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The Politics of Competition and Institutional Change in European Union: The First Fifty Years

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Competition causes suppliers of goods and services to lower prices, raise quality, and innovate. It is crucial for maximizing social welfare in a market economy. Ironically, however, the market by itself does not guarantee competition, unless one makes heroic assumptions about the costlessness of market entry (North 1981; Neumann 2001: 5ff.). As Adam Smith famously warned, 'people of the same trade seldom meet together . . . but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices'. Yet it is not just monopolies, cartels, and mergers that can inhibit competition. Government subsidies and special privileges may also distort the market—within a country and even abroad through trade. Competition thus is an inherently political issue, as well as an economic one.

Safeguarding competition, whose economic importance is explicitly acknowledged in Article 3(1)g of the Treaty of Rome, is one of the most prominent governance functions of the European Commission for the EU Common Market. The Commission exercises real, supranational power in this realm.[2] In sometimes dramatic 'dawn raids', the antitrust experts of the Directorate-General Competition (DG Comp) have discovered and broken up illegal market-sharing, price-fixing, and other competition-impeding agreements from sugar and steel pipes to vitamins, video game consoles, and cars. When Volkswagen, for instance, was

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[2] Title VI of the Treaty of Rome (as amended), which contains the Rules on Competition, still applies only to the EC portion of the EU, but in keeping with the series title, I speak of the EU throughout this chapter. For simplicity, I also refer to specific articles as renumbered in the Amsterdam revision of the Treaty and use 'DG Comp' even for the period prior to 1999, when it was called 'DG IV'. DG Comp's remit is similar to the shared remit of the Department of Justice's Antitrust Division and the Federal Trade Commission's Bureau of Competition in the USA, though EU law establishes an administrative process rather than a judicial one, and DG Comp's authority extends to government subsidies and other 'state aids', over which the US competition agencies have no say.

found in 1998 to have banned its Italian dealers from selling to German and Austrian customers (in whose home markets VW was selling the same cars at a notably higher price), the EU forced them to end the practice and fined VW 90 million euros for violating EU competition rules. Similarly, DG Comp's Merger Task Force has blocked or forced changes in the terms of merger agreements that they considered a threat to competition in the European market.[3] The merger of petroleum products giants TotalFina and Elf Aquitaine in 2000, for instance, was allowed only on the condition that the companies sold off a large number of motorway service stations in France, of which they otherwise would have controlled 60 percent. The merger of Pfizer and Pharmacia in 2003 was allowed only conditional on the sale and/or licensing of some of their pharmaceutical patents for products for which competition would otherwise have been severely reduced. Commission powers in the realm of competition policy extend even to firms headquartered outside the EU, as evidenced not only by the ongoing EU antitrust action against Microsoft but also by EU intervention in the proposed mergers between General Electric and Honeywell, which was blocked when GE rejected the Commission's conditions for approval. Moreover, the Commission's power is clearly supranational, as most evident in the realm of subsidies ('state aid(s)'). Here, the EU has, for instance, forced the governments of Germany, Austria, and France to stop giving competition-distorting loan guarantees to public banks; it has also made companies like SCI Systems repay subsidies that the Commission found had been paid to them by the Dutch government, in violation of EU rules, for the building of a computer assembly plant.

While some of its decisions are quite controversial and virtually all of them involve fierce conflicts of interest (Ross 1994: 132ff., 176ff.), DG Comp is generally highly respected. Inside the EU, 'the competition portfolio has become one of the most powerful and prized positions in the Commission' (Hix 2005: 244), and its civil service positions are among the most prestigious in Brussels. DG Comp not only enjoys the highest degree of discretion of any DG (Pollack, 2003*a*: 94f.), it is also very respected among the general public and outside competition policy experts. An international survey of public and private sector specialists in the summer of 2006 identified DG Comp as the most trusted and admired among thirty-eight competition watchdogs (Cavendish 2006). In the realm of state aid, it 'has managed to elicit an unusually high degree of compliance', which exceeds compliance with comparable competition authorities at the national level (Wolf 2004: 88).

It has not always been that way: The DG Comp started out in the early years after the Treaty of Rome as 'a sleepy, ineffectual backwater of Community

[3] The Merger Task Force was a separate unit within DG Comp until 2004. Its functions have now been taken over by merger specialists within DG Comp's industry-specific Directorates B through E.

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administration' (Wilks and McGowan 1996: 225). It had only 'a handful of "A" grade officials' (Goyder 2003: 531), and 'little prestige' was attached to working there (Cini and McGowan 1998: 24; see also Cini 1996: esp. 461ff.). European-level competition authority thus has experienced a striking and largely unanticipated institutional evolution over the past fifty years. How might we explain such institutional change?

Büthe and Swank (2006) have recently shown that a modified neofunctionalism—understood explicitly as a HI theory of institutional change—provides a compelling explanation for the evolution of merger control authority in the EU. Such a neofunctionalist theory recognizes that institutional change may arise out of intergovernmental bargaining. The critical insight, however, is that institutional change can occur even when the member states oppose it, provided that *subnational actors*, using the political opportunity structures of the supranational institutions, act jointly with supranational actors, each *pursuing their own, selfish interests*. As a HI theory, this modified neofunctionalism also leads us to pay close attention to the sequence of events in the process of European integration (Büthe 2002), such as when intergovernmental bargaining over institutional change followed rather than preceded the change. This chapter extends Büthe and Swank's analysis of the evolution of supranational merger control authority to the other issue areas of EU competition policy: antitrust enforcement and state aid (subsidies). I first discuss the theoretical argument, focusing on the hypothesized causal mechanisms. I then sketch the institutional evolution of EU competition authority in the three areas of competition policy from the provisions of the Treaty of Paris through the most recent developments. As I show, the theory helps explain why competition policy has so decisively shifted to the EU level, as well as when those shifts have occurred. The finding that neofunctionalism explains institutional change over time as well as the variation across issue areas also refutes the common assertion that it cannot predict or explain variation in the evolution of the EU (e.g. Moravcsik 1993: 477).

Competing over Competition? Explaining Institutional Change

Neofunctionalism has its origins in Ernst Haas's first theoretical account of the process of European integration (Haas [1958] 2004; see also esp. Börzel et al. 2005; Schmitter 2004). It is in essence a HI theory of institutional evolution and change. Neofunctionalism combines what are essentially rational choice assumptions of traditional liberal IR theory—that individuals pursue their self-interest in instrumental ways and that there is a multitude of subnational groups that can become political actors both domestically and transnationally—with an assumption usually associated with social constructivism—that self-interest is a function of identities and loyalties, which are highly persistent in the short run

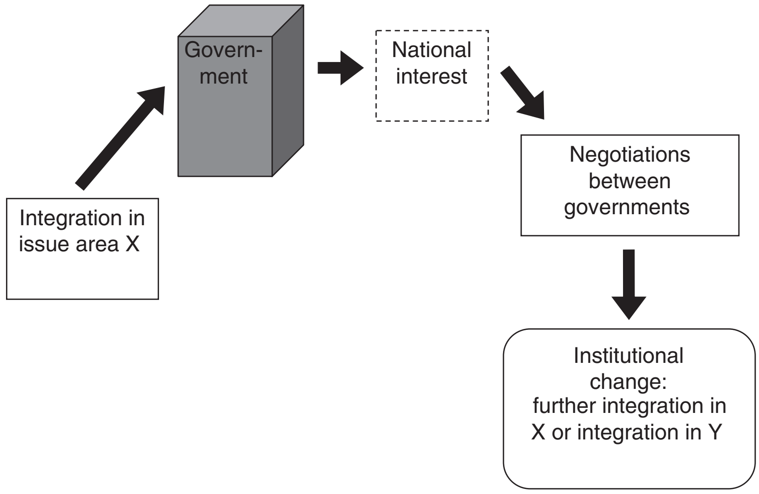

FIGURE 10.1. Institutional change in neofunctionalism (1).

but malleable over the course of time (Büthe and Swank 2006). Based on these assumptions, neofunctionalism identifies three paths toward greater integration, recognizing that any shift of political authority from the national to the supranational level will engender opposition, as well as support.[4]

First, neofunctionalism predicts greater integration in a partially integrated issue area, or some integration in an issue area that was previously not integrated, when governments see it as being in the aggregate economic interest of the country. Here neofunctionalism differs little from Realist intergovernmentalism, except that it specifies one particular reason for why governments might decide to pool decision-making in a particular issue area at the supranational level: to achieve agreed objectives in *another* issue area. This of course is the famous spillover mechanism (Figure 10.1).

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The second path to institutional change starts from the assumption that the observed or imagined experience with supranational authority in *some* issue areas leads a subset of subnational actors (i.e. groups with distinct interests within a country, including possibly within the government) to expect that further integration would be to their benefit. If these conditions hold, neofunctionalism expects those subnational actors to seek institutional change shifting decision-making to the supranational level. Each subnational actor may do so by trying to influence its national government's preferences through the normal course of domestic politics

[4] This section is largely based on my own close reading of the foundational work by Haas (1958), though I go beyond his work to incorporate key insights from the more recent historical institutionalist literature (see Meunier and McNamara (in this volume) and Büthe and Swank (2006), which are entirely consistent with Haas's assumptions and logic, but not spelled out in his works.

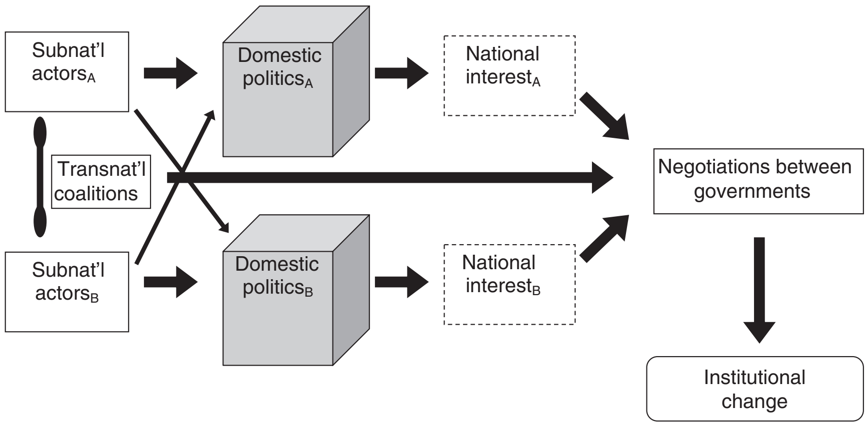

FIGURE 10.2. Institutional change in neofunctionalism (2).

(thick short arrows in Figure 10.2), which may result in institutional change subject to intergovernmental negotiations.[5]

If this were all, the second causal mechanism would differ little from liberal intergovernmentalism. But unlike liberal intergovernmentalism, neofunctionalism does not treat domestic politics as a hermetically sealed system. Based on its assumptions, neofunctionalism expects subnational actors not just to lobby their respective national governments but also to form transnational coalitions and to engage in transnational politics to advance their interests (thin, diagonal arrows in Figure 10.2). This strategy should be particularly attractive to those who cannot build the political coalitions at the domestic level to achieve their desired policies but see a chance of forming a majority at the EU level. Accordingly, neofunctionalism expects such subnational actors (or their transnational coalitions) also to pursue their interests directly at the inter-/supranational level by lobbying the Council collectively, especially in issue areas where the Council decides by majority.

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The third and most distinctive causal mechanism starts from the observation that, in many issue areas, the European Commission and the ECJ also provide political opportunity structures, which neofunctionalism expects subnational actors to use if doing so promises to advance their interests. It is this push for increased integration by subnational actors that gives the Commission and/or the ECJ the chance to bring about institutional change. Based again on the assumption of self-interestedness, neofunctionalism would expect the representatives of these supranational institutions to generally favor greater integration—at least

[5] Neofunctionalism lacks a theory of domestic politics, but its basic liberal IR theory assumptions suggest that subnational actors are more likely to succeed in redefining the national interest the more economically powerful and numerous they are, and the more concentrated their interests.

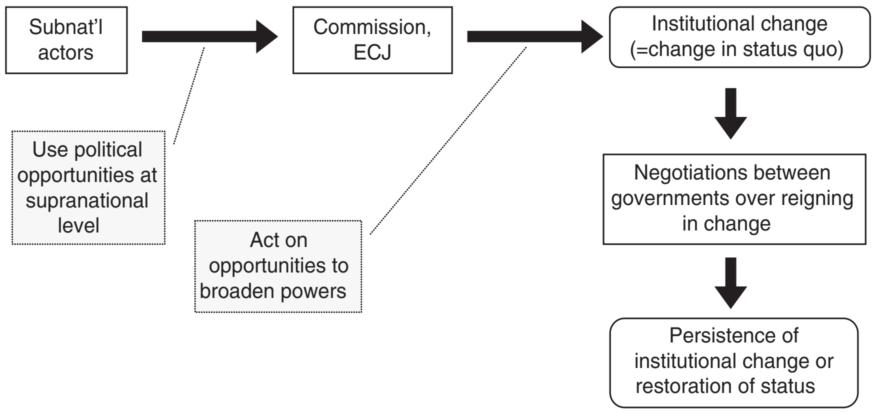

FIGURE 10.3. Institutional change in neofunctionalism (3).

within the constraints of identity and loyalty (Hooghe 2005): Greater integration enhances their power and ensures them of more interesting, more substantively important work. Consequently, the Commission and the ECJ are generally expected to act on such opportunities to broaden their powers. *This can lead to institutional change without any prior bargaining among the member states* (top portion of Figure 10.3).

Member state governments might then of course undo any such changes—but their negotiations start in this case from a new status quo. This changes the political dynamic: The *status quo ante* cannot be restored if a single member state or a blocking minority of states favor the new arrangements over the old ones (see also Stone Sweet and Caporaso 1998: 127f.). In other words, those who favor the change can ensure that it persists, even though they could not have brought it about through intergovernmental negotiations.

In sum, neofunctionalism emphasizes subnational actors and transnational coalitions pursuing their own material or ideological interests. These subnational actors and transnational groups are expected to act in concert with supranational actors and to make use of the political opportunity structures provided by existing national and European institutions. They will push for a shift of authority from the national to the supranational level *if such a shift allows them to achieve their goals more efficiently or if they expect to be able to form a winning coalition at the European level while they cannot do so domestically.* Note that institutional change for neofunctionalism is not expected to occur automatically. Quite to the contrary, it is expected to arise out of political conflict. Supranational actors might of course foster groups that see further integration as being in their interest (Burley and Mattli 1993; Alter 2001), but institutional change is expected to occur only if and when such groups exist and take the initiative. The alternative route—supranational actors, especially the Commission, attempting to extend its own powers vis-à-vis member states through overtly political proposals for institutional change—is expected to fail since such overtly political attempts will stimulate opposition, whereas incremental change with the support of (and at least in seeming response to demands from) subnational actors will likely succeed (Haas [1958] 2004: xxxiv, 26, 106ff.).

The next three sections provide brief analytical accounts of the institutional evolution of the EU in the three issue areas of competition policy, from the law and practice under the ECSC and the provisions in the Treaty of Rome to the latest changes of 2003–04. As stipulated by the analytical framework above, these narratives pay close attention to sequence. They also illustrate the importance of substate actors engaged in transnational politics for explaining specific unanticipated consequences or the initiational institutional arrangement, as well as the broader process of institutional change in the EU.

Antitrust Policy: Restrictive Practices and Abuse of Market-Dominating Position

The competition provisions of the Treaty of Paris, the founding treaty of the ECSC, were 'the lengthiest and most detailed in the entire document' (Gillingham 1991: 283). After months of bitter opposition from cartel-operating industries, which was overcome only thanks to American prodding (Gillingham 1991: 254–83; see also Berghahn 1985: 285f.)—and despite persistent concerns about creating a 'dictatorship of experts' (Rittberger 2001: 695, quoting the Dutch chief negotiator)—the six prospective member states agreed on strong antitrust enforcement authority for the supranational HA, the ECSC's version of the Commission. Articles. 65 and 66 prohibited all 'agreements' and 'concerted practices' that would 'prevent, restrict, or distort the normal operation of competition within the common market' for coal and steel and authorized the HA to enforce these rules, grant exceptions under specified conditions, and act against abuses of economic power (Gerber 1998: 339, 341). But although Monet (quoted in Gillingham 1991: 313) interpreted these provisions as 'a mandate to dissolve cartels, ban restrictive practices, and prevent any concentration of economic power', the HA of the ECSC exercised these powers in the realm of antitrust only starting in 1956 and even then only with great restraint (McLachlan and Swann 1967: 117ff.; Diebold 1959: 350ff.; Haas [1958] 2004: 76ff.).

Notwithstanding this restraint in the early years of ECSC, the inclusion of similar language against cartels and monopolies in the Treaty of Rome was hotly contested, partly due to cross-nationally different visions of competition policy (see Gerber 1998: 346f.; Motta 2004: 17–24), but also due to conflicts of interest *within* the prospective member states of the EEC. That relatively powerful antitrust provisions were included in the Treaty of Rome in the end was due to a coalition in the late stages of the 'Messina' negotiations between the governments of the Netherlands and Belgium and some ordo-liberal officials from the internally divided German government, who sought at the European level the strong competition and antitrust rules that they had been unable to get through at the domestic level (Milward 1992: 217f. Groeben 2002: 17, 66–71, Hentschel 2002: 279).[6]

Specifically, Article 81 established that agreements among two or more 'undertakings' (i.e. firms or other economic entities), 'which may affect trade between Member States and . . . have as their *object or effect* the prevention, restriction, or distortion of competition' are prohibited (emphasis added). Contractual provisions to this effect are not enforceable.[7] Somewhat more vaguely, Article 82 established the principle that the EU could and would intervene against 'any abuse . . . of a dominant position', including distortion of supply, dumping in order to bankrupt competitors, etc. The Commission (represented by DG Comp) was to act as the executive, with the power to enforce these provisions (Gerber 1998: 349ff.).

Legal provisions, however, do not make practice. The Commission's power of antitrust enforcement was subject to implementing regulation that was to be passed by the Council within the first three years. When it was finally passed in March 1962 as 'Regulation 17', it nominally gave the Commission truly supranational powers in antitrust enforcement (including supremacy over national courts and regulators), though 'it is almost certain that the politicians in the Council at the time had little conception of the potential for independent action latent in Regulation 17' (Wilks and Bartle 2002: 164). In fact, to many it seemed that EC competition policy was just an exercise in declamatory politics, where regulatory governance is delegated to an agency to give the appearance of addressing an issue that is important to a certain constituency, while ensuring that little or nothing would be done by the understaffed, under-resourced regulator (Mitnick 1980: 335f.).

Yet DG Comp tried to make the most of what it got. It built institutional capacity in the early years and slowly began to test its supranational powers, focusing at first primarily on Article 81 violations (Cini and McGowan 1998: 21ff.). The case against 'restrictive practices' that became the first one to solicit ECJ involvement, *Établissements Consten and Grundig* v. *Commission* (56 and 58/64 [1966] ECR 299) is exemplary of DG Comp's work in the early years: Grundig

[6] Ordo-liberalism is a philosophical school of thought—motivated in part by the experience with cartels and trusts in Weimar and Nazi Germany—that rejects government intervention when it seeks to direct economic activity but sees the state as having a necessary 'ordering' function in the economy to safeguard individuals against any concentration of political *and economic* power that would threaten their freedom and equality of opportunity.

[7] Exemptions could be granted in the interest of technological advancements or economic 'progress' if the agreements did not substantially impede market competition.

(a German electric and electronic goods manufacturer) had made Consten its exclusive distributor in France, ensuring relatively high prices for Grundig products in France. After the removal of quotas for electronic goods within the EEC in 1961, UNEF, a competitor to Consten, had started parallel importing of Grundig products into France. Grundig gained an injunction against UNEF in French courts, but UNEF lodged a complaint with the Commission, which declared the agreement between Grundig and Consten void. When Consten and Grundig challenged the Commission's decision (as well as its authority on the matter), the Court upheld much of the Commission's decision and, more importantly, affirmed Commission authority as a matter of principle, against the firms—and against the governments of Germany and Italy, which had joined the case in support of the firms' position. As predicted by the neofunctionalist argument above, it was private, subnational actors pursuing their economic self-interest who provided the Commission with an opportunity to move from nominal to actual antitrust enforcement authority under Article 81 when one of them (UNEF) pushed for expanded supranational authority. This institutional change took place despite continued differences among the member states about its desirability. The private actors also provided the ECJ with an opportunity to develop an expansive competition law doctrine. The success of UNEF showed others that they could advance their interest with the help of the Commission. This led in turn to further complaints against restrictive agreements by competitors or customers, as well as quiet tip-offs about cartel agreements, such as the famous price-fixing agreement that covered 80 percent of the European market for dyestuffs (busted in 1969, with fines imposed for the first time on firms headquartered outside the then-member states).

The provisions of Article 82, against abuse of a market-dominant position, gained 'teeth' only in the late 1960s and early 1970s. This is consistent with the neofunctionalist argument emphasizing subnational actors: Conflicts of interests among private parties involving an (alleged) dominant position in the European market could only arise after the completion of the customs union in 1968. Here, the ECJ became involved initially when economic competitors invoked Article 82 in domestic courts and those courts asked the ECJ for advisory opinions, beginning in the late 1960s and early 1970s. Those early ECJ decisions, 'indicat[ing] a willingness to support attempts by the Commission to find abuse in cases of high prices by dominant firms' (Gerber 1998: 357), helped establish the Commission's authority in this realm as well.

DG Comp continued to gain stature in antitrust and greatly expanded its case load in the 1980s and 1990s. It achieved notable successes in taking on companies like IBM for abuse of its dominant position in the computer market (1980–84), numerous industries for market-sharing agreements (e.g. insulated pipes, 1998; airline services, 2001), price-fixing (e.g. amino acids, 2000; ferry services, 1996, 1998), exclusive purchasing (e.g. musical instruments, 2003; ice cream, 1992), and exclusive/selective distribution agreements (car manufacturers, ongoing).[8] As the ECJ has repeatedly confirmed, the Commission has truly supranational authority on these matters, including the power to conduct invasive investigations, level substantial fines (to the tune of €2 billion for cartels in 2001 alone, Nugent 2003: 142), and force changes in corporate structures or practices on firms found to be in violation of EU competition law. DG Comp's increasing prestige led to a virtuous circle in attracting high quality EU staff, helped further by the leadership of high-profile and able Commissioners Sutherland (1985–8), Brittan (1989–93), van Miert (1993–9), and Monti (1999–2004). Its prominence was surely also aided by the increasing neoliberal economic consensus in Europe (McNamara 1998). But sequence matters here: the key institutional change, the acquisition of real supranational power in antitrust by the Commission, largely preceded these developments. It has exercised these powers increasingly and very visibly in the course of the 1990s and in several prominent instances against the express preferences of the largest member states; yet taking away or seriously curbing the Commission's antitrust enforcement authority has not even been seriously discussed anymore in any of the treaty revisions since (and including) the SEA.

Two more recent developments warrant mention. The Court of First Instance (CFI), created in the wake of the SEA, attained responsibility for competition (antitrust and merger) cases starting in November 1989. This institutional change followed largely the second path outlined above in that the CFI was created by agreement among the member states, at the suggestion of the ECJ as the case load of the ECJ rapidly increased and private interests (esp. firms) called for faster judicial decisions (e.g. Cini and McGowan 1998). Starting with the *Italian Flat Glass* decision (T-68, 77 & 78/89, [1990] 4 CMLR 535), the CFI has asserted the power to review the facts of competition cases *de novo*. Moreover, in a number of cases the CFI overturned DG Comp decisions for DG Comp's failure to provide a thorough economic analysis—which is especially difficult for abuse of dominance cases (e.g. Motta 2004: 411). These CFI decisions have led to the hiring of numerous economists at a DG so far dominated mostly by lawyers. Yet, as Harding and Yoshua point out, the common perception of a Court that is now restricting the Commission's authority in competition matters is quite mistaken. They find that appeals to the CFI have increased simply with the number of decisions taken by DG Comp (see also Guersent 2003: 50f.) and 'a large number of such claims brought . . . are rejected by the Court' (Harding and Joshua 2003: 179). Moreover, CFI decisions to overturn were limited to a few cases where DG Comp had made clear errors, and for much of the 1990s, 'the

[8] See *Report on Competition* XXVIII 1998 Sec.(99)743 Final:36, 140f.; XXXI 2001 Sec.(2002)462 Final:19, 31; XXX 2000 Sec.(2001)694:36f.; XXVI 1996: paragraph 97; XXVIII 1998 Sec.(99)743 Final:36, 140; XXXIII 2003 Sec. (2004) 658 Final; *Official Journal* 1993 L183:1–37; and http://ec.europa.eu/comm/competition/car_sector/ (last visited 6/10/2006).

Court of First Instance spent its time in cartel cases confirming the Commission's fact finding and approving the manner of its exercise of power' (2003: 179). At the same time, the CFI cases illustrate the seriousness of the underlying conflicts of interest. Consistent with the theoretical assumptions above, they show that private parties might also use the political opportunity structures at the supranational level to challenge the Commission's competition authority if doing so can help them overturn Commission decisions that are detrimental to their interests.

Finally, the implementation of EU antitrust policy was reformed by Council Regulation 1/2003 (OJ January 4, 2003:L1/1-25), which replaced Regulation 17 and came into effect on May 1, 2004. These reforms provide for a larger role for national competition authorities and national courts (for details, see Wilks 2005: 131ff.). Some have warned that these reforms constitute a renationalization of competition policy and thus an anti-integration institutional change (e.g. Mestmäcker 1999). A close examination of the changes and the proposals leading up to Regulation 1/2003 show, however, that these changes were long sought by DG Comp itself (see e.g. Cini and McGowan 1998: 179ff.). Regulation 1/2003 includes several safeguards against the inconsistent application of EC antitrust law in different national jurisdictions and reserves for DG Comp the power to take over any particular case (Riley 2003*a*, 2003*b*). In effect, the changes amount to a farming out of the vast majority of minor, routine cases to national agencies that have been to a large extent trained and socialized by DG Comp, to which they remain tied in an exemplary transgovernmental network, the European Competition Network (Slaughter 2004: 21, 36).[9] The changes thus allow DG Comp to focus its limited resources on crucial big cases and should make DG Comp more efficient as well as politically stronger as the hub of the ECN, in line with the demands by firms and transnational business lobbies in Europe for a faster 'one-stop' decision-making process.

Merger Review[10]

Article 66 of the Treaty of Paris gave the ECSC HA the power to block mergers if they created firms with the power 'to influence prices, control or restrain production and marketing, or to impair the maintenance of effective competition

[9] See http://ec.europa.eu/comm/competition/antitrust/ecn/ecn_home.html. As recently as 1997, more than half of the member states were judged as lacking national competition authorities with the capacity to apply Articles 81 and 82. See Cini and McGowan [1998: 193); today all member states have such authorities, including (with some variance, see Hölscher and Stephan (2004: esp. 335ff.)) the new member states, where extensive training and 'socialization' for the often newly created competition authorities has been part of the transition assistance provided by the EU.

[10] This section draws largely on Büthe and Swank (2006), where more detailed references can be found. Following the EU's practice, I use mergers here in a broad sense to include acquisitions and equity investments. In EU law, they are collectively referred to as 'concentrations'.

in a substantial part of the market for such products'. All mergers involving firms in the industries regulated by the ECSC had to receive prior authorization from the HA, though this requirement was not intended to impose a tight constraint. In fact, Article 66 makes authorization the default *unless* the merger predictably has the above effects. In practice, this was understood to make mergers generally permissible unless they created an enterprise with a monopolistic position in its market (Gerber 1998: 340f.; Haas [1958] 2004: 81), and the HA did not begin to impose conditions (or block mergers) until 1958 (McLachlan and Swann 1967: 197ff.).

The Treaty of Rome was a further step back for supranational merger review—mergers are not even mentioned. By most accounts, this omission was not accidental: Mergers were generally considered desirable by European governments in the 1950s. This view was tied to an industrial policy seeking economies of scale in a world where 'European corporations were . . . smaller in size than their American (and Japanese) counterparts' (Dumez and Jeunemaître 1996: 232). Therefore, European companies were still 'frequently encouraged [to] merge' through most of the 1960s 'even when the effect would clearly have been to hinder competition' (1996: 232). Even in the 1970s and 1980s 'several [member state governments] did not want to cede any authority [over mergers] to the Commission' (Schwartz 1993: 624). Yet the Commission acquired authority over European mergers all the same. How could this happen?

Based on the general provisions for competition policy (Articles 81 and 82), the Commission started to claim in the early 1970s that it already had authority over (some) mergers. It exercised this power for the first time in December 1971, when it prohibited the acquisition of a Dutch company, TDV, by its German competitor, SLW, for exacerbating SLW's already dominant position in the market for certain packaging materials. SLW's American parent, Continental Can Company, appealed this decision to the ECJ in February 1972, arguing *inter alia* that the Commission had no authority to apply Article 82 to mergers. In its 1973 decision (ECJ case 6/72, 1973 ECR 215), the Court decided against the Commission on the facts and let the merger go ahead. However, it held that the overarching intentions of the Treaty, especially Article 3(1)g, and the provisions in Articles 81 and 82, logically required that Article 82 should also be applicable to mergers in which a company increased its dominant position in a market (Goyder 2003: esp. 336f.).

Having been given the opportunity by the actions of the Commission and by the actions of private actors from several member states, which were pursuing their interests by shifting political activity to the supranational level, the ECJ thus advanced the cause of integration. However, while supporting the view that merger review and antitrust were linked and that the Commission had some authority over them, the court did not specify how far that power extended nor how it was to be exercised. The Commission therefore proceeded to propose to the Council a clarification of scope and process through a merger regulation that would formally grant merger control authority (for details, see Allen 1977; Pollack 2003*a*: 287ff.). These overt political proposals for institutional change in 1973, 1981–82, 1984, and 1986 were rebuffed by the Council every time.

Subnational actors, however, began to make use of the political opportunities offered by the ECJ decision in the *Continental Can* case. In particular, firms demanded that DG Comp review and block certain mergers of their competitors. These actions of subnational actors led to further institutional change when in 1981 Philip Morris sought to acquire a large stake in one of its major competitors in the European cigarette market, Rothmans, from the South African conglomerate Rembrandt. Three other competitors thereon submitted complaints to the Commission, asserting that the merger violated Articles 81 and 82, triggering an investigation by DG Comp. Philip Morris and Rembrandt satisfied the Commission's initial objections through a revision of their agreement, and the Commission thereon cleared the merger and rejected the competitors' request to block the equity investment altogether. Two of the competitors then took the Commission to court over this rejection. In its 1987 decision in *British American Tobacco Company Ltd* v. *Commission* (142/84) and *R. J. Reynolds Industries* v. *Commission* (156/84), the ECJ upheld the Commission's decision on the facts, but used the opportunity to confirm the Commission's authority over mergers in much more general terms than in *Continental Can*. The resulting dynamic is well summarized by Bulmer (1994: 432): 'The corporate uncertainty that was created, in part orchestrated by the Commission, resulted in . . . an unstoppable alliance of the Commission, ECJ jurisprudence, corporate actors and their interest groups . . . for the establishment of a clear set of supranational rules.' Multinational firms began to notify the Commission of any merger intention and asked for advance clearance. They also formed transnational coalitions to lobby national governments as well as the member states' representatives jointly in the Council for the swift adoption of a merger regulation that would establish specific thresholds for EC jurisdiction and criteria for allowing mergers.

The resulting Merger Regulation (4064/89), which was adopted by the Council with unanimity in December 1989, was important in that it increased legal certainty for economic actors and resources for DG Comp. It also arguably went beyond Articles 81 and 82 (Partan 1993: 286). But again sequence is crucial to understanding institutional change: the regulation just formally assigned to the Commission powers that it had largely already acquired informally.

In the later 1990s, the Commission then blocked a number of mergers and imposed strict conditions on others, thus acting repeatedly against the express wishes of the largest member states. Yet, as in the realm of antitrust, the changes brought by the revision of the Commission's mandate in Council Regulation

139/2004 (OJ December 16, 2003: L24/1) primarily seem to strengthen the Commission further. They allow it to defer merger reviews to national competition authorities while retaining supremacy over those authorities. It constitutes 'decentralization without renationalization', while the threshold for mergers with a 'Community dimension' remains unchanged (and thus effectively has been lowered). Also as in antitrust, recent decisions of CFI have demanded more thorough economic analysis, but court insiders deny that the CFI has raised the standards of evidence for a negative (blocking) merger review decision, and the judgments do not appear to be indicative of a general weakening of DG Comp's authority (Vesterdorf 2005).

In sum, DG Comp's attainment and exercise of merger review authority constitutes a series of even more striking institutional changes than its attainment of antitrust authority. These changes are well explained by the modified neofunctionalist theory of institutional change developed above.

State Aid(s): Subsidies, Tax Breaks, and Special Provisions/Guarantees

Article 4(c) of the Treaty of Paris stated categorically that 'subsidies or aids granted by States, or special charges imposed by States, in any form whatsoever' were considered 'incompatible with the common market for coal and steel and shall accordingly be abolished and prohibited within the Community'. Other provisions in the Treaty, however, tempered the strict prohibition of what became known in the EU as 'state aids', allowing in particular for governments funds to help with adjustment to economic openness (see Ruggie 1983). In practice, the HA pushed member states toward a significant reduction in subsidies, but also allowed long transition periods (e.g. McLachlan and Swann 1967: 42ff.).

In the Treaty of Rome, state aids are addressed in Articles 87–89 (originally 92–94). Article 87 (1) contains a general prohibition of 'any aid [i] granted by a Member State or through State resources in any form whatsoever [ii] which distorts or threatens to distort competition [iii] by favoring certain undertakings or the production of certain goods . . . [iv] insofar as it affects trade between Member States' (each of the four elements has been subject to extensive debate, see Plender 2004). It is followed by criteria for statutory and discretionary exemptions. Article 88 requires member states to notify the Commission of all planned state aid, which within two months has to either clear the aid—based on Article 87 (2) or (3)—or initiate a full 'contentious' review, at the end of which it may conclude that the member state must 'abolish or alter' the aid if it is found to violate Article 87. The power to review state aid prospectively or *ex post* and to grant exemptions is delegated exclusively to the Commission, except in that Article 88 (2) para. 3 allows for the Council to unanimously grant an exemption in 'exceptional circumstances'. Article 89, finally, allows for the Council to pass implementing Regulations.[11]

Notwithstanding these treaty provisions, which in many ways resemble those for antitrust, state aid has long been considered the competition area where Commission authority has been the weakest and where the shift toward unambiguously supranational authority has been the most recent (and subject to repeated litigation). In part this might be explained by inherent differences. Since it involves external review of the policy decisions of member state governments, state aid policy is inherently supranational with no direct counterpart at the national level save in federal systems (Cini and McGowan 1998; Thielemann 1999; Wolf 2004). Any decision to restrict or prohibit state aid pits the Commission directly against one or more of the member states. While some economic liberals within governments might quietly welcome EU pressure to reduce subsidies as a counterweight against the clamoring for subsidies from domestic groups, more often member state governments seek to retain their autonomy. A direct challenge to the decision-making autonomy of the state is bound to be politically sensitive. Moreover, state aid need not just distort or reduce competition, as cartels do. Rather, state aid may at the same time help in achieving important EU objectives outside market integration and efficiency, such as reduced economic disparities within the EU or adjustment assistance to the losers of liberalization. Subsidies have also long been a key instrument of industrial policy and a potential substitute for trade policy (Nicolaïdis and Vernon 1997: esp. 292ff.). The Treaty accordingly exempts, as a matter of principle, aid to individual consumers based on social criteria (from housing subsidies for the poor to progressive taxation) and disaster relief aid (87(2)); it also *allows* the Commission to consider as 'compatible with the common market', aid to underdeveloped regions within the EU, aid to facilitate economic adjustment, and (since Maastricht) aid to promote culture (87(3)). These inherent characteristics of state aid, however, cannot explain why DG Comp's state aid control has acquired 'teeth' in recent years.

In the early years, the Commission appeared to limit itself to defining 'state aid', which was at best vaguely defined in the Treaty. State aid thus came to be understood to include subsidies, tax breaks, state guarantees, and any other special treatments that give a particular firm or industry a competitive advantage. Proposals by the Commission for a detailed implementing regulation went nowhere in

[11] The provision allowing for the Council to exempt a particular case distinguishes state aid from the other issue areas of competition policy, restricting Commission discretion (Pollack 2003: 99f.). The rarely used provision does not, however, amount to an opportunity for the Council to overrule the Commission *ex post*, as the ECJ held in *Commission* v. *Council* (C-110/02 [2004] ECR I-0633). For various reasons, state aid in four industries/economic sectors is governed by a different set of procedures and/or in different DGs: transport, coal, fisheries, and agriculture.

the Council, and after 1972 the Commission stopped submitting further proposals (Cini 2001: 197)—until the late 1990s, when it felt that its authority in this realm was sufficiently well established to ensure that the Council would not use such a regulation to roll back the Commission's powers (Wolf 2004: 89). To be sure, the lack of an implementing regulation did not keep the Commission from gathering information about state aid, conducting the reviews that it was asked to do in Article 88(1), nor acting against national export promotion programs. But through most of the 1970s, the Commission still rarely challenged sectoral, regional, and other forms of state aid that member states considered an integral part of their industrial policies. This restraint was surely due in part to DG Comp's realization that it would be wise to gain experience and power in less controversial issue areas such as antitrust before challenging the member states directly. But it also appears to have been a function of savvy political calculation consistent with the theoretical argument above: Those benefiting from state aid generally have concentrated interests and tend to be well organized whereas the costs tend to be diffuse, which makes it very difficult to put together a self-sustaining coalition in favor of reducing state aid, as long as markets are mostly national and subsidies are available to an entire industry. Only after the full integration of the European product markets, especially the removal of a multitude of nontariff barriers through the Single Market program (1986–92), could the Commission hope to find and foster political allies among substate actors who would have concentrated interests in genuinely supranational (aid-reducing) authority over state aid to counteract the political opposition from state aid recipients.

Even though member states are required to notify the Commission of all planned aid prior to giving it, compliance with the notification requirement has been far from perfect. For some time, the Commission has therefore relied on complaints from competing firms (or other governments) to make them aware of possibly illegal, unnotified state aids (Cini and McGowan 1998: 139). In the late 1980s, then, in an apparent case of learning from its own earlier successes in fostering constituencies for its authority in other areas of competition policy, the Commission adopted an explicit policy of encouraging complaints about state aid by European businesses (Smith 1998: 63). To be sure, the political sensitivity of publicly lodging a complaint against the government of one's own country or a major trading partner has meant that competitors of aid-receiving firms have sometimes preferred 'tipping off' the Commission to unnotified aid quietly rather than having any public involvement with DG Comp (e.g. Peterson and Bomberg 1999: 70f.). But as the Commission's review of state aid became better known as offering a political opportunity structure, firms increasingly made use of the opportunity (Smith 1998: 98). As in antitrust and merger review, many of those complaints in the 1990s have come from competitors of a subsidized firm or nationally subsidized industry. They have taken the form of complaints against the Commission for failure to formally review the aid program under Article 88(2) or failure to prohibit it (Cini 2001: 203). In other words, they were demands for more supranational governance.

As in the other issue areas of competition policy, the Commission thus incrementally gained authority in response to demands from substate actors pursuing their own selfish interests, often with help or *ex post* confirmation from the Court. Most important here was the power to impose repayment of aid (from the aid-receiving entities to the aid-granting state) as a penalty in cases where the Commission established *ex post* that illegal aid had been given. 'Recovery of illegal state aid' was not provided for in the Treaty, and many member states opposed it. Yet the ECJ noted as early as *Commission* v. *Germany* (70/72 [1973] ECR 813) that it had to be an available remedy in order to retain the incentive for governments to notify the Commission *ex ante*. And the Court explicitly confirmed the power of the Commission to impose such penalties when the Commission's authority was challenged in *France* v. *Commission* (301/87 [1990] ECR 307) after the Commission started to impose such penalties in the mid-1980s (Priess 1996).

Yet do these institutional changes matter? Is the Commission actually exercising influence? Studies of state aid tend to show that the total amount of aid has barely declined and only recently has it declined consistently. Only about 1 percent of state aid notifications to the Commission result in a rejection. As Mitchell Smith points out, however, those might be the wrong numbers to focus on (1996: 564f.). Informal communication between governments and DG Comp ensures that many aid proposals are revised in ways that make them less market-distorting, before they are even initially submitted or well before the Commission might otherwise open an Article 88(2) investigation. The very informality of this practice makes it hard to establish how common and substantial such revisions are, but the very existence of the practice suggests that the Commission has real power in this realm and Smith concludes: 'The evidence suggests that Member States over time increasingly have had to adapt their industrial policies in significant ways to take account of DG IV's state aid policies' (Smith 1998: 57). Moreover, compliance of member states with EU state aid rules has in recent years been notably better than compliance of the federal states of Germany with similar rules at the national level or compliance with rules against subsidies in GATT/WTO (Wolf 2004). All of this comes in the context of apparently improved compliance with the notification requirement. As reported in the Commission's biannual *State Aid Scoreboard*, the percentage of 'registered aid cases' known to the Commission but not notified by the government in question has declined from 15 to 11 percent from the early 2000s to 2005 alone, despite increased incentives for competitors and taxpayers to notify the Commission of state aid that governments might have failed to notify.

Some recent developments should be briefly noted: After the CFI gained jurisdiction over state aid cases by private plaintiffs in 1994, resulting in an increase in state aid-related court cases brought by substate actors, the court began to demand more extensive economic analysis in critical cases (as in the other issue areas). The resulting demand on DG Comp's resources contributed to the Commission's decision to seek, after all, Council regulations on state aid. Council Regulation 994/98 (OJ 1998 L142/1) authorized the Commission to exempt entire categories of aid from the notification requirement, akin to the 'block exemptions' in antitrust (thus freeing up DG Comp resources previously needed to conduct the initial two-months review of aid proposals) and 659/99 (OJ 1999 L83/1) largely codified DG Comp's review procedures. Since 2001, aid to small and medium-sized companies and training aid is categorically exempted, as is aid below a certain ceiling (*de minimis* rule), while private parties can take complaints directly to national courts (thanks to direct effect of EU law) if they feel that a government is abusing a block exemption (Sinnaeve 2001; Rehbinder 2004). Finally, the EU has increasingly sought to externalize its state aid policy vis-à-vis its trade partners, for example via the EEA and association agreements (see, e.g. Cremona 2003; Rydelski 2004).

Alternative Explanations

While a proper discussion of alternative explanations of the developments sketched above is beyond the scope of this chapter, I want to address some of the most promising alternatives briefly. First, principal–agent theory has become a popular framework for the analysis of politics in the EU and has yielded important insights into variation in member states' ability to control the EU institutions (e.g. Pollack 2003*a*: here esp. 281–299; Tallberg 2000). As currently formulated, however, this approach to the delegation of authority leads one to overlook actors outside the principal–agent relationship such as the subnational actors that I have found to have played a crucial role in all three issue areas and which neofunctionalism (as refined here) emphasizes as central to institutional change.

Second, ideational or constructivist explanations have illuminated important episodes in the process of European integration (e.g. McNamara 1998; Parsons 2003) and might contribute to a more complete explanation of the developments in EU competition policy. As noted above, the ascent of neo-liberal economic thought in the 1980s and 1990s surely contributed to the increased prestige of DG Comp. By itself, however, this ideational shift cannot explain the variation in the timing of changes across the issue areas of competition policy.

Intergovernmentalism, finally, allows for significant changes only as a function of agreements among the member states; it therefore cannot account for the many incremental but cumulatively substantial changes described above. Where (some) change did come about through an intergovernmental bargain (as in the passage of the 1989 Merger Regulation), neofunctionalism provides an endogenous explanation for the underlying change in government preferences, which remains exogenous for intergovernmentalism (see, e.g. Schwartz 1993).

Neofunctionalism—as a HI theory in the broad sense espoused by Meunier and McNamara (this volume)—can account for these observations and is heuristically more useful: It leads us to pay close attention to sequence and to discover that Council Regulations in the realms of merger and state aid codified rather than created Commission authority. It also leads us to see (possible) actors and actions at the sub- and transnational level that are beyond the purview of other theoretical approaches. In a Lakatosian sense, then, it is most promising as a theory of institutional change in the EU.

Conclusion

In this chapter, I have sketched the major developments in the key areas of EU competition policy over the 'first fifty years' since the Treaty of Rome. I have sought to provide an overview of one of the economically and politically most important and interesting issue areas, on which political science scholarship is still scarce. I have focused on the key dynamics of the institutional evolution in EU competition policy, namely how DG Comp came to attain real supranational power at different times in the different issue areas of competition policy, sometimes against the express preferences of the member states. I also have tried to show that we can understand and explain these dynamics by adopting a modified neofunctionalist theoretical perspective. The key theoretical contributions here are to clarify the centrality for neofunctionalism of substate actors engaging in transnational politics and integrate key insights from historical institutionalism. This theoretical perspective yields, I have suggested, a superior explanation for the evolution of the politics of competition in the EU over the last fifty years. Its analytical usefulness across several issue areas suggests that Haas's foundational neofunctionalist work deserves a second, close reading and that the theory can and should be fruitfully developed further.

Given my findings, a key question for the future of competition policy is: When might subnational actors be expected to push for further integration? In the realm of competition policy, the existence of concentrated interests that can benefit from the shift of authority to the supranational level in a given issue area of competition policy appears to be a prerequisite. Yet it does not make a push for institutional change automatic. Numerous factors enter into a firm's (or potentially consumer group's) decision to raise a concern with DG Comp or bring a case at the CFI or ECJ. Indeed, it may be an inherent weakness of HI theorizing that the appreciation for context and contingencies makes it difficult to generate precise *ex ante* predictions, even as it yields better explanations.