1 Arguments for and against Policies to Promote National Champions

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Governments around the world, and particularly within the European Union, are deeply divided about the proper role of industrial policy, with preferences ranging from neoliberal approaches to strong government support for national champions. Some politicians argue that hands-off governance facilitates the sellout of national economies, while others suggest that interventionist governments only hurt themselves when creating huge and inefficient corporations. Some arguments are based on national interest that comes at the detriment of foreign interest, which would call for a transnational coordination and supervision of industrial policies that foster national champions. Others argue that the world as a whole may be better off if national industrial policies succeed in spurring innovative firms that increase productivity and spark economic growth worldwide. The chapters collected in this volume provide new perspectives on these issues and discuss the pros and cons of government support for national champions.

The issue of government support for national champions derives added momentum from the recent financial and economic crisis. In the aftermath of the failure of the large US-based bank Lehman Brothers, which hit the gobal financial sector and threatened the existence of other banks, many politicians were happy to justify the subsidization of large banks with reference to their system-relevant role in a tightly interweaved financial sector. Following the same rationale, politicians feared that the bankruptcy of firms in other sectors that are characterized by a dense network of input–output relations, such as automotives, might hurt national interests and initiate a bandwagon effect and hence cause further bankruptcies that affect the labor market.

Beyond the innovative contributions of each chapter, with this combined volume we aim to add to the existing literature in three distinct areas. First, most contributions in this volume take a European perspective, which involves issues emerging from the European Union's substantial market integration. The volume thus extends on collections on industrial policy that focus on the United States (Krugman 1986) or Japan (Itoh et al. 1991). Second, this volume primarily studies industrial policy for national champions with the rigor of economic models and thus complements more qualitative overviews such as Bianchi and Labory (2008) or Sekkat and Buigues (2009). Third, given the recent topicality of government bailouts, this volume chooses to explore the specific theme of promotion of national champions rather than the broader topics of industrial policy. Most arguments in favor of or against policies to foster national champions can be grouped under three types of models (see Gollier and Woessmann 2009 for a policy-oriented review): "classical" models that discuss market imperfections in static equilibrium, models that stress the dynamic nature of an economy characterized by constant change through innovation, and models that depict the political economy of the decision-making process. The contributions in this volume cover all three types of arguments. Given the multiple dimensions of the arguments, there is no single definition of what constitutes a "national champion," and we allow each chapter to put forward the most suitable operationalization in its particular context.

In the view of many observers, arguments in favor of champions-promoting policies are most persuasively made in a dynamic context, so we start our collection with three chapters taking a dynamic economy view. In reality, though, most champions-promoting policies may be best understood from a political-economy perspective, so we next turn to two chapters that stress the political-economy view. The final three chapters are in the more classical tradition suggesting that national champions could conceivably have emanated from deviations of perfectly competitive markets.

1.1 Analyses in Dynamic Settings

In chapter 2, Philippe Aghion revisits the traditional case for protecting "infant industries." In such a setting the argument involves learning-by-doing effects that lead to downward-sloping cost curves, and government intervention at the industry's birth can be justified as a mean of speeding up production externalities. Government intervention could take the form of subsidizing or protecting national production. Aghion suggests an innovation-based model of economic growth to depict the effects of protection on domestic innovation and growth in such a setting. In his model, industrial policy is beneficial only in "extreme" situations, namely by offering temporary protection in small countries that are behind the global technology frontier and by targeted intervention in industrial niches.

In chapter 3, Kathy Fogel, Randall Morck, and Bernard Yeung analyze the dynamic effects of national champions and estimate the association between national champions and economic growth in standard cross-country growth regressions. They build on their previous research (Fogel, Morck, and Yeung 2008), which supports the Schumpeterian concept of creative destruction, in that higher turnover in a country's group of biggest businesses is associated with higher macroeconomic growth. In their analysis, they estimate the association between the turnover in corporate control of a country's big business and economic growth. They find no statistically significant association here and speculate that one possible explanation might be that control turnover is among the increasingly entrenched insiders who obtain corporate power.

In chapter 4, Cécile Aubert, Oliver Falck, and Stephan Heblich provide an evolutionary perspective on the effects of subsidizing national champions. Focusing on the role of locally bound spillovers, they consider national champions at different stages of the industry life cycle and show that it may be efficient for governments to subsidize innovative firms in their early stages and to protect mature firms from competition. In reality, however, they suggest that politicians may tend to concentrate on externalities at the mature stage of the lifecycle, which are either transitory or come at the expense of foreign-country consumers. This leads us to what, in a positive rather than normative sense, may be more powerful explanations of the emergence of policies that foster national champions: political-economy arguments.

1.2 Political-Economy Analyses

The next two chapters turn to examples of what Aghion in chapter 2 refers to as "the powerful political economy counterargument(s)" against policies to protect national champions.

In chapter 5, Massimo Motta and Michele Ruta approach the topic of national champions from the perspective of determinants of merger policy in globalized markets. They argue that arguments that assume benevolent national governments "are probably not the most useful in understanding governments' attitudes toward mergers." In their view, to be able to understand real-world merger policy, such economic arguments rather have to be accompanied by political-economy arguments. The authors point out that, first, depending on the location of the firms (home or abroad), mergers have different effects on consumers, merging firms, and nonmerging competitors; second, even though antitrust decisions can be delegated to independent authorities, governments still exert some influence on merger policy; and third, some groups in society are politically better organized than others to pursue their interest. As a consequence, as long as national governments are politically motivated, they will succumb to lobbying by domestic firms.

The general point that lobbying can lead to policies supporting "champions" with inefficient production is well established by now. But how exactly do such mechanisms work, and what kind of inefficiencies can emerge in practice? In chapter 6, Paul Seabright revisits the Airbus case—perhaps the most frequently mentioned European "champion" (see also Neven and Seabright 1995)—arguing that politically sponsored firms in safety-critical industries may be particularly prone to delivery delays. In a simple model of team production, he shows that the extent of this problem is greater, the more safety-critical the industry. This behavior is in direct contrast to that of profit-maximizing firms, which generally exert a great deal of effort to produce well in advance of deadlines in order to ensure that the occurrence of unexpected problems will not jeopardize the deadline. Politically sponsored firms will typically be less motivated to meet production deadlines because they generally receive a smaller proportion of the rents arising from meeting the deadlines. The ensuing delivery delays can be viewed as a "hidden cost" of the political sponsorship of industrial "champions."

1.3 Analyses in Static Settings

The "classical" argument in favor of policies to promote national champions comes from strategic trade theory. As Brander and Spencer (1985) have shown, policies to promote national champions are "efficient" from a national perspective if—because of increasing returns to scale—the domestic firm can extract monopoly rents on the foreign market, as long as national governments do not take into account the welfare of foreign residents. Thus, governments acting on behalf of their respective citizens should promote competition at home, but encourage monopolies of their national firms abroad. This type of beggar-thy-neighbor policies may be viewed as the basic argument in favor of promoting national champions.

In chapter 7, Christian Gollier and Bruno Jullien take up this strategic trade theory argument, placing it in a situation of inefficient financial markets. Under the assumption that inefficient financial markets create credit rationing, national firms are inhibited from exploiting their competitive advantage abroad. In this view, encouraging monopolies both abroad and in the home market may be "efficient" because it enables firms to self-finance their expansion abroad. In the tradition of static-economy arguments, policies to promote national champions based on such mechanisms are welfare maximizing from a national perspective but not from a global perspective. They create the usual prisoner's dilemma situation where in equilibrium, each national government will subsidize national firms, most of which are bound to fail to emerge as global champions.

In chapter 8, Sara Biancini models another type of noncompetitive market: national champions that arise from formerly public monopolies. With the liberalization of formerly monopolistic industries, sector-specific regulation is implemented to facilitate market entry and reduce the strategic advantage of the formerly public monopolies. This way regulation of the former monopolist turns into regulation of the "national champion" that deals in international markets. In a model with two firms and two regulators, Biancini shows that market integration can be welfare reducing because of its impact on the budget constraint of regulated firms. In her model, cooperation among regulators is a way to avoid globally suboptimal policies in which countries are willing to pay transfers to inefficient national producers.

In chapter 9, Jens Suedekum develops a model of Bertrand competition with economic patriotism. In his model there are two domestic firms and one foreign firm, and all compete in the domestic market. To model the implications of economic patriotism when it comes to a choice between creating a national champion and accepting a foreign takeover, Suedekum provides a scenario where there can either be a national merger that creates a national champion or a takeover of one of the national firms by the potentially more efficient foreign rival. A welfare-maximizing domestic competition agency is charged with approving any change in the ownership structure. In the model, decreasing transport costs make the foreign takeover more likely when the government is unbiased by economic patriotism. However, when the domestic government is biased by economic patriotism, promotion of the national champion is more likely.

1.4 Some Synoptic Observations

The chapters of this volume shed light on important new aspects of the question of whether governments should try to promote national champions. The richness of the different static, dynamic, and political-economy models provides a much more in-depth understanding of industrial policy than any individual model could. What becomes clear from the different perspectives, though, is that it is not easy to make a general case in favor of policies that promote national champions on purely economic grounds.

While several deviations from perfectly competitive markets can make champions-promoting policies "efficient" from a national point of view, such static-equilibrium considerations tend to be inefficient when taking the perspective of global welfare. In other words, international cooperation would make welfare-maximizing governments refrain from champions-promoting policies. There are more obvious arguments in favor of champions-promoting policies in dynamic models that advertise the infant industry argument, but it becomes clear that these are very special cases whose existence has to be doubted in the majority of real-world situations. The little empirical evidence that exists on the matter tends to suggest that, if anything, entry barriers and state control, including attempts to defend national champions, tend to reduce rather than spur technological catch-up and economic growth (Nicoletti and Scarpetta 2003), as does the stability that "champions"-promoting policies tend to provide to big business.

Real-world policies promoting national champions seem much more readily understandable in political-economy terms than in economic-efficiency terms. Governments may be inclined to succumb to the lobbying pressure of leveraged interests as long as the constituency of those who are paying for it is more dispersed. What is worse, political-economy arguments may suggest that what Aghion terms the "commonsense" approach to industrial policy, namely "experiment and then make sure you can stop the intervention if it turns out not to be efficient," may not be viable after all: if the main reason for champions-promoting policies to exist in the first place is that governments are subject to political pressure from vested interests, then stopping such policies may prove infeasible, be they efficient or not.

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