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Europe: Rising Economic Nationalism?

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Summary

Several members of the European Union (EU) over the past year have been erecting barriers to cross-border mergers and acquisitions, possibly in violation of their Single Market commitments. The main focus of these anti-competitive actions, often dubbed economic nationalism or economic patriotism by the press, is on corporate control, particularly in the banking, steel, and energy sectors. Unlike in the 1980s, when the main opposition to creation of the Single Market for goods, capital, labor, and services came from companies resistant to being exposed to more international competition, the main opposition to liberalization today comes from some member state governments (and or politicians) fearful of losing national prestige and jobs as a result of merger activity. This report examines the nature and significance of rising economic nationalism, as well as how U.S. interests may be affected. The report will be updated as events warrant.

The Single Market

Today's European Union had its beginnings in 1957 with the creation of the European Economic Community (EEC). The economic core of the EEC called for the free movement of goods, capital, services, and people among its original members — France, Germany, Italy, Belgium, the Netherlands, and Luxembourg.[1] During its first two decades, considerable progress was made in eliminating tariffs and quotas on trade in goods among its members. Much less progress was made in freeing up the movement of services, capital, and people. For example, service sectors such as telecommunications, rail transport, banking, and medicine remained largely divided along national lines. Trips from one country to another required frequent passport checks, changes of money, and customs inspections, slowing commerce and travel considerably. Member states also maintained controls on capital flows as tools of national economic policy.[2]

[1] The EEC later became simply the European Community (EC) and even later the European Union. For discussion of the evolution of the EU, see CRS Report RS21372, *The European Union: Questions and Answers*, by Kristin Archick.

[2] John Van Oudenaren. *Uniting Europe, An Introduction to the European Union*, Rowman &
(continued...)

In support of the creation of a single European market where goods, services, capital and people could cross borders freely, member states enacted in 1987 the Single European Act (SEA), which made completion by 1992 of an open and free European market a top priority. To facilitate achieving this objective, the member states agreed to pass single market legislation by a qualified majority rather than by a unanimous vote. While substantial progress was achieved by 1992, the process is still on-going.[3]

For the EU to overcome remaining barriers, it is necessary for the European Commission in Brussels to propose EU-level directives (or laws). These directives, in turn, have to be adopted by the Council of Ministers and implemented in a non-discriminatory fashion by each member state. Through this cumbersome and complicated legislative process, directives governing the free movement of capital, labor, and services have taken more than a decade to be crafted and implemented. In terms of capital market liberalization, the directives affecting mergers and takeovers were substantially watered down, resulting in limited market liberalization.

Barriers to Cross-Border Mergers

Since the summer of 2005, a number of EU member states have erected barriers to prevent cross-border mergers and acquisitions that undermine the effort to deepen the single market. These include new anti-takeover laws, politically engineered corporate mergers of domestic firms, and populist appeals to national security or economic patriotism. Some in the media and representatives of the European Commission in Brussels have claimed that these actions are evidence of resurgent economic nationalism in Europe. The most prominent and recent of these actions occurred in:

- **France:** the government orchestrated a quick merger of two utilities, publicly traded Suez SA, a French utility, and state-controlled Gaz de France (GDF), to fend off a potential takeover by Enel of Italy; passed a new decree giving the government the right to veto or impose conditions on foreign takeovers in 11 "sensitive" sectors; and expressed concerns about the prospect that PepsiCo was interested in buying the French yogurt giant, Groupe Danone. Most recently, in June 2006 French President Jacques Chirac stated that as a "matter of principle" he was against the proposed merger of the New York and Euronext stock exchanges.[4]

- **Italy:** Italian politicians from both major political coalitions advocated blocking French bids for Italian companies in retaliation for France's treatment of Enel; and Italy's Central Bank blocked the acquisition of various Italian banks by European rivals;

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[2] (...continued)
Littlefield, 2005, pp 119-120.

[3] Ibid., p. 130.

[4] Jenny Anderson and Heather Timmons, "NYSE's Coup Stirs Political Opposition in Europe," *New York Times,* June 15, 2006.

- **Spain:** The Spanish government is attempting to prevent a hostile takeover of its gas utility **Endesa SA** by the German electricity and gas utility **E. On A,** and has stated that Madrid will do everything in its power to ensure that Spain's energy companies remain Spanish;

- **Poland:** In order to protect the dominant position of a state-owned bank, Poland attempted to block the merger of two Polish subsidiaries of the Italian bank UniCredit and the German bank HVB;[5]

- **Luxembourg:** Together with France, Luxembourg endeavored to block Mittal, an Indian steel maker, from a takeover of the European conglomerate Arcelor — a company formed in 2002 from three European firms based in Luxembourg, Spain, and France; and

- **Germany:** The government has clashed with the European Commission over 'Volkswagen Law', which protects Volkswagen from hostile bids.

European Commission Reaction

Actions that discourage foreign companies from bidding for firms which are regarded as strategic or national champions present the EU with a significant challenge in its efforts to enforce the principle of the free movement of capital.[6] Several EU officials have weighed into the public debate to warn about the dangers of resurgent economic nationalism in certain member states. EU Competition Commissioner Neelie Kroes threatened to break up the EU energy giants in order to open the market for greater competition, while Internal Market Commissioner Charlie McCreevy said he refused to turn a blind eye to recent moves to defend national champions from foreign takeovers. While neither questioned the principle of the mergers, both warned that protectionism in principle and in practice was contrary to community law. Commission President Jose Manuel Barroso has gone further by arguing that "no member state, even the biggest member state, can go it alone. Economic nationalism was never the solution and is even less so today."[7]

In the spring of 2006, the Commission initiated a number of actions to counter the rise of economic nationalism. These included a request to the European Court of Justice to rule on Poland's attempt to block an Italian lender from acquiring a stake in a Polish bank; a request to the Italian government to comply with a June 2005 ruling by the European court on investment in Italian energy companies; a similar request to the Spanish government to comply with the court's ruling over similar restrictions on foreign

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[5] *Financial Times,* "Do not browbeat your central bank, Warsaw," March 20, 2006.

[6] The free flow of capital is a right under Article 56 of the Rome Treaty, but the right is subject to limited exceptions. These exceptions are listed in Article 58 (measures to protect public order and public security) and in Article 296 (measures to protect national defense).

[7] White, Aoife. "EU's Barroso calls on EU leaders to shun nationalism, boost economy, Associated Press Newswires, March 21, 2006.

investment in Spanish energy companies, and a request to France to justify its 2005 foreign investment decree affecting foreign investment in strategic sectors.[8]

In reality, EU regulators lack sufficient powers to force countries to abide by various treaties intended to encourage competition and a single European market. The current EU merger regulation, for example, leaves primarily to national regulators responsibility to oversee national acquisitions. The takeover directive contains exemptions and leeway for member states to adopt various kinds of anti-takeover defenses.[9] Filing lawsuits against rule-breaking member states in the European Court of Justice in Luxembourg can take years to resolve and may not guarantee results that are consistent with a single market.[10] In addition, when the European Commission files lawsuits against member states in the European Court, it risks igniting nationalistic or anti-Brussels sympathies.[11]

Significance of Resurgent Economic Nationalism

There are at least two perspectives on the significance of the resurgence of economic nationalism. One view, which is more optimistic, interprets the resurgence as a reflection of how far the single market today has advanced, particularly as the blocking of mergers remains one of the few areas left for national authorities to play an interventionist role in a world where markets are increasingly global. A second view, which is more pessimistic, interprets the resurgence as part of larger pressures and developments that have put support for trade liberalization, as well as support for a strong Europe, on the defensive.

Optimistic Perspective. This view sees the rise of government interventions primarily as a sign of how far liberalization of markets and the single market have advanced. As Europe-wide obligations have increasingly narrowed the scope for national authorities to impose barriers on intra-EU trade in goods, services, and people, issues of corporate control are viewed as one last area where national authorities still wield some power.[12] Thus, it can be argued that recent actions to stop foreign takeovers represent the end of the battle, not the beginning.

Unlike in the 1980s when the main opposition to the creation of a Single Market came from companies resistant to being exposed to more international competition, the main opposition today comes from national governments and politicians fearful of losing national prestige and jobs as a result of merger activity. From this perspective, with many of the larger and older members of the EU experiencing high unemployment and

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[8] *Oxford Analytica Daily Brief,* "European Union: Commission Pries Open Energy Sector," April 18, 2006.

[9] *Oxford Analytica Daily Brief,* "European Union: Diluted takeover law set for approval." December 4, 2003.

[10] Jacoby, Mary. "EU Regulators Toil to Keep Member Markets Open," *Wall Street Journal,* March 9, 2006.

[11] *Oxford Analytica Daily Brief,* European Union: Nationalist Response to liberalisation," March 8, 2006.

[12] Jacoby, Mary. "EU's Kroes Rejects Talk Of Protectionist Battle," *Wall Street Journal,* March 30, 2006.

slow growth, a backlash against policy changes that encourage more competition and corporate restructuring should not be unexpected. These observers maintain that as firms begin to develop Europe-wide ambitions, especially in three fragmented industries — telecommunications, banking, and energy — the momentum behind EU liberalization policy will further erode the capacity and willingness of governments to pursue economically nationalistic policies.[13]

It is also emphasized that the resurgence of economic nationalism has emerged while Europe is experiencing a wave of mergers. The value of cross-border mergers involving EU-based firms as bidder and target in 2005 was the highest since the 1999-2000 Internet boom. Whatever the tendency towards protectionism, the vast majority of merger activity evidently is taking place without much public or political controversy.[14]

The optimistic view asserts that even some of the controversial mergers are being settled in a manner consistent with free market principles. Despite the early objections of the governments of Luxembourg and France, Mittal and Arcelor agreed in June 2006 to a merger creating the world's largest steel group. This outcome was trumpeted by the Financial Times as a "victory over economic protectionism or "patriotism" peddled by some continental European politicians."[15]

Pessimistic Perspective. An alternative and more pessimistic perspective holds that anti-merger actions are symptomatic of a deeper process where progress on economic integration and completing the Single Market is slowing down. These actions are viewed not only as at odds with the EU's founding principles of a common market that binds the countries together, but also raise doubts over whether some member states have a different vision of Europe, where national interests take precedence over European interests.

Some data do show that progress on implementing the Single Market is slowing. While many of the newer members are implementing Single Market directives in an exemplary manner, some of the older members are lagging in this regard. Beyond implementation lapses, there is plenty of scope for member states to shirk EU-wide obligations, as an increasing number of infringement cases seems to suggest. Moreover, in difficult economic times, the temptation for some governments to go down the nationalistic path seems to be increasing rather than decreasing.[16]

Intertwined with the upsurge in economic nationalism is the notion that the nationality of ownership matters. Thus the merger of two French or Polish firms is acceptable but the takeover of a French or Polish firm by an Italian or German firm is not. While this notion may not contradict EU law or obligations per se, it certainly contradicts the spirit. The EU embodies the notion that countries are better off when they share sovereignty and that nationality should not matter in the single market. But some

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[13] *Oxford Analytica Daily Brief,* March 8, 2006.

[14] *Oxford Analytica Daily Brief,* "European Union: M&A recovering despite protectionism," September 16, 2005.

[15] *Financial Times,* "Mittal-Europa steel," June 27, 2006, p. 14.

[16] *Oxford Analytica Daily Brief,* March 8, 2006.

countries or populist political leaders now appear more determined to defend sovereignty than cede powers to Europe.[17]

The Commission has long had to battle member states on such issues. But it has become less willing to do so recently after voters in France and the Netherlands last year rejected a common EU constitution casting doubt on French and Dutch willingness to accept direction from EU institutions in Brussels. Accordingly, some observers maintain that member states are ganging up on Brussels because it has lost some of its legitimacy.[18]

Although protectionism has always been present in the EU, commentators assert that what makes today's developments most striking is the way some governments — particularly France and Poland — present it in a positive light without even mentioning EU treaty obligations. As Dominique de Villepin, France's Prime Minister, stated in July 2005: "When the world is changing, it is a question of gathering our strengths... and defending France and other things French." Lech Kaczynski, the populist Polish president, put it even more bluntly by stating that "What interests the Poles is the future of Poland and not that of the EU."[19] A number of polls show that the general public is becoming more skeptical about Europe as well.

Impact on U.S. Interests

The United States and the EU share a huge and mutually beneficial economic partnership. As the largest bilateral trade and investment relationship in the world, actions by either economic superpower can have important economic and political repercussions not only for each other, but also the rest of the world.

If anti-foreign merger actions escalate in Europe, the United States could have a number of concerns. Perhaps most importantly, resurgent protectionism could aggravate Europe's economic problems and lead to lower economic growth rates. In the process, U.S. exports to and investments in Europe could be curtailed.

Resurgent economic nationalism that discriminates against U.S. companies could also provoke the United States, as well as other countries, to retaliate in response. Such a reaction could undermine the mutual economic benefits, including millions of jobs, that are derived from the robust two-way flow of foreign trade and investment. It could also hurt EU efforts to play a constructive foreign policy role, particularly in calling on other countries to open their markets and in bringing the Doha Round of multilateral trade negotiations to a successful conclusion.

While these are all legitimate concerns, the EU's market opening activities still appear more powerful than the limited anti-merger actions of some governments. On balance, these anti-merger actions have had limited economic and political effects to date.

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[17] *Economist*, "Charlemagne: The nationalist resurgence," March 4, 2006; and Dempsey, Judy "New Polish Chief a Skeptic on Integrated Europe," *New York Times*, March 9, 2006.

[18] Jacoby, Mary. "EU Moves to Enforce Market Rules," *Wall Street Journal,* May 5, 2006.

[19] Parker, George. "Barbed response: how Europe could be rent asunder by barricades to business," *Financial Times*, March 22, 2006.