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Europe's New Protectionism

A former policy insider outlines the disturbing trend.

BY STEFAN SCHÖNBERG

The French against the Italians, the Spaniards against the Germans, the Poles against the Italians, Luxemburg against a Netherlands-based company, and in between the EU Commission. Europe is experiencing a wave of merger initiatives, and, at the same time, a wave of state intervention against market-driven, cross-border takeover bids. For example:

- French and Luxemburg government resistance against the hostile takeover bid by Mittal Steel, the world's largest steelmaker, on behalf of its French/Luxembourg rival Arcelor;
- The Spanish government's attempts to prevent a takeover of the Spanish electricity company Endesa by its German competitor Eon;
- A hastily arranged marriage between the two energy companies Gaz de France and Suez, initiated by the French authorities in order to prevent a takeover of Suez by the Italian energy concern Enel;
- A political storm in Poland concerning the merger of the two banks BPH and Pekao, owned by UniCredit of Italy, and the growing market-share of foreign-owned commercial banks in the domestic banking market.

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Whether such walling-off attempts risk "an August 1914 effect," as the Italian economics minister Giulio Tremonti warns, is rather doubtful. But revived protectionism, particularly in the energy sector, and the promotion of "national champions" could potentially spread by epidemic proportions—becoming sort of an economic bird flu in Europe.

Whereas the Mittal bid was characterized by its opponents as "a symbol of globalization against a symbol of Europeanization," the resistance against the subsequent intra-European takeover offers exposes the deep-seated distrust on the part of European governments of the rules of the European single market and the oversight role of the European institutions. This development is particularly irritating because, in contrast to past practice, governments are not afraid of deliberately projecting the image of acting in an anti-market, protectionist manner. Under the label "economic patriotism" ad hoc legislation is being prepared on the national level allowing national authorities to veto or impose conditions on foreign takeovers of "strategic assets," facilitating the dispersion of "poison pills" by companies trying to thwart unwelcome takeover bids, or prohibiting mergers with foreign companies (partially) those owned by their governments. France has announced that it intends to protect by law eleven "strategic sectors" against foreign investors, prompting EU internal market commissioner Charlie McCreevy to warn of creating a new Maginot line. The head of the Luxembourg government, Jean-Claude Juncker, on his part, is questioning hostile takeovers as an instrument for corporate restructuring in the European Union altogether.

What is behind the wave of neo-protectionism and economic nationalism?

The natural suspicion that government involvement merely represents the usual tendency of companies which are afraid of being exposed to stronger competition to mobilize public support for their purposes comes up too short as an explanation. Also, governments should know better than what they proclaim publicly, namely that "national champions" provide more reliability in the services of utility companies or in the supply of banking services, and contribute to more competition in the markets. Empirical evidence suggests the opposite.

More than anything else, government intervention in national energy, steel, banking, and other markets rather reflects the wish to control the forces of markets and globalization, seen as threats by many Europeans, and a reawakened belief in national solutions.

The distrust in industrial restructuring through market forces is based on the conviction that nationality of company ownership matters, and that governments become stakeholders when self-appointed "national champions" are affected or when a major corporate reorganization results in layoffs. Particularly in the continental European countries, governments continue to be preoccupied with preserving jobs instead of creating new ones. The self-imposed political paradigm that globalization needs to be "shaped" and the so-called European Social Model preserved results in holding up reforms and structural adjustment. This, in turn, means sacrificing productivity gains and hence welfare gains.

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Impenetrable Yet Ineffective

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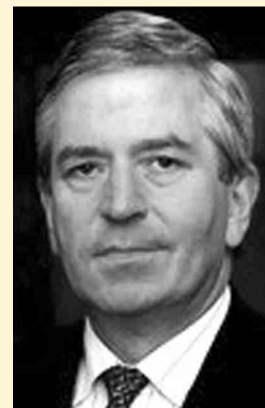

Charlie McCreevy

Such reservations apply irrespective of potential benefits government-sponsored mergers may yield. Even if there were short-term advantages for individual companies or branches, their consequences are rarely beneficial for consumers and the economy as a whole. And they would soon be wiped out because protectionism deters other investors and invites countermeasures by other countries, including other EU members. Also, neither the experience that a number of market-driven mergers turned out to yield only dubious economic benefits, nor the fact that some countries are attracting more direct investment than others, qualifies as an excuse for state intervention. It is the shareholders' duty to decide on mergers.

Brussels has failed to discourage the impression that it just might like to see "national champions" being substituted by "European champions."

However damaging economically, in many countries the interventionist approach finds support from a majority of workers and consumers who are lead by their governments to believe that state intervention can shield them against cuts in social standards, competition from low-cost countries, and unemployment.

While convinced European integrationists put their faith in corrective action to be taken by the European institutions, market-optimists trust that market forces will ultimately prevail. Both sides may become disappointed in the end.

The EU Commission has reacted forcefully to the growing protectionistic behavior of some EU member states, pointing to the need to respect the EU treaties and the principles of the European single market. A warning to Madrid concerning the Spanish government's attempts to halt the Endesa takeover was followed by Commission challenges to similar protectionist moves in France and Poland.

In principle, the Commission can intervene against restrictions to market access by national governments on two levels. It can examine whether state-sponsored mergers taken to fend off foreign investors unduly impede competition in a specific EU market segment and, if necessary, impose conditions on such mergers such as conditions limiting the range of business activities of the merged company. The European competition rules, however, provide for such examinations only if one of the involved companies obtains less than two-thirds of its turnover on the domestic market.

Once it considers a proposed cross-border merger justified, the EU Commission intervenes if protective measures imposed by the government of a member country against foreign investors violate EU rules such as the principle of free capital movements or the right to set up companies throughout the European Union. If convinced of contraventions of European law, it is bound to initiate proceedings against the member state concerned. If necessary, it will take a non-complying member state to the European Court of Justice.

In practice, however, the influence of the Commission in safeguarding a functioning competition within the Union and in securing non-discrimination of cross-border direct investment faces limitations.

First, the main instrument, apart from moral suasion against member states violating their treaty obligations—the initiation of an infringement procedure—is often the beginning of a cumbersome and time-consuming process. By the time the European Court of Justice finally delivers its verdict, matters frequently have been overtaken by factual developments. For instance, a treaty infringement procedure initiated by the Commission against Spain in 2001 for stipulating that private investors need the approval of the Spanish government for exercising their voting rights in a Spanish energy company if they hold more than three per cent of its capital will only now be arriving at the European Court of Justice.

Second, the Commission risks undermining its influence by linking its justified concerns over government interference with the call on member states to shift more competencies to Brussels. Neither common energy policy directed by Brussels nor a European regulatory agency for the energy sector appear necessary for safeguarding competitive market structures or popular with member governments, thereby unnecessarily arousing resistance in national capitals.

Third, the difference between "competition" and "competitiveness" has become blurred in Brussel's perception. While the Commission has pushed market liberalization relentlessly in order to promote corporate competitiveness, many markets, for instance energy, have become more oligopolistic in the course of that process. In some areas, Brussels has failed to discourage

the impression that it just might like to see “national champions” being substituted by “European champions.” Market liberalization is not enough. It has to be accompanied by a consistent application of European competition law.

Lastly, the Commission’s efforts in favor of a free European capital market would be deemed more convincing by the eastern new member states if such efforts were accompanied by stronger efforts to overcome the asymmetry, still prevailing in the European Union, between free capital movements and the freedom of labor movements. In particular, western Europe remains still largely closed to labor migration from the East.

While it is uncertain to what extent Brussels will succeed in stopping national governments from blocking cross-border mergers, market-oriented observers trust in the eventual superiority of market forces. They point out that government resistance against foreign takeovers is just a relic of earlier attempts in Europe to shape national industrial policies, policies which have failed for the most part, and that such resistance is, therefore, just a backlash against inevitable change. Indeed, the political excitement over the present merger activities can be interpreted as a sign of the momentum of corporate restructuring in Europe, with a growing number of companies developing pan-European ambitions.

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Whether “the market-opening activities of companies look more powerful than the market-closing instincts of governments” as *The Economist* believes (March 4, 2006) is debatable, however.

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The much watered-down version of the EU directive intended to open the market for services—a sector accounting for 70 percent of the Union’s GDP—was sponsored by major continental EU countries against more liberal Commission proposals. It has now been largely agreed to by the European Parliament and national governments. This demonstrates that some governments are prepared to accept substantial economic costs when it comes to protecting existing economic structures and jobs. Compared to these considerations, the prospect that protective measures in the energy sector undermine Europe’s position in the WTO and the European call on other countries, such as Russia, to open their energy markets, is unlikely to work as a major deterrent to European governments. The economic model of many European governments remains defensive, whether seen in the light of globalization, of Europeanization, or of the need to include all kinds of “stakeholders” in a purely domestic restructuring. Therefore, at least for the time being, the strange coexistence of enterprises acting market-driven and governments exercising conflicting political influence is set to prevail in Europe.

Why should a (former) central banker be concerned about resurgent protectionism in the European Union?

Apart from the fact that the independence of a European central bank—and a prospective member of the Eurosystem—is being jeopardized by the Polish government trying to pressure the central bank into blocking a pan-European commercial bank merger it does not like, central bankers must be worried about the prospect that the tide of political and economic integration may have turned after last year’s failure of the European Union’s planned Constitutional Treaty. The success of the euro rests on increasing market integration, not least on the free cross-border flow of capital. The protectionist conduct of some EU countries risks rolling back some hard-won progress in the single market and undermining the market integration that underpins the common currency. ◆