In Pursuit of Selective Liberalization: The Impact of European Integration on State Capacities*

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Numerous scholars have considered the impact of global interdependence on the capacities of states -- their freedom to choose policies and their abilities to implement them successfully. In the case of West European countries, some analysts have depicted economic integration as a response to the diminished capacities of the state. For scholars believing in the continued primacy of the nation state, the very notion that European integration "strengthens" the state made it possible to reconcile bold progress in European integration beginning in the mid-1980s with the continuing sovereignty and dominance of the nation state.

Beginning in the mid-1980s, national executives in West European states converged on a general preference for fiscal and monetary prudence and liberalization of markets for goods and services; European integration permitted them to lower the political risks of pursuing these ends by "locking in" commitments to liberalization and neutralizing domestic political opposition.[1] By enabling national executives to more readily pursue desired objectives, European integration strengthened the capacities of states.

Our knowledge of the domestic political consequences of the European integration process expanded immensely during the 1990s, and research abounds on the implications of EU policies, including the growth of interest articulation and mobilization at the European level,[2] the expansion of trans-European political party activity,[3] and the relative autonomy of EU institutions.[4] The developments documented in this literature raise critical questions about whether, how, and when European integration in fact enhances state capacities.

Since it is reductionist to argue that every step toward economic liberalization fulfills the preferences of national executives of European Union member states, we must refine the notion that member state executives have successfully locked in a preference for economic liberalization. The preferences of national executives in West European states are more accurately defined by the notion of "selective liberalization." This term suggests that national executives indeed prefer economic liberalization, but that they also wish to control the scope and timing of the liberalization process. They may wish to give public sector enterprises the time and resources to prepare for competition from the private sector, or to protect public sector activities they deem politically vital, or which serve diverse constituencies, especially in politically decentralized polities. Yet studies of the integration process suggest that as the European integration process has developed, some important steps toward liberalization have been foisted on reluctant member state governments, most typically by supranational institutions like the European Commission.[5]

This essay examines more closely the ways in which European integration has altered the interaction between important societal actors and their governments. The integration process has enhanced opportunities for societal interests to circumvent the national political arena, raising the prospect that they, too, may under certain conditions acquire new political resources that enhance their abilities to achieve their own political objectives. Where these actors are private sector business associations that share the general objective of market liberalization, their augmented political opportunities may enable them to force the pace of liberalization, diminishing the capacities of national executives to control the scope and timing of the process. The argument presented here relies on empirical evidence from the European Community's efforts to regulate the payment of industrial aid to public enterprises by member

state governments. While the governments of member states have agreed on the general aim of freer and fairer competition embedded in the objective of a single European market, they repeatedly have sought exceptions in sectors such as public broadcasting, postal services, and banking. Yet because of the growing autonomy of the Commission of the European Communities to pursue the broad objective of liberalization, and the consequent mobilization of private sector interests, the liberalization process cannot be closely controlled by governments.

The essay first presents two cases in which the privileged interaction between member state executives and European Commission officials generated information asymmetries that ultimately "strengthened" the capacities of members of national executives to promote liberalization selectively. But the essay also examines two more recent cases, in which, by contrast, private sector businesses in France and Germany have discovered opportunities to challenge longstanding privileges of public sector enterprises -- the postal service in France and Germany's system of state banks, or Landesbanken. This evidence demonstrates that when governments choose economic liberalization, they cannot necessarily control the process that follows. Where European Community institutions possess substantial autonomous policy capacities; actors constrained in the domestic political arena are faced with enhanced opportunities for interest realization through European Union institutions; and the rewards of interest articulation at the European level accrue privately to those who take action, governments are constrained in their pursuit of selective economic liberalization.

Strengthening State Capacities

Scholars have posited two mechanisms through which interaction between national governments and European Community institutions augments state capacities. The first, a positive means by which integration "strengthens the state," is the broadening of policy options available to governments. The second is essentially a negative mechanism, in which members of national executives enter into European-level commitments in order to lock in a particular policy course and undermine domestic political opposition.[6]

Both of these mechanisms focus on motivations for the interstate bargains that drive European integration, from the Treaty of Paris establishing the European Coal and Steel Community to the 1992 Maastricht Treaty. Historian Alan Milward, the foremost proponent of this argument, argues that the very founding of the European Coal and Steel Community (ECSC) represented an effort to "rescue" the nation state from the failings of the interwar years and World War II. Rather than relinquishing sovereignty to a supranational authority, European statesmen hoped to use European institutions to augment the capacities of their states and to enhance their abilities to win the allegiance and support of their citizens.[7] Milward further suggests that in the postwar environment faced by West European states, integration represented an attractive option between protectionism and interdependence, or full-fledged entry into multilateral institutions that would severely constrict policy choices. These states simultaneously needed to expand markets for industrial goods, protect emerging sectors, and defend agricultural incomes. Integration made it possible to attain these objectives through selective and adjustable forms of protection.[8]

Revealing the second of the mechanisms by which integration strengthens

the state, Andrew Moravcsik asserts that EU institutions were created by governments precisely to enable them to achieve domestic political objectives through "other" means.[9] Member state governments therefore tolerate the authority of the EU "only insofar as it strengthens, rather than weakens, their control over domestic affairs."[10] Moreover, the intensification of interaction of member state governments in European-level institutions (the Council of Ministers) and with the EU bureaucracy (the European Commission) generates information asymmetries that redound to the benefit of national executives vis-a-vis other domestic political actors and institutions, including national parliaments. These interactions generate "elite cartels" which make it possible for national executives to control the domestic political agenda and define available policy options, costs, and tradeoffs.[11]

The examples that follow illustrate how these processes of broadening policy options and tying hands have worked in practice to augment capacities of governments to foster selected steps toward economic liberalization. The first case illustrates how in the late 1980s, Britain's Department of Trade and Industry allied with the European Commission to lower the political costs of implementing its preferred policy of reducing productive capacity in the shipbuilding sector in favor of alternative economic development. The second case reveals how modernizers in Spain's Socialist government worked with the Commission to rein in subsidies to the loss-making state airline company, Iberia; place management of the enterprise on sounder economic footing; and generally boost the fortunes of those in the government wishing to supplant an entrenched culture of inefficient management of public enterprises.

British shipbuilding

Shortly after taking office in 1979, the government of Margaret Thatcher

began to reduce state holdings in shipbuilding, nationalized by the Labour government in 1977. By the mid-1980s, the British government was prepared to eliminate all shipbuilding capacity in exchange for alternative industrial development, to be fostered by a program of enterprise zones. In April 1988 the Department of Trade and Industry announced plans to sell the remaining holdings of British Shipbuilding to the private sector. Buyers were found for all of these assets, with the exception of North East Shipbuilders, Limited (NESL), a company with 2,800 workers located in Sunderland and equipped to build large merchant ships. Hoping to terminate state-owned shipbuilding rapidly, the government closed NESL in December 1988, gaining approval from the European Commission for payment of £45 million in redundancy aid.[12]

By mid-1989, lobbying by local political interests and the labor movement for a reopening of North East's two yards intensified as global demand for merchant shipbuilding increased.[13] Nonetheless, the yards were pronounced unequivocally closed in July 1989 following a declaration by the European Commission that aid approved in December 1988 was conditioned on the permanent termination of shipbuilding at the two North East sites.[14] Any attempt by the British government to negotiate a return to shipbuilding, even by a private buyer, would result in the Commission's reappraisal of the approved redundancy aid.[15]

The Commission's ruling appears to have been a constraint on the Conservative Government's policy making autonomy. However, government policy favored the creation of economic dynamism and industrial diversification through the investment incentives embodied in its plans for enterprise zones. The preferences of the British government therefore were consistent with the European Commission's decision on shipbuilding at Sunderland and with the Commission's broader aim of reducing shipbuilding capacity and improving

overall industrial competitiveness. The decision on the fate of the shipbuilding site was negotiated privately between the Commission and the Department of Trade and Industry. Representatives of British Shipbuilders, who preferred privatization of shipbuilding with subsidies to make a purchase more attractive to private investors, were excluded.[16] Information asymmetries were therefore extreme, making it possible for the British government to strategically invoke the Commission's ruling to diffuse opposition to its plans for an enterprise zone and industrial diversification in Sunderland.

The Conservative governments of Margaret Thatcher had large parliamentary majorities throughout the 1980s. However, by the late 1980s, recession, high interest rates and unemployment made it important for the government to minimize the costs of implementing controversial policies. With the prospect of widespread dislocation resulting from the closing of the Sunderland shipbuilding site, the government invoked the Commission as a constraint on domestic policy choice. This facilitated completion of the final and most contested phase of the shipbuilding selloff and undergirded the government's plans for an enterprise zone to help diversify British industry, attract foreign direct investment, and enhance Britain's international industrial competitiveness.

By allying with the European Commission, the Department of Trade and Industry (DTI) altered the environment in which actors outside the government formulated their policy preferences. Before the DTI invoked this constraint on domestic policy alternatives, opponents of the government's program of industrial diversification, defeated in their efforts to sustain government subsidies of British shipbuilding, could still pressure the DTI to keep the Sunderland yards intact in the hope of finalizing terms with a private buyer. By bringing in the European Commission, the government ruled this out. At this

point, opponents of the termination of shipbuilding could do no more than launch a rhetorical attack on the government for failing to represent Britain's interests and on the European Commission for meddling in British affairs. The Conservative government's industrial policy makers thereby secured their most favored political result and eliminated the prospect of achieving only a second best outcome. Moreover, the Conservative government garnered an additional benefit: the outcome added credibility to their efforts to depict an aggressive Brussels "Eurocracy" representing a pervasive threat to parliamentary sovereignty.

Spain's State Airline

In January 1995 the Spanish Government informed the European Commission that it planned to invest 130 billion pesetas ($1 billion) in its state airline, Iberia, as part of a restructuring plan. Iberia had accumulated losses of approximately Pt200bn between 1990 and 1994. The effort to restore Iberia's economic viability quickly became a two-level game in which modernizers in a divided governing party allied with a European Commission that shared its objectives of reduced subsidies and a transformation from public sector governance by political criteria to sound business management. The Socialist government had recently appointed to Iberia a new Chairman, Javier Salas, and new Chief Executive, Juan Saez. The new management team was placed atop Iberia to reform its politically-driven management by ex-ministers and executives of other public sector enterprises, and to develop professional, market-disciplined management by private sector executives.[17] This step to alter Iberia's corporate culture reflected a broader tension within the government

over macroeconomic policy between those favoring state shrinkage and those more deeply committed to public investment and ownership.

Late in 1994, the new management team stepped up cost-cutting efforts, informing employees that substantial wage cuts and layoffs would be required to keep Iberia viable. They cautioned that the European Commission would not approve a desperately-needed capital infusion from Teneo, the state holding company, without agreement on such a package.[18] When employees failed to agree in initial bargaining rounds and staged a one-day strike, Salas warned that the alternative to the pay accord was to sell off substantial parts of the company. Coinciding with Salas' warning, EU Competition Commissioner Karel Van Miert publicly rejected the Spanish Government's claim that Iberia's need was legitimate due to special circumstances, principally a sharp devaluation of the peseta and huge losses on the company's Latin American assets. Salas, in turn, announced that without the pay agreement demanded by the Commission, Iberia would be bankrupt by March 1995.[19]

The cleavage running through the Socialist government had turned the issue of the capital infusion into a battleground. While the Transport Ministry argued publicly that Iberia had a legitimate case for receiving assistance due to the special circumstance of the peseta's sharp devaluation and the unexpected length of Spain's recession, the Industry Ministry endorsed the view that the Commission would not approve the capital infusion unless the cost cuts pushed by Salas and Saez were achieved and Iberia's board of directors reorganized. In mid-March 1995, Spain's Minister for Industry reported that the Commission

would not authorize aid to Iberia unless political appointees on Iberia's board were replaced with business professionals from the private sector, institutionalizing a more market-oriented approach to the management of the company.[20]

The drive to cut public spending came partly from the EU itself, following a July 1994 meeting of Finance Ministers. In accordance with the terms of the Maastricht Treaty, the ministers cited Spain's deteriorating budget picture and recommended a set of macroeconomic policy guidelines for 1995 to reduce public sector deficits. Economy Minister Solbes sought to put Spain on course for a reduction in the public sector deficit to the Maastricht target of 3 per cent by 1997, partly through large-scale privatizations in the telecommunications, oil and banking sectors and partly through cuts in public investments. Solbes emphasized the critical importance for Spain to move toward the convergence criteria for the third phase of EMU, and underscored that the required reductions in government spending would come through cuts in government transfers to public and private enterprises rather than reductions in social spending.[21]

After nine months of deliberations, the European Commission in January 1996 approved the infusion of capital into Iberia, but gave a victory to the modernizers in Spain's government by approving only a portion of the requested transfer, and making approval conditional upon Iberia's divestment of its holding in Aerolineas Argentinas.[22] Modernizers in Spain's governing Socialist Party had worked closely with the European Commission to constrain policy choices and thereby challenge party traditionalists wishing to continue the

practice of generous subsidization and political management of public enterprises. Expressing his satisfaction with the outcome, Economy Minister Solbes commented that the amount "is a figure with which we can live and with which we can resume the modernisation and adaptation programme as planned."[23]

These cases suggest that interaction with EU institutions can indeed strengthen the capacities of national executives to promote economic liberalization measures, not only relative to societal actors and other institutions of government, but vis-a-vis other actors *within* the executive as well. However, there is mounting evidence that the process and outcomes generated by European integration are not driven exclusively by the interests of member state executives -- or by an other single actor or set of actors.[24] The increasing authority of the EU institutional apparatus -- especially the Commission and the Court of Justice -- to implement and interpret policy, attracts growing numbers of trans-European, national and subnational lobbying groups; represents an additional arena for interest articulation for political actors; and induces mobilization of interests around policies affected by the integration process.[25] The development of EU institutions therefore not only extends chances for members of national executives to signal their firm commitment to particular policy objectives, tie their hands, and exploit information asymmetries; it also alters the opportunity structures facing societal actors. While European integration may sometimes enhance the capacities of national executives to

pursue selective economic liberalization, the behavior of private sector actors may at other times constrain state capacities.

An Alternative to State-Centric Theory

Strong capacities to pursue selective economic liberalization imply that national executives can fend off the opposition of political actors opposed to market liberalization, reduction of subsidies, economic convergence, and fiscal austerity, but also retain the option of "capitulating" to such demands if politically desirable. From a statist perspective, societal interests mobilize within the national political arena to articulate and pursue their interests; if they mobilize sufficient resources, they can induce their governments to act on their behalf. While societal interests as well as the autonomous preferences of national executives contribute to the process of national preference formation, the interests expressed by societal actors are mediated by national governments.[26]

An approach that incorporates the multiple arenas in which both state and societal actors interact recognizes the critical point that governing institutions and policies are causal factors in the process of political mobilization. Acting on their preferences, member state executives may seek to lock in certain broad policy objectives. However, policies generate incentives for interests to mobilize, and institutions shape and direct the process of mobilization. Consequently, economic integration does more than simply foster the articulation of particular societal interests in the national political arena; it also opens channels for the expression of these interests directly at the European level.[27] Societal actors may

therefore pursue their interests outside national politics if EU institutions offer accessible channels and viable prospects of preference satisfaction. These channels are especially well developed in the area of competition policy, where the Commission's success in constructing the state aid regime and its visibility in combatting subsidies to state-owned industries in particular has proven a catalyst for closer attention to state aid from private sector firms and business associations. As EC policies have promoted market liberalization, especially in public sector activities such as telecommunications and postal services, newly-entering market competitors have attempted to exploit the Commission's state aid regime to further the liberalization process. The Commission has encouraged private actors to bring more state aid cases before national courts, since Article 93 of the EC Treaty, which prohibits the granting of aid that distorts competition in the internal market, is directly enforceable at the national level. However, the Commission's activism has drawn attention to its exclusive competence to investigate suspected breeches of state aid regulations and its willingness to confront member state governments that violate the rules. Its activism therefore has generated an incentive for private actors to bring complaints directly to the Commission.

Moreover, while a state-centric perspective inherently confines politics to interest conflicts either between states or between national governments and supranational institutions, a broader perspective includes the possibility that conflict *within* states, whether within governments or between governments and societal interests, may be the dominant line of contention in a policy area. A

multi-level perspective acknowledges the possibility of unintended consequences of steps toward economic integration and, therefore, the prospect that even if national executives drive the major agreements on which European integration is built, ultimate outcomes are indeterminate. In short, state capacities may sometimes be constrained rather than augmented by the process of economic integration.

Indeed, there is ample evidence that in the case of industrial subsidies, the relationship between national executives and the European Commission does not simply strengthen members of the executive relative to other institutions or societal groups. The process may also privilege particular members of the executive, governing coalition, or ruling party, over others. This accords with the findings of research on the domestic political consequences of intensified interaction between national executives and transnational political actors, such as international lending agencies with whom factions of governing groups may collude in order to enhance their leverage over domestic political opponents.[28]

Furthermore, the European Commission has relied heavily on private interests to broaden its autonomy to make and enforce state aid policy. The EC Treaty grants the European Commission exclusive competence to require that member state governments "abolish or alter" aid to enterprises the Commission deems incompatible with the internal market.[29] Nonetheless, in practice the Commission's authority has developed only gradually. The process has been highly sensitive politically since member state governments have used subsidies as an instrument of industrial policy for decades. Following the 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 mobilizing a constituency in the business community favoring rigorous control of aid to industry by governments.[30]

As it sought to implement a fully functioning internal market beginning in the late 1980s, the Commission also came to rely on complaints by third parties -- typically firms competing with an aid beneficiary in the public sector -- to help justify the aggressive application and development of state aid regulations. Using these resources as well as its Treaty authority, the Commission was able to develop its capacities to investigate state aid cases, establish precedents, make decisions, and extract compliance from member state governments. Moreover, Commission officials could offset some of the political pressure they face from ministers of member state governments lobbying on behalf of national industry by pointing to private complaints and the need for neutral application of the rules.

Ultimately, members of national executives are not the only actors whose preferences may be privileged by European economic integration. The integration process strengthens some societal actors over others. Moreover, under some conditions, rather than strengthening members of the executive relative to societal actors, integration may strengthen societal actors relative to the executive. This emergent constraint on state capacities is illustrated by two recent cases in which private firms competing with providers of public services

have relied on European Community rules and institutional channels to challenge the use of state resources.

Sytraval and the French Postal Service

Decisions by the European Court of Justice have expanded the opportunities for private sector actors to utilize European-level institutions as a locus of interest articulation and a means of preference satisfaction. This is reflected in the changing nature of state aid cases before the Court of Justice. Until the mid-1990s, state aid cases typically consisted of Commission actions brought against member states for violating Treaty articles or failing to implement Commission decisions. In the late 1990s, an increasing number of cases before the lower court, the Court of First Instance, consist of actions by private firms or business associations against the Commission for failing to give adequate consideration to allegations of instances of illegal state aid. Prior to these cases, the rights of interested parties to do anything more than submit evidence to the Commission were nowhere codified; the Commission has been able to dismiss third party complaints that it is politically unprepared to pursue. However, recent Court decisions resulting from dissatisfaction by private parties with the Commission's treatment of their complaints have increased the burden on the Commission for justifying its dismissal of a complaint. This added demand on the Commission threatens to break up elite cartels between the Commission and national executives that permit the Commission to control the state aid agenda and national governments to pursue selective economic liberalization.

The landmark case is the 1995 Sytraval judgment.[31] In this case private sector French firms providing security services filed a case against the Commission for failing to rule that the French government had infringed EC Treaty Articles governing internal market competition when it set up a state-owned commercial company to furnish security and other services for the French post office. In 1987, the French post office set up Sécuripost to provide transportation of valuables, protection and surveillance services, seconding more than 220 officials to Sécuripost. Based on an agreement between the Ministry of Posts and Telecommunications and Sécuripost, the French post office granted Sécuripost loans and several forms of favorable treatment, including use of post office premises at no cost, maintenance and refueling of Sécuripost's vehicles by the post office's garages at advantageous rates, and exemption from both unemployment insurance fund contributions and payments for redundancy or dismissal of any employees seconded from the post office.

In 1989, several French business associations and individual undertakings providing services competing with those offered by Sécuripost, including Sytraval[32] and Brink's France, submitted a complaint in which they requested that the Commission initiate an investigation of illegal state aid pursuant to Articles 92 and 93 of the EC Treaty. After several exchanges with the French government, the Commission ultimately announced on December 31, 1993 that no state aid existed according to the available evidence. In March 1994, Sytraval and Brink's France brought an action for annulment of the Commission's decision before the Court of First Instance.[33] The action filed with the Court

asserted that the Commission had failed to provide Sytraval and Brink's with adequate reasons for dismissing their complaint, as required by Article 190 of the EC Treaty.[34] The Court of First Instance ruled that the Commission had not made its reasons for rejecting the complaint sufficiently clear to enable the complainants to defend their rights and for the Court to exercise its power of review.[35]

The Commission appealed the lower court's decision, arguing that the EC Treaty obligates it to do no more than provide the complainant with a copy of its decision addressed to a member state. In April 1998 the European Court of Justice, while taking a more limited view of the Commission's obligations than the Court of First Instance, nonetheless confirmed that the Commission must provide "clear and unequivocal" reasoning for reaching the conclusion that arguments put forward by complainants fail to demonstrate the existence of state aid.[36]

The Court of First Instance in particular has sought through its decisions to enhance the rights of third parties lodging complaints with the Commission.[37] Moreover, there is evidence that a growing range of actors is seeking to utilize the Commission's role in regulating state aid to check undesired policies of governments. In a case brought before the Italian courts in 1997 and referred to the Court of Justice for a preliminary ruling, employees of the Italian post office argued that the exemption of the post office from laws limiting fixed-term employment contracts constitued an illegal state aid that advantaged the Italian post office in relation to its competitors.[38] Arguably, societal mobilization in

response to the application of state aid policy has generated a new form of checks and balances in the domestic politics of West European countries.[39] This explains why, 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. What was at stake for each of these governments was the susceptibility of their industrial policies to challenge by private sector actors -- including not only actors from other member states, but from their own societies as well.

Germany's Landesbanken

Implementing a meaningful competition policy within the single European market increasingly demands that the European Commission and the governments of the EU member states define reasonable levels of compensation to public enterprises for the public service functions they perform. Since most public enterprises, including postal services, public broadcasting, and banks, not only provide public services, but also engage in business which competes with the private sector, public aid exceeding that which compensates for public service functions yields an advantage in competitive activities. The Sytraval case illustrates the nature of the issue, which also has become contentious in Germany's banking sector.

German banking includes a system of state banks (Landesbanken) as well as local savings banks (Sparkassen) created to carry out public services. The

Landesbanken were established to serve as clearing banks for the networks of Sparkassen and to provide financial services to their state governments. The Landesbanken comprise some of the largest banking institutions in Germany.[40] The local savings banks are regulated by Land law, and were originally established to provide banking services, such as savings accounts and credit, especially for home purchases, to lower- and middle-income families, and to service the financial needs of public authorities and local firms.[41] The public authorities that created the savings banks are fully liable for their debts. State banking laws restrict the activities of these savings banks to their regions and limit their investments in some assets. Nonetheless, over time, the 13 public sector Landesbanken and 624 Sparkassen, which operate more than 23,000 offices, employ more than 375,000 workers,[42] and conduct more than a third of all banking business in Germany, have come to operate similarly to commercial banks, engaging in corporate lending and international investment banking.[43] This is especially true for the Landesbanken, which as a result have increasingly entered into direct competition with commercial banks.

The Landesbanken have received capital injections through housing development funds and because of government loan guarantees are able to obtain higher credit ratings that lower their borrowing costs. In response to these advantages accruing to the Landesbanken, the Bundesverband deutscher Banken (BDB), industry association for Germany's commercial banks, has sought to exploit the political opportunity opened by the European Commission's aggressive implementation of state aid policy in the years following the

development of the single European market. The BDB first did so by complaining to the Commission against Westdeutsche Landesbank, the largest of Germany's public sector banks, which in 1992 received an infusion of $2.5 billion from housing development funds on which it provided only a minimal return to the state of Nordrhein Westfalen.[44]

The commercial banks initially attempted to resolve the issue through negotiations at the federal level. After several rounds of discussion between the federal government, the BDB, and the Bundesverband Oeffentlicher Banken (VOEB), the association of public sector banks, the BDB announced in March 1997 that it was no longer prepared to participate in talks at the national level, and that it would pursue the issue exclusively in Brussels.[45] The VOEB, arguing that the commercial banks were simply reacting to the growing market presence of the public sector banks and trying to secure their market position, joined the smaller DSGV, the Federation of German Savings and Giro Banks, in a threat to withdraw support for European monetary union.[46] By introducing the Westdeutsche Landesbank case, Germany's commercial banks intended to draw the Commission's attention to the general issue of state loan guarantees extended to the Landesbanken. Rather than taking on this politically sensitive issue directly, the BDB used the case of Westdeutsche Landesbank to lead the Commission into a broader confrontation with the German government.[47]

Ultimately German negotiators at the June 1997 Amsterdam summit secured the agreement of other member state governments to language that deferred conflict over the issue. This agreement materialized as a "Declaration of

Public Credit Institutions" annexed to the June 1997 Amsterdam Treaty which acknowledges that Germany's public credit institutions are entitled to full compensation for their public service functions. However, the declaration states that compensation should be strictly limited to that required by the public service duties performed, thus leaving open the question of the admissability of state guarantees of bank liabilities.[48] The German savings banks represented by the DSGV interpreted the agreement as an endorsement of state guarantees. Nonetheless, the European Commission and other member state governments remained opposed to the benefits granted to the Landesbanken. The Commission expressed concern about the ability of the large Landesbanken to use state guarantees of their liabilities to obtain more favorable credit ratings.[49] In November 1998 the Commission presented this position before the Council of Economics and Finance Ministers (ECOFIN). The Commission's report asserted that where the service offered can also be provided by a market actor, any compensation provided by the government violates EC competition rules. The Commission report contrasted the German banking system with that in Sweden, where a public credit institution set up under the auspices of the postal service is required to serve sparsely-populated areas, and is justly compensated for performing that public service function. The fact that the Landesbanken maintain a national banking network does not qualify them for compensation for provision of a service of general economic interest.[50] There is significant support for the Commission's position among EU member state governments; at

the November 1998 ECOFIN Council, the German government alone expressed opposition to the Commission's report.[51]

Although it has yet to take action against the Landesbanken, the European Commission has taken a clear position that state guarantees provided to the Landesbanken violate EC competition rules. The Director of Schleswig-Holstein's Landesbank has called the Commission's involvement a "frontal attack" against the existence of Germany's public credit institutions.[52] Given their prominent role at local and state level, the Sparkassen and Landesbanken have been able to draw on extensive political support spanning the divide between political parties. Helmut Kohl endorsed the integral role of the public banks in Germany's federal system, particularly after the public credit institutions threatened to withhold their support for the single currency.[53] The Minister-Presidents of the Laender also took to the defensive. Following a January 1997 meeting in Brussels with Jacques Santer, Nordrhein-Westfalen Minister-President Johannes Rau, claiming to speak for the Minister-Presidents of all the Laender, expressed the view that the German banking system would be "unimaginable without the Sparkassen and Landesbanken."[54] Heide Simonis, Minister-President of Schleswig-Holstein, accused the private banks of "treachery," and warned EU Competition Commissioner Karel van Miert against conducting a one-sided investigation in the interest of the private banks.[55]

By taking advantage of the opportunity to shift the conflict from the national to the European level, Germany's private banks have gained the Commission as a powerful ally. By empowering Germany's private banks

relative to the public credit institutions, the Commission advances its own broader interest in more sharply defining the role of public services and limiting government aid. However, the European Commission lacks the political support required to directly challenge the German government. Yet the introduction of the single currency is likely to change this as a consequence of intensified competition in the banking sector, which will intensify interpenetration between markets of countries in the euro zone. With this further globalization of the European banking system, the coalition against Germany's Landesbanken is likely to grow to include commercial banks headquartered in other EU countries, including France. Once complaints from these banks begin to reach the Commission, its will begin to accumulate the political leverage required to act against the Landesbanken. Ultimately, the German government may be forced to fundamentally reform longstanding arrangements for the Landesbanken, an integral part of Germany's federal structure. The Landesbanken may have to retreat from some activities that compete with the commercial banks, or undertake partial or complete privatization.[56]

When does integration constrain state capacities?

The empirical evidence examined here indicates that while national executives may be able to promote general economic liberalization, the forces they unleash by committing to this objective render *selective* economic liberalization unsustainable. While national executives may gain added

leverage to break down domestic political opposition to desired policies, some societal actors may, on the contrary, experience new opportunities to challenge their governments in areas not yet marked for liberalization.

Under what conditions is this most likely to occur? The emergence of increasingly autonomous EU institutions -- especially the European Commission and Court of Justice -- have critical implications for the ability of societal interests to pursue alternative strategies of preference satisfaction.[57] The extent to which European integration enhances the abilities of organized interests to achieve their preferences depends upon three factors: the degree to which EU institutions possess significant autonomous regulatory capacities in the policy area in question; the state of existing opportunities for domestic political action; and the rewards of interest articulation at the European level -- in particular, whether benefits are captured privately or consist simply of public goods.

European Commission Policy Autonomy

The European Commission possesses significant formal, treaty-based legal authority to regulate member state aid to industry. However, this authority was largely dormant until implementation of the single market project was fully underway in the late 1980s. More precisely, through the 1970s the Commission essentially met the needs of member state governments for facilitating adjustment in sectors with excess capacity and muting costly regional aid competition.[58] In other words, the Commission fulfilled the role of a neutral enforcement agent that eases the path to international agreements and thereby enhances the ability of states to achieve their objectives. Yet once

implementation of the single market began, the Commission developed from the foundation of EC Treaty articles ever more potent autonomous capacities to control state aid. Using decisions of the European Court of Justice, an expanding network of codified regulations, and growing involvement of private actors supportive of efforts to reduce distortions of competition, the Commission strengthened its abilities to obtain information from member state governments that were at times reluctant to provide it, to impose conditions on the granting of industrial assistance,[59] and to demand repayment of illegally-granted aid.

In its efforts to augment its autonomy in the state aid area, the Commission relied on complaints by third parties -- both governments and private sector actors including individual firms and industry associations -- to counterbalance political pressures from national ministers to grant their governments greater latitude to aid public enterprises. Private actors have been encouraged by the Commission's highly visible commitment to combatting industrial aid that distorts competition within the single market. The Commission's record of confronting governments that violate the rules offers compelling evidence that the state aid unit is ideologically committed to the principle of fair competition and to the need to reduce subsidies in order to enhance industrial competitiveness. The state aid policy regime therefore offers private sector actors significant opportunities to transcend the confines of interest articulation in the domestic political arena.

Opportunities in Domestic Politics

What opportunities did private sector actors have to challenge subsidies paid by their governments to public enterprises providing competing goods or services prior to the development of the Commission's autonomous capacities? In practice, few. EC law is indeed directly applicable at the national level, so that private actors in theory have the option of bringing their governments before national courts for alleged violations of the competition provisions of the Treaty. However, in cases of alleged state aid, private actors can only sue other parties for failure to notify the European Commission about the payment of an aid. The decision about compatibility of the aid with the single market ultimately rests with the Commission. Moreover, complaining directly to the Commission is a less costly option than going through national courts. The opportunity for private firms to bring an alleged violation by a competitor to the attention of an activist European Commission, intent on expanding its authority to regulate state aid, therefore represents a fresh opportunity for unaided firms to pursue their objective of fair competition. However, prior to the Sytraval case, the Commission could choose -- whether on economic or political grounds -- not to investigate an alleged violation. Sytravel and other recent Court decisions have begun to break down the elite cartel between national governments and the Commission, in which national executives acknowledged the Commission's growing authority while simultaneously asking the Commission to proceed gradually and respect limits, particularly in the area of public services.

For political actors that face severe constraints in national politics, European-level policy making may comprise a dramatic shift in political opportunities. The prospects for business associations to block the expansion of public services into areas served by private firms, or to prevent government aid to public enterprises, are extremely limited, especially in political systems in which there is a long tradition of close involvement between government ministries and public enterprise, as in France.[60] In addition, the activities of national competition authorities focus on mergers and abuses of dominant position *within* the private sector rather than instances in which government aid to industry and public enterprises distort competition with private firms.

Do Benefits of Interest Mobilization Accrue Privately?

Finally, private actors may perceive strong incentives to challenge government aid to public enterprises that compete with their economic activities because the benefits generated by the Commission's scrutiny of government actions accrue directly to competing firms. This is best illustrated by contrast with another policy area -- public procurement -- that shares with state aid policy the objective of freer competition. Public procurement concerns the contracting for supply of goods and services by public authorities at all levels. While procedures for open and competitive public tendering have been legislated by the Community, enforcement depends substantially on private complaints. However, firms that complain to the European Commission about violations of procurement rules by public authorities do not privately capture any direct benefits; on the contrary, they generate public goods. When the Commission

finds that public procurement legislation has been violated, the contracting authority may be required to reopen the public tender; however, procedures for assessing infringements of the rules are extremely cumbersome, and violations often are not uncovered until after contracts have been fulfilled. Even where the contracted service has not yet been performed, the party that originally complained is not necessarily awarded the contract in question. Contractors also run the risk of being punished by public authorities, which may disqualify them from future public tenders. Reflecting these factors, the Commission has found it difficult to mobilize a private sector constituency in support of stricter enforcement of public procurement legislation.[61] The constituency for state aid enforcement has grown in part because most private parties damaged by the award of illegal aid to public enterprises perceive a significant probability of substantial net gains.

Implications: State Capacities in Comparative Perspective

Ultimately, then, the process of European integration, by altering the opportunities and incentives for political actors, has not only affected the multi-level political games that take place between governments and publics and within governments; it also has enabled private sector actors to scrutinize and potentially constrain government behavior in new ways. As the table below suggests, in both the Sytraval and Landesbanken cases, the development of substantial autonomous capacities by the European Commission in the area of state aid policy has redefined the political opportunties open to private actors:

European Integration and Changes in Political Opportunity Structures

Country	Case	Primary Mechanism(s) of Shift in Power	Who was Empowered?
UK	Shipbuilding (NESL)	information asymmetries between advocates of sustained shipbuilding capacity and protagonists of government's enterprise zone policy	Department of Trade and Industry and highest levels of national executive
Spain	Airline (Iberia)	information asymmetries within divided governing coalition; alliance between faction of ruling party favoring a break with tradition of state subsidization and agents of state aid policy enforcement in European Commission	economic modernizers in Spain's governing Socialist Party
France	Postal Service	mobilization of private sector actors in response to European Commission activism in area of state aid policy; decisions of the Court of First Instance and European Court of Justice	private sector security firms competing with public enterprise (Sécuripost) set up by Postal Ministry
Germany	Public Banking (Landesbanken)	European Commission autonomy in area of state aid policy; bolstered by introduction of single currency and consequent integration of the European banking system	commercial banks

In contrast, in the cases of British shipbuilding and Spain's national airline, portions of the executive were strengthened by information asymmetries emerging from their elite cartel with the Commission. But in both sets of cases -- those in which portions of the exective gained political leverage as well as those in which private actors experienced expanded political opportunities -- the policy capacities of the European Commission were integral to the shift in power relations. The Commission's autonomy makes it a pivotal ally, both for members of national executives seeking to control the process of economic liberalization and for societal actors pursuing liberalization in areas where their governments are not yet prepared to proceed.

It is clear that the European integration process *sometimes* strengthens state capacities. Where political mobilization does not allow societal groups to surmount information asymmetries, or there is insufficient incentive for societal actors to exploit channels of influence newly opened by the policy activities of EU institutions, integration strengthens the ability of some members of the executive to achieve their objectives relative to others or relative to other government institutions or societal actors.

However, in areas like state aid policy, in which the European Commission has developed substantial autonomous capacities, there is increased transparency of relations between governments and the public sector, private sector actors damaged by competition from the public sector perceive strong incentives for action, economic integration alters the political opportunities

facing private sector actors and may ultimately constrain state capacities. Private sector actors gain leverage from EC regulations that they previously lacked -- leverage that enables them to challenge the industrial policies of their governments. As the example of state aid policy demonstrates, selective economic liberalization is elusive because no single actor or set of actors firmly controls the liberalization process set in motion by member state agreement. Ironically, while the foundations of economic integration may be laid by national executives in their quest to solve national policy problems, the dynamics of integration demonstrate that even in a process dominated by political elites, society matters.

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1. Andrew Moravcsik argues that the pooling of sovereignty is a strategy for governments to make their policy commitments credible and "to lock in future decisions against domestic opposition." See Andrew Moravcsik, *The Choice for Europe* (Ithaca, NY: Cornell University Press, 1998), p. 73. Wayne Sandholtz analyzes this potential explanation for "choosing (monetary) union," but points out that only the impact of the single European market and the fact that preference formation by member state governments is endogeneous to the integration process can explain why member state governments chose this particular means of tying their hands. See "Choosing Union: Monetary Politics and Maastricht," *World Politics* 47, No. 1 (1993), 1-39.

2. See, for example, Justin Greenwood and Karsten Ronit, "Interest Groups in the European Community: Newly Emerging Dynamics and Forms," *West European Politics* 17 (January 1994), 31-52. On the mobilization of regional

interests, see Liesbet Hooghe, "Subnational Mobilisation in the European Union," *West European Politics* 18 (July 1995), 175-198.

3. On political party activity, see two pieces by Robert Ladrech, "Partisanship and Party Formation in European Union Politics," *Comparative Politics* 29 (January 1997), 167-86; and "Political Parties and the Problem of Legitimacy in the European Union," in Thomas Banchoff and Mitchell P. Smith, eds, *Legitimacy and the European Union* (Routledge, 1999), 93-112.

4. This literature includes work on the European Parliament and the European Court of Justice, but especially on the European Commission. See, inter alia, Laura Cram, "The European Commission as a Multi-organization: Social policy and IT Policy in the EU," *Journal of European Public Policy* 1, 2 (Autumn 1994), 195-217; Mark Pollack, "Delegation, Agency, and agenda-setting in the European Community," *International Organization* 51, 1 (Winter 1997), 99-134; and Mitchell P. Smith, "Autonomy by the Rules: The European Commission and the Development of State Aid Policy," *Journal of Common Market Studies* 36, 1 (March 1998), 55-78.

5. For one of the best analyses of this process in the context of the European Commission's push for liberalization of the telecommunications sector, see Wayne Sandholtz, "Institutions and Collective Action: The New Telecommunications in Western Europe," *World Politics* 45, no. 2 (1993), 242-70.

6. Andrew Moravcsik, "Why the European Community Strengthens the State: Domestic Politics and International Cooperation." Paper presented to the

Conference of Europeanists, Chicago, 31 March- 2 April 1994; and Moravcsik, *The Choice for Europe.*

7. Alan S. Milward, *The European Rescue of the Nation State,* (Berkeley: University of California, 1992), 72.

8. Alan S. Milward and Vibeke Sørensen, "Interdependence or integration? A national choice," in Alan S. Milward, Frances M. B. Lynch, Ruggero Ranieri, Frederico Romero, and Vibeke Sørensen, *The Frontier of National Sovereignty* (London: Routledge, 1993).

9. Andrew Moravcsik, "Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach," *Journal of Common Market Studies* 31 (1993), 473-524.

10. Moravcsik, "Preferences and Power," 515.

11. Moravcsik, "Why the European Community Strengthens the State;" and Moravcsik, *The Choice for Europe*, 76.

12. *Financial Times*, June 16, 1988, p. 6.

13. Lloyd's Register reported in June 1989 that world shipbuilding orders had reached their highest level in four years (*The Times*, June 7, 1989, p. 26). Hearings of the Commons Select Committee on Trade and Industry took place on the day following release of the report, and committee members criticized the Government for so thoroughly reducing capacity that British Shipbuilders was left unable to take advantage of the upturn in demand for merchant shipbuilding, the forte of NESL (HC 517(i), pp. 7-9).

14. See the *Financial Times*, July 11, 1989, p.10; July 14, 1989, pp. 10 and 20; and *The Times*, July 14, 1989, p. 13.

15. Hansard 156, p. 1145; p. 576w.

16. HC 517(i), p. 14.

17. *Business Spain*, November 1994.

18. Reuter News Service, Western Europe, October 24, 1994.

19. *Flight International*, November 23, 1994.

20. *Gaceta de los Negocios*, March 17, 1995.

21. *La Vanguardia*, September 10, 1995, pp. 62-3, Foreign Broadcast Information Service translation.

22. The approved amount was 87 billion pesetas rather than the 130 billion originally requested. *Financial Times*, December 20, 1995, p. 3

23. *Aviation Europe*, December 21, 1995, p. 1.

24. The point is made most comprehensively and forcefully by Gary Marks, Liesbet Hooghe and Kermit Blank, "European Integration from the 1980s: State-Centric v. Multi-Level Governance," *Journal of Common Market Studies* 34, (September 1996), 341-378.

25. On the institutions of the EU as alternative arenas for interest articulation, see Jeremy Richardson, "The EU as an Alternative Venue for Interest Groups," Paper presented at the Annual Meeting of the American Political Science Association, Boston, 1998; Wayne Sandholtz, "Membership Matters: Limits of the Functional Approach to European Institutions," *Journal of Common Market Studies* 34, 3 (September 1996), 403-29; and Thomas Banchoff and Mitchell P.

Smith, "Conceptualizing Legitimacy in a Contested Polity," in Banchoff and Smith, eds, *Legitimacy and the European Union* (London: Routledge, 1999), 1-23.

26. This is the essence of what Andy Moravcsik has termed "liberal intergovernmentalism." See Moravcsik, "Preferences and Power."

27. As Marks, Hooghe and Blank argue, the links developed by the integration process "break open the mould of the state." See "European Integration from the 1980s," 369.

28. See, e.g., Bruce M. Wilson, "When Social Democrats Choose Neoliberal Economic Policies: The Case of Costa Rica," *Comparative Politics* 26 (January 1994), 149-168. Also see Mitchell P. Smith, "Democratic Deficit or Deficit of Democracy? European Integration and Privileged Institutional Position in Domestic Politics," in Yossi Shain and Aharon Klieman, eds, *Democracy: The Challenges Ahead* (London: Macmillan, 1997), 161-183.

29. This authority is codified in Article 93 of the Treaty.

30. Smith, "Autonomy by the Rules."

31. Court of First Instance, judgement of 28 September 1995, Case T-95/94, Sytraval and Brink's France v Commission [1995] ECR II-2651.

32. Sytraval is the acronym for Chambre Syndicale Nationale des Enterprises de Transport de Fonds et Valeurs.

33. In taking this action, Sytraval and Brink's France used the provisions of Article 173 of the EC Treaty, which permit any "natural or legal person" to institute Court proceedings against a decision by one of the EU institutions addressed either directly to themselves or which affects them directly.

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34. As amended by the 1993 Maastricht Treaty, Article 190 states that "Regulations, directives and decisions...adopted by the Council or the Commission, shall state the reasons on which they are based and shall refer to any proposals or opinions which were required to be obtained pursuant to this Treaty."

35. As described in Judgment of the Court of Justice, 2 April 1998, Case C-367/95, paragraph 20.

36. Judgment of the Court of Justice, 2 April 1998, Case C-367/95, paragraph 63. Beginning with Sytraval, a struggle over the nature of third party rights developed between the Tribunal (Court of First Instance) and Court of Justice. In its rulings, the Tribunal has sought to make rights of third party complainants in state aid cases similar to those in cases of anti-competitive practices (governed by Articles 85 and 86), including the right of complainants to have access to case files; the Court of Justice, whose interpretation has prevailed, takes the narrower view that state aid investigations are conducted between the Commission and a member state government, with the Commission simply required to provide third parties with an "adequate explanation" of its reasoning.

37. For example, on September 15, 1998, the CFI announced its decision in the BP Chemicals case (case T-11/95), in which it annulled a Commission decision not to investigate a complaint about capital injections into EniChem, a subsidiary of the Italian state holding company ENI. A critical distinction between the political significance of this case and Sytraval is that the complaint lodged against

EniChem came from a company in another member state, while in Sytraval private firms were challenging the policies of their own government.

38. Judgment of the Court of Justice of the European Communities of May 7, 1998, joined cases C-52/97, C-53/97, and C-54/97. Reported in *Competition Law in the European Communities*, Vol. 21, issue 8 (August 1998), pp. 184-187.

39. This was how a Commission official described these developments in an interview with the author in Brussels on January 19, 1999.

40. As of 1988, three of the Federal Republic's 10 largest banks were Landesbanken. See Jeremy Edwards and Klaus Fischer, *Banks, finance and investment in Germany* (Cambridge, Cambridge University Press, 1994), Table 5.2, p. 101.

41. Edwards and Fischer, *Banks, finance and investment in Germany* , 97-105.

42. *Der Spiegel*, 10/1997, p. 106.

43. On the activities of Germany's public sector banks, see *Financial Times*, December 18, 1996, p. 24.

44. See *Financial Times*, January 14, 1997, p. 2.

45. "Bankenverband dringt auf puenktlichen," *Sueddeutcher Zeitung*, March 18, 1997. One commentator pointed out the contradiction of a government that supported the construction of the single European market yet sought special status for public credit institutions. The private banks would have to pursue their rights outside the national level, since in German domestic politics, the complaints of the private banks "have no chance." See Winfried Muenster, "Das

Thema des Tages: Nur Bruessel sichert den Wettbewerb," *Sueddeutsche Zeitung,* September 25, 1997.

46. *Frankfurter Allgemeine Zeitung,* April 25, 1997, p. 19.

47. Author's interview with European Commission official, January 21, 1999.

48. Declaration 37 of the Amsterdam Treaty, which states that "The Conference notes the Commission's opinion to the effect that the Community's existing competition rules allow services of general economic interest provided by public credit institutions existing in Germany and the facilities granted to them to compensate for the costs connected with such services be taken into account in full."

49. Bettina Schragl, "EU: Kompromiss Bei Banken-Privilegien," *Wirtschaftsblatt,* June 19, 1997, p. 3.

50. "Report of the European Commission to the Council of Ministers: Services of general economic interest in the banking sector," adopted by the Commission on June 17, 1998, and presented to the ECOFIN Council on November 23, 1998.

51. Confirmed in author's interviews with EU officials, Brussels, January 20 and 21, 1999.

52. *Der Spiegel,* 10/1997, p. 106.

53. See *The Economist,* "Power Banking," February 15, 1997, p. 69.

54. Press release, Düsseldorf, 24 January 1997 (www.NRW.de). Calling for the European Commission to preserve the status quo, Rau described the public, cooperative and commercial banks as "three pillars" of the German system of

credit institutions that enjoy high public trust. Rau credited the public sector banks with facilitating structural adjustment and numerous local and regional cultural and social projects

55. *Sueddeutscher Zeitung,* April 2, 1998.

56. Dieter Hein, analyst for Commerzbank, one of Germany's largest commercial banks, argues that this is the likely outcome, with dramatic consequences for the German banking system and penetration of German financial services by banks in other eurozone countries. See Tony Barber, "Private call for German banks: A european ruling may herald big changes," *Financial Times,* December 9, 1998, p. 28.

57. See, inter alia, Jeremy Richardson, "The EU as an Alternative Venue for Interest Groups," paper presented at the Annual Meeting of the American Political Science Association, Boston, September 1998.

58. Smith, "Autonomy by the Rules," p. 59.

59. Such conditions may include selloffs of unprofitable subsidiaries, reductions in aid intensities, and capacity reductions. See Mitchell P. Smith, "Integration in Small Steps: The European Commission and Member-State Aid to Industry," *West European Politics* 19 (July 1996), 563-82.

60. This is precisely why the European Commission, while willing to cede parts of its monopolies and mergers regulatory capacities to national authorities, insists that national authorities cannot police state aid to industry; in accordance with the principle of "subsidiarity," the EC is the lowest level at which this can be done.

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61. Author's interviews with officials of DGXV, the Commission's administrative service responsible for single market implementation, June 1997.