Originally published in French in *La Tribune*, 12 September 2006

NICOLAS VERON

'Economic Patriotism': Lessons from Italy

'Economic Patriotism' is now officially part of France's government policy for just over a year. This expression appeared first on 27 July 2005, a few days after market rumours about a bid by PepsiCo for Danone, when Prime Minister Dominique de Villepin declared to journalists his wish to "gather all our energies to support a true economic patriotism" in order to "defend France and what is French".

These words are ambitious, but also ambiguous. What does patriotism mean when applied to companies, and what can be learnt on its possible effects from recent developments? The Italian banking sector provides fascinating glimpses of the possible answers to these questions.

The key public policy body in this case has been Italy's central bank. The Banca d'Italia enjoys considerable prestige and in the past has provided more than its share of the country's leaders, including Prime Minister Lamberto Dini and Presidents Giuseppe Einaudi and Carlo Azeglio Ciampi. From his appointment in 1993 until last year, Banca d'Italia's Governor, Antonio Fazio, had become the chief defender of Italian banks against possible foreign bidders. For this he made extensive use of its powers of prudential supervision, under which he had a say in all banking mergers and takeovers. Foreign banks could at most hope for minority stakes, such as the one held by Crédit Agricole in Banca Intesa.

This fierce defense of the banking sector's Italianità was put to its decisive test in March 2005. That month, ABN Amro of the Netherlands launched a bid on Banca Antonveneta, and another bid by Spain's BBVA on Banca Nazionale del Lavoro (BNL) soon followed. Governor Fazio tried to favour competing bids by Italian players, respectively Banca Popolare di Lodi (renamed BPI in June 2005) on Antonveneta and Unipol, an insurance company, on BNL.

Initially, the two-pronged counterattack move looked successful. But it eventually failed, principally because of the European Commission's expression of concern about the possibility of it being contrary to Europe's internal market rules, and of the leaking of wiretap transcripts that hinted at an unhealthy connivance between Governor Fazio and BPI's chief executive. As a consequence, ABN Amro secured control of Antonveneta in September 2005; BNL finally fell into the hands of BNP Paribas in early 2006; and Fazio was forced to resign in December 2005. Mari Draghi, a Goldman Sachs executive who had previously spent a full decade as head of the Italian Treasury, succeeded him as Governor and took exactly the opposite stance. Far from offering unconditional protection to Italy's banks, he made clear that they should now care for themselves, and their survival. In May, he explicitly asked banks not to give him any more advance notice of their merger or acquisitions projects, so as not to interfere with market forces in the reorganization of Italy's banking landscape. Thus, he made the rules clear, and candidly accepted the possibility of a foreign takeover as a prospect that would force banks to restructure and to improve their performance.

This was a bet, which now looks quite successful. Most industry observers reckon that Banca d'Italia's new stance under Governor Draghi led to, or at least accelerated, the recently announced merger between Banca Intesa and Sanpaolo IMI, the sector's numbers two and three. When this deal was announced on 25 August, both banks' share prices bounced, a rare event for such a large merger and one that underlines that, at least seen from the stock market, it makes a lot of strategic sense indeed. The merged entity immediately ranks itself among Europe's largest players and now appears well armed for future international expansion. By contrast, the smaller Intesa and Sanpaolo were the two most parochial among the euro area's 15 largest banks, with respectively 69 % and 89 % of their banking revenue generated inside Italy.

This sequence of events brings several useful lessons. When 'patriotism' is primarily about protection and about preventing national companies to be purchased by foreigners, it rarely succeeds. But the alternative does not mean that public authorities have no strategy. Another form of 'patriotism' leads policymakers to stimulate the corporate world and render it more competitive, by carefully acting on incentives and sending the right signals to the marketplace. Mario Draghi did exactly that, and thus helped the birth of a new 'champion'.

In France, all the new measures that were announced in July 2005 and subsequently implemented were inherently defensive. They were a decree providing special protection for companies in sectors deemed 'sensitive'; a new piece of legislation attempting to hamper the possibility of takeovers; and another one providing incentives for companies to grant stock to their employees in order to protect their capital. There is a risk that all these moves ultimately become counter-productive – as was the government's rhetoric against Mr Mittal a couple of months ago. Sadly, the proposed merger between Suez and Gaz de France is treated in the same defensive mode: first the undiplomatic rebuttal of Enel's proposal, then a hyperactive involvement by the Prime Minister that raises eyebrows abroad, and most recently a backlash against the integration of Europe's electricity sector with the new, oddly named "transitory regulated tariff for market adjustment".

Let's not forget the lesson from Italy. Public interventionism generally leads to business failures when it is merely defensive. But by clarifying the rules of the game and making them credible, in a way that leads to market integration rather than fragmentation, the state can create an environment that fosters corporate success.