing Paper, n°8, October 6, 2014](#).

By and large, innovation is the only answer to both sustaining current life standards and overcoming severe environmental concerns. This is especially true in the case of energy, where increasing resource scarcity calls for the rapid development of renewable energy sources, such as biomass, solar and wind.

The issue is: despite this considerable increase, renewable energy can still not compete with fossil fuel, the production

of the latter being cheaper and its distribution more efficient. Hence without a long-term perspective, the development of renewable energy cannot take place. Public support, it is well-known, is better equipped than private parties to take such a stance. And to understand which policy design may best spur innovations in renewable energy is a key question.

Public policies aim to spur investments in green capacity and technical change and to reduce the cost of RE generation. The adoption of the Kyoto agreement on climate change mitigation too has created a consensus about certain environmental policies (i.e. emission trading schemes). Over the past 20 years, OECD countries have increasingly supported innovation in RE by diversifying the range of RE policies (see Figure 1 for selected countries).

Meanwhile, liberalization has changed the working of energy markets in most OECD countries. It has increased market competition by lowering entry barriers and privatizing energy producers. We view liberalization of the energy market as positive for innovation. Radical innovation is mainly developed by newcomers. And large incumbents have little incentive to fully develop new technologies that would question their past investments in large-scale energy production.

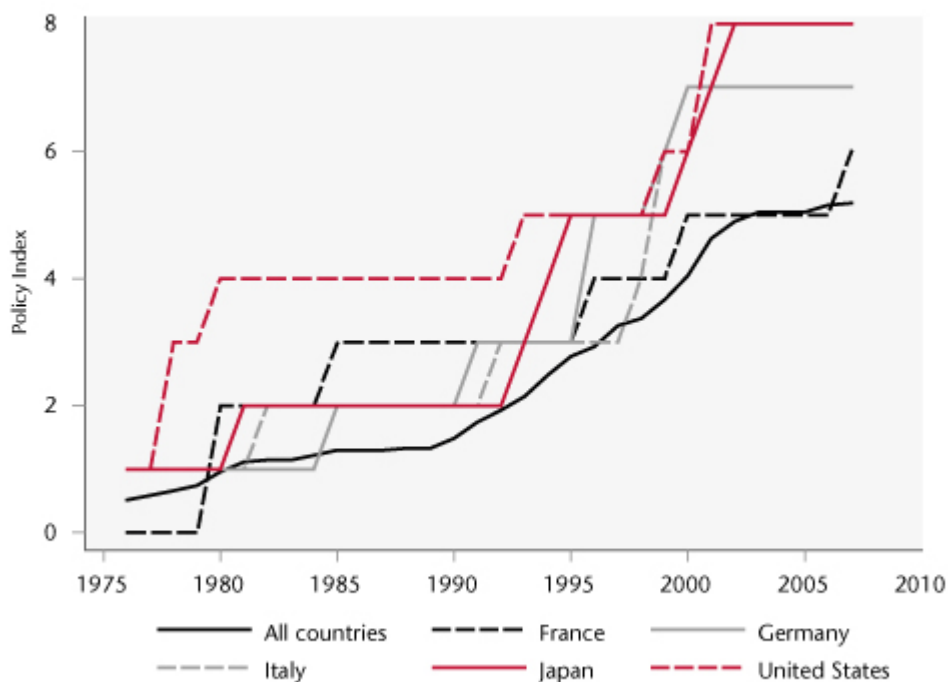
In a context of amplified public support to RE innovation and increased liberalization of energy markets, it is important to test how the interplay between the two affects innovation in renewable energy.

We find that renewable energy policies are more effective in fostering green innovation in liberalized energy markets. We find that such policies are three times as effective in highly deregulated energy markets than in more regulated ones. In general, this complementary effect is one of the largest drivers of innovation, especially for frontier patents. This

result is summarized in Figure 2 where we depict the estimated effect of RE policies on innovation as a function of the degree of market deregulation. This effect is positive only for countries with a level of regulation below average, as is the case for Germany and the United States.

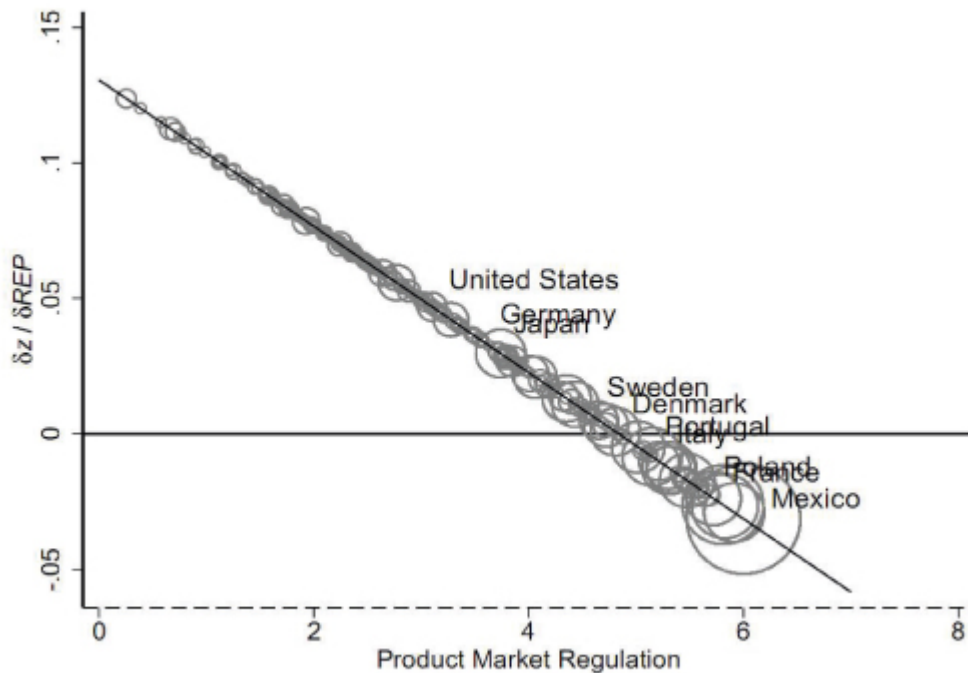
Our conclusion is that the effect of RE policies on innovation is crucially mediated by the degree of competition in the energy market. Therefore, and again, in the energy sector, in contrast with the common belief that competition demands no State intervention, innovation policy and competition complement each other.

Figure 1. Evolution of the Policy Index (REP) for 5 countries and for all countries (1976-2007)



Source: See Nesta et al. (2014).

Figure 2. Estimated marginal effect of RE policies on RE innovation



Source: Nesta et al. (2014).

[1] This research project benefited from funding from the European Union Seventh Framework Programme (FP7/2007-2013) under grant agreement n°320278 (RASTANEWS).

[2] See: Nesta, L., Vona, F., Nicolli, F., 2014. "Environmental Policies, Competition and Innovation in Renewable Energy," *Journal of Environmental Economics and Management*, vol. 67(3), 396-411.

**The war between taxis and
chauffeur-driven private**

cars: everyone has their reasons

By [Guillaume Allègre](#)

Editor's note: This post was first published on the OFCE blog on 21 October 2013, when the issue of car with driver services was a subject of intense debate. Given the recent events in France, it seemed appropriate to republish this text by Guillaume Allègre.

"What's worse is that everyone has their reasons"

Jean Renoir, *La Règle du jeu*

In the war between taxis and chauffeur-driven private cars (*voitures de tourisme avec chauffeur* – VTCs), everyone has their reasons. We noted in [a previous post](#) that the discourse on innovation masked a classic conflict over distribution between producers, who want to defend their incomes, and consumers, who want an inexpensive quick-response taxi service including at peak times. This conflict is coupled with another no less classic one between holders of licenses with a scarcity value and new entrants, who support opening up the market.

In this conflict the current regulatory system is absurd. Limiting the number of taxi licenses was intended to support the income of independent taxis and prevent them from working too many hours per day to achieve a decent income. However, the authorities have committed two errors. First, by allowing the transfer of licenses, they transferred the benefit of quotas on taxi drivers to the license owners: a taxi driver now must either rent their license or buy it at a price reflecting its scarcity value (230,000 euros in Paris in 2012!). The current situation is even more absurd given that new licenses are [allocated free of charge](#) (to a waiting

list): if the *préfet* allocates 1000 new licenses for free, then a value of 230 million euros at market prices will be transferred to the fortunate winners (who may subsequently rent out the licenses)!

The second error is that the government has allowed the taxi license bubble to expand. The high price of licenses clearly reflects that supply is too low relative to demand. But it would now be unfair to penalize those who have just spent a fortune acquiring a license by, for example, massively increasing their number: why should recent purchasers pay for the shilly-shallying of the regulatory authorities?

What's the solution?

It would be preferable to put an end to a system that generates constant worry about the value of licenses issued for free. But redeeming all the licenses at their market price would be costly and would result in the unjust enrichment of those who received a license for free.

One solution, which was proposed in the [previous post](#), is to buy the current licenses over time (as taxi drivers retire), not at their market value but at their acquisition value plus interest, and to assign new licenses that are free but not transferable. This system would compensate recent purchasers, without contributing to the unjust enrichment of those who have obtained a license for free or at a very low price. It would allow a transition from a system of transferable licenses to a system of non-transferable licenses in which the number of licenses in circulation and the division of the market between chauffeured cars and taxis would depend on the demand for services and not on the nuisance power of one or the other party. This system is of course complex, but it would help to overcome past mistakes in the fairest way possible.

For further information: [Chauffeur-driven private cars:](#)

[Victory of the anti-innovation lobby?](#)

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The sources of an industrial renewal

By [Jean-Luc Gaffard](#)

French companies in many sectors have had to deal with a relative increase in unit labour costs, a relative decline in the price of value added, and lower margin rates, meaning that many of them are facing strong competition and are relatively uncompetitive on price due to not having innovated and invested enough in the past. The result over the last decade has been a significant loss of substance in France's industrial network and a worsening foreign trade deficit. The challenge of carrying out an industrial renewal is clearly posed. This is not limited simply to manufacturing but encompasses any activity that is likely to deal with demand on a relatively large scale and is organized on an industrial basis^[1].

It is common sense to assume that the solution lies in the renewed capacity of these companies to innovate, to export and quite simply to expand, or in a word, in the ability to regain or acquire the non-price or structural competitiveness that they are currently lacking. The difficulty they face is that their lack of price competitiveness is leading them to seek immediate reductions in cost to the detriment of investment in innovation. Faced with this difficulty, economic policy makers

must resolve a real dilemma: either to take measures to compete on taxation, social contributions, or even wages in an effort to restore companies' price competitiveness at the risk of further weakening aggregate demand and ultimately negatively impacting their turnover, or to keep the existing system of taxation at the risk of depriving these companies of the means to invest and innovate.

The consensus of the day naturally denies the existence of such a dilemma. The presumed neutrality of money and the budget, coupled with the flexibility of the markets for goods and labour, is supposed to help the economy back on the path of steady, stable growth. Businesses, now reassured by the restoration of balanced public accounts and freed of excessive regulatory constraint, are again free to invest.

This consensus embodies a reductive vision of the functioning of market economies. The model of perfect competition, which is the standard in this instance, pictures a world where companies respond simply to price signals sent by the markets for goods and by factors whose operation is immunized against any power exercised by one or another protagonist in these markets. Somehow or other, this is what is meant by the assumption of efficient financial markets whose function is to discipline firms and States. The reality is very different. Markets are naturally and necessarily imperfect. Companies develop strategies on pricing, production and investment that deal with this market environment at the same time that they help to shape it. It is important to recognize this reality before trying to define economic policies suited to it.

The sources of business competitiveness

In an industrial market economy, business growth comes from *innovation*, in other words from companies' ability to develop non-price or structural competitiveness that is more robust and more lasting than just price competitiveness. Technological or organizational innovation aimed at the

creation of new products or services or at the exploration of new markets entails however a *detour away from production*. Time is needed to develop a new production capacity before using it and benefiting from it.

Generally, this new capacity has a higher construction cost than the cost of simply replacing existing capacity. Additional costs must be borne before the corresponding additional income can be collected. A loss of competitiveness, in principle temporary, is apparent. This could be reflected in increases in current prices (of old products) if the hike in costs is to be passed on immediately or, more likely, by a reduction in margins. The performance of the production of existing goods or services is thus negatively affected by the decision to innovate [\[2\]](#).

In this context, it is still necessary for the company to remain competitive on prices in the short term in order not to lose significant market share to its competitors. It is in regard to this immediate requirement that the issue of *labour costs* comes up. This is a particular issue in the euro zone where in the absence of possible adjustments via exchange rates, legal and regulatory differences on social and fiscal matters create real distortions in competition – and when, furthermore, the international fragmentation of production (in reality the relocation of segments of production to countries where wages are lower but qualifications identical) is providing businesses that have the ability or opportunity to exploit this an advantage in terms of the costs passed on in product prices, margins and investment volumes.

Maintaining or regaining immediate price competitiveness will not, however, suffice. It is still necessary to encourage companies to innovate. But when investments, including intangible investments, are irreversible and when information on the future configuration of the market is not immediately available, it is difficult for companies to do this. They cannot base their decisions on price signals alone. They must

be able to secure their investments by acquiring sufficient knowledge about the future market, that is to say, not only the size of demand, but also about competing and complementary offers. The point is to ensure that competing investments do not exceed a certain threshold and that complementary investments attain a certain threshold. This is possible only thanks to practices that have to be considered monopolistic, which are related to different forms of connections between the companies concerned[3]. This kind of *organizational strategy* foregrounds, not a particular company, but a *network of companies*, a sort of ecosystem that often brings together a local dimension and capacity to project outwards. The characteristic of these networks is to balance competition and cooperation. Practices that can be characterized as market imperfections here become incentives to innovate. They help to define the *boundaries* of the firm best suited to the decision to innovate.

What is true of investment in physical capital is equally important for investment in human capital. This investment has a gestation period that essentially amounts to the learning time. This is an essential element in developing new productive capacities. Its products must be secured. The labour relationships specific to a company and to the networks of firms between companies contribute to this. The *stability* of the employment relationship, which binds the employee to the company, is a decisive factor in the learning and retention of professional experience. The *mobility* of employees between companies is another factor. This mobility enables each company to draw on what an employee has learned in another company developing the same sort of skills. It is also a source of increases in wages, but it becomes possible only if companies are in a situation of monopolistic competition.

The difficulty of innovating even when investments are irreversible and market information is incomplete requires

having access to financing in order not only to bridge the gap between the profile of costs and the profile of revenue, but especially to have a lengthy financial commitment, that is to say, stable financial relations or control of the capital. The problem most innovative firms encounter is that the assets created are not easily re-deployable (including intangible assets). This constraint, which justifies developing the organizational means to acquire credible information about the market, requires at the same time being able to enjoy continuing financial support.

Goals and means of an industrial renewal policy

Identifying in this way the stimulants of business growth should guide the policies to be implemented, which are reducible neither to competition policy nor to industrial policy. These policies concern the operation of various markets (goods markets, labour markets, credit markets and financial markets). They make use of a variety of instruments and are situated at different geographical levels.

Industrial policy should set itself the goal of stimulating *cooperation* between companies, including competing firms, and, more broadly, of contributing to the formation of ecosystems involving companies, banks and research institutions. The point here is not at all to designate products or technologies or even territories to promote *a priori*, but instead to help foster market conditions that encourage companies to invest in the ways that seem most promising. The criteria adopted for subsidies or tax relief should meet this objective, which is obviously more complex than that recently put forward of targeting sectors where competition is strong [4]. This should be the specific objective of funding for France's "competitiveness clusters", as well as of other forms of public assistance.

Industrial policy has a *regional dimension*, since companies have a tendency to group together to benefit from external effects, in particular learning synergies not only with regard to technological knowledge but also to knowledge of the market. This phenomenon is in line with the willingness of local authorities to assist in the creation of clusters. However, there is no evidence that these local authorities have the information they need or that they can avoid being captured by lobbies. Competition between them can be expensive when it involves tax competition, which can probably improve the situation of some but only at the expense of others, and which negatively affects overall performance. This inevitably raises the issue of the competence, number and size of the local authorities.

Competition policy is not a substitute for industrial policy. It must pursue the same objective, *i.e. to distinguish between competition and cooperation*. From this perspective, the role that competition policy should play is to punish imperfections and distortions that are harmful to innovation and validate those that foster it. The handling of cooperation agreements in R&D is indicative of this requirement. It cannot be exclusive. Other types of agreement must be able to escape the common law on competition.

Labour market policy must set itself the goal of strengthening the ways and means of *enhancing skills*. First and foremost, this means creating the conditions for stabilizing the employment relationship, which is a source of learning for employees and of making sure that companies retain the skills acquired. These conditions are undoubtedly covered by the employment contract itself, but they are also inseparable from the constitution of the communities or clusters making up innovative business networks. These networks are "local" labour markets in which labour mobility between firms is potentially beneficial to all the partners with respect to mastering new skills. Moreover, an end needs to be put to

incentives that contribute to perpetuating the privileging of low-skilled or unskilled jobs. Finally, legal and regulatory conditions that permit businesses to hold onto jobs in the event of temporary difficulties (*i.e.* the use of short-time working) should be strengthened.

Banking policy should set itself the goal of creating *stable relationships between companies and financial institutions*. So-called relationship banks, which collect information on borrowers, have higher costs than traditional banks, but they also have the advantage of providing resources to businesses facing liquidity problems linked to the characteristics of the innovation cycle. In fact traditional intermediation increases the growth rate of the economy and reduces its long-term volatility, as opposed to market-based funding[5]. It is also important to refocus the financial system on traditional intermediation, especially on business credit, and to return to a form of separation between the two types of activity, so that lending to business avoids the consequences of the inevitable vagaries of market activity[6].

Fiscal policy must set itself a dual objective. The short-term goal is to *reduce labour costs* by reducing the rate of employers' social contributions and increasing the tax on value added. The medium-term objective is to *penalize unproductive activities*, those whose contribution to growth is dubious. From this perspective, it is undoubtedly necessary to tax financial services and to make greater use of taxes on wealth and the transmission of wealth, as is recommended by the International Monetary Fund. Without prejudging the possible ways tax reform could be implemented, there is a two-fold importance to reform: first, to promote the production of industrial-type goods and services that are suited to international trade, and second, to carry out a redistribution of income and wealth in order to increase the potential demand for these goods and services.[7]

Industrial renewal poses a major challenge for the French

economy, which is now caught between the German economy and the Spanish economy. It requires a reorientation of all the policies that affect and guide corporate behaviour, going beyond just manufacturing firms – policies that are not reducible to either the search for lower costs or to the promotion of new technologies or to compliance with the rules of free competition.

[1] On the nature of industrial organization, see Chapter 4 of the work by N. Georgescu-Roegen, 1971, *The Entropy Law and the Economic Process*, Cambridge Mass., Harvard University Press.

[2] See C. M. Christensen, 1997, [*The Innovator's Dilemma*](#), Harvard, Harvard Business School Press.

[3] G. B. Richardson, 1990, *Information and Investment*, Oxford, Clarendon Press. G. B Richardson, 1998, [*The Economics of Imperfect Knowledge*](#), Cheltenham, Edward Elgar.

[4] P. Aghion, M. Dewatripont, L. Du, A. Harrison and P. Legros, 2012), "Industrial Policy and Competition", [*NBER Working Paper*](#) 18048.

[5] Bolton P., X. Freixas, L. Gambacorta, and P. E. Mistrulli, 2013, Relationship and Transaction Lending in a Crisis, [*BIS Working Paper*](#), no. 17.

[6] T. Beck, 2013, Finance and Growth: Too Much of a Good Thing, [*Vox eu*](#).

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[7] Keen M., 2013, Tax Policy in (and for) Hard Times, Vox eu <http://www.voxeu.org/article/tax-policy-hard-times#.Um7TETxwZzA.gmail>

IMF, 2013: Fiscal Monitor, Taxing Times, World Economic and Financial Surveys <http://www.imf.org/external/pubs/ft/fm/2013/02/fmindex.htm>

Tales from EDF

By [Evens Salies^a](#)

The challenge facing policy-making on the reduction of greenhouse gas emissions is not just environmental. It is also necessary to [stimulate innovation, a factor in economic growth](#). Measures to improve energy efficiency [1] demand high levels of investment to transform the electricity network into a [smart grid](#). To this end, EU Member States have until 2020 to replace the meters of at least 80% of their customers in the residential and commercial sectors with “smarter” meters. In France, these two sectors account for 99% of the sites connected to the low-voltage grid (< 36 kVA), or about 43% of electricity consumption and nearly 25% of greenhouse gas emissions (without taking into account emissions from the production of the electrical power that supplies these sites).

These new meters have features which, as has been shown by research, lead to lower energy consumption. The [remote reading](#) at 10 minute intervals of data on consumption, which is transmitted in real time to a remote display (a computer screen, etc.), immediately shows the savings in electricity, which, with two surveys per year, was previously impossible. High-frequency remote reading also makes it possible to expand

the range of vendor contracts to include rates that are better suited to customers' actual consumption profiles. The "pilot" flying the transmission network can better optimize the balance between demand and a supply system that has fragmented due to the growing number of small independent producers. For distributors [2], remote reading solves the problem of gaining access to meters [3].

These features are supposed to create the conditions for the emergence of a market for demand-side management (DSM) that is complementary to the supply market. This market would give non-traditional [suppliers](#) an opportunity to differentiate themselves further by offering services that are tailored to the needs of the DSM customer [4]. This could lead to significant gains in innovation if other companies that specialize in information and communication technology also develop software applications that are adapted to the use of the smart meters. However, in France, the policy on the roll-out of smart meters does not seem to be facilitating greater competition. Innovation could stop at the meter due to a [decision](#) by the French Regulatory Commission (CRE) which states that:

"The features of advanced metering systems must strictly meet the missions of the electricity [distributors] ... Thus the additional features requested by some stakeholders [essentially suppliers] which are subject to competition (basically remote displays) are not accepted."

A reading of this paragraph would seem to indicate that the suppliers are not willing to bear the cost of developing these features. However, according to Article 4 of this decision, which specifies the list of features for distributors, none of them seems to have been left exclusively to the competitive sector. In practice, households with a computer can check their consumption data without going through their provider or a third party.

It is worth considering the costs and benefits of such an approach, which *a priori* would seem to amount to the monopolization of the DSM market by the distributors.

This approach will make it possible to quickly reach the goal of 80%, since the CRE has opted for a public DSM service: the distributors, who have public service obligations, will roll out the smart meters. The “Linky” meter alone, from the dominant electricity distributor, the ERDF, will be installed on 35 million low-voltage sites, covering 95% of the national distribution network [5]. There is thus little risk of under-investment in the demand-response capacity that electricity suppliers will soon have. In fact, as the suppliers do not have to bear the costs of the manufacture and deployment of the meters, they can quickly invest in the development of these capabilities. In addition, the equalization of subcontracting costs for the manufacturing of the meters and their installation throughout the French distribution network will make for considerable economies of scale. Finally, the low rate of penetration of meters in countries that have opted for a decentralized approach (the cost of the meter and services are then borne partly by the households concerned) argues in favour of the French model. This model is more practical since it removes most of the barriers to adoption.

Despite this, the degree of concentration in the business of the distribution and supply of electricity to households raises questions: ERDF is affiliated with EDF and has a virtual monopoly on the supply of electricity to households. In terms of innovations in DSM services, it would seem that EDF has little reason to go beyond its subsidiary’s Linky project – first, because of the costs already incurred by the Group (at least five billion euros), and second, because the quality of the default basic information mechanism in Linky will be sufficient to lead to a cost for migrating to DSM services offered by competitors. [6] Alternative suppliers will of course be able to introduce innovative tariffs. But so

will EDF. One way to overcome this problem would be to set up a Linky platform so that other companies' applications could interact with its operating system. With the agreement of the household and possibly a charge for access to the data, the business would of course be regulated, but entry would be free. This would stimulate innovation in DSM services, but would not increase competition since these companies would not be electricity suppliers. Would the consumer have a lot to lose? This would obviously depend on the amount of the reduction in their bills. Given that the price of electricity is likely to rise by 30% by 2017 (including inflation), we are worried that consumers' efforts to optimize their consumption will not be rewarded. The net gain in the medium term could be negative.

Finally, we can ask ourselves whether with Linky the EDF group is not trying to reinforce its position as the dominant company in the supply of electricity, a position that has grown weaker since the introduction of competition. With DSM service installed by default on 95% of the country's low-voltage sites, Linky will become an element in the network infrastructure that all DSM service providers will have to use. From the point of view of the rules on competition, one must then ask whether ERDF and its partners have properly communicated information about the Linky operating system, without any favouritism being shown to the EDF Group and its subsidiaries (Edelia, NetSeenergy). The story tellers would like to tell us a beautiful tale about encouraging innovation in energy and the digital economy in order to deal with the ecological transition. Knowing that the current CEO of the company in charge of the architecture of the Linky information system, Atos, was Minister of the Economy and Finance just prior to the launch of the Linky project in 2007, there seems to be room for doubt

[11] "Energy efficiency improvement" and "energy savings" are

used interchangeably in this post. For precise definitions, see Article 2 of Directive [2012/27/EU](#) of the European Parliament and of the Council.

[2] The distributors manage low and medium-voltage lines. [ERDF](#) has the largest network. The networks and meters are licensed equipment, which are the property of the local public authorities.

[3] This would nevertheless involve, for example for ERDF, the elimination of 5000 jobs (compared with 5900 retirements, see Senate Report no. 667, 2012, Vol. II, p. 294).

[4] In accordance with the NOME law of 2010, suppliers and other operators must be able to make ad hoc reductions in the consumption of electricity for certain customers (temporarily cut the supply to an electric boiler, etc.), which is called demand-response load-shedding.

[5] In areas where the ERDF is not a supplier, other experiments exist, such as that of the distributor SRD in Vienna, which has installed its smart meter, i-0uate, on 130,000 sites.

[6] See the document by the DGEC, 2013, the Working group on smart electricity meters (GTCEC) – [Coordination document](#), February [in French].

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The citizen must be the foundation of any industrial policy – even a free market one

By [Sarah Guillou](#)

The purpose of industrial policy is to direct productive specialization towards sectors that are deemed strategic for well-being or economic growth. This means recognizing that productive specialization is important for growth. But what criteria should be used to determine the importance of a given sector? The argument developed here is that there are no sound criteria that do not refer to the collective preferences of present and future citizens.

There are a limited number of theoretical principles for justifying an industrial policy and demonstrating its effectiveness. From the defence of nascent industries (List, 1841) to support for basic industries that generate externalities for growth, the theoretical arguments set out very limited conditions for the exercise of policy. The international legal framework is also very stringent, especially for European Union countries whose authorities are concerned primarily with creating a level playing field for all EU companies and keeping control over payments by the State.

The limited space for industrial policy

In this limited space, the exercise of industrial policy has struggled to find reasons to exist. Even though a movement of “normalization”, dear to Dani Rodrik, currently seems to be affecting the study of industrial policy (see Aghion et al., 2011), it is still not part of “normal” policy in the same way

as monetary, fiscal, or trade policy, for example. Industrial policy is exceptional policy resulting from exceptional circumstances. It is in the definition of this term “exceptional”, of its nature and its temporality, that industrial policy derives its legitimacy. Even recently, exceptional circumstances, both political and economic, have served as strong grounds for industrial policy, whereas they actually conceal policies to promote employment and satisfy electoral objectives. Illustrations of this include businesses set up to rescue factories, from Lejaby lingerie units to SeaFrance, as well as announcements of regulations on plant closures when a buyer exists. Even though these interventions have the benefit of reducing information asymmetries between the players by offering mediation that is often useful, they are not really part of industrial policy.

The only “authorized” industrial policy today that is consistent with the institutional and legal framework of Europe and America is one that meets the conditions inherited from liberal doctrine on state intervention in the functioning of the economy. One may wish that the rules on intervention were re-defined – which by the way, would bring a little more transparency into state practices – but the ambition of this note is both more modest and broader. This note aims to show that, even within the minimalist framework of the free market approach, industrial policy must be defined in accordance with a social project that engages the productive specialization of the economy.

As a general principle, liberal doctrine considers competition to be the most efficient process for allocating resources. In other words, competition is the best system for maximizing wealth creation. Indeed, it is supposed to foster emulation between the players and motivate them to increase their productivity and performance; to allow the eviction of inefficient activities that waste poorly exploited resources; and, finally, to ensure equality and freedom among the players

with respect to market entry, and thus the free exercise of economic activity. Liberal economic theory thus envisages only very specific situations for the exercise of industrial policy.

In this framework, state intervention is justified (i) to restore competitive conditions concerning transparency of information; (ii) to support investment in activities that generate positive externalities, such as R&D, or conversely to discourage activities that generate negative externalities, such as pollution, and (iii) to support activities that are considered strategic. Note that these are precisely the three justifications that underpin the European Union's policy on industry and competition. It should be noted above all that while the last two reasons do indeed call for an industrial policy, they demand a higher principle of a political nature that invokes the collective preferences of present and future generations.

Encouraging the externalities that arise from R&D spending does not of course necessarily reflect a political choice. Indeed, the underlying economic logic might be sufficient: the externalities from R&D include a boost in productivity induced by the diffusion of knowledge, which benefits society as a whole. This increased productivity provides additional growth that fuels the creation of jobs and wealth. It is indeed this economic dynamic that is emphasized by the European authorities, including the European Commission (see Buch-Hansen and Wigger, 2010; EC, 2011), just as it underpins American policy on subsidies for R&D (Ketels, 2007). The policy decision to support R&D and more generally investment in human capital can thus be based simply on economic logic.

Any policy that is intended to guide specialization involves society's future

Nevertheless, this logic is not enough: once we have accepted that investment in R&D is needed, then it is necessary to

decide how to ensure that public resources, which are scarce and whose opportunity cost is rising as debt mounts, are invested in the wisest way. The definition of industrial policy must be based on a set of political (and legal) guidelines that are precise enough to lead business to invest in technology whose returns are inherently uncertain. For example, companies do not spontaneously tend to invest in clean technologies. Incentives need to be created that induce them to adopt sustainable development pathways, as is shown by the results of Acemoglu et al. (2011).

In general, any policy that aims to guide specialization involves the future of society: directing the production process towards sustainable development and environmental protection is a decision that will ensure the sustainability of resources, the quality of life and technological innovation. Directing capital towards strategic technologies, such as biotechnology, nanotechnology or space, is a necessity in light of the heavy investments – the fixed costs – that are associated with their development, given that mastering these technologies is essential to society's future well-being. Finally, investing in human capital, a prerequisite to any policy to support R&D, is a way not only to improve people's living standards and quality of life and to qualitatively strengthen their ability to adapt to technological change, but also to ensure the strength and sustainability of democracy (Glaeser et al., 2007).

A commitment to a policy of support for investment in research and education is of course widely shared by political leaders, as it is a general feature of a progressive vision of society, or, in short, a certain vision of social welfare. And a package of measures to meet the objectives of a policy to support R&D in France does clearly exist: the research tax credit for the country's "competitive clusters"; in this respect, France is often seen as a driving force in terms of its industrial policies. But the purpose evoked to justify

these measures is to ensure competitiveness, and not specifically economic growth *per se*.

Nevertheless, the selection of promising technologies and investment in the specializations of the future demands that politics takes precedence, as it must take a stand on the technological future of society, including in matters of protection, security, health and the environment. Ultimately, even a free market industrial policy assumes political choices that correspond to a vision of society. And it is in the name of this social vision that the expenditure associated with industrial policy can be justified. The justifications related to the economic mechanisms set the constraints, but policy choices must set the goals. The expression of collective preferences during the forthcoming electoral processes requires that the technological implications of policy proposals be expressed as clearly as possible.

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"Buy French": From the slogan to the reality

By [Jean-Luc Gaffard](#), [Sarah Guillou](#), [Lionel Nesta](#)

The current election campaign is lending weight to simplistic proposals like the slogan "buy French", which evokes the need for France to re-industrialize. And to accomplish this, what could be simpler than to convince the population to buy native products designated with a special label? This is also more politically correct than advocating a straightforward return to protectionism. Employment is expected to benefit, along with the balance of trade. But if we look more closely, not only is it difficult to identify the geographical origin of products, but even if that were possible, any preference that these products might enjoy could well wind up in job losses.

This solution for dealing with the need for re-industrialization ultimately reflects a refusal to get to the bottom of the problem.

Can we really define what it means to “buy French”? Does it mean buying the products of French companies? What about buying products made in France by foreign companies instead of buying products made abroad by French companies? These simple questions show that it is not so easy to pin down what is “Made in France”. One major difficulty is that the final goods produced in a country usually incorporate intermediate goods manufactured abroad. It may even happen that the components of a final product are manufactured by a competitor in another country. The iPhone is emblematic of this [fragmentation](#). Should we refrain from purchasing intermediate goods from low-wage countries even though this makes it possible to produce final goods at a lower cost and boost exports by being more competitive on price? Those who think so should no longer be touting German industry as an example, since everyone knows about the growing share of imported inputs in the production of the final goods Germany exports (OECD, *Measuring Globalisation: OECD Economic Globalisation Indicators 2010*, p. 212).

Imagine, nevertheless, domestic consumers who are able to identify products with a high labour content and are ready to make sacrifices out of a spirit of economic patriotism. Don't the polls tell us that over two-thirds of consumers would be willing to pay more for French goods? While there are doubts about whether they would actually do this, it would be risky to ignore the opportunity cost of such a choice. Buying more expensive products simply because they are French reduces purchasing power. Other goods and services would not be purchased or would be bought for less abroad. The balance sheet for employment is far from certain.

Should this exercise in economic patriotism actually materialize, it would be a way that consumers form attachments

to certain types of products, in this case based on their place of manufacture, which would in turn reduce the intensity of competition. This could lead the companies concerned to cut back on their efforts to become more competitive on price and other factors. Why, indeed, should they shell out for expensive and risky investments when have a guaranteed customer base? It's a safe bet that they will not do this much, if at all. The national economy would then be locked in a low technology trap, doomed to slower growth, obviously with damaging consequences for employment in the medium and long term. This would also deprive the economy of the means to innovate and improve the competitiveness of its products.

Finally, it is likely that the willingness to buy French products would benefit products that replace goods made elsewhere in Europe rather than goods made in developing countries, either because the latter are no longer manufactured at all in France or because the price differences with French products would still be prohibitive. Ultimately it would not be possible to avoid further shifts in production to low-wage countries, with the consequent job losses. Furthermore, from a European perspective the non-cooperative character of this kind of measure could lead our European partners to adopt reciprocal measures, which would be detrimental to exports and employment.

The slogan "buy French" masks a refusal to see that the downturn is a global phenomenon which calls for a comprehensive response at the European level, and a refusal to consider a proactive industrial policy that takes into account the realities of supply as well as demand.

This is not just a matter of looking the other way. France is undergoing a deindustrialization process that threatens its capacity for growth. But who can deny that this phenomenon has accelerated with the crisis and that this acceleration is set to increase [as the general austerity measures and restrictions on bank credit further undermine domestic and European demand](#)

for consumer durables? Unless we are willing to accept that an entire segment of industry in France and elsewhere in Europe is destroyed, with no hope of ever returning, and with as a consequence still greater disparities between countries and sharper conflicts of interest, it is clearly urgent to support this kind of demand.

Is this kind of support “the solution”? Of course not: propping up demand will not be enough, as an industrial policy aimed at strengthening the supply side is also needed. The point is not to protect domestic production nor to promote the conquest of foreign markets through competition on taxation or social charges, but to stimulate investments designed to produce new goods and services, which is the only way to create stable jobs. Rather than try to rely on dubious slogans, the goal should be to consolidate production that has the advantage of being high quality in terms of design, safety and reliability, and which corresponds to what French and European consumers genuinely want.