

Capitalism, nationalism and economic warfare

Simon J. Evenett¹
University of St. Gallen, Switzerland

In this short presentation I will reflect on certain linkages between capitalism, nationalism, and economic warfare. Inevitably my choice of subject matter reflects what I know, or rather what I think I know something about. I do not claim to be comprehensive in my treatment of this multi-faceted and important matter. Rather, I hope to raise a number of matters that may help stimulate discussion amongst ourselves.

I was tempted to add the clause "in the 21st Century" to the title of my talk to indicate that my focus would be on more recent developments. As is often the case, what is fashionable today is often a reaction against what was accepted wisdom in the recent past. For our purposes, of course, the relevant recent past included the almost decade-long celebration of the virtues of markets that we experienced in the 1990s. Like many, I was quite caught up in this mood. Being based in Washington, D.C. for a good part of this decade it wasn't hard to be. Even so, I remember chairing a session at the Brookings Institution in which the-then EU Ambassador to the United States, Mr. Hugo Paemen, was speaking just after the G7 Summit in Denver in 1997. Ambassador Paemen subtly warned the audience that the triumphant tone taken at Denver could be counterproductive and might induce a backlash. Moreover, he argued the U.S. may be doing well, but so were some EU member states. Well, we did not have to wait long for the Ambassador's comments to ring true. The East Asian Financial Crisis, which began with Thailand's currency being knocked off its peg with the dollar in July 1997, soon spread to many of the fast-growing newly-industrialised countries. When the dust settled the latter blamed "Washington" for (at least) part of the crisis and repudiated the Washington Consensus, which has guided economic reforms in much of the 1980s and 1990s.² Once the well performing developing countries began putting some distance between themselves and the policy recommendations of the World Bank and IMF, it wasn't long before many others in Africa, Latin America, and elsewhere rejected the pro-market prescriptions. From Fall of the Berlin Wall to the Fall of the Baht took a mere seven years.

So what set of principles then began to guide national economic policies? Apart from a few countries in Latin America, there seems to be little appetite for a return to full-scale state control of the "commanding heights" of the economy and for comprehensive state-planning. Yet, governments still have definite goals for their countries and still appear to be dissatisfied with leaving private sector development to the market. Dissatisfaction with supply-side policies seems as great as distrust of financial sector liberalisation. Policymakers often seem to be looking for some type of halfway house between the old dichotomy of state and markets. (Some innovative politicians "spun" this as a search for a "third way" but after 10 years of Mr. Blair's government in the U.K., with its attendant tax rises, failed public service reform, and clogged infrastructures of all types, the lustre of this approach has worn off.) The term that many politicians and a few entrepreneurial economists have alighted on is

¹ Professor of International Trade and Economic Development, Department of Economics, University of St. Gallen and Director of the Swiss Institute for International Affairs and Applied Economic Research (SIAW). Email: simon.evenett@unisg.ch. Other contact information, writings, and presentations can be found at www.evenett.com.

² This is not to suggest that East Asian nations necessarily accepted or even adhered to the consensus. Just simply that after the 1997 Crisis began they were not prepared to be publicly associated with it.

"industrial policy" and it is quite remarkable how often this is referred to in current discussions. So if industrial policy is the current policy mantra, what is its relationship to nationalism and economic warfare? In what follows I will make a few comments on these matters.

The first important point to bear in mind is just how elastic the term industrial policy is. I once had to review for the WTO the different types of industrial policy and the only comprehensive definition I could come up with was that industrial policy was "not macroeconomic policy." Just about every other state measure had, at some point or the other, been referred to as industrial policy! There is, I suppose, an important message buried in here and that is that much of what has been called industrial policy is in fact unlikely to be very nationalistic or associated with economic warfare. Policies to train more engineers and to improve schools are unlikely to raise concerns of nationalism in trading partners etc. The elasticity of the term industrial policy also makes it very hard to comprehensively attack. Even so, in my view this does not lift the burden off the proponents of each industrial policy initiative to explain precisely what targets they want to accomplish, why those targets are sensible and feasible, what the consequences of the proposed measures are, and why those measures most effectively attain the stated goals at least possible harm to other interests. Industrial policy advocates have a lot of work to do to turn a convenient slogan into an effective programme for government.

The second point to make about industrial policy is that, from what we have seen in some countries, it need not be at all discriminatory against foreign commercial interests. South Africa, for example, wanted to boost its automobile industry after the fall of Apartheid. The government there developed an elaborate set of incentives (which essentially involved giving credits to be used against import tariffs paid for any parts, components, and final cars exported and for certain productive investments made in South Africa) which were open to all firms. A number of German and Japanese automobile makers responded to these incentives and production and exports duly took off. Supporters of industrial policy hail this programme as a tremendous success.³ I take no position on the latter. I merely note that there may be instances when industrial policy creates no tensions with trading partners and the like. More generally, to the extent that industrial policies seek to attract foreign direct investors then--at least at the time of luring them in⁴--it is difficult to see how these policies would be "nationalistic" in the sense of being anti-foreigner. Put differently, the chase for foreign direct investment may take some of the edge off any nationalistic components of industrial policy.

To the extent that industrial policy is discriminatory and anti-foreigner, how might the latter manifest itself? In recent years the answer might be in terms of policies towards cross-border foreign mergers and acquisitions (both defensively and offensively) and policies towards state aids or subsidies. With the last French Administration emphasising "economic patriotism" and the fracas over the potential takeover of Danone and the actual takeover of Arcelor, these matters are well known to Europeans. Americans will recognise the importance of state-aids issues as they are at the core of the so-called Boeing-Airbus trade dispute. Proposals to buy American companies are now reviewed independently for their effects on national security and some in the U.S. Congress have argued that effects on "national economic security" should be taken into account.⁵ Now, the first reflection I have on this development is that these policy matters are all related to competition law and the

³ See, for example, the analysis and conclusion in Justin Barnes, Raphael Kaplinsky, and Mike Morris. "Industrial Policy in Developing Economies: Developing Dynamic Comparative Advantage in the South African Automobile Sector." *Competition & Change* (2004). Volume 8. Number 2.

⁴ Post-establishment treatment of foreign investors is another matter as recent experience in the energy sector in Russia has indicated.

question must arise as to whether competition agencies have the standing, the guts, and the support to be able to resist (if not entirely stop) this manifestation of economic nationalism? To its credit the European Commission has been taking a tougher stand against state aids within Europe--even so, there is a long way to go. Worse, little is being done in this regard outside of Europe. When it comes to resisting foreign takeovers and discouraging politicians' attempts to form national champions, however, competition agencies have shown precious little leadership at all. For instance, where was the opposition from the two U.S. antitrust agencies to the treatment of Dubai Ports World in its attempted takeover of P&O's ports on the Eastern seaboard of the United States last year? I am not alone in viewing these matters with some alarm. Last year the Chairman of the Steering Committee of the International Competition Network, the club that the some competition agencies formed to help prevent this issue from being taken up at the WTO, bemoaned this very fact publicly at their annual conference in Cape Town. The conclusion I draw from events such as these is that competition agencies would rather preserve their own independence, funding, and powers than challenge measures which principally harm foreign commercial interests.⁶ Without competition agencies intervening the only restraint left on these forms of economic nationalism is the self-restraint of politicians.

Economic nationalism in the form of policies towards cross-border mergers and acquisitions is rapidly acquiring a North-South dimension, to employ a quaint phrase from the 1970s. Perhaps the big difference with previous discussions of economic nationalism, which tended to be confined to discussions between Europe, North America, and Japan, is that the new emerging powers (Brazil, Russia, India, and China) all have ambitious plans for industrial policy and the development of internationally competitive firms. The Chinese, for example, want to produce a so-called "national team" of 120 conglomerates modelled on the Japanese Kieretsu and the Korean Chaebol. A vice-premier of China motivated this policy as follows (which certainly help me fulfil the "Economic Warfare" mandate in the title of this paper!) *"In reality, international economic confrontations show that if a country has several large companies or groups it will be assured of maintaining a certain market share and a position in the international economic order. America, for example, relies on General Motors, Boeing, Du Pont and a batch of other multinational companies. Japan relies on six large enterprise groups and Korea relies on 10 large commercial groupings. In the same way and in the next century our nation's position in the international economic order will be to a large extent determined by the position of our nation's large enterprises and groups."*⁷

Celebrations in India when the nominally Indian company⁸ Mittal Steel eventually bought Arcelor strongly indicate that the Indian government identifies its overseas commercial interests with that of "its" companies. One might think that these are isolated incidents but the potential for many more are highlighted by UN figures indicating that Brazil, China, and

⁵ The debate over the so-called CFIUS (Committee on Foreign Investments in the United States) process has been extremely revealing, even worrying for those concerned about the openness of the United States to international investment.

⁶ The irony will not be lost on those who follow the debates between trade policymakers and competition policymakers. The latter accuse the former of being mercantilist, while claiming to be interested in national economic welfare. In fact, it would seem that competition agencies have been just as willing to sit by and watch national economic welfare be circumvented by politicians' interventions in cross-border mergers and acquisitions. That or they are too afraid to act. Neither in my view gives them much of a right to criticise those who take a more trade-based perspective.

⁷ This quotation was reported in *Jingji Ribao* on 1 August 1998 and is reproduced in Peter Nolan. *China and the global business revolution*. Palgrave. Basingstoke. (2001, page 71).

⁸ The company is legally speaking Dutch and is headquartered in the United Kingdom!

India each already have 1225, 3429, and 1700 multinational companies, respectively.⁹ Looking forward, I suspect that merger and acquisition policy will become a far more controversial topic and will as a result cease to be a matter only handled by technocrats in competition agencies. Firms from developing countries are often acquiring Western companies for their technology and managerial and other know-how and this is likely to engender something of a backlash, especially if the former are expected to use the acquired knowledge to move quickly up the value-chain. These matters will quickly become important components of commercial policies and potentially viewed through the lens of mercantilism and economic nationalism.¹⁰

The next question, then, is whether these potential developments are a disaster? No doubt one could paint a picture of governments engaging in repeated beggar-thy-neighbour policies towards foreign commercial interests. The creation of national champions, blocked takeovers, subtle forms of expropriation could all be part of that gloomy picture. But surely the point must be made--haven't we been here before? Haven't policymakers recognised before--in other policy settings---that beggar-thy-neighbour policies typically leave everyone worse off and that the solution is to negotiate some type of multilateral restraint on the use of "bad" policies? Whether it is currency devaluations, tariff wars, or resorting to obscure non-tariff barriers policymakers have risen to the occasion and negotiated international accords that deliberately tie the hands (somewhat) of national policymakers and stop them from shooting their economies in the foot. What reason do we have to believe that policymakers wouldn't eventually see the need for an international accord on takeovers and state-aid related measures, if indeed they become more prominent instruments of economic nationalism? Are we to believe that policymakers are more suspicious now of foreign interests than in the past? (If so, what evidence is there to support this claim?) Moreover, are we to believe that the current architecture of international agreements and organisations could not be a suitable home for a new initiative on these lines? For sure, many of the international economic organisations have taken a beating in the last 10 years (the World Bank, the IMF, and the WTO come to mind) but are they irreparably broken?

Perhaps the biggest challenge facing those who eventually seek to negotiate an international agreement to curb the likely future manifestations of economic nationalism is precisely that it is no longer an intra-industrial country concern. The number of significant players in any such negotiation has risen to include Brazil, China, India, and Russia, and under some circumstances South Africa, Saudi Arabia, and Indonesia. The bi-polar domination of the international economic organisations by Europe and the United States has given way to a multi-polar alternative, at least as far as the WTO is concerned.¹¹ I do not mean to suggest that the new poles are likely to be any more difficult to negotiate with than the existing poles, rather that all are learning what negotiating is like in this brave new world and the potential for miscalculations are high.¹² Worse, as evidenced by a recent policy paper of The Atlantic Council of the United States¹³, some in the West are so frustrated with negotiations in this brave new world that they want to go it alone, or at least seek refuge with a coterie of long-

⁹ These statistics were taken from Annex Table A.I.6 of the *World Investment Report 2006*, published by UNCTAD. The statistics refer to the last year that data was available for a given country. For reference the comparable number of multinational companies headquartered in the United States is 2418.

¹⁰ I have developed these points at greater length in two papers titled "Does The Return of Industrial Policy Pose a Threat To Competition Law?" and "Trouble In Paradise: Will Technocrats Review Global Mergers Forever?" These papers can be downloaded from www.evenett.com and are available upon request.

¹¹ Although it should be noted that Russia is not yet a member of the WTO.

¹² The slow torturous pace of the Doha Development Round is evidence, I believe, of this learning-by-doing negotiations in a multi-polar world.

¹³ *Transatlantic Leadership for a New Global Economy*, The Atlantic Council of the United States, April 2007.

standing fellow travellers. This is the wrong response. If economic nationalism and economic warfare lay waste to the world economy of the 21st century it will almost certainly be because of a failure of statesmanship. Beggar-thy-neighbour practices are not new. Existing multilateral mechanisms could be adapted to curb such practices. Our forefathers recognised the attendant challenges and risks for the world economy and saw their way through similar troubled times, the question is whether we can too.¹⁴

¹⁴ I have developed some further thoughts on what this might mean for the WTO and for the EU's commercial policy in a paper titled "EU Trade Policy in A Multipolar World, " forthcoming in *Intereconomics*. This paper can be downloaded from www.evenett.com and is available upon request.