The Transatlantic Divide

How the United States and Europe differ in economic policy.

BY SEBASTIAN DULLIEN

While globalization is perceived as a challenge both in the United States and in Europe, the policy debate in both regions differs widely with even the position of the right and left sometimes reversed.

Following standard stereotypes, it is clear that Americans are more pro-market than Europeans. Does not the old continent struggle with the consequences of its politicians continuously fiddling around with the free-market forces? According to the same clichés, part of the difference stems from the stronger leaning of Europeans towards the political left as the left worldwide usually pushes for stronger government interventions.

A closer look at current national policy debates reveals a much more nuanced picture. In some fields, such as free trade, it can even be argued that Europe is at the moment more free-market than America, with parts of the American left playing much more protectionist tunes than their European counterparts. And in other fields, the European left surprisingly takes positions which in the United States are today often associated with a certain breed of free-market Republicans.

While on both sides of the Atlantic challenges from globalization have been a dominant topic in economic policy debate, the reactions have been quite different. Both the European Union and the United States have experienced extremely strong growth

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in Chinese imports over the past years, with the respective bilateral trade balances with China deteriorating sharply. In both regions, stories about the offshoring of thousands of jobs have featured strongly in the national media. On both sides of the North Atlantic, a very small portion of the toys or apparel sold is still made at home.

However, it has been mainly American politicians who have started to blame the rest of the world for the domestic industries' problems. Not only is Democratic presidential hopeful Senator Hillary Clinton (NY) regularly referring to the American middle classes' fear of having their jobs shipped abroad, Senator Jim Webb (D-VA) stated in his reply to President George Bush's State of the Union address that it is the duty of the U.S. government to "to insist that [the American workers'] concerns be dealt with fairly in the international marketplace." The union-supported Economic Policy Institute even called for "a pause" in passing new trade agreements—something that would be unthinkable from a German union think tank. The U.S. Congress is now working on a number of broad trade and currency bills which again might threaten punitive tariffs against low-wage countries which actively manage their exchange rates.

In Europe, by contrast, there might be resistance to globalization as a symbol (as witnessed in the occasional tearing down of a McDonald's restaurant in France), or against foreign companies taking over domestic corporations and laying off parts of the workforce. However, resistance against foreign investment can also be witnessed in the United States, as seen in the current CFIUS (Committee on Foreign Investment in the United States) renewal following the Dubai Ports World incident. And when it comes to simple trade in goods or services, calls for policy intervention in Europe have been extremely rare. In Germany the long period of job losses after the 2001 recession gave rise to Hans-Werner Sinn's idea of the "Bazaar economy"—the claim that German industry was only expanding its export market share by outsourcing the production of intermediary inputs to low-cost countries while destroying jobs at home. There were never calls for restricting trade or even having other countries adjust their exchange rates. Instead, the debate focused on domestic policy reforms to cope better with globalization.

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The second surprising difference between the economic policy debate in Europe and the United States emerges when it comes to how agents from the different ends of the political spectrum position themselves with respect to public deficits and possible bubbles in asset markets. While in Europe, conservatives are the primary advocates of the reduction in government deficits, and the left is more willing to accept higher borrowing, the situation in the United States is reversed. Here, successive Republican White House aspirants have claimed that "deficits don't matter" and advocated tax cuts even at the expense of significantly increasing public deficits, while the Rubin Democrats have demanded austerity and more disciplined fiscal policy. In Europe, mainly conservatives warn against both an overly lax monetary policy and the encouragement of asset price bubbles, while in the United States it is a collection of left-of-the-center pundits who have been sounding alarms about bubbles in the real estate market. The *laissez-faire* officials in the Bush Administration, as well as the current and former Fed chairmen, have been much more benign towards possible asset market misalignments than their colleagues at the Frankfurt Euro-Tower.

Surely some part of these contrasts in the economic policy debates can be explained by differences in economic structure between the United States and most continental European economies. First, all European economies are much more open than the United States. While at first sight this might increase the fear of globalization, it seems to have the opposite effect. Workers employed in the export sector learn quite quickly how important foreign business is for the well-being of their company, and their own job and income. For the workers in the Mercedes factories in southern Germany, the rest of the world not only competes with their autos, but also helps secure those jobs in the first place with low-value production going to foreign markets.

In contrast, if European companies do not sell much abroad, it might be easier for managers to use globalization as both an excuse for results from bad management as well as a tool to put pressure on its workers. In this context, it is interesting to note that even within largely pro-trade Europe, the more open countries seem to be less prone to protectionism. France, perhaps the most protectionist country in Europe, actually is the second-least open country in the Eurozone (after Italy), with an import penetration of less than 25 percent.

A second factor helping the Europeans more easily accept globalization than the Americans is the more generous social safety net. Especially in the very open Scandinavian countries, workers are well-cushioned from trade-induced structural changes, but in Germany or France as well the social system provides some relief from the mishap of unemployment. Moreover, the stronger redistributive policies in continental Europe make even permanent losses in some professions due to international trade more bearable as their relative loss in social status and disposable income will often be far less than the initial loss in wages.

Europe's rather generous social safety net might be another reason why the political left in Europe is much less concerned about asset price bubbles than the left in the United States: As seen at the end of 2001, the bursting of bubbles can cause recessions and job losses, especially for the low-qualified as this group always loses out first in a labor market downturn. Since this group is relatively more protected in Europe, their representatives might not fear the consequences of a bursting bubble as much as their U.S. counterparts.

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Moreover, low-income workers in the United States might actually be hit harder by the popping of a bubble than those in Europe. A special feature of the macroeconomic imbalances and possible bubbles in the United States is the existence of the twin deficits in both the current account and the government budget. This lack of domestic savings makes the American economy very dependent on the import of foreign capital. Most scenarios of a correction of U.S. asset prices include a sharp devaluation of the U.S. dollar. This devaluation might well burden low-income earners disproportionally. In this group, a larger share of income is spent on food and manufactured goods, both of which can be expected to become more expensive as the dollar depreciates.

In Europe, in contrast, the possible bursting of a bubble (say in the real estate sector of Spain or Ireland) is not necessarily associated with a depreciation of the currency. The Eurozone's overall current account is almost balanced, and a decline in value of the euro in a magnitude as some believe possible for the greenback seems unrealistic. Moreover, a larger part of Europe's workers still work in the manufacturing sector. Any strong depreciation of the euro, while of course hurting the workers' purchasing power, would at the same time make their jobs more secure and might even provide for an increase in incomes as the profit situation of their companies improves, thus mitigating the initial loss in real income.

Finally, the difference in attitudes towards the government budget deficit between the political left and right on both sides of the Atlantic might be explained with the special political economy of tax increases in America. At least since George H.W. Bush lost the presidential election in 1992 after breaching his promise not to raise taxes, it is taken for granted that American voters punish tax increases. But there is little evidence of such a consistent large voter response to tax policy among Europeans. In the United States, a large fiscal deficit might be used to push through cuts in government expenditure, especially in social programs (exactly as advocated by some conservatives under the term "starve the beast"). In Europe, where citizens are actually keen on generous public spending, a structural budget deficit might at the end be filled by higher taxes without political recoil. Recent developments in Germany illustrate this. The grand coalition of Christian Democrats and Social Democrats hiked the national VAT rate by three percentage points with the larger part of the revenue being used to fill shortfalls in the budget, without structurally touching any expenditure or seeing significant response in the polls.

Not all of the transatlantic differences in responses to globalization can be attributed to structural differences between the economies. One additional reason seems to be the nature of the respective academic economic discourses. Americans seem to be more pragmatic in their dealing with basic principles in economics, for better or worse. German academic economists (who have shaped much of the European Union's approach to macroeconomic, trade, and competition issues) are still very much entrenched in the Erhard tradition of "Ordnungspolitik"—an approach that derives its policy conclusions from basic principles with rather less focus on empirical analysis. The U.S. policy discussion as a result is much more diverse, with a heavier focus on empirical evidence, than the European. The European economics debate sticks more to orthodoxy.

The recent debate on the minimum wage in Germany and the United States exemplifies this difference. In Germany, parts of the Social Democrats demanded the introduction of a legal minimum wage, with proposals ranging from €5.00 to €7.50 an hour. In the United States, Congress has voted to increase the legal minimum wage by 40 percent to $7.25 per hour. While a significant number of economists spoke out for the proposal in the United States, it is hard to find a single prominent German economist who would support introducing any legal minimum wage.

What is more, even the analysis of the consequences differed widely. In the United States, surveys among economists show that they believe on average that an increase in the minimum wage by 10 percent would cut employment in the low-earnings sector by perhaps one percent (which would translate into a labor demand elasticity of 0.1). In contrast, German economists claim that an increase of wages at the bottom of the wage distribution by 10 percent would cut employment by 10 to 20 percent (translating into a labor demand elasticity 10 to 20 times as high). While U.S. economists have produced a vast body of empirical literature on the effect of higher minimum wages to support their low estimates of the demand elasticity for low-wage labor, the German empirical evidence is thin and often fails to distinguish changes in macroeconomic environment and in the relevant wage variable.

The Deficit

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George H.W. Bush

The more diverse economic debate in the United States might have made it easier for politicians on both sides to deviate both from what is perceived as common knowledge as well as from their own ideological prejudices. For the left in America, the prospect of violating the accepted economic wisdom that all countries benefit from free trade thus might not seem to be as threatening as in Europe, especially now that they can more easily find at least some academics who show how some of their clientele might be better off with some kind of protectionism. And for the political right, deviations from the New Classical ideas of hands-off-approaches to the economy, both in macro stabilization as well as in agreeing to a higher minimum wage, might be more acceptable—at least if giving up basic principles pragmatically helps to respond to pressing problems such as a recession or the feeling of the average American of being left out of the economic expansion.

While this openness may lead to inconsistent policy and some resistance to globalization in the United States that is not found in Europe, it also has its benefits. After all, at least over the past two decades, the United States managed a much more impressive overall economic performance than Europe with its more open-minded policy approach, even with the occasional call for protectionism sprinkled in. ◆