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Between Regulation and Competition: Hard and Soft Resistance to Europeanisation in the Financial Services and Defence Sector

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BETWEEN REGULATION AND COMPETITION: HARD AND SOFT RESISTANCE TO EUROPEANISATION IN THE FINANCIAL SERVICES AND DEFENCE SECTOR

To the extent that the European Union may be considered a political system, it is at best a plural political system. Decision making reflects the combination of efforts to accommodate the diversity found in the Member States and establish common rules, often yielding less than fully coherent outcomes. The establishment of the Single European Market may have entailed a degree of convergence, but like earlier and subsequent deals it also reflected the states' efforts to project their own regulatory systems onto the EU level and/or to protect industry. At the same time, the evolution of EU competition policy has produced a supranational regime which is enforced by the most independent Directorate General (McGowan & Wilks 1995). Focussing on two of the three sectors that have been partially exempted from EU competition policy and Single Market rules the present paper explores the implications of exemptions, sources of resistance to Europeanisation and pressure for change. The central argument is that competition authorities and competition policy, particularly DG Competition but also national competition authorities and the EFTA Surveillance Authority, provides the main diver behind liberalisation, while sector regulators tend to be more receptive to Member States' particular problems. Both are engaged in a game of exploring the limits imposed by the Single Market rules and exemptions. Hence the suggestion that even the protected sectors are caught between regulation and competition.

Competition policy is a cornerstone of the Single Market, a key tool for both enforcing its rules and expanding its scope. To be sure, its evolution has been gradual and somewhat uneven, not to say controversial. Driven by the changing relationship between the European Court of Justice and the Commission as much as inter-governmental agreements, DG Competition's role and independence expanded to the extent that it was described as something akin to an independent federal agency more than a decade ago (Wilks 1992). Over the last decade this has entailed a 'public turn' as the EU competition policy regime has been extended to the public sector (Gerber 1998), encroaching on territory previously pertaining to the Member States. DG Competition's ability to pursue this depends in no small part on its autonomy and greater appreciation of the EU rules than most of its interlocutors, in other words on its 'calculative capacity' (From 2002). Likewise, a degree of pressure is being exerted on the sectors that have been excluded from Single Market or competition rules. Come 2000, however, a degree of countervailing pressure, though hardly a backlash, emerged. Hence McGowan's suggestions that "European competition policy is entering a new phase – one of multi-level regulation characterised by a shared agenda between national and European authorities" (2000:145). Most European states have reformed public governance in general and competition policy in particular, in a process that may be described as 'spontaneous alignment' with the EU regime (Sauter 2001). If this expansion of the scope of competition policy seems in line with neo-functionalist 'spillover', "the limits of European competition policy seem to reflect the limitations of the neofunctionalist version of European integration" (McGowan 2000:117). The present paper suggests that these limits reflect the diversity (plurality) of regulatory regimes found in the Member States, exploring the limits of Europeanisation and their permanence or lack thereof.

The present project focuses on the three sectors that have long been singled out for special consideration, the media, the defence industry and financial services. The present paper's central focus is on the financial services industry and the defence sector (the media industry being addressed in another part of this project). Protection of 'essential interests' related to the production and procurement of arms is exempt in the Treaty of Rome, and the 1989 Merger Control Regulation allows states to take appropriate measures to protect interests in areas related to public security (defence), financial services and plurality of the media. If Europeanisation is defined in terms of Member States adapting to and accommodating developments in European integration by aligning national policy regimes with EU rules, the sectors exempt from competition policy obviously illustrate the limits of Europeanisation. However, there is considerable pressure to extend liberalisation to these sectors, which are in any case only partially protected. The limits to Europeanisation are therefore not only manifest in negotiated exemptions, but this is also a question of how rules are transposed and applied. The boundaries between competition and regulation are being explored and tested, from both sides.

The three exemptions reflect most states' assertions that these are sectors of vital national concern. This is reminiscent of Hoffmann's (1966) distinction between 'high' and 'low' politics, inasmuch as states have shielded functions that they consider at the heart of their activity from the full force of European integration. A key question, now as then, is the longevity of these exemptions. Changes in economic policy and developments in European integration have change the logic of some of these exemptions, from protection of vital concerns to protection of economic interest. To the extent this is the case, pressure for Europeanisation may be expected. The central concern in the defence sector was a classic high politics question, the protection of the states' defence capabilities. Hence the blanket exclusion in the Treaty of Rome. However, the completion of the Single Market and rapid expansion of competition has generated pressure for the removal or modification of the armaments exemption. The increasing importance of 'dual use' products in military hard- and software and the need for European standardisation of equipment due to common military activities have added to this pressure. Still, however, no state is prepared to be the 'first mover' in abandoning defence protection, even if it is is increasingly driven by economic and industrial policy concerns. Likewise, the exemption of the financial services sector in the Merger Control Regulation reflected concerns that citizens' savings might be threatened by insufficiently vetted mergers or acquisitions, but has since been used to defend national firms from foreign take-overs. An earlier paper in the present project therefore described it as a 'not-so-single market' (Eliassen, Sitter & Skriver 2001). In both cases, the states are divided on the need for exemption. Broad agreement on the exemptions remain only in the media sector, where the logic of protecting plurality remained. Even here it is under increasing pressure, as the DG Competition seeks to separate commercial from cultural concerns.

In what follows, the limits to Europeanisation are explored in terms both decision making in a plural system and in terms of implementation. The first section sets out the framework for analysis. The subsequent three sections explore the negotiated compromises that make up EU the rules and exemptions; 'hard' resistance to Europeanisation driven by political interference, problems of transposition or incomplete implementation; and 'soft resistance' by way of use or abuse of exemptions and other relevant legislation. The pattern that emerges is one in which the scope of exemptions is being narrowed by extension of the Single Market logic to protected sectors, often driven by competition policy, while successful resistance to Europeanisation shifts from the 'hard' to a 'soft' variety.

Europeanisation and Resistance in a Plural Political System

Because the European Union is plural political system there is greater scope for resisting or circumventing central legislation than in most Member States. In this context, it is a plural system not only because it combines different nations (Taylor 1991; Gabel 1998), but because it integrates states with different institutions. Western European states have developed considerable and much-analysed diversity in their models of capitalism and regulation, including the competencies and independence of regulatory authorities and approaches to competition policy, and EU-driven convergence has been limited (Wilks 1996; Scharpf 1999; Eyre & Sitter 1999; Gerber 1998; Eyre & Lodge 2000). Decision making is therefore not simply a question of building consensus across party or national interests, but also of designing institutions that are compatible with Member State institutions and accommodate their different regulatory institutions. These differences in turn reflect differences in the states' industrial policy, as well as domestic reform processes in any given sector. For the states, EU-level policy making is therefore often a matter of efforts to project their own (or preferred) institutions onto the EU level. Decision making involves efforts to accommodate a considerable degree of diversity, which in turn suggests that there is ample scope for states to demand explicit exemptions, nebulous formulations or open-ended outcomes when they are in a position to establish a blocking minority. In other words, making common policy is not only about establishing common rules and adjusting Member State legislation where necessary, but often also about mutual accommodation where possible.

Pluralist Policy Making in a Plural Political System

Taking this one step further, the EU is not only a *plural* system, but also a *pluralist* one in the comparative politics sense of a large number of actors with different interests shaping decision making and producing somewhat unpredictable outcomes (O'Leary & Dunleavy 1997). The combination of a high number of actors with different and changing preferences means that pluralist analysis of liberal democracy, focussing on incremental decision making and relaxing the rational choice element may be warranted. This includes not only the Member States and EU institutions, but also differences within these, e.g. different Directorate Generals' preferences (Bulmer 1993, 1998). While pluralist analyses (Richardson 1996), particularly in the form of historical institutionalism (Pierson 1996), usually offer explanations of the limits to states control of policy making or integration, they also invite questions about diversity (Peterson 1995) and the limits of Europeanisation (Lodge & Eyre 2000).

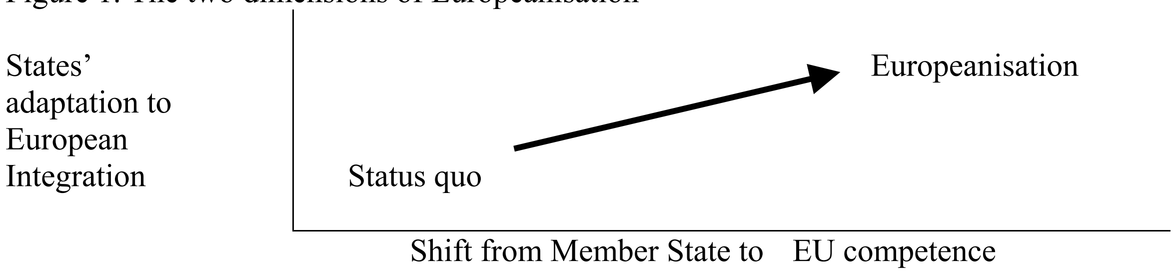
Although policy making is a question of designing credible regimes, it is also shaped by existing institutional set-up. The EU has developed into a 'regulatory regime', partly because its limited financial resources make regulation the most appropriate tool of governance (McGowan & Wallace 1996; Majone 1996). Regulatory developments therefore "reflect a pragmatic attempt to live with the constraints imposed by the Community's present institutional structure, and, in particular, the inherent limitations in the Commission's executive powers" (Hancher 1996:64). The Commission is generally committed to a regulatory approach that is compatible with the Single Market rules and, at lest in the case of the Directorate General for Competition, its competition policy. Hence the scope for pressure for liberalisation, from some Member States and DGs, even in sectors where permanent or temporary exemptions have been granted. The flip-side of this coin is that the EU system relies on the Member States for transposition of directives into national laws and that surveillance of implementation is a difficult task at best, if for no other reason than limited resources (Cini 1996).

A considerable degree of uncertainty is introduced inasmuch as accommodation of the more protectionist states and Directorates Generals' interests might weaken the EU's regulatory approach and liberalisation process. This suggests a degree of compromise and 'muddling through', more open-ended and possibly less coherent decision making, let alone implementation. Three limits to Europeanisation are therefore suggested. First, policy making in a plural system is based on reaching a negotiated consensus, and therefore provides opportunities to project protectionism from the member state level into EU policy. Second, because most EU decisions come in the form of directives that require transposition into national law, and often enforcement by national regulatory authorities (NRAs), there is considerable room for diversity. Third, the operation of a plethora of EU and national rules, both general and sector-specific, provides opportunities for indirect, or soft, resistance to Europeanisation inasmuch as EU rules may be circumvented. It is of course no coincidence that these three levels reflect the Doern's three levels for analysis of competition policy, the macro level of public policy, meso level of rules and institutions and micro level of implementation, enforcement and compliance (1996).

Resisting Europeanisation by Negotiating Exemptions

The first source of resistance to Europeanisation of a given policy sector is simply objection to the establishment of a common EU-level regime or extension of EU rules to that sector. If Europeanisation is defined as the process of adapting to and accommodating developments in European integration by aligning national policy regimes with the EU regime, it can be broken down into two dimensions (figure 1). First, the establishment of an EU regime, and second, the Member States' adaptation to this regime and adjustment of policy practices. The latter clearly depends party on the latitude and discretion provided for in the former. The first step in protecting a sector from liberalisation is therefore blocking the adoption of an EU-level regime, or if an EU regime is negotiated, to secure exemptions, loopholes or nebulous formulations that provide scope for discretion in transposition and application. Although decision making pertaining to the single market takes place under rules that permit Qualified Majority Voting in the Council of Minister, the Member States have proven reluctant to over-ride dissenters on protected sectors. Moreover, neither the Commission nor Parliament has proven above blocking or watering down proposals for liberalising legislation. Although international cooperation is usually associated with free trade and liberalisation because protectionism may be carried out unilaterally, this is only partly the case for extending the Single Market. States that favour liberalisation may carry this out unilaterally, up to a point where reciprocal opening is required, while the more protectionist states are often in a position to block or delay EU decision making. When it comes to protected or heavily regulated sectors, EU decision making is to some extent based on the '*slowest* common denominator'. This sets the parameters for Europeanisation and its limits.

Figure 1. The two dimensions of Europeanisation



In the financial services sector, key states like France, Germany and Italy have long been identified as obstacles to the establishment of a fully competitive and open market in banking and financial services (Molyneux 1996). This is perhaps not surprising, given that they feature relatively low competition compared to the Anglo-American models (de Bandt & Davis 1999). The sector is covered by Treaty articles on freedom of establishment and movement of capital (Articles 43 and 56), as well as by competition policy and Single Market rules. Resistance to full competition has come in the form of negotiating and applying exemptions to EU merger rules, as well as more indirectly in the form of state subsidies, public ownership and financial guarantees distort or inhibit competition and restructuring (Hurst, Peree & Fischbach 1999). As for the defence sector, Article 296 of the Treaty (formerly 223) provides specific exemptions for armament procurement and defence products from rules on competition and free movement. Despite efforts by the Dutch presidency to have this exemption removed at Maastricht it remains, more because of national economic interest than national security. The key reason is the historical symbiosis between defence firms and the state, which has clearly limited the scope for EU policy. With the success of CFSP, the exemption makes little military sense, and it should be seen as a logical part of the Single Market rather than defence and security (Mawdsley 2000).

Resisting Europeanisation by Limiting Adaptation to the EU regime

To the extent that an EU policy regime is the result of negotiation and compromise, it is likely to include ambiguities and room for discretion. The second and third sources of resistance to Europeanisation are related to the way states adapt to new EU policy regimes. This includes efforts to override or set aside legislation, problems related to transposition of EU rules and application of rules is such as way as to limit their impact. This applies not only to the EU rules and directly relevant national legislation, but also to more indirect rules. In the three-by-two table that this yields (figure 1), a distinction is made between 'hard' open resistance to Europeanisation in the shape of conflicts over interpretation or political decisions to circumvent rules, and more opaque 'soft' forms of resistance that are caused by limited policy adjustment or application of rules.

Table 1. Resistance to Europeanisation	Political intervention	Incomplete transposition	Application of rules
EU rules	Hard resistance	Hard resistance	Soft resistance
Indirectly relevant national rules	Hard resistance	Soft resistance	Soft resistance

'Hard' resistance to Europeanisation is related to the transposition of EU rules into Member State law and the extent to which national rules are aligned with EU rules or openly resisted. Lack of transposition, as reported to the European Commission, is the most obvious but least frequent problem. As a rule Member States do not openly resist incorporation of EU rules into national law. Neither do they usually openly seek to circumvent it by political intervention. The procedures for the Commission's recourse to legal action have been clearly established and tested, particularly in the field of competition policy. Incomplete or partial transposition is more problematic, in terms of identification of the problem as well as greater uncertainty of the often lengthy legal process. However, as Single Market rules (particularly competition policy) are extended to cover sectors that have long been subject to complex sector-specific regulation, incomplete adjustment of national regulation emerges as a potential problem. Although national rules may appear compatible with the EU regime to the government in question, determining this is likely to require a test case. Much the same holds when the Commission suspects that national rules open for violations of EU rules. In other words, EU legislation may leave national legislation in place that appears to be compatible with EU law until its use is actually tested.

By contrast, 'soft' resistance to Europeanisation refers to less transparent, often unintentional, forms of resistance. Most EU legislation leaves considerable scope for discretion in transposition or application, the result of which is that implementation may yield very different forms of regulation across the Member States. National Regulatory Authorities differ in their legal bases and the mixture of economic and social goals that they are charged with pursuing, and come in a wide range in terms of size, resources and independence. Their relations with national competition authorities vary with national practice, as do their lines of accountability and appeals procedures. The scope for discretionary power therefore varies considerably, and may be used to limit the state's adaptation to the Single Market. Moreover, several states maintain a range of other rules that undermine the operation of the EU regime, or at least the state's adaptation to it. Sate aid and public ownership have caused problems across sectors. Inasmuch as this represents a limit to the state's adaptation to European integration it need not be a problem, but rather a reflection of the EU's plural nature. However, in several cases soft resistance to Europeanisation has been used to circumvent and counter liberalisation.

In the following three sections, the three sets of limits to Europeanisation are explored, drawing on cases that have been reported in the press over the last few years (and identified by industry experts and officials as key concerns in interviews during 2001 and 2002).

Table 2. Europeanisation and Resistance	Europeanisation	Resistance
First-order Europeanisation	EU rules	Exemptions
Second-order Europeanisation	State rules and priorities	'Hard' resistance
Third-order Europeanisation	Operation/implementation	'Soft' resistance

First-Order Europeanisation and Resistance I – European Integration: Exemptions and the Pressure for Change

The sectors that are exempt from the Merger Control Regulation are exceptional also inasmuch most Member State governments consider them of central importance to their economic or industrial policy and are reluctant to relinquish control of them, let alone entertain the prospect of full competition. Although two considered here, financial services and defence industry, differ considerably in terms of the scope of their exemptions from Single Market rules, they reflect similar concerns on the part of Member States and the Commission. National regulation reflects long-standing institutional differences, and the EU exemptions constitute an attempt to accommodate this. In both cases the Commission and the more liberal states (and political parties) favour extending the Single Market logic to the sectors. For some Member States this is a largely problem of incomplete contracting, a question of how to ensure mutual liberalisation and opening. For others, however, it is a question of essential economic interest that reflects the domestic policy and industry structure. The central issue in the defence sector is the sector's general exemption from competition policy, whereas in the financial services sector the exemption is limited to the regulation of mergers and acquisitions. In both cases the balance between sector regulation and competition policy, between the exemptions and Single Market rules, are being tested and explored.

The central issue in the defence sector has been the balance between national sovereignty and the benefits of European co-ordination, in military as well as economic terms (De Vestel 1998). So far the requirement that states maintain their own defence procurement capabilities has counted heavily, even if a good case can be made against national defence industries (Krause 1992). However, industrial policy concerns have encroached on this debate inasmuch as defence procurement generates demand for domestic industry. Even when foreign suppliers are used, this tends to be balanced by offset obligations. These require domestic industry deliver civil or military products to the foreign supplier (or, in some cases, government) for up to the total amount of the sum spent on procurement. In other words, domestic industry benefits even from defence procurement abroad. Hence the resistance to changing Article 296.

The main problem in terms of limited Europeanisation of the financial services sector is fragmentation, or rather states' potential to use national prudential rules to inhibit cross-border merges. The lack of cross-border consolidation in the sector means that DG Competition has generally not found problems with cross-border mergers. To be sure, because banking is embedded in national institutions, culture and language, the '1992' programme was expected to lead to restructuring because of competitive pressure rather than cross-border take-overs (Dufey 1993). However, the Commission is taking an increasing interest in the sector. As Competition Commissioner Monti emphasised when discussing the sector, "the risks associated with market power are well known […] Less obvious are the risks associated with too fragmented markets" (Monti 1999). Most Member States feature specific 'prudential rules' for the sector, sometimes divided into separate rules governing banking and insurance. They are loosely governed by parameters laid down in EU directives and designed to ensure quality of services, which require interventions by supervisory authorities to be based on prudential principles (securing sound and prudent management) rather than national and/or economic interests. However, they allow for a degree of divergence in national rules that limits the single market (Horn 1999), and prudential rules have been used to discourage foreign take-overs.

Under the 1989 Merger Control Regulation DG Competition vets mergers involving aggregate world turnover of € 5bn and EU turnover of € 250m. Below these thresholds, mergers are covered by national competition authorities, most of which have reformed or adopted merger rules along the lines of EU competition policy (Martin 1998). However, Article 21 of the MCR permits member states to take appropriate measures to protect legitimate interests other than those taken into consideration by the MCR, as long as these are compatible with EU law. It defines legitimate national interest to include prudential rules pertaining to the financial sector as well as defence interests and plurality of the media. The exception for the finical services sector was originally designed largely to avoid export of 'bad debt' (Whish 1993; Cook & Kerse 1996). Upon British insistence, a directive on harmonising take-overs was to follow (Eyre 1999). However, in July 2001, a 273-273 vote in the European Parliament temporarily ended a 12-year effort to establish a framework for common EU take-over rules. In the words of diplomats cited by the *Financial Times* (4 July 2001), this reflected “blatant national manipulation”. In the run-up to the vote the German government dropped its support for the proposed directive on the grounds that it would leave German companies vulnerable to hostile foreign take-overs (by banning defensive measures without prior shareholder consultation).

In both cases, the pressures for and against change are indicative of the different priorities of different DGs and Member States. In terms of pressure for abandoning the exemptions or extending the reach of competition policy, the Commission is proving the key actor. Its arguments in favour of abandoning the defence exemption are linked both to efficiency and cost as well as equal treatment of defence industries in different Member States. However, the DGs for industrial policy and external relations have adopted markedly different approaches to this question, the former focussing on free markets and the latter more sensitive to military concerns and more open to intergovernmental approaches (Mörth 2000). Moreover, technological developments and the resulting increase in ‘dual use’ products (i.e. both military and civilian) adds pressure to end what amounts to industrial protection. Civil hardware and software makes up a growing share of military equipment. In the financial services sector DG Internal Market focuses more on medium-term efforts to create a single market in financial services by 2005, and it adopted a Financial Services Action Plan to this effect in 1999. It has demonstrated less interest in specific cases of potentially problematic interpretations of the banking and insurance directives. By contrast, the more independent DG Competition appears eager to assert its role as the only relevant competition authority in cases above the EU threshold and reluctant to back down in the case of a potentially precedent-setting case.

However, a number of Member States’ have proven reluctance to relinquish control over sectors that are considered essential to industrial policy. Most Member States not only want to maintain the Article 296 exemption, but have strengthened their offset instruments and increased their use. Although some states are prepared to revise or abandon this provision, none is prepared to do so unilaterally. No state is prepared to se its industry exposed to competition in this filed as long as others are protected. Although there has been a shift from restriction to purely national provision or strict offset conditions toward more European or international co-operation in this field, the compensatory logic remains. In the financial services sector several governments have criticised both the EU and their own regulatory authorities for acting against the ‘national interest’. The fact that long-standing EU rules prohibit intervention based on national interest or designed to protect national firms against foreign competition has not prevented politicians in several states openly invoking national interest and the need to build or protect ‘national champions’ (Molyneux 1999).

Second-Order Europeanisation and Resistance II – Hard resistance: Transpositions and incomplete implementation

Hard resistance to Europeanisation was defined above in terms of missing or incomplete transposition of EU rules, the maintenance of directly relevant national rules that are incompatible with the EU rules, or open political defiance of or interference with rules or independent agencies. Because all actors have accepted the defence sector exemptions from competition law, hard resistance to Europeanisation is not necessary. The key questions are related to the softer versions of resistance to Europeanisation, and centre on efforts to exploit and stretch the rules as far as possible in terms of defining what kind of products fall into the military category. However, two recent cases have seen the Commission and the ESA adopt a harder line on exemptions in the financial services sector. The defence cases have proven less controversial, if only because most states engage in offset and both public and company interest is limited. It likely to remain so as long as the systems are in place, and only the removal of protection promotes some fears of voter and union reactions.

Due to the relatively nebulous rules set out in the directives governing the financial services sector and the broad MCR exemptions, transposition has not been a major problem and there have been few serious infringements. The controversies have arisen over application of prudential rules, which can at worst be seen as (deliberate) incomplete transposition or failure to adjust related legislation, and at best as misunderstandings concerning the implications of the EU rules. The question of the scope left by prudential rules for national protection in the financial services sector remained unanswered for a decade. Exploring the limits of these rules required test cases, and two key cases stand out over the last few years. The Commission's swift response in the Portuguese 'Champalimaud case' indicates that rather than taking a lax view of bank sector mergers, it was increasingly keeping alert to potential cases to test the limits of Article 21 of the MCR. There was no secret that it had long suspected that national prudential rules were used across the EU in defence of government preferences that are incompatible with the Single Market. In the words of one Commission official suggesting this was an opportunity to clarify the rules where national discrimination inhibits the development of a single market in financial services: "the implications of this case will be like a bomb" (*Financial Times* 23 July 1999). The second case concerns the Finnish bank and insurance group Sampo's efforts to acquire the Norwegian insurer Storebrand, which generated considerable controversy when taken up by the Commission and the EFTA Surveillance Authority (the Commission's counterpart for the EFTA pillar of the European Economic Area agreement, which extends Single Market rules to Norway, Iceland and Liechtenstein).

Portugal still provides the only case of legal action in the Court of Justice over a member state's violation of EU rules relevant to mergers and acquisitions in the financial services sector. The government's intervention in June 1999 to block the acquisition of the Champalimaud group by the Spanish bank Banco Santander Central Hispano (BSCH), drew a sharp reaction from the Commission, which decided that the action violated both Article 21 of the MCR and single market rules. Even before this event, the Portuguese authorities had drawn criticism for excessive interference: “Portuguese banks have been sheltered from foreign competition and have enjoyed the paternalistic guidance and protection of the government” (*Economist Intelligence Unit*, Country Profile: Portugal 1999/2000). The acquisition was blocked party because the merger marked the end of a tacit agreement by Spanish and Portuguese banks to keep out of each other’s markets. The Finance Minister’s ‘despacho’ suspending all voting rights in Champalimaud shares was justified on the grounds of late and incomplete notification, absence of transparent structure and protection of the national interest, and was thus *largely* on supposedly prudential grounds. However, given the high profile of the case and the fact that intervention came within 24 hours of the notification and left no room for appeal, redress or supplying additional information, it could hardly escape the attention of the Commission (which cleared the merger as per MCR rules in August). Using its full range of tools, it took action based on violation of competition rules, rules on the right of establishment and rules governing supervisory authorities in the insurance sector, and it adopted an interim measure suspending the Portuguese government’s decision. In October it declared the ‘despacho’ incompatible with the MCR, prompting the Portuguese government to take the case to the Court of Justice. In the event, a compromise was worked out that saw BSCH take control of 40% of the Champalimaud group, and following the Commission’s clearance of this proposed merger in January 2000, the Portuguese government accepted it and withdrew its case against the Commission, thus precipitating closure of the infringement procedure.

A similar case developed in Norway during the summer and autumn of 2001, with Finnish Sampo’s bid for the Norwegian insurer Storebrand. Although the Commission cleared the merger, the Norwegian Ministry of Finance was expected to bloc it when the Finnish company withdrew its offer due to broad share price fall in the wake of September 11th. When the Sampo bid was announced in May, a rival offer from the partly state owned Den norske Bank was welcomed by most politicians in terms of prevention of a foreign take-over. Finance Minister Schjøtt-Pedersen’s comment “it is of vital interest that Storebrand remains a Norwegian company, owned and run from Norway” (*Aftenposten*, 21 May 2001) raised questions about the motives for subsequent acts by the government, regulator and state-owned companies holding Storebrand shares. When it cleared the merger, the Commission took the unusual step of warning the government that it was monitoring the situation closely (*Agence Europe* 31 July 2001). The EFTA Surveillance Authority (ESA) had already questioned the Norwegian rules that preclude ownership of between 10% and 90% of financial institutions, on the grounds that it violates free movement of capital. The government’s defence rested partly on an article permitting a foreign institution to own down to 50%, as long as all the remaining shares are held by financial institutions (which would manifestly not be the case with Storebrand). In theory, a single share owned by a private owner could stop the take-over. Employing both rules, which the government maintained were in accordance with EEA (and therefore Single Market) rules, the financial regulator Kredittilsynet recommended that the Ministry of Finance block the take-over (Kredittilsynet 2001). Although Sampo’s withdrawal of the bid defused the immediate confrontation, the ESA issue a Reasoned Opinion against Norway for failure to comply with EEA rules on free movement of capital and to implement the Credit Institutions Directive (ESA 2001), and the offending legislation is now under review. However, Den norske Bank is trying to use its window of opportunity to acquire Storebrand.

The two cases illustrate the continuing reluctance of many governments to accept foreign ownership in the financial service sector, and the extent of their powers of discretion. Ministers in both governments made public statements that suggest that they considered the use of prudential rules to protect national interest perfectly reasonable. When blocking the deals, the governments favoured alternative offers by the Banco Comercial Portugues and Den norske Bank. Prime Minister Guterres emphasised that "the national interest must be defended" (*Times* 25 August 1999), but maintained that the government's actions were perfectly compatible with EU law because the decision was not taken on competition grounds. Schjøtt-Pederesen's 'vital interest' argument was reported widely shared by Norwegian MPs (*Aftenposten* 2 July 2001). The Portuguese government argued that BSCH's non-compliance with Portuguese law raised doubts as to its ability to guarantee prudent management. Moreover, in the words of Finance Minster Franco "the EU exists so inter-penetrations between economies can be achieved progressively, not so that vital sectors of national economies can be taken by assault" (*Financial Times* 20 June 1999). His ministry stressed that "the Government reaffirms its conviction of having acted in total conformity with national and EU law" (*European Report* 24 July 1999), much as the Norwegian government would two years later. In other words, using stock market and prudential rules to prevent a foreign acquisition was supposedly perfectly reasonable, a view the Commission hardly shared. Monti (2000) has emphasised the need to ensure that member states "do not intervene against merger processes for protectionism reasons or to foster national interests" and that "the case BSCH/Champalimaud gave me a clear opportunity to show this determination". The transposition and application of EU rules are frequently open to interpretation, and the scope of prudential rules more so than most. Although they are evidently compatible with a degree of protection, the limits were established in the Champalimaud and Storebrand cases.

An additional form of resistance to Europeanisation, direct political intervention, qualified as 'hard' inasmuch as it centres on confrontation related to rules. However, given the scope for resistance to political interference from NRAs, this is far less likely to succeed. Europeanisation and privatisation has limited the scope for direct intervention that contravenes rules, although as *International Money Management* commented (6 August 2001): "Certain EU member states, especially France, pay only lip service to the [insurance] directive and overtly, in a protectionist manner, continue to thwart the efforts of many product providers and non-French advisers to capitalise on this legitimate opportunity." Although French competition rules and regulatory practices were aligned with EU competition law in the mid-1980s, this has not prevented efforts on the part of politicians to intervene in and shape the resulting restructuring of the financial sector, albeit with limited success. The government's efforts to intervene to promote a three-way merger between Banque Nationale de Paris, Paribas and Societe Generale in 1999 was driven by its aim to create large national institutions that would be able to resist foreign take-overs in a sector that was already penetrated by foreign ownership. Negotiations for a friendly merger between the three, dating back to 1998, broke down when, in early

1999, SG and Paribas announced their intention to merge. This prompted a hostile bid from BNP for both banks, setting off a six-month process of bids and counter-bids that would draw in the three relevant regulatory authorities and several cabinet ministers. When the dust settled, the banking authority Cecei declared BNP's bid for Paribas successful and its bid for SG not so, drawing criticism from several ministers along the way. Interior Minister Chevenement, admittedly not noted for his enthusiasm for European integration, let alone free markets, complained that "the national interest was not taken into account. SG is exposed to a raid by foreign predators" (*Financial Times*, 30 August 1999). Reportedly in an effort to prevent a potential foreign take-over, Governor of the Bank of France and Cecei Chairman Trichet had earlier ordered BNP and SG to continue negotiations after they had broken these off (*Financial Times*, *Daily Telegraph* 30 August 1999). Even Finance Minister Strauss-Kahn, adopting a more neutral pose, had made it clear that involvement of a foreign bank in the deal would be against 'the national interest' (*Financial Times* 23 June, 30 June 1999).

Both the Portuguese and Norwegian cases suggest that hard resistance to Europeanisation is likely to be a futile game in the medium to long run, because the Commission and ESA are prepared to use such cases to demarcate (or push back) the limits of exemptions to competition policy and Single Market rules. To the extent that this is the case, the excluded sectors are coming under increased pressure for Europeanisation. However, the short-term effects are less dramatic. In both cases the confrontation arguably resulted at least partially from the governments' misunderstanding of the implications of EU rules, and was therefore resolved through compromises on the part of the governments and/or companies involved, with a degree of successful protection in the short term.

Third-Order Europeanisation and Resistance III – Soft resistance: the limits of Europeanisation

In contrast to hard resistance to Europeanisation, soft resistance entails more nebulous acts that limit the pressure for adaptation to EU rules. As indicated in table 1, this may result from the application of rules that conform to EU law if the effect is to limit the pressure for Europeanisation, in the form of other rules that are not directly linked to the EU rules but nevertheless undermine their operation, or through the development of new rules to circumvent or postpone the effect of Europeanisation. Examples of all three forms of soft resistance to Europeanisation can be found in the financial services sector. There are few cases of confrontation between the Commission and states over application of article 296, the only recent example being DG Industry's challenging the German Federal Office for military technology and public contracts' awarding contracts for rubber protection pads for military vehicles without an EU invitation to tender, on the grounds that these are used in peacetime for non-military activities (CEC 2001).

Several member States feature prudential rules that, while apparently not falling foul of Article 21 of the MCR, are nevertheless applied so as to inhibit foreign mergers and acquisitions. Referring to national financial authorities in general, then Internal Market Commissioner Monti emphasised the need for such institutions to operate in a justifiable, objective and open manner (*Reuters* 3 June 1999). Italy is the clearest case, as the Bank of Italy enjoys wide discretionary powers to shape developments in the banking sector, acting as its antitrust authority. In practice, this has resulted in a sector that is hardly open to acquisitions by foreign institutions. Commenting on the openness of the market to foreign acquisitions *Reuters* (11 October 1999) reported that "Italian banking stocks are now seen to have only limited upside potential because financial sector consolidation is being orchestrated by the Bank of Italy and not the market." Using procedural or prudential rules, Italian financial regulators have ensured that it is difficult for new actors, let alone foreign banks, to penetrate the market without the consent of the authorities. The Bank of Italy has drawn considerable criticism for interventionist tendencies, notably over its opposition to hostile bids and its efforts to negotiate deals that prevent bidding wars. Commenting on the openness of the market to foreign acquisitions, the *European Banker* (18 July 2001) concluded that the central bank "has demonstrated extreme reluctance to sanction large-scale cross-border deals too often for anyone to believe that such a deal is practical. Attention has inevitably turned to the leading domestic players." As of December 2000, only three foreign banks had been able to acquire more than 5% in an Italian bank, while during that year alone Italian banks acquired 14 foreign banks. An executive at the Spanish bank BBVA, which saw its plans to merge with UniCretio blocked by the Bank of Italy in 1999, called central bank governors "the biggest obstacle against the free movement of capital within the European Union" (*Financial Times*, 12 March 2001).

The principal obstacle to EU-driven restructuring of financial services in terms of rules that indirectly shelter markets from liberalisation lies in state aid. In addition to relatively transparent direct state aid, this includes other rules that amount to illegal state aid, such as financial guarantees for banks. The former is of course relatively well documents. Referring to the Crédit Lyonnais, Westdeutsche Landesbank and Banco di Napoli cases of state aid, Monti emphasised that "the Commission requires state aid to banks to be coupled with radical restructuring plans and reforms to corporate governance […] either the unlawful State aid has to be repaid or divestments have to take place" (Monti 1999). Nevertheless, France's repeated state aid to Crédit Lyonnais was approved by the Commission in 1995, 1996 and 1998 on the grounds that it was considered compatible with the Single Market on the light of the bank's restructuring and privatisation.

The complaints by private banks to the Commission over illegal German state aid to public banks illustrate a more subtle form of protection of banking markets from competition. The country's more than 500 municipally owned savings banks, which control half the market and are shielded from mergers and acquisitions by legislation, constitute a formidable obstacle to restructuring of the bank sector, let alone foreign acquisitions. The public guarantee system, under which the public sector owner is required to keep the financial institution viable, attracted the Commission's attention in December 1999 upon complaints from the European Banking Federation targeted at the whole system of guarantees. In its formal request that Germany to bring State guarantees in line with EU law, the Commission argued that this is the equivalent of illegal state aid, because "the measures are based on State resources and favour certain groups of undertakings, they distort competition and affect trade within the community" (European

Commission, 8 May 2001). Although the legislation in question is currently under review, it is unclear to what extent German authorities are willing to amend the existing system, rather than merely seek to adjust the law so as to be EU compatible. At a much less problematic level, national laws or rules that are not directly linked to the sector may simply limit the effects of Europeanisation or the national institutions' need to adapt simply because the sector draws little foreign interest. The Greek finacial services sector illustrates the point, as restructuring of the financial services sector remains largely driven by domestic banks due to rigid labour laws and low profits.

The third option for soft resistance to Europeanisation, explicit use of (let alone designing) indirect rules to circumvent or reduce the pressure for adjustment to EU-driven liberalisation, is less frequent. Examples from the financial services sector include an EEA state delaying privatisation to prevent acquisition by foreign institutions. The Icelandic bank sector went through a restructuring process driven by privatisation and liberalisation in the late 1990s, although the government and major banks expressed concerns about competitive pressure from foreign rivals. When the Svenska Enskilda Banken's bid for a majority of the largely state-owned Landsbanki Islands in 1998, the government simply delayed the privatisation process. Two years later, the Competition Council would block the government-supported merger of the two banks that remained in state hands. Distorting privatisation in favour of domestic firms, while remaining within the letter of the law is of course not limited to the EEA Three. In a similar case in France in 1998, Finance Minister Strauss-Kahn rejected Dutch bank ABN AMRO's bid for Credit Industriel et Commercial when it was being privatised, reportedly in favour of a lower bid from Credit Mutuel that offered better job assurances (*Financial Times* 12 March 1999).

Given the Member States' role in implementation and the Commission's limited resources, 'soft' resistance appears to be the more effective form of resistance to Europeanisation. The financial services sector provides ample examples of governments attempting, and to some extent succeeding, to protect national industry. The question is more problematic in the defence sector, where the nature of offset provisions makes it somewhat difficult to combat even if a consensus were to be reached. To be sure, public procurement rules could address the practice of purchasing all military equipment at home, or even military and civilian indirect offset (where the company awarded the contract, or its host government, agrees to buy goods from the tendering country for the equivalent amount). However, Given the possibility of building direct offset (the company awarded the contract uses sub-contractors from the awarding country) into joint contracts, the scope for 'soft resistance' is considerable.

Conclusion: Between Regulation and Competition

The central argument is that the sectors that have long enjoyed exemptions from Single Market and competition rules are increasingly being squeezed between regulation and competition. The consensus that generated the exemptions in the first place is weakening, not only in the shape of DG Competition and DG Internal Market's increasing readiness to confront Member State governments, but also in the form of a number of governments questioning the exemptions. Or rather, this is the case inasmuch as the completion of the single market, the arrival of the single currency and increasing competition (including public procurement) provides incentives for separating commercial and security concerns. In the financial services this means separating prudential and protectionist concerns, in the defence sector military and industrial policy concerns. As the limits of Europeanisation its exemptions are being tested, this warrants differentiating between first-, second- and third-order Europeanisation.

Distinguishing between the three levels of Europeanisation and resistance prompts the suggestion that third-order Europeanisation and soft resistance is gaining importance. If Europeanisation is defined in terms of adaptation to European integration, resistance appears to be a considerable challenge at the implementation level even when resistance to first- or second-order Europeanisation is limited. In the financial services sector, soft resistance has proven more effective, even if it has led to some confrontations. Even in the defence sector, where exemptions to first-order Europeanisation are long-established, the use of offset instruments are increasingly debated and the Commission is beginning to focus on the implications of dual-use products for states' invoking Article 296. In short, the games over the limits to Europeanisation has to some extent moved to the third level, to questions about how rules are operated and applied.

The emphasis on second- and third-order Europeanisation warrants focus on the role played by the Commission, particularly the DGs for Competition and Industry, and certain competition authorities in driving Europeanisation, and on some governments and national sector regulators in resisting this. As the protected sectors come under increasing pressure and are gradually exposed to competition, and the research agenda shifts from first- to second- and third-order Europeanisation, comparative politics analyses of the interplay between governments, regulatory and competition authorities at different levels are called for. If, as per McGowan's argument above, the limits to Europeanisation reflect the limits to neo-functionalist integration, this warrants focus on how diversity is accommodated in plural political systems. The present exploration of two of the sectors partially excluded from Single Market rules indicates that although considerable efforts have been (and continue to be) made to accommodate institutional plurality, the scope for exemptions is decreasing. Although cultural difference may continue to warrant exemptions from rules, defence and financial security are losing some of their salience. Nevertheless, differences in states' institutional set-ups make for different responses to the pressure for Europeanisation. Soft resistance therefore becomes increasingly salient as the logic of competition is extended into the commercial elements of previously protected sectors. And at that level, the limits to Europeanisation are only beginning to be explored.

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