Senior European Experts

The EU and "Economic Nationalism"

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"We are seeing… the return of protectionism not just in Asia and in Latin America, but in Europe and America."

Chancellor of the Exchequer, Mansion House, 21 June 2006

"Defending national champions in the short-term, usually ends up relegating them to the second division in the long-term."

Jose Manuel Barroso, 31 March 2006

Background

The Italian energy company Enel has a habit of playing walk-on parts in European history. A dispute over an unpaid Enel gas bill led to a critical European Court of Justice ruling on the primacy of European over national law in 1964 (Costa v. Enel); forty years later in 2006 it was a hostile bid for a French energy giant that put Enel in the centre of the European stage once again. The action of Enel in seeking to takeover the Suez Company was not surprising; the reaction of the French Government did cause surprise. The decision by Prime Minister de Villepin of France to engineer a merger between Suez and the state-owned Gaz de France and to announce the subsequent deal from his official residence, dramatically highlighted the return to economic nationalism in parts of Europe.

Commentators have said that the "spectre of protectionism" is once again haunting Europe, as governments frightened by the rise in cross-border takeovers and mergers and faced by stubbornly high levels of unemployment have sought to protect high profile national companies and to promote national "champions". Although France is often singled out for criticism, there have been examples in countries as diverse as Spain, Germany and Poland. This national interference in the Single Market has galvanized the European Commission and its president Mr Barroso. This paper looks at some of the cases that have raised issues of protectionism, examines why this apparent regression to past bad practice is under way and looks at the robust response of the European Commission to this phenomenon.

The Return of Economic Nationalism

A brief survey of some of the major examples of company takeovers and mergers that have prompted national intervention shows the extent of the problem:

France

The Suez/Gaz de France merger announced in February 2006 was a response to a threatened takeover by Enel but it was not the first time the French Government had intervened in a possible takeover. The alleged plans by the US food company PepsiCo to takeover Danone (a French food business that owns Evian mineral water) in the summer of 2005 led to a political controversy in France with both the President and the Prime Minister denouncing the idea. Critics saw this as a mixture of anti-Americanism and protectionism, motivated by fears of job losses and national pride while defenders of the French Government's approach accused PepsiCo of hostility to trade unions. In the event, there was no PepsiCo takeover.

President Chirac opposed "as a matter of principle" the proposed merger of the New York Stock Exchange with the Euronext stock exchange in June 2006. Earlier, the French Government had joined with those of Luxembourg and Spain in expressing concern about the possible takeover of steel firm Arcelor by rival Mittal (it subsequently went through). France passed a law designed to protect 11 "security-related" sectors of the economy (but which includes casinos and private security firms) from takeovers and implemented the EU takeover directive in French law in a way that allows a form of defence to takeover bids designed to frustrate them.

Italy

Although the Italian industry minister cancelled a meeting with his French counterpart in protest at the Suez/Gaz de France merger, Italy has itself frustrated attempts by European rivals to takeover Italian companies. The central bank intervened to try to prevent the Banca Antonveneta and Banca del Lavoro (BNL) being takeover by a Dutch bank (ABN AMRO) and a Spanish bank (Banco Bilbao Vizcaya Argentaria, BBVA); in the event ABN AMRO succeeded in its bid.

Spain

The attempted takeover of the Spanish gas utility Endesa SA by the German electricity and gas company E.ON in February 2006 provoked controversy in Spain, where the Government was trying to merge Endesa with another Spanish gas business, Gas Natural, to create a "national champion". Emergency legislation was passed to prevent E.ON from taking over Endesa SA.

Poland

Economic nationalism is not only seen in the "old Europe" of the West. Despite the Polish and EU authorities approving of a merger between the second and third largest banks in Poland – both of them owned by banks in other EU countries – the Polish Government opposed the deal. The deal eventually went ahead but the Polish Government had objected because it feared a loss of jobs as result of the merger and because it argued that the new institution would reduce competition.

Germany

Germany still has a 1960 law which prevents any shareholder from acquiring more than 20 per cent of the voting rights of the carmaker Volkswagen, and which gives federal and regional governments seats on VW's supervisory board, despite this having been ruled a breach of the EU's competition laws by the Commission. The structure of German companies makes foreign takeovers generally quite difficult.

A Return to Past Sins?

There is no single explanation for the apparently sudden revival in economic nationalism in Europe over the last two years. Europe has of course been here before; the possibility of a return to the era of "national champions" and the reduction in competition and market efficiency that results, is why the EU has strict competition rules under the Treaty of Rome.

Commentators have several explanations for the revival of protectionism. These include the very high level of cross-border mergers and takeovers in the EU. Cheap credit and strong profits in 2004 triggered a boom in takeovers in 2005, the value of deals almost reaching €1 trillion in Europe. Many cross-border takeovers took place without much fuss but a few became politically controversial.

Increasing public fear of the perceived adverse consequences of globalisation undoubtedly influenced politicians in some countries. The defeat of the European Constitutional Treaty in France in 2005 partly resulted from a feeling that French social protection measures were threatened by the EU. It was easy for those opposed to the takeover of French firms to play the same card and claim that foreign companies would not respect the rights of French workers.

France has a long tradition of suspicion of free trade and of state intervention in the economy. Sometimes called "Colbertism", after Louis XIV's Minister of Finance, Baptiste Colbert, who opposed free trade and pioneered state intervention in the economy, protectionism and state ownership have periodically been revived as a feature of French government policy. Despite the influence of the EU's single market, the state still has significant economic assets under its partial or full control. These include a stake in Renault and the ownership of France Telecom and of the nuclear electricity industry. Critics inside France as well as outside have accused the French Prime Minister Dominique de Villepin of wanting to revive this tradition of protectionism.

In Germany, the takeover of Mannesmann by Vodafone in 2000 caused considerable anxiety and made German politicians sensitive to foreign takeovers of large firms. The former German Chancellor, Gerhard Schroeder, sat on VW's supervisory board for eight years so it is not surprising that he fought to protect the company against foreign takeovers (US equity firms have acquired about 16 per cent of VW over the years) and defended the 1960 law.

Both the EU and the US have experienced a substantial loss of jobs in manufacturing; in recent years this has been particularly associated with companies moving their manufacturing plants to Eastern Europe, India, China and the Far East. Although a recovery may be under way in the eurozone, the decline in the number of manufacturing jobs in Europe is likely to continue.

The failure to convince people in the EU 15 of the merits of enlargement before May 2004 may have added to the problem. The sense of being under siege from all sides, with low-wage workers from the accession states on the one hand and job losses as both manufacturing and service jobs move offshore, has increased voter fears about job insecurity.

The EU's Response

The European Commission, as the defender of the single market, has not been slow to react to the growing signs of protectionism and state intervention. On 8 March 2006 the Commission announced that it had concluded that Poland's actions in respect of the banking merger were a violation of the EU's Merger Regulation and it started infringement procedure against Poland.

At the Strasbourg plenary session of the European Parliament on 15 March 2006, the Commission issued a declaration on company mergers and takeovers. "Europe thrives by taking down barriers between Members States, not by erecting them", the Commission said. It went on to add that "open and competitive markets are key drivers for jobs and growth in Europe". The Commission said that it would "always look with concern" at state intervention in cross-border corporate restructuring and that it would continue to make its enforcement role a priority. The Commission's declaration was an unusual step and a signal that although it would look case-by-case at each merger or state intervention, its general determination to maintain the single market as an area for the free movement of capital (as required by the Treaty) was made very clear.

The Commission is now pursuing two particular aspects of competition law: the use of so-called "golden shares" by governments to prevent foreign takeovers; and at drawing up a standard set of criteria for bank takeovers so that central banks cannot in future frustrate legitimate overseas business buying domestic banks. The Commission has ordered France to change the law that protects certain sectors from foreign takeovers on the grounds of the strategic and security importance. The Commission said that parts of the law are a violation of the free movement of capital and the right of establishment.

In specific cases that have attracted concern, such as the Gaz de France and Suez merger, the Commission has launched an investigation on the grounds that initial inquiries show that competition could be affected by the proposed merger. This is the first stage of a process that could see the merger prevented. An indirect benefit of the French Government's action has been to transfer Gaz de France from state to private ownership.

The Commission approved the takeover of Endesa by E.ON, and formally told the Spanish Government that it had acted illegally in blocking the deal. As a result the Spanish Government indicated it would back down. The Spanish Industry Minister accepted the authority of the Commission in cross-border competition questions but because Spain has not promptly withdrawn the conditions it placed on the E.ON takeover of Endesa, the Commission has started proceedings against the Spanish Government.

Germany has already been taken to the European Court of Justice over the Volkswagen law and it is expected that the Court will rule against Germany in its judgment next year.

The Commission has shown by its robust action that it will not accept the return of economic nationalism without a fight. In so doing the Commission is demonstrating not

only its commitment to the rule of law in the EU but also the essential role of the Commission as the defender of competition and choice in the single market.

The events of the last two years have shown the limits of economic nationalism. Most of the contentious takeovers – such as Mittal and Arcelor and the banking deals in Poland and in Italy – have gone ahead. Although there maybe setbacks from time to time, attempts at economic nationalism have not succeeded because the Single Market is mature enough to deal with this challenge and in doing so has demonstrated one of its most important benefits.

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Senior European Experts

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