Jnl Publ. Pol., **21**, 3, 219–238
DOI: 10.1017/S0143814X0100112X
© 2001 Cambridge University Press
Printed in the United Kingdom

How Adaptable is the European Commission? The Case of State Aid Regulation

MITCHELL P. SMITH *Political Science, University of Oklahoma*

ABSTRACT

With the institutionalization of Europe's single market during the past decade, the Commission of the European Communities has faced dramatic changes in its policy environment. These include the intensified mobilization of firms and business associations that make new demands on Community regulatory regimes, and the accumulation of European Court of Justice decisions that alter the Commission's regulatory latitude. This essay examines developments in Community regulation of government aid to industry to assess how well the Commission has adapted to emerging constraints on its regulatory capacities. The essay finds that the Commission invited representatives of the national governments of EU countries to legislate conditions for applying regulations on government aid to industry in the mid-to-late 1990s – in a policy area in which the Commission in the past guarded its autonomy closely – not due to pressures from national governments, but as a response by the Commission's state aid policy unit to potential constraints on its regulatory capacities.

Bureaucratic agencies often seek to broaden their institutional autonomy, and skillfully develop mechanisms to accomplish this. This is certainly true of the Commission of the European Communities, which has been described by numerous scholars as a highly successful policy entrepreneur, adept at taking advantage of its unique status as an agent for multiple governments to carve out a significant sphere of autonomy in the initiation and implementation of policies designed to promote European integration. Explaining how the Commission does this was an important dimension of the scholarship on European integration in the 1990s (Cram, 1994; Nugent, 1995; Sandholtz, 1993, 1996; Pollack, 1997; Smith, 1998).

However, with the institutionalization of Europe's single market over the course of the past decade, the Commission, like the other institutions of the European Union, has faced dramatic changes in its policy

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

environment. These include the mobilization of societal actors such as firms and business associations that make new demands on Community regulatory regimes, and the accumulation of European Court of Justice decisions that alter the Commission's regulatory latitude. How well has the Commission adapted to new constraints on the exercise of its regulatory function? The relevance of this question has become increasingly evident since the March 1999 resignation of the College of Commissioners. Accompanying the Commission crisis was a recognition among Community- and national-level policy makers that consequential shifts in relations between Community institutions and the maturation of the Community as a polity mean that the European Commission operates in a substantially altered setting from that which prevailed at the inception of the Single Market project in the mid-1980s.

Studies of the adaptation of public bureaucracies to changing political conditions probe both the type of stimuli that provoke bureaucratic adaptation and the nature of the response forthcoming. Wood and Waterman (1993) find that agencies respond to multiple stimuli, including discrete events, ongoing developments ('event processes') and changes in the 'tone' of relations between political actors and the bureaucracy. These responses come in multiple forms and may happen rapidly or may be distributed across time. In their study of the responses of the Environmental Protection Agency in the U.S., for example, these authors found that responses to court decisions – in this case, referrals to courts following increases in judicial penalties for violaters of EPA regulations – were substantial and rapid (Wood and Waterman, 1993, 519).

Taking developments in Community regulation of government aid to industry as an 'event process', this essay asks whether the European Commission has been similarly able to adapt effectively to changes in its policy environment. Between late 1996 and 1998, the European Commission invited the Council of Ministers, the representatives of the national governments of EU countries, to legislate conditions for applying regulations on government aid to industry. This step appears especially perplexing because regulation of state aid is perhaps the area of greatest policy autonomy for the Commission. Working from powers it is granted in the European Community's founding treaty, the Commission's competition directorate fought hard to advance the reach of state aid policy as an integral part of Europe's single market project. Furthermore, the Commission had resisted an effort by the Council of Ministers in 1990 to use the very same legal mechanism invoked by the Commission in 1996 to impose constraints on the application of state aid policy.[1] At that time, although representatives of national governments expressed concern that the rigors of state aid regulation

https://doi.org/10.1017/S014381 4X0100112X Published online by Cambridge University Press

would impede their ability to compete with countries outside the Community regulatory regime, the Competition Commissioner firmly rejected the request, citing the urgency of upholding the separation of powers between the Commission and the Council established in the EC Treaty (Agence Europe, 1990). One interpretation of the Commission's request for Council action in 1996 is that it represents a retreat from this position and a capitulation to pressures from national governments. But such an interpretation assumes a static policy environment in which the only variable factor is the degree of member state government pressure on the European Commission. In fact, scrutinizing the content of the changes pursued by the Commission suggests that, rather than acting in response to pressures from national governments, the Commission sought to adapt to significant changes in its policy environment.

The European Commission reviews grants of aid to enterprises by national and subnational governments when those measures are reported to the Commission by the appropriate national government (as required by European Community law) or by competitors who believe the aid violates single market rules. Many forms of aid are compatible with the single market; others are deemed inadmissible because they severely distort trade between member states. The proposals put before the Council by the Commission in late 1996 sought to exempt benign categories of aid from Commission scrutiny, and to more carefully define and circumscribe the rights of third parties lodging complaints with the Commission about alleged illegal aid to competitors. These proposed measures reflected the competition directorate's desire to alleviate its burgeoning state aid caseload and to defuse the growing threat of third parties demanding Commission action in areas of state aid policy which the competition directorate was unprepared or politically unable to pursue. The increase in the competition directorate's state aid caseload, the growth of complaints to the Commission by third parties, and an increase in European Court of Justice cases filed against the Commission by third parties for its failure to act on their allegations of illegal aid, all responses to the Commission's activism in the area of state aid policy, represent critical changes in the Commission's policy making environment.

Recent literature that views the European Union (EU) as an evolving polity has recognized the role of EU institutions, especially the European Commission, as catalysts for interest mobilization (Grande, 1996; Sandholtz, 1996). This work has uncovered ways in which the EU institutions enhance their autonomy by stimulating the organization or articulation at the European level of interests demanding more integration as a means of realizing their preferences. However, there is an

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

additional dimension of this process that remains less thoroughly explored. Over time, the demands of interests mobilized at the European level may create consequences unanticipated by the EU's supranational institutions, and which ultimately threaten to constrain their autonomy.

In the first instance, organized interests and their institutional interlocutors may engage in a mutually beneficial interaction in which the former identify a productive venue for pursuing their interests, while the institution draws on the strength of organized interests to enhance its autonomy relative to other policy making organs. If the institution is not effective, the interests directing their activities toward that institution will find other avenues to pursue their objectives. However, if the institution augments its ability to achieve its policy objectives, it becomes a more attractive locus of interest articulation. Therefore interests relying on policy measures of the European Commission for preference satisfaction are unlikely to reduce or cease their demands as the Commission increases its institutional efficacy and autonomy relative to the executives of national governments; on the contrary, these demands are likely to intensify both in scope and number. What are the implications of these demands on institutional resources, and what are the consequences? What happens when these demands ultimately threaten the ability of the European Commission to independently set important components of the agenda for integration? How readily does the European Commission adapt?

Critical to the relative autonomy of the European Commission vis-à-vis national governments is a balance between policy rigor and restraint. In its pursuit of European integration, the Commission balances relatively autonomous development of regulatory regimes with a cartelistic relationship with national executives. Ultimately the forces that give the European Commission leverage in its efforts to achieve the first element of this balance – broader autonomy relative to member state executives – may make it vulnerable to the claims of private interest groups. This may endanger the second element – the elite cartel that keeps some issues off the regulatory agenda because they would inflame political tensions with national governments. In short, crucial to the Commission's relative autonomy is its ability to selectively *withhold* its regulatory capacities in the face of dangerously contentious politics; this discretion may be threatened by private interests who demand that the Commission strictly apply the rigorous competition rules at the core of Europe's single market, and enlist the European Court of Justice (ECJ) to force the Commission to do so.

Awareness of these second order effects of political mobilization is essential to understanding the European Commission's reliance in the

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

late 1990s on the Council of Ministers to more sharply define the application of state aid policy. The essay first analyzes how the European Commission expanded its autonomy in this policy area. Beginning in the late 1980s, the Commission relied increasingly on complaints from firms competing with aided public sector enterprises to legitimate a more rigorous policy of control of government aid, and especially the more focused application of state aid regulation to the public sector. The Commission exercised substantial latitude in choosing which complaints to pursue most vigorously; this choice was shaped by the competition directorate's independent plans for advancing the state aid agenda, which required systematic action in some sectors (such as banking) and restraint in others (public television and postal services, e.g.). However, by the mid-1990s, the policy environment began to change in critical ways. Firms or industry associations filing complaints were less willing to leave the Commission so much discretion to decide whether or not to act on their complaints. With increasing frequency, they turned to the European Court of Justice to challenge the Commission when it failed to act. The Commission's successful efforts to cultivate a constituency for a stricter state aid regime ultimately threatened to constraint its own ability to define the agenda for state aid regulation. It was at this point that the Commission turned to Community legislative channels, in part to circumscribe the legal rights of third parties lodging complaints. Just as it had relied on private sector complaints to augment its autonomy relative to national governments, the Commission now called upon those governments to help guard its autonomy from private interests.

Institutionalist perspectives on the European integration process have demonstrated how member state governments are constrained by past decisions, and supranational institutions thereby rendered more independent. However, supranational institutions themselves also face limits as they encounter organized interests in European society. The ability of a supranational agent like the European Commission to promote integration, while initially enabled, subsequently may be limited by the political dynamics of regulatory governance. Constituencies that are mobilized by the spread of European integration to new policy areas, and which may in the first instance help the Commission to shape the political agenda, also may intensify demands on the institution that in turn require it to undertake new tasks and expend additional scarce resources, and which may limit its independent agenda-setting abilities. By examining this process, the article reveals constraints on the ability of the supranational European Commission to organize political space in predictable ways, as well as the manner in which it responds to limits of policy entrepreneurship and the political impact of constituencies newly mobilized by regulatory policy.

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

Mobilizing a Constituency and Building Regulatory Capacities

Institutionalist theories of politics recognize that the actions of governments may mobilize interests by providing resources and formal or informal channels of representation or by articulating new policies or ideas that legitimate the claims of certain groups (March and Olsen, 1984, 739; Pierson, 1993, 601; Immergut, 1998, 20). In contrast to behavioralist approaches which depict political mobilization as a reflection of aggregated individual preferences, institutionalist perspectives view political mobilization as a response to government policies (Cameron, 1974; Walker, 1991, 49–50; Immergut, 1998, 6–7).[2] Government action may therefore be instrumental, whether intentionally or not, in inducing actors to identify their interests and mobilize on their behalf. In the European Union context, several authors have demonstrated the link between the activities of EU institutions and the mobilization of particular interests, such as the proliferation of subnational mobilization in response to enhanced opportunities for preference satisfaction at the EU level (Hooghe, 1995). Similarly, processes of consultation that precede major initiatives in the European single market typically induce formal organization of interests. For example, in response to the European Commission's early efforts to liberalize postal services, national postal service operators formed PostEurop, a Brussels lobbying organization. PostEurop subsequently played an important role in coordinating opposition to postal services liberalization measures in the late 1990s. This coalescence of formal interest associations includes instances of spontaneous mobilization as well as interest mobilization consciously fostered by the European Commission (Hooghe, 1995; McAleavay and Mitchell, 1994). The Commission's independent preferences and multiple mechanisms for pursuing these make it an attractive locus of interest articulation – these features render the Commission an additional 'optio(n) for societal actors in their choice of allies and arenas' (Sandholtz, 1996, 405).

Indeed, the literature on interest representation in the European Union establishes that interest articulation through national channels is supplemented through interest mobilization and articulation directly at the European level (Andersen and Eliassen, 1993; Greenwood and Ronit, 1994).[3] National and European political arenas are interconnected rather than autonomous political spheres (Marks, Hooghe and Blank, 1996, 346). As a consequence, a growing array of interests, including not only business associations and firms, but also representatives of cities, regions, and regional development councils, social services, and environmental groups, are now represented at the European level through both formal and informal mechanisms (Andersen and Eliassen, 1993, 40–1; Hooghe, 1995).

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

Functioning as correctives to state-centered approaches which cast the interests of national governments as the primary determinants of outcomes, historical institutionalist analyses of European integration have focused on the European Commission's gains from agency losses and constraints on member state governments. Factors enabling the Commission to exercise some autonomy relative to both member state governments and societal interests include the independence of the Commission from the electoral cycle, the stability of the Commission's preferences and the long time horizon with which it operates (Pierson, 1996, 135), and the Commission's flexibility in pursuing its objectives (Cram, 1994, 210; Nugent, 1995; Pollack, 1995, 19). However, European-level aggregation and articulation of private interests pose not only opportunities, but also challenges for EU institutions as they seek to carve out some operational autonomy. Pierson (1996, 137) suggests that the vast scope of EC decision making renders it difficult for member state governments to control the development of policy. Yet the same may be said for the European Commission. Even though it may have a comparative advantage in information resources and long-term planning, as the evidence below illustrates, the Commission can not perfectly anticipate the results of institutional dynamics, legislative initiatives, Court decisions flowing from cases it initiates or in response to its enforcement efforts, or the mobilization of new constituencies in response to policy initiatives.

Furthermore, the Commission is dependent upon private interests, acting both collectively and individually. To promote integration, the Commission must mobilize critical constituencies that enter into the formation of national government preferences. Without such constituencies, the Commission's chances of achieving desired legislative outcomes are seriously diminished. Additionally, even if the Commission exercises substantial autonomy as an agenda-setter and is able to structure decision-making dynamics in ways that promote legislative approval of its proposals, slippage easily can occur in policy enforcement. In a number of regulatory regimes, such as state aid control and the single market in public procurement, the Commission depends heavily on individual economic agents to lodge complaints about violations of Community law for effective enforcement. Indeed, as some scholars have recognized, constituencies of the European Commission, ECJ, and Parliament comprised respectively of subnational actors, including consumer and environmental groups and transnational business; national courts (Alter, 1996); and national electorates, not only strengthen the autonomy of supranational institutions, but also 'act . . . as a constraint on the freedom of action of the supranational institutions' (Pollack, 1997, 130).[4] The European Commission therefore may

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

encounter new constraints on its regulatory authority as constituencies mobilized in response to Commission initiatives intensify their demands on the institution's resources.

As an examination of the development of the European Commission's regime of state aid regulation demonstrates, several mechanisms have contributed to the growth of European Commission autonomy. Article 93 of the EC Treaty (renumbered as Article 88 by the Amsterdam Treaty, effective May 1, 1999) grants the European Commission exclusive competence to require that member state governments 'abolish or alter' aid the Commission deems incompatible with the internal market. Nonetheless, in practice the Commission's authority has developed only gradually. This has been a highly politicized and cautious process, since national governments have used subsidies as an instrument of industrial policy for decades. Following the 1986 Single European Act, the Commission developed its capacities in the state aid area through decisions of the Court of Justice, articulation of an extensive framework of rules, and by fostering the mobilization of a constituency in the business community favoring rigorous control of aid to industry by governments (Smith, 1998).

The Commission came to rely on complaints by third parties – typically firms competing with an aid beneficiary – to help justify the aggressive application and development of its state aid authority. Since the Commission's regulatory authority derives from the rule of law and its political neutrality, it garners substantial leverage from the existence of countervailing political pressures and its claim to consistent enforcement of the rules. Using these resources as well as its Treaty authority, the Commission since the late 1980s has been able to develop its capacities to investigate state aid cases, establish precedents, impose conditions on the approval of aid, and extract compliance from member state governments.

While Commission efforts to rein in state aid often are welcomed by government ministers facing pressures for subsidies from domestic constituents,[5] national government officials with at least equal frequency lobby the Commission's state aid unit for approval of politically sensitive industrial aid packages. These political pressures give the Commission an incentive to generate additional resources with which it can defend the integrity of the state aid regime by actively cultivating private complaints. For example, from late 1997 to 1999, the Commission had gathered substantial evidence following a complaint initiated by the BdB, Germany's federation of commercial banks, alleging that the German system of subsidising state-owned public sector banks severely distorted competition within the single market and therefore constituted an illegal state aid. The competition directorate had made it a priority to begin addressing the numerous distortions of competi-

https://doi.org/10.1017/S014381 4X0100112X Published online by Cambridge University Press

tion resulting from claims by national governments that particular public sector activities were entitled to substantial subsidies by virtue of their status as protected 'services of general economic interest'. Germany's public sector banks were a prime example of this phenomenon, and therefore a critical case if the Commission hoped to advance the state aid regime in the politically delicate area of subsidised public sector activities. However, political constraints prevented the Commission from taking decisive action against Germany's public sector banking system. The public sector banks played a central role in Germany's federal system, and were protected by close links between the state banks and state political leaders prominent in the main political parties. While the Commission's competition unit pursued a negotiated solution with Germany's political leadership, it also intensified pressures on the German public sector banks and their defenders in state politics by encouraging the European Banking Federation (EBF) to submit a complaint against Germany's public sector banks for distorting competition within the euro-zone.[6] When the EBF filed this third-party complaint in December 1999, it substantially altered the balance of debate within Germany.[7] The complaint from the EBF cultivated by the Commission therefore had significance beyond the Commission's immediate desire to see a reduction in subsidies to Germany's public sector banks; it was part of an initial step toward the tighter application of state aid rules to public services desired by the competition directorate.

As the state aid regime developed from the second half of the 1980s, the Commission was able to use complaints filed by individual firms and industry associations to its advantage without these becoming a constraint on its independence. In the absence of any Court decision to the contrary, rules regarding the treatment of information provided by third parties did not require the Commission to do anything more than receive and investigate the allegations. Moreover, neither the Treaty nor EC secondary legislation stipulated that the Commission must respond to a complaint within a certain time period. On the one hand, the Commission's ability to control outcomes increased, while on the other, the state aid unit largely set its own agenda, focusing on cases and industries that enabled it to accumulate credibility and a record of rigorous, neutral and consistent application of the rules without excessive confrontation with national governments.

The Changing Policy Environment

While the articulation of a web of rules emerging from the EC Treaties has enabled the Commission to create a rigorous regime of state aid control, private interests increasingly have seized on those rules to

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

demand tougher enforcement of state aid policy, often in areas in which the Commission is unprepared to act. This is especially true in some public services in which political accommodation between the Commission and national governments has fostered gradualism and piecemeal liberalization rather than a rapid and thorough application of the state aid constraints embodied in Community competition law. The Commission has encouraged private actors to bring more state aid cases before national courts, since EC Treaty articles prohibiting the granting of aid that distorts competition in the internal market are directly enforceable at the national level. However, the Commission's activism and visibility in combatting subsidies, especially to state-owned industries, has drawn attention to its exclusive competence to investigate suspected breeches of the state aid rules and its willingness to confront member state governments when violations occur. Its activism therefore has generated an incentive for private firms to bring complaints directly to the Commission. One consequence has been a rise in the number of state aid cases requiring the competition directorate's attention; this explains the resort by the Commission in 1996 to Council regulations to exclude certain categories of aid from formal notification requirements.[8] Furthermore, where the Commission has responded cautiously to complaints from private interests because of political constraints, these actors increasingly have followed the Commission's example and taken their cases – against the Commission – to the European Court of Justice.

Until the mid-1990s, state aid cases before the Court typically were Commission actions brought against member states for violating Treaty articles or failing to implement Commission decisions. However, as private sector actors have gained familiarity with EC institutional channels, procedures, and state aid rules, an increasing number of cases before the Court of First Instance has come to consist of suits against the Commission for failing to fully investigate complaints. Third parties always have been entitled to submit evidence to the European Commission, but their rights beyond this have not been established. The Commission exercises exclusive competence to decide to formally investigate a state aid and assess its compatibility with Europe's single market. By encouraging private actors to come forward with evidence of state aid violations, therefore, the Commission could expand its ability to police aid without having to surrender control over the state aid agenda. But recent Court decisions resulting from dissatisfaction by third parties with the Commission's treatment of their complaints have altered these favorable conditions for the Commission. These decisions have increased the burden on the Commission for dismissing complaints from private actors, potentially threatening the Commission's ability to control the state aid policy agenda.

https://doi.org/10.1017/S014381 4X0100112X Published online by Cambridge University Press

The landmark case is the 1995 Sytravel judgment. In this case, private sector French firms complained to the Commission when France's Ministry of Posts and Telecommunications set up a state-owned commercial company, Sécuripost, to furnish security and other services for the French post office, extending various forms of government assistance. After the Commission ruled that no state aid existed according to the available evidence, several French business associations and individual undertakings, including Sytraval and Brinks France, asked the European Court of Justice to annul the Commission's decision. Ultimately the ECJ in April 1998 ruled that the Commission must provide 'clear and unequivocal' reasoning for concluding that arguments put forward by third parties fail to demonstrate the existence of state aid, modestly but notably strengthening the standing of private parties submitting claims alleging illegal aid (ECJ 1998, paragraphs 62–3). In contrast to the substantial body of literature indicating ways in which the Court has been a boon to Commission autonomy,[9] this ECJ decision suggests that mobilization of private actors also can render the Court a mechanism of constraint on the Commission. Moreover, when the Commission filed its appeal of the Sytraval decision before the Court of Justice, the Commission was joined before the Court not only by the French government, but also by the governments of Germany, Spain, and the Netherlands, illustrating the degree to which the outcome threatened the balance between the Commission's relative autonomy and politically informed restraint.

In several instances the Court has ruled against parties seeking annulment of Commission decisions to dismiss their complaints against competitors. In other cases, though, third parties have prevailed. In September 1998 the Court of First Instance ruled in the case of BP Chemicals as well as that of Gestevisión Telecinco.[10] In the first, the Commissions had permitted a third consecutive capital injection into EniChem, a subsidiary of the Italian public undertaking ENI.[11] BP Chemicals, a UK competitor of EniChem, argued that the Commission was obligated to open a formal investigation into the third capital injection, since ENI was continuing to incur losses despite the two prior injections of funds designed to facilitate restructuring. The Court ruled that the Commission had infringed BP's rights as an interested third party, and supported BP's request to have the Commission's decision annulled. The second case, Telecinco, emerged from complaints lodged with the Commission by one of Spain's three private television companies alleging that grants to public sector regional television companies by regional governments and subsidies granted to the public television authority by Spain's central government were incompatible with the single market. The complaint languished with the Commission for four

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

years, after which Gestevisión Telecinco brought an action against the Commission for failing to initiate the formal investigatory process required where there are doubts about the compatibility of a state aid with the single market. The slow response was not simply a case of bureaucratic omission; the delay reflected the Commission's reluctance to make judgments about how to enforce state aid rules in the area of public broadcasting.[12] When Telecinco submitted its complaint, the Commission was in the early stages of an internal debate over how to value public service obligations and what level of compensation for public service functions could be permitted without distorting internal market competition. Ruling in favor of Telecinco, the Court judged that the Commission had failed in its obligation to come to a timely decision on a state aid complaint (Court of First Instance, 1998).

Developments unfolded in a somewhat similar fashion in the postal services sector, where private sector complaints essentially ran ahead of Commission efforts to organize liberalization of the sector. In 1994, United Parcel Service (UPS) approached the European Commission with evidence that the German postal service was using profits generated by its monopolized letter handling services to subsidize its parcel delivery services, in which UPS and other firms competed with Deutsche Post. The case perfectly illustrates the value of agenda-setting autonomy to the Commission. The Commission's competition directorate saw potential merit in the complaint. During the three-year period for which the Deutsche Post dossier remained with the competition directorate, the competition policy regulator learned that Deutsche Post's commercial parcel sector had sustained losses of DM 27.5 billion from 1984 to 1996, which had been financed by Deutsche Post's other – monopolized – operations. The losses were incurred as Deutsche Post priced its parcel services below cost, using this predatory pricing to keep competitors out of parcel services in Germany. However, the Commission was not prepared to open a full investigation of Deutsche Post. The state aid policy unit's agenda was already crowded with sensitive cases, several involving Germany, and the Competition Directorate General (DG) more broadly was enmeshed in efforts to complete the liberalization of the telecommunications sector and achieve implementation of energy sector liberalization. Second, the Commission would not take decisive action until it had generated support in the Council of Ministers. In response to the resulting delay, UPS ultimately sued the Commission in the European Court of Justice for its failure to act. In September 1999, the Court of First Instance ruled that the European Commission had failed to act in a timely fashion on the complaint filed by United Parcel Service (Court of First Instance, 1999).

Accompanying the introduction of the single currency, the European

https://doi.org/10.1017/S014381 4X0100112X Published online by Cambridge University Press

Commission has sought to increase the rigor of competition policy, including state aid control, especially in sectors such as banking that feature prominently in more fully integrated European markets. This aggressive policing of state aid to industry by the Commission has attracted close scrutiny by national governments. In order to guard its policy effectiveness in core sectors the Commission must minimize confrontation with governments in peripheral sectors. For the European Commission, protecting its regulatory capacities and overall policy rigor depends substantially on the selective exercise of restraint. Decisions emerging from the mobilization of the private sector in response to Commission activism, like Sytraval, BP Chemicals, Telecinco and UPS, threaten the close control over the state aid agenda required by the Commission to sustain some policy autonomy relative to national governments.

Institutional Adaptation to Event Processes

Potential constraints on the regulatory capacities of the European Commission have emerged from success in mobilizing private support for and reliance on EU policy regimes and institutional channels. Indeed, developments in the area of state aid policy suggest that the exercise of autonomous regulatory capacities by the European Commission can have perverse results. Beginning from the treaty language granting it legal authority to regulate aid to industry from member state governments, the Commission fostered increased reliance on the Community state aid regime by firms and industrial associations interested in rigorous oversight. Mobilization of these actors initially enhanced the Commission's leverage vis-à-vis member state governments. But the Commission's growing authority in the policing of state aid created incentives for firms and national industry associations to make demands on the Commission's state aid capacities, ultimately generating constraints that the Commission had not anticipated.

How could the Commission respond to these potential encroachments on its autonomy? And what would constitute effective adaptation to an increasingly constrained policy environment? Effective adaptation may be defined as the conscious adoption by a unit of a policy making institution – in this case, the state aid unit of the European Commission's Competition DG – of measures that embody the greatest likelihood of preventing or minimizing reductions in regulatory capacities that otherwise would occur.

Three choices were available to the Competition DG's state aid unit. First, this unit of the Commission could simply continue to defend its actions in the European Court of Justice in what it could expect to be

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

a growing number of complaints lodged by private sector firms and business associations in response to the Commission's failure to fully investigate their complaints against public sector competitors. Second, the state aid unit of the Competition DG could attempt to swiftly and thoroughly investigate all claims submitted to it in order to remove the cause of the growing number of court actions against the Commission. And finally, the Commission could attempt a bolder approach, forestalling legal proceedings by seeking to limit the rights of third parties to challenge the Commission's actions in court.

The first response would be damaging to the Commission. Its decision to neglect some complaints about aid to the public sector would be an ongoing object of contention, and in the wake of negative Court decisions, the state aid unit would have to expend additional resources on each case anyway. Resource constraints would only intensify, reducing the capacity of the Commission to regulate government aid to industry. The second alternative was essentially unviable because the Commission's state aid unit lacks the resources to investigate all the state aid complaints it receives with equal thoroughness. Moreover, to treat all clams equally would be to surrender efforts to extend the state aid regime in a systematic manner. Again, the Commission would have to reallocate the scarce resources devoted to state aid regulation in a manner that would constraint regulatory capacities.

In contrast with these responses, legislatively codifying the cartelistic relationship with national governments and circumscribing the rights of third parties would enable the Commission to secure its relative autonomy vis-à-vis both member state governments and private interests. Moreover, the risk of losing the support of advocates of the tougher state aid regime is minimal for the Commission because firms that compete with the public sector have powerful financial incentives to continue to lodge complaints. One consequence of a clear limitation of the rights of complaining parties could be to induce the pursuit of more state aid cases through national courts, something the Commission has sought to encourage in order to reduce its own administrative burden and thereby ease resource constraints in the area of state aid policy.

The regulation governing state aid procedures adopted by the Council of Ministers in March 1999 does much more than spell out the extent and limits of third parties lodging complaints. The Council regulation reflects a bargain between national governments and the Commission's competition directorate that secures the exchange of Commission policy rigor and relative autonomy, on the one hand, for restraint, on the other. Accordingly, the legislation grants the Commission considerably enhanced powers to enforce state aid decisions, while firmly establishing legal certainty for aided enterprises. Thus the Com-

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

mission acquires the right to issue 'information injunctions' when governments do not supply information needed to make a decision on a state aid case, and can refer the matter directly to the European Court of Justice if a government does not comply. In addition, the Commission also gains the power to conduct on-site monitoring visits where it suspects noncompliance with Commission decisions.[13] Governments obtain two desirable elements from the regulation, both involving the concept of 'legal certainty'. Governments are required to inform the Commission when they extend aid to an enterprise. The 1999 regulation does not change this. However, the regulation establishes a firm timetable for Commission decision-making once it is informed of a state aid. Furthermore, the regulation makes it clear that an aid cannot retroactively become incompatible with the single market. This clears the way for the Commission to extend the reach of state aid policy to public sector activities without an excessive threat to the finances of these enterprises. In turn, by virtue of these measures, aid recipients gain certainty that aid they have received is legal within the rules of the single market, and is not subject to repayment at a future point.

The 1998 Telecinco judgment was instrumental in the Commission's desire to codify time limits for state aid decisions. The Commission argued that it was not required to come to a decision when asked to do so by Telecinco because it was still in the preliminary phase of its investigation, and had not yet decided to open the formal investigatory process. However, the ECJ ruled that the Commission cannot deny third parties their legal rights to challenge the Commission by indefinitely prolonging a preliminary investigation (Court of First Instance, 1998, paragraph 74). The 1999 Council regulation establishes that if the Commission does not initiate formal proceedings within 2 months, the aid may be considered authorized by the Commission and may be implemented by the government (Article 4(6)). This forecloses Telecinco-type cases in which the Commission faces legal proceedings when the politics of a sector require delay rather than full application of the state aid regime.

The 1999 regulation also enshrines the principle that decisions on state aid cases are matters between the European Commission and national governments. Since the 1995 Sytraval decision, the Commission's competition directorate has emphasized the bilateral nature of state aid procedures; the 1999 regulation in this sense codifies the exclusive character of the interaction between the Commission and national governments. This is important because in the original Sytraval decision, the Court of First Instance found that the Commission's rejection of the allegations of illegal aid constituted a formal 'decision' addressed to the complaining parties. Accordingly, the Court of First Instance appeared to significantly expand the rights of third parties in the state aid area,

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

indicating that the Commission was obligated to share information obtained in the course of its investigation and to give third parties the right to comment on this information. Moreover, in the absence of this step, the Commission was bound to consider objections the third party would likely have raised had it had access to information at the Commission's disposal (Court of First Instance, 1995, paragraphs 66, 72 and 78). The Commission could not place the burden of proof regarding the existence of an illegal state aid on the complaining party, and could not dismiss a complaint simply by referring to the inadequacy of the information provided by the complaining party.[14]

The ECJ's decision in the Commission's appeal of Sytraval only upheld a portion of these third party rights. In Sytraval as in Telecinco, the ECJ ruled that third parties indeed have legal standing to challenge the Commission's conclusions regarding a complaint. However, the Commission is not obligated to hear a third party's comments on information gathered by the Commission, or to enter into discussions with the third party (ECJ 1998, paragraphs 54, 58, 60–61). Still, the Commission is required to conduct a 'diligent and impartial' examination, which may take it well beyond the information provided in the third party complaint, and to fully explain the reasoning for its action. The 1999 regulation initiated by the Commission stipulates that interested parties will directly be informed of a decision not to open a formal investigation following a state aid complaint, and that they will be provided with copies of Commission decisions. But such decisions are always and only addressed to a member state government.

Preserving Regulatory Capacities through Bureaucratic Adaptation

Explaining the European Commission's volte-face on the involvement of national governments in the regulation of state aid requires understanding of both the nature of the Commission's autonomy vis-à-vis national governments and the evolution of the European Commission's policy environment – in particular, the changing relationship between the European Commission and its policy constituencies. The autonomy of the Commission's state aid unit is relative rather than absolute; it independently defines the agenda within boundaries defined by the political requirement that liberalization in areas served by the public sector proceed gradually and with broad support from national governments. Support from the private sector state aid constituency is a useful instrument for encouraging member state governments to support (or ease their opposition to) liberalization. However, whereas in 1990 the Commission was concerned primarily to safeguard its nascent autonomy from the Council of Ministers of member state governments, by

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

1996 it was sufficiently concerned about the threat to its autonomy from private interests to risk Council interference to help protect its control over the state aid agenda.[15] The Commission was prompted by the growing caseload generated by the development of state aid policies as well as increasing demands from mobilized constituents of the state aid regime. Prior to the surge in the Commission's caseload and in Court cases brought by third parties against the Commission, such as Sytraval, BP Chemicals, Telecinco and UPS, the Commission was unwilling to countenance Council intervention in this area of exclusive Commission competence.

In turn, national governments value the gradual approach to more far-reaching application of the state aid regime to public sector activities pursued by the Commission's competition directorate. This explains their support for the Commission's proposal for a Council procedural regulation governing the application of state aid rules. To the extent that private interests push the European Commission into investigations it is reluctant to conduct, national governments will face pressures to open to competition sectors which previously were protected by their cartelistic relationship with the Commission.

The evolution of the policy making environment in the area of state aid regulation left the European Commission unable to secure the balance between independent agenda setting and politically-informed restraint. Put differently, the Competition DG's state aid unit faced growing encroachment on its ability to set the regulatory agenda. Without effective policy adaptation, which in this case involved the radical step of inviting legislation from national governments in a policy area formally reserved to the Commission, the state aid regulator faced the threat of significant constraints on its regulatory authority.

To what extent is this instance of regulatory adaptation generalizable beyond state aid policy? The Commission's policy making environment is in part the product of a discursive relationship between institutional action and interest mobilization. Changes in the policy making environment induced by this dynamic in fact have fostered bureaucratic adaptation in policy areas other than state aid. Recognizing the dangers of drifting outside their institutional comparative advantage in regulatory agenda-setting, interest-group consultation and drafting legislation, Commission policy units have sought to decentralize legislative enforcement in policy areas crucial to the single market. For example, in the single market for procurement of goods and services by public authorities, the Commission's internal market DG proposed in 1996 that member states designate independent regulatory authorities to monitor compliance with public procurement regulations, citing as an example Sweden's National Board for Public Procurement

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

(Commission, 1996, 17; Commission, 1998, 12–13). The Commission has sought to justify the use of national audit offices or competition authorities as independent bodies to oversee the single market in public procurement in functional terms: such authorities would serve as local sources of information about the regulatory regime and could rapidly and informally resolve local cases of alleged violations of Community rules. But the impetus behind the Commission's call for such a system of regulatory enforcement is that it would enhance the ability of the Commission to define the agenda for regulatory integration by freeing the public procurement unit, increasingly bogged down with minor cases, to 'concentrate on cases having a Community-wide impact or raising major questions of interpretation' (Commission 1998, 12). Reflecting a similar adaptation to the shifting policy making environment, the Commission's Competition DG has launched an effort to give national authorities a larger role in the enforcement of competition rules applicable to restrictive practices and abuses of dominant market position (Commission, 1999).

These measures reflect an effort to consolidate increasingly scarce Commission resources in the area of regulatory agenda-setting, a conscious choice in favor of activities in which the Commission's policy units possess a comparative advantage. Steering between the policy needs of national governments and the intensifying demands of other constituents for the resources they provide, units of the European Commission can only guard their capacities to set elements of the agenda for European integration through effective adaptation to a changing policy environment.

NOTES

1 The mechanism is Article 94 of the EEC Treaty, which became Article 89 in the Amsterdam Treaty that took effect on May 1, 1999. In 1990, the Italian Industry Ministry, acting in the European Council Presidency, was concerned that growing constraints on industrial policy resulting from the Commission's state aid regime would disadvantage European Union Member States vis-à-vis competitors outside the EU.

2 For example, in his discussion of mobilization theory, Walker (1991, 54) asserts that 'the steady expansion of the power and responsibility of the federal government figures as one of the major causes of the recent growth of new organizational devices for linking citizens and their government.'

3 In his study of interest representation by British business associations, Robert J. Bennett finds that while lobbying UK government officials, ministers, and MPs and UK representatives to the European Council remain the principal channels through which businesses articulate their interests on matters affected by European integration, a substantial number of firms lobby directly in Brussels on an individual firm basis (approximately one-third) and through European associations (80%). See Bennett (1997, 74; and 77, Table 2).

4 As Pollack (1997, 130) compellingly describes the duality of this situation, 'all three supranational institutions navigate constantly between two sets of institutions: the member government principals that created them and may still alter their mandates and the transnational

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

constituencies that act both as constraint and resource in the institutions' efforts to establish their autonomy.'

5 For an account of this phenomenon, see Mitchell P. Smith, 'The Commission Make Me Do It: The European Commission as a Strategic Asset in Domestic Politics', in Neill Nugent, ed., *At the Heart of the Union: Studies of the European Commission* (London: Macmillan, 1997), pp. 167–186.

6 The Federation's case alleges that 'state guarantees gave public banks an unfair advantage in the highly competitive euro-zone'. See Deborah Hargreaves, 'Brussels to act on German bank guarantees', *Financial Times*, July 28, 2000, p. 8.

7 For details of this episode, see Mitchell P. Smith, 'Europe and the German Model: Growing Tensions or Symbiosis', *German Politics*, Vol. 10, No. 3 (December 2001), pp. 118–139.

8 The proposed Directive became 'Council Regulation (EC) No. 994/98 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid'. See *Official Journal of the European Communities* OJ L142, May 14, 1998.

9 Among the most important works on this topic are Sophie Meunier-Aitsahalia and Karen Alter, 'Judicial Politics in the European Community: European Integration and the Pathbreaking Cassis de Dijon Decision', *Comparative Political Studies*, 26 (1994), pp. 536–61; and Anne-Marie Burley and Walter Mattli, 'Europe Before the Court: a political theory of legal integration', *International Organization*, Vol. 47 (1993), 41–76.

10 The Court of First Instance, set up in 1989 to alleviate the backlog of cases experienced by the European Court of Justice (ECJ), is the venue for state aid cases unless they are appealed to the ECJ.

11 For a description of the BP Chemical ruling, see Case T-11/95, *Competition Law in the European Communities* 21, No. 10 (October 1998), pp. 229–230.

12 The Commission in fact used this argument to defend its deliberate approach before the Court, asserting that the recent opening of television to commercial competition and the sensitive role of public broadcasting required 'a particularly cautious approach'. See Telecinco, CFI [1998], paragraphs 44 and 46.

13 See Council Regulation EC 659/1999 of 22 March 1999, *Official Journal* L 083, March 27, 1999, pp. 1–9. The 'information injunction' is established in Article 10(3); Article 22 concerns on-site monitoring.

14 European Commission, *Competition Policy Newsletter*, Vol. 1, No. 6, Autumn/Winter 1995, pp. 46–7.

15 The state aid unit sought to reduce the risks of this measure by attempting to introduce the proposal under the Irish presidency of the Council, since the Irish government supported the increasing rigor of state aid enforcement. However, when the proposal was discussed at the November 1996 Industry Council, some member states feared that the Commission sought to use the proposal to enhance its powers, while the cohesion states (excluding Ireland) led by Spain sought to tie the discussion of state aid enforcement to the renewal of the cohesion funds. The Commission chose not to formally submit the proposal in this environment.

REFERENCES

Agence Europe (1990) 'Letter from Industry Council President Mr. Battaglia to His Colleagues' and 'Letter From Commission Vice-President Sir Leon Brittan to the President of the Industry Council', No. 1656. Reprinted in Emma Boylan, 'The piecemeal approach to Procedural Rules in State Aid Cases', Master's Thesis, College of Europe, Bruges, May 1996.

Alter, K. J., 1996, The European Court's Political Power, *West European Politics*, 19, 3, 458–487.

Alter, K. J., 1998, Who are the 'Masters of the Treaty'?: European Governments and the European Court of Justice, *International Organization*, 51, 1, 121–147.

Andersen, S. S. and Eliassen, K. A., 1993, Complex Policy-Making: Lobbying the EC, in Andersen and Eliassen, eds., *Making Policy in Europe*, 35–53. London: Sage.

Cameron, D. R., 1974, Toward a Theory of Political Mobilization, *The Journal of Politics*, 36, 1, 138–171.

Cram, L., 1994, The European Commission as a Multi-Organization: Social Policy and IT Policy in the EU, *Journal of European Public Policy*, 1, 2, 195–217.

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press

Commission of the European Communities, 1996, Public Procurement in the European Union: Exploring the Way Forward, 27 November.
Commission of the European Communities, 1998, Communication from the Commission, Public Procurement in the European Union. Brussels, 11 March COM(1998), 143 final.
Commission of the European Communities, 1999, White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty, Commission Programme No. 99/27, Brussels, 28 April.
Court of First Instance, 1995, Case T-95/94, *Sytraval and Brink's France v Commission*. ECR II-2651. Judgment of 28 September.
Court of First Instance, 1998, Case T-95/96, *Gestevisión Telecinco v Commission of the European Communities*. Judgment of 15 September.
Court of First Instance, 1999, Case T-127/98, *UPS Europe SA v Commission of the European Communities*. Judgment of 9 September.
European Court of Justice, 1998, Judgment of 2 April, Case C-367/95, Commission of the European Communities appeal against the judgment of the Court of First Instance of 28 September 1995 in Case T-95/94, *Sytraval and Brink's France v Commission*.
Grande, E., 1996, The State and interest groups in a framework of multi-level decision-making: the case of the European Union, *Journal of European Public Policy*, 3, 3, 318–338.
Greenwood, J. and Ronit, K., 1994, Interest Groups in the European Community: Newly Emerging Dynamics and Forms, *West European Politics*, 17, 1, 31–52.
Hooghe, L., 1995, Subnational Mobilisation in the European Union, *West European Politics*, 18, 1, 175–198.
Immergut, E., 1998, The Theoretical Core of the New Institutionalism, *Politics & Society*, 26, 1, 5–34.
March, J. G. and Olsen, J. P., 1984, The New Institutionalism: Organizational Factors in Political Life, *The American Political Science Review*, 78, 3, 734–49.
Marks, G., Hooghe, L. and Blank, K., 1996, European Integration from the 1980s: State-Centric v. Multi-level Governance, *Journal of Common Market Studies*, 34, 3, 341–78.
McAleavey, P. and Mitchell, J., 1994, Industrial Regions and Lobbying in the Structural Funds Reform Process, *Journal of Common Market Studies*, 32, 3, 237–248.
Nugent, N., 1995, The Leadership Capacity of the European Commission, *Journal of European Public Policy*, 2, 4, 603–23.
Pierson, P., 1993, When Effect Becomes Cause: Policy Feedback and Political Change, *World Politics*, 45, 595–628.
Pierson, P., 1996, The Path to European Integration: A Historical Institutionalist Analysis, *Comparative Political Studies*, 29, 2, 123–63.
Pollack, M., 1995, Obedient Servant or Runaway Eurocracy? Delegation, Agency and Agenda Setting in the European Community, Harvard University Center for International Affairs Working Paper, No. 95-10.
Pollack, M., 1997, Delegation, Agency, and agenda-setting in the European Community, *International Organization*, 51, 1, 99–134.
Sandholtz, W., 1993, Institutions and Collective Action: The New Telecommunications in Western Europe, *World Politics*, 45, 2, 242–70.
Sandholtz, W., 1996, Membership Matters: Limits of the Functional Approach to European Institutions, *Journal of Common Market Studies*, 34, 3, 403–29.
Smith, M. P., 1998, Autonomy by the Rules: The European Commission and the Development of State Aid Policy, *Journal of Common Market Studies*, 36, 1, 55–78.
Walker, J. L., 1991, *Mobilizing Interest Groups in America*. Ann Arbor: University of Michigan Press.
Wood, B. D. and Waterman, R. W., 1993, The Dynamics of Political-Bureaucratic Adaptation, *American Journal of Political Science*, 37, 2, 497–528.

MITCHELL P. SMITH
Political Science, University of Oklahoma
455 W. Lindsey, Room 205
Norman, OK 73019, USA
Tel: (405) 325-8893
Fax: (405) 325-0718
e-mail: mps@ou.edu

https://doi.org/10.1017/S0143814X0100112X Published online by Cambridge University Press