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The Internationalisation of Asset Ownership in Europe

Edited by
Harry Huizinga and Lars Jonung

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The Internationalisation of Asset Ownership in Europe

Financial markets in Europe have become increasingly integrated in recent years, leading to a rise in foreign ownership of domestic equities and other assets. This volume brings together ten expert contributions to provide an authoritative analysis of the evolution and implications of foreign ownership in Europe today.
In addition to providing new data on the extent of foreign ownership in Europe, the authors analyse some of the major challenges it brings for policy-makers at both the European and the national level. Part I looks at the legal framework for foreign ownership and for cross-border mergers and acquisitions. Part II explores important aspects of the economic impact of foreign ownership, including taxation and labour market outcomes, from a European perspective. The volume concludes with four in-depth country studies that focus on the process of asset internationalisation in Sweden, Finland, the United Kingdom and Italy.

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Preface

As the economies of Europe become ever more integrated, a key dimension of change is the growing cross-border ownership of assets. This internationalisation of ownership brings important economic advantages. As asset portfolios become diversified across borders, incomes are increasingly buffered against shocks to production – and this in turn can help foster greater specialisation and efficiency in the production process. But this ongoing process also poses challenges to European policy-makers, because the integration of financial markets has moved well ahead of adjustments in the policy-making process.

To shed further light on these issues, and also to promote policy discussion, this volume documents recent developments in the foreign ownership of assets across Europe, analyses major drivers of the process and explores some of its implications.

The chapters in this book were originally presented at a conference on 'The Internationalisation of Asset Ownership in Europe', hosted by the Directorate General for Economic and Financial Affairs of the European Commission (DG ECFIN) in Brussels on 27–28 February 2003.

Remarks prepared by the discussants and by outside commentators greatly helped the authors in revising their contributions. At DG ECFIN, we would like to thank Klaus Regling, Director-General, and Jürgen Kröger, Director of Economic Studies and Research, for their generous support for this project. We are also grateful to Michèle Devuyst and Bénédicte Herry for secretarial support.

BRUSSELS, JULY 2004
HARRY HUIZINGA AND LARS JONUNG

Introduction

Harry Huizinga and Lars Jonung

The creation of a single European financial market is an objective that, to a considerable extent and in a formal sense, has already been attained. By 1990 the European Union had abolished most restrictions on international asset holdings. This means that EU member states are obliged to allow residents of other EU countries and of third countries to own national 'domestic' assets. Firms, for instance, have the right of establishment anywhere in the Union. At the same time, restrictions on the national asset composition of private and pension portfolios have been lifted. The Maastricht Treaty, which came into force in 1994, elevated the principle of internal and external capital mobility in the European Union to treaty status.

Financial market liberalisation leads to a more international investment strategy on the part of institutional as well as individual investors. On the institutional side, we expect financial market integration to cause investment funds to allocate a larger share of their overall portfolios to foreign assets, inside as well as outside the euro area. Larger foreign shares in investment portfolios logically lead to larger shares of national assets being owned by foreigners. Hence, foreign ownership of all kinds of assets – including bank assets, government bonds and equities – is expected to increase with growing financial market integration. The logic of international portfolio diversification would imply that the foreign ownership of some assets – and exchange-traded securities in particular – could approach 100 per cent, at least for some of the smaller EU member states. This would be a startling outcome, and also one for which many policy-makers seem not to be fully prepared at present.

De jure financial liberalisation has contributed to financial market integration in Europe in several ways. Figure I.1 shows the evolution of the level of international financial integration for an aggregate of industrial countries and for a sub-aggregate of EU member countries between 1991 and 2001, using an index developed by Lane and Milesi-Ferretti

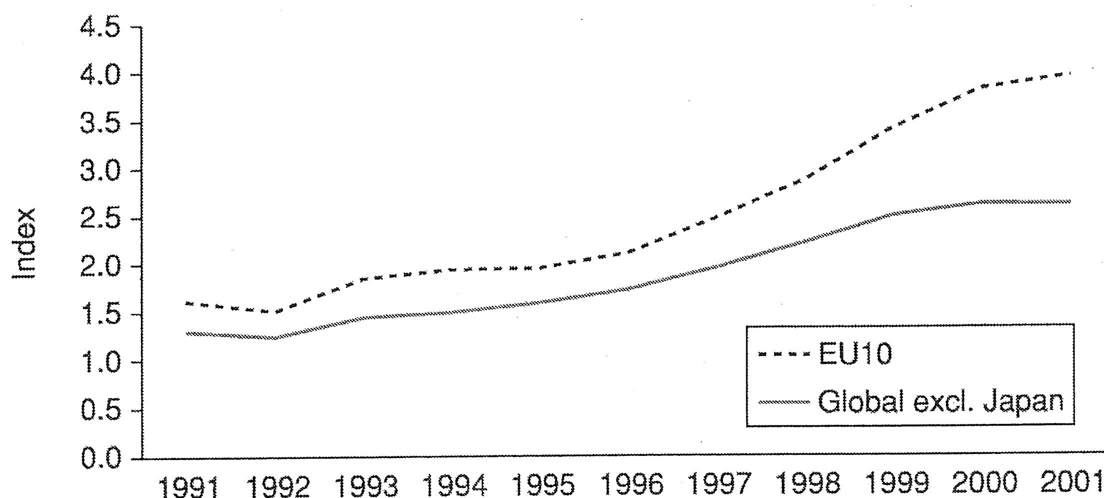

Figure I.1 International financial integration.
Note: The EU10 countries are Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Spain and the United Kingdom. The group referred to as 'global excl. Japan' consists of the EU10 countries plus Australia, Canada, New Zealand, Switzerland and the United States.

(2003).[1] This index measures the sum of foreign assets and foreign liabilities as a ratio of GDP.[2] Figure I.1 demonstrates a strong positive trend, with a marked acceleration from the mid-1990s onwards. EU member states demonstrate above-average levels of international financial integration.

Although it is masked by the aggregate data, there is considerable cross-country variation in the degree of international financial integration and the relative importance of equity versus debt components. Table I.1 displays the country data for the most recent year available (2001, but 2000 for Sweden). The data reflect high foreign ownership rates for several asset classes in Europe. For instance, the foreign ownership shares of the equity of non-listed firms for Western and Eastern Europe are calculated to be 19.2 and 44.2 per cent respectively in 2000, as reported in this volume. In comparison, the foreign ownership shares of the equity of exchange-listed firms in Western and Eastern Europe are calculated at 27.0 and 14.2 per cent respectively in 1997. In contrast, Cai and Warnock (2004) report a foreign ownership share of US-traded equity of only 5.4 per cent in 2000. Especially in recent years the foreign ownership of exchange-traded shares in Europe has increased significantly, with foreign ownership exceeding 70 per cent of exchange-traded shares in Finland in 2000. Price-based measures of financial market

[1] See also chapter 5 in *The EU Economy: 2003 Review* (European Commission, DG ECFIN, 2003).
[2] The membership of these aggregates is determined by data availability.

Table I.1. *Overall cross-border exposure – country data*

	Sum of foreign assets and foreign liabilities as percentage of GDP	Sum of FDI and portfolio equity assets and liabilities as percentage of GDP	Net foreign assets as percentage of GDP
Austria	3.2	0.6	−0.2
Belgium	6.6	2.4	0.6
Denmark	3.1	1.3	−0.2
Finland	3.6	2.0	−0.9
France	3.6	1.7	0.1
Germany	3.0	1.0	0.1
Greece	1.5	0.2	−0.4
Ireland	15.0	6.1	−0.1
Italy	2.0	0.5	0.0
Netherlands	6.7	3.1	−0.1
Portugal	3.3	0.8	−0.4
Spain	2.4	0.9	−0.2
Sweden	3.2	1.6	−0.3
United Kingdom	6.5	2.0	0.0

Note: Figures refer to 2001 for all countries apart from Sweden, for which data refer to 2000.
Source: European Commission, DG ECFIN (2003).

integration also point to increased integration in recent years. Money market and also government bond yield differences in the euro area, for instance, have narrowed since the advent of the common currency, the euro.

Financial market integration is expected to yield a range of economic benefits. Foreign direct investment (FDI) leads to a rationalisation of production as firms aim to exploit their firm-specific technological advantages internationally. The international application of best technologies by multinational firms should enhance labour productivity everywhere and ultimately lead to higher returns to capital and higher wages. Improved international portfolio diversification, in turn, helps individuals – and also countries – to attain higher welfare by smoothing consumption in the face of asymmetric or country-specific productivity shocks.

Financial market integration may already be yielding significant benefits in terms of higher productivity and more effective international risk diversification. Further gains will be realised in the years to come, as

economic agents continue to adjust to the reality of international capital mobility. However, policy-makers as well as private agents need to adjust to realise the full potential benefits of financial market integration. In the days before capital mobility, countries determined their tax and legal regimes governing capital ownership more or less in isolation, neglecting open-economy considerations. These policies mostly affected the domestic owners of national assets, thereby limiting the potential for creating international policy externalities. In the last decade or so EU countries have experienced almost complete international capital mobility, which is putting the spotlight on the implications for foreign investors of national regimes towards asset ownership. In fact, some of the shortcomings of national policy autonomy in the tax and legal areas are now becoming apparent.

With increased cross-ownership of assets, part of the incidence of capital income taxation rests on the foreign owners of national assets. In other words, part of the corporate income tax can effectively be exported to non-resident owners. International ownership of assets thus introduces an incentive for countries to increase their corporate income taxes. Some economists predict that foreign ownership will reach high levels for small open economies in the future, and consequently that tax exportation could lead to taxation levels that are 'too' high. On the other hand, increased tax competition among member states may contribute to the opposite outcome — that is, taxation levels that are 'too' low. Recently, several member states have reduced taxes on capital income significantly. At present, it is unclear which of these opposing forces will dominate in the future.

A second policy-related problem stemming from increased financial market integration is that countries may be more inclined to excuse defensive measures against hostile takeovers. The reason is that with capital mobility, a bidder for a national firm is more likely to be a foreigner. Hence, defensive measures that effectively increase the agreed takeover price for foreigners may force foreigners to pay more to acquire domestic assets. Some aspects of corporate law can thus be equivalent to export taxes on the sale of national assets in their impact on asset prices. Such implicit asset export taxation may be rational from a national political economy perspective, but it may prevent efficient international mergers and acquisitions from taking place and hence be undesirable from an EU perspective.

Along similar lines, one may argue that the internationalisation of asset ownership may constitute a barrier to improved investor protection in the form of, say, improved information flows to investors and the guaranteed independence of company boards. The reason is that, for

publicly traded companies, the management and controlling shareholders are often domestic, while foreigners are more commonly minority shareholders holding some shares as portfolio investments. In this scenario, improved investor protection will prevent domestic parties (i.e. management and controlling shareholders) from taking advantage of foreign parties (i.e. foreign, atomistic investors). In this instance, the gains to be reaped from improved investor protection will, to a large extent, accrue to foreign residents because stock prices will start to reflect the improved investor protection. Thus, the incentives for countries to improve investor protection may be reduced after a significant foreign ownership share of the common stock of exchange-listed firms has been established. On the other hand, there are strong reasons for countries competing for foreign capital to improve and maintain their attractiveness by offering a good corporate governance structure.[3] Thus, we would expect the future to tell us which of these opposing forces will be the stronger one.

It is possible to argue that the problems related to the tax and legal treatment of asset ownership may get worse *after* a substantial foreign ownership share has been established. This suggests that, ideally, countries should get their national tax and legal regimes in order *before* establishing full international capital mobility. However, free capital mobility has now been enshrined in the Maastricht Treaty, and hence policy-makers no longer have the luxury of discussing the optimal ordering of policy moves when considering financial market liberalisation. Rather, policy-makers today face the challenge of establishing a tax and legal regime governing asset holdings that is the proper one for the European Union as a whole in the face of free capital mobility.

In practice, we see considerable variation across EU member states both in terms of capital income taxation and in the areas of the law and corporate governance. This suggests that some countries may be able to institute better policies than others, perhaps by establishing and upholding an international reputation for the proper treatment of international investors. As indicated, tax and legal policies regarding asset holdings potentially have some inherently 'beggar thy neighbour' aspects, in that they may advantage domestic residents (either public or private) at the expense of foreign residents. This suggests that policies that are appropriate for Europe as a whole cannot be established by reputation building at the national level alone. Policy coordination at the European level will be necessary. Indeed, following the corporate debacles of Enron and

[3] This argument is stressed in chapter 5 in *The EU Economy: 2003 Review*, (European Commission, DG ECFIN 2003).

other firms in the United States, the European Union introduced a Corporate Governance Action Plan in 2003 aimed at improving corporate governance by strengthening shareholder rights through improving access to company information and facilitating voting *in absentia*. Also, the roles of independent non-executive directors and the board's accountability for the company's financial statements are to be strengthened. Similarly, coordinated policies to prevent excessive exportation of corporate income tax can be envisaged at some point in the future.

Judging from the above account, much has already happened and much is continuing to happen concerning the internationalisation of asset ownership in Europe. This volume brings together ten expert contributions that shed light on the significance and evolution of foreign ownership in today's Europe. It contains – in addition to this introduction – six 'horizontal' chapters dealing with a particular aspect of foreign ownership for several countries, followed by four country studies that examine a variety of aspects of foreign ownership for individual countries. The book is divided into three parts. Part I deals with the legal framework regarding foreign ownership in the European Union. It outlines the development of restrictions on foreign ownership in the Union and focuses on European aspects of takeover regulation. Part II is concerned with a range of recent developments regarding foreign ownership. These include how foreign ownership affects labour markets and corporate tax policies. Evidence on the extent of international portfolio diversification in the Union is also presented. Its ultimate impact on the smoothing of national consumption aggregates in the face of shocks to GDP is considered as well. Part III contains four country studies for Sweden, Finland, the United Kingdom and Italy. These case studies focus on several aspects of the process of asset internationalisation for the country in question.[4]

Part I The legal framework

A detailed account of the legal framework pertaining to foreign ownership of assets within the European Union is given in the chapter by Raes. His starting point is the Treaty of Rome, which established the free movement of goods, persons, services and capital when it came into force in 1958. However, progress concerning the free flow of capital

[4] The focus in this volume is on the internationalisation of asset ownership in Europe. Aspects of the evolution of ownership from a global perspective have recently been examined in the contributions in Mork (2005).

was slow. The full liberalisation of purchases and sales of financial assets and financial services did not become part of EU law until 1990. The Maastricht Treaty instituted full freedom for internal and external capital movements in the Union in 1994.

As described by Raes, the legal framework allows a number of exceptions to free capital movements, thus restricting foreign ownership. These restrictive measures are based on Community laws, on agreements between the Union and individual member states, and on the Organisation for Economic Co-operation and Development (OECD) and General Agreement on Trade in Services (GATS) frameworks. Restrictions on the free flow of capital may, according to Community laws, be based on several grounds, 'general interest' considerations being perhaps the most pertinent to current policy-making. Under this heading we find a set of nationally applied techniques to prevent or reduce foreign ownership, such as 'golden shares', limits on share voting rights, veto rights concerning mergers and acquisitions, etc. Raes also deals with third-country restrictions adopted by the Community, and with international cooperation conçerning capital flows. Finally, he notes that the abstract rules of the Maastricht Treaty are being clarified by crucial decisions by the European Court of Justice. Thus, case law is currently in the process of evolving in this field.

Barriers to international takeovers that one member state considers to be in the 'general interest' may stand in the way of the restructuring of corporate Europe – a process that is commonly deemed necessary to improve overall production capacity. The legal barriers to such a restructuring have become more glaring since the introduction of the common currency and the elimination of across-the-board capital controls. The solution appears to be an EU directive on takeovers.

In their chapter, Berglöf and Burkart point out that large differences in corporate governance among EU member states, in particular between the UK system and those of Continental Europe, have made it difficult to establish pan-European takeover directives. Attempts by the European Commission to get legislation passed by the European Parliament failed in 2001.

To get things moving again, the Winter Group, set up by the European Commission, examined these and related issues in a set of reports published in 2002.[5] The Winter Group advocates more contestability of corporate ownership and a more level playing field for takeovers by suggesting a mandatory bid rule and a break-through rule. The latter rule is to enable a bidder who has achieved a qualified majority of equity

[5] See European Commission (2002) – 'the Winter Report'.

to overcome statutory defences, including any differentiation of votes. This break-through rule proved controversial and was subsequently dropped from the Commission's draft directive on cross-border mergers. In the final directive the break-through rule and the defensive measure provisions were reinserted, but as optional items.

After describing the prevailing systems of ownership and control in Europe, Berglöf and Burkart make an assessment of the impact of various proposals for pan-European takeover rules, based on a survey of empirical and theoretical work on corporate governance and on takeovers. Here they identify a number of trade-offs and inconsistencies. In short, every step towards a common system will impact differentially across the member states due to differences in initial conditions. In their conclusions, Berglöf and Burkart stress that existing corporate governance structures in Europe have evolved into complex and interdependent systems. We should not expect the search for a common system to be an easy one. They suggest that national as well as EU takeover regulation should aim primarily at improving transparency as a way of fostering corporate governance in Europe.

Part II Recent developments

Firms engaging in FDI combine international technology and product knowledge with local labour. Thus, FDI can be expected to affect national labour markets. Indeed, one major potential benefit of inward FDI is improved labour market opportunities for local workers. Scheve and Slaughter set out to evaluate the impact of inward FDI on European labour markets in their contribution. After reviewing recent trends in US foreign direct investment in Europe, they conclude that it is unclear whether multinationals increase the relative demand for high-skill labour in host countries. There is substantial evidence, however, that multinationals pay higher wages, even after controlling for plant characteristics such as plant size. This wage premium may reflect higher worker productivity due to the superior technology or business practices used by multinationals. Alternatively, multinationals may pay higher wages due to greater job insecurity.

Scheve and Slaughter argue that multinationals that operate in more competitive international markets may display a relatively elastic labour demand that at the same time is subject to shocks in the international market place. As a result, local labour market outcomes at foreign-owned plants may be more variable. Indeed, they find that worker insecurity in the United Kingdom, as perceived by the workers themselves, is positively correlated with the FDI share in their industry of employment.

As evidence of international rent sharing, Scheve and Slaughter further discuss the finding that worker compensation at foreign plants appears to be influenced by a multinational's worldwide profitability.

A second major advantage of FDI is that multinational firms contribute corporate income taxes to national treasuries. In fact, high rates of foreign ownership in local firms may provide countries with an incentive to impose relatively high corporate income taxes, as part of the corporate income tax burden is effectively exported. In their contribution, Denis, Huizinga and Nicodème report some evidence that foreign ownership and effective rates of corporate taxes are indeed positively related across Europe. The positive impact of foreign ownership on taxation may have prevented a 'race to the bottom' in corporate income tax rates in Europe so far. It may turn into a challenge for policy-makers if foreign ownership rates continue to increase in the future. For the year 2000 the average foreign ownership share in Europe is reported to be 26.7 per cent for firms without an exchange listing. There are reasons to expect this number to grow in the future.

Denis, Huizinga and Nicodème also present some evidence on the determinants of the foreign ownership of non-listed equities. Among these determinants are indicators of the quality of a country's corporate governance and of its rule of law. Specifically, foreign ownership rates appear to be higher in countries with weaker investor protection. The reason may be that multinational firms – subject to relatively high-quality home-country investor protection standards – have a comparative advantage when operating in countries with lower standards. The tendency for countries with weak shareholder protection to attract high rates of foreign ownership may provide these countries with an incentive to improve investor protection in order to avoid completely losing control over their private sectors.

The mirror image of the internationalisation of national physical assets is the internationalisation of investment portfolios. Adjaouté, Danthine and Isakov ask whether the investment portfolios of Europeans are now better diversified than they were five or ten years ago, and whether trends towards increased international diversification have been accelerated by the advent of the euro. The evidence they present points towards some favourable, if modest, changes. The elimination of currency-matching requirements within the euro area has certainly led institutional investors to increase their holdings of international securities. This has been accompanied by a strong convergence of yields on EU government securities.

Similarly, there is evidence that equity risk premia across European stock markets are converging. For firms in countries with hitherto

high-risk premia, this convergence has brought a reduction in the cost of equity capital. The introduction of the euro is reported to have led to a shift in the investment strategies of European equity investors from focusing on country portfolios to focusing on Europe-wide industry portfolios. Such a paradigm shift makes sense if the introduction of the euro has significantly reduced the country-level risk associated, for instance, with national currencies. The authors do, in fact find some evidence that in recent years a strategy of combining industry portfolios could have performed better than the old method of weighing country portfolios. An exclusive focus on industry risk, however, would leave some opportunities to diversify risk internationally unexploited, even in the current euro area. Changes in investor behaviour and asset price formation have so far not led to a strong correlation of consumption growth rates across European countries. This suggests that significant progress can still be made in asset diversification in Europe.

Kalemli-Ozcan, Sørensen and Yosha examine in detail whether the recent rise in financial integration in Europe, including cross-border holdings of financial claims and cross-border ownership of firms, has contributed to risk sharing and consumption smoothing. They start from the fact that capital markets allow individuals as well as countries to separate production (output) and consumption decisions. Hence, in principle, capital markets can provide a mechanism for risk sharing, or 'macroeconomic insurance'. In line with this, the authors explore empirically the extent of risk sharing within the European Union through net factor income flows – being the difference between GDP (the value of the aggregate production within a country) and GNP (the value of aggregate production owned by residents of a country). Their econometric tests for the EU member states show that, in most recent years, financial integration across member states has buffered asymmetric shocks in a way identical to the pattern reported for the United States. Furthermore, risk sharing is rising in the euro area, although it is far less pronounced than in the United States. They expect this rise to continue in the future.

Finally, turning to policy conclusions, Kalemli-Ozcan, Sørensen and Yosha recommend measures to foster financial integration within the European Union. Such measures will lead to improved risk insurance, thus facilitating adjustment to country-specific shocks in the Union.

Part III Country studies

This part presents case studies of the evolution and impact of foreign ownership in four European countries: Sweden, Finland, the United

Kingdom and Italy. Sweden and Finland have experienced remarkable increases in foreign ownership in the past ten years as a result of financial deregulation and other legal changes affecting foreign investors. Due to this rapid transformation of the distribution of the ownership of firms and financial assets, foreign ownership has received considerable attention in public debate.[6] In contrast, the United Kingdom has traditionally been more open to foreign investments, and foreign ownership of United Kingdom enterprises has not been seen as a concern in political discussion.

For the case of Sweden, Henrekson and Jakobsson provide a broad survey of the forces determining the ownership structure and corporate governance in a small open economy with a strong corporatist political culture where the ownership of capital and the control of firms are strongly separated, as in many other European countries – in contrast to the US corporate governance model. In fact, no other industrial country demonstrates such a large gap between cash-flow rights and control rights as Sweden. Benefiting from access to a wealth of data (generally lacking for most EU member states), they explain the evolution of the Swedish model of corporate governance since World War II. They distinguish between two phases. In the first phase, from the end of World War II to the mid-1980s, when financial markets were strongly regulated and foreigners were barred from the Stockholm Stock Exchange, a small set of domestic owners emerged controlling the equity – that is, the voting rights – of Swedish industry. According to Henrekson and Jakobsson, this pattern was due to a 'paradoxical' but deliberate policy regarding ownership and private wealth creation. Tax policies as well as other policies were designed to discourage private wealth holdings, while corporate policies encouraged the control of ownership with a small private wealth basis through the use of differential voting rights and of private foundations with tax-exempt status.

The second phase began when Swedish financial markets and the market for ownership were deregulated during the 1990s, allowing foreign capital to flow into Sweden and foreign investors to compete with domestic ones for the ownership of Swedish companies. As domestic ownership remained subject to discriminatory taxation compared to foreign ownership, this contributed to a process whereby foreigners rapidly acquired a sizeable share of Swedish firms and equity. Several

[6] For example, economic issues pertaining to foreign ownership in Sweden are examined in the contributions in Jonung (2002). They deal with three major questions: the causes of changes in domestic/foreign ownership, the consequences of foreign ownership, and policy responses to foreign ownership. In Finland a similar debate is taking place, as reported in chapter 8.

major companies listed on the Stockholm Stock Exchange, such as Volvo, Saab, Aga and other 'crown jewels', were taken over by foreign companies. The number of employees in foreign-owned firms has expanded rapidly in the past ten years.

At present two different forces are challenging the Swedish corporate control model: first, rising foreign ownership; and, second, the growth of large corporatist pension funds. Henrekson and Jakobsson argue that the present corporate model does not appear to be sustainable. Current owners do not command the financial resources required to maintain their control. Thus, pressure is strong to reduce the gap between cash-flow rights and control rights. In this way the old Swedish model of concentrated private corporate control will be phased out, or, at least, decline in importance. A model is emerging in which the government and a few large corporate and private pension funds will be the dominating domestic owners. At the same time, the share of foreign ownership will increase. It is too early to tell what kind of corporate governance model will evolve from this new ownership situation.

Finland has seen a dramatic increase in the foreign ownership of shares in listed Finnish companies, to over 60 per cent in 2002, as shown by Ylä-Anttila, Ali-Yrkkö and Nyberg. Fundamental changes in the Finnish financial system over the past twenty years – the liberalisation of both domestic and international capital movements – were instrumental in the internationalisation of the ownership of Finnish assets. These changes, incidentally, contributed to a deep economic crisis in the early 1990s. Foreign investors have been attracted to Finland in part by the potential to benefit from its technological edge, but this also raises concerns that advanced technologies will be transferred abroad.

Ylä-Anttila, Ali-Yrkkö and Nyberg argue that the globalisation of Finnish capital markets has occasioned several changes in the corporate governance of Finnish firms, such as greater stress being placed on more independent boards of directors and a shift of emphasis towards creating shareholder value. Empirical evidence using firm-level data shows that foreign-owned firms have performed much better than domestic ones in creating added value and achieving a high return on capital. The large outward flow of FDI is consistent with the view that Finland is attractive as a country for the location of headquarters. Social stability and high-quality data communication links favour setting up headquarters in Finland. Other factors, however, work towards the migration of corporate headquarters out of Finland – such as the Finnish system of taxation with regard to options and personal income.

In the United Kingdom, foreign direct investment and the foreign ownership of domestic companies have failed to attract political

reactions – in contrast to the experience in Sweden and Finland. In their contribution on the political economy of foreign investment in the United Kingdom, Capie, Wood and Sensenbrenner argue that foreign ownership has been a political 'non-issue'. They engage in the task of exploring a set of social, political and economic factors determining why this should be so. After describing the evolution of foreign investment in the United Kingdom in a historical perspective, presenting some 'new political economy' hypotheses to explain the British attitudes of benign neglect towards foreign ownership, and surveying previous work on inward investment into the country, they sift through the evidence.

Pulling together their survey of determinants, they conclude that foreign ownership has not been determined by the party in power, the exchange rate regime or the macroeconomic situation. They point to two important factors behind the UK view. First, the United Kingdom has been a major capital exporter for a long time. Thus, when capital started to flow inwards, there was a general belief in the benefits of free cross-border flows of asset ownership. Second, the UK system of corporate governance has played an important role. The United Kingdom's 'outside' corporate governance system, in contrast to the mostly 'inside' corporate governance systems on the Continent, has given management a strong position vis-à-vis the shareholders. In this case, the issue of whether ownership is national or foreign becomes less of an issue.

Finally, Mariotti, Onida and Piscitello present a study of foreign ownership and firm performance in Italy. In recent years Italy appears to have received relatively little inward FDI. Inward FDI represented only 6.3 per cent of gross capital formation in Italy in 2000 – against 42.2 per cent for the European Union as a whole. In 2002, after the bubble had burst, the difference was smaller but still significant: 6.2 per cent in Italy versus 22.5 per cent in the union. The share of employment at foreign-owned companies in Italy, at 17.9 per cent, was also relatively small in a European context. Data from the Reprint database reveals that most FDI is in manufacturing, is majority-owned by the parent company, has Europe as the investing region and is located in the Italian North-West. In addition, recent flows of inward FDI have been mainly directed at smaller companies, although start-ups or greenfield investments play only a minor role.

Mariotti, Onida and Piscitello go on to test how a foreign acquisition of an Italian plant affects employment and labour productivity, compared to plants that are taken over by a domestic firm or not taken over at all. Compared to no takeover, a foreign takeover leads to significant increases in both employment and labour productivity a few years after the acquisition, especially if the target firm is small or if the investor is a

European firm. A domestic acquisition, by contrast, appears to have no significant impact on labour productivity, while employment may even fall. They conclude that FDI in Italy appears to have brought medium-term benefits in terms of job creation and competitiveness. Thus, policies aimed at attracting foreign investors may have beneficial effects on this account.

Together, these four case studies show that the actual and perceived role of foreign ownership has varied considerably across European countries in recent years. Finland has attained a very high share of foreign ownership of listed companies – at more than 60 per cent in 2002. Financial market liberalisation and the logic of portfolio diversification imply that this may be what is in store for the rest of the European Union as well in the foreseeable future. In fact, foreign capital inflows have already played a major role in the transformation of the economies of the new member states that entered the Union in 2004.

A major challenge for European policy-makers now is to agree on minimum coordinated policies towards the ownership of capital and corporate governance in order to make high levels of foreign ownership sustainable in the future. Only then can Europe fully realise the potential benefits of foreign ownership in terms of higher levels of productivity and risk reduction through portfolio diversification.

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