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The Evolution of Supranational Antitrust Enforcement and Control of Government Subsidies in the EU

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Safeguarding competition is one of the most prominent governance functions of the European Commission for the EU Common Market.¹ The Commission exercises real, supranational power in this realm. 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 cars and candle wax to steel pipes, sugar, vitamins, and video game

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¹ For simplicity, I will use the acronym “EU” throughout this article. For the same reason, I will refer to specific articles as re-numbered in the Amsterdam revision of the Treaty and use “DG Comp” not just to refer to today’s Directorate General Competition, but also to its predecessor for the period prior to 1999, when it was officially “DG IV.”

consoles. In February 2007, for example, the EU imposed fines of €992 million (US\$ 1.3 billion, ¥ 156 billion) on the elevator and escalator manufacturers Kone, Schindler, and ThyssenKrupp, along with 17 subsidiaries and collaborators, for operating a cartel for the installation and maintenance of elevators and escalators. In unannounced searches prompted by a tip-off from an undisclosed private source, followed by leniency-seeking self-reporting by subsidiaries of Kone and Otis, DG Comp had found evidence that the companies had persistently and systematically colluded to carve up markets, fix prices, and rig procurement contracts in Belgium, Germany, Luxembourg, and the Netherlands from at least 1995 until January 2004, when DG Comp launched its dawn raids on the companies at its own initiative (see, e.g., Buck 2007).² And the elevator cartel was only one of eight cartels, involving 45 companies, busted by DG Comp in 2007; followed by seven cartels involving 37 companies busted in 2008.

Commission antitrust enforcement powers extend even to firms headquartered outside of the EU, as evidenced by the fines against Otis (of U.S. multinational United Technologies), Schindler (of Switzerland), and Japanese multinational Mitsubishi for its elevator subsidiary's participation in the Dutch elevator cartel, as well as EU intervention in the proposed mergers between General Electric and Honeywell, which was blocked when GE rejected the Commission's conditions for approval (see Büthe and Swank 2006). Moreover, the Commission's power is clearly supranational, as most evident in the realm of government subsidies ("state aid"), where the EU has forced governments to revise their legal and financial relationships with public banks and made companies repay subsidies that distorted competition in the common market.

DG Comp is not just powerful but also generally highly respected, even though its decisions almost always involve fierce conflicts of interest (Ross, 1994: 132ff, 176ff). 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, 2003:94f), it is also very respected among the general public and outside competition policy experts. International surveys of public and private sector specialists have for several years now identified DG Comp as one of the most trusted and admired among 38 competition watchdogs (e.g., Vascott *et al*, 2008). And 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).

DG Comp's power and prestige were neither guaranteed nor expected when the European Economic Community was established. The Directorate General Competition started out in the early years as "a sleepy, ineffectual backwater of Community administration" (Wilks with 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?

In previous work (especially Büthe 2009), I have argued and shown that a modified neofunctionalism—understood explicitly as a historical institutionalist theory of institutional change—provides a compelling explanation for the evolution of merger control authority in the EU. Such a theory recognizes that institutional change may arise out of inter-governmental bargaining. The critical insight, however, is that institutional change can occur even when the member states oppose it, provided that *sub-national actors*, using the political opportunity structures of the supranational institutions, act jointly with supranational actors, each pursuing their own, selfish interests. As a historical institutionalist theory, this modified neofunctionalism also leads us to pay close attention to the sequence of events in the process of European integration (e.g., Büthe 2002; Pierson 2004; Thelen 1999, 2003), such as when intergo-

² The €992 million record fine against the elevator cartel has in the meantime been exceeded by a fine of almost €1.4 billion against the car glass cartel, busted in November 2008 (see Tait 2008).

vernmental bargaining over institutional change followed rather than preceded the change.

Most theoretical models in the social sciences are developed to explain (and in that sense “fit”) a particular phenomenon or set of empirical observations. The gold standard for assessing these models is therefore their “out-of-sample performance,” that is, the ability of a theoretical model to help us understand or explain observations beyond those for which it was developed, though within its scope conditions (see de Marchi 2005). It would under most circumstances be unrealistic to expect macro-historical qualitative research to yield the number of out-of-sample observations to allow statistical analysis of a theoretical model’s explanatory leverage beyond the observations known at the time to the researcher who developed it, but it is nonetheless worth aspiring to out-of-sample testing. This article seeks to provide such an out-of-sample test of Büthe (2009) by using the theoretical model that was developed to explain the evolution of supranational merger control authority to analyze here the evolution of antitrust enforcement, where the Commission attained supranational authority much earlier than in the realm of merger review, and to analyze the evolution of control over state aid (subsidies), which the Commission has attained later and less exclusively.

I first discuss the theoretical argument, focusing on the hypothesized causal mechanisms. I then provide a brief empirical analysis of the institutional evolution of EU authority to engage in antitrust enforcement and control of state aid (subsidies) since the legal framework for EU competition policy was established in the Treaty of Rome in 1957. As I will show, the theory helps explain why authority has so decisively shifted to the EU level, as well as when those shifts have occurred. More broadly, I show that, contrary to the claim of some critics (e.g., Moravcsik, 1993:477), a modified neofunctionalist theory can indeed explain variation in the evolution of the EU.

Explaining Institutional Change: The Theoretical Model

Most theoretical perspectives that have been popular in the study of

the EU in recent years cannot explain the institutional changes that we observe in EU competition policy. Intergovernmentalism with its variants explains institutional changes as a function of exogenous changes of member states’ preferences, followed by inter-governmental bargains (e.g., Schwartz 1993). Yet, I have found that grand bargains were not as important for the evolution of merger review authority as incremental, yet cumulatively substantial changes. In addition, changes in member states’ preferences, which must remain exogenous for intergovernmentalism, need to be explained. Principal-agent models (e.g., Pollack 2003; Tallberg 2000) restrict the analysis to the relationship between the member states (as “principals”) and the Commission’s Directorate General Competition (as the “agent”). They consequently leave out private actors, which played a crucial role as drivers of EU institutional change in the realm of merger control (Büthe 2009) and may have differed in their economic and political salience across antitrust enforcement and state aid (thus offering an explanation for the variation across these issue areas, as discussed below). Finally, ideational or constructivist theories, which focus on the rise and increasing dominance of neo-liberal economic ideas (e.g., Jabko 2006; McNamara 1998; Parsons 2003), surely highlight an important contributing factor, but cannot explain variation across antitrust, merger review, and state aid (subsidies).

To overcome the deficiencies of these theoretical perspectives and explain the institutional evolution of the EU in the realm of merger control, I have in my previous work developed a theoretical argument that I view as a restatement of neofunctionalism, explicitly understood as a historical institutionalist theory of institutional evolution and change. I have argued that 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 sub-national 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 but malleable over the course of time (Büthe 2009).³ Based on these assumptions, I identified 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.

First, institutional change—in the sense of increased integration in a given issue area or integration in an issue area that was previously not integrated—may be brought about by governments taking the initiative, acting in the aggregate economic interest of their respective countries (Figure 1). 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 is the famous spill-over mechanism.

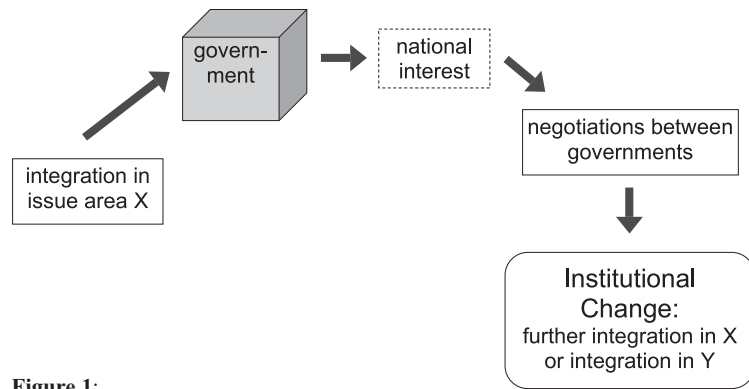


Figure 1:
Institutional Change in Neofunctionalism (1)

³ This argument is based on my 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, which are entirely consistent with Haas' assumptions and logic, but not spelled out in his works.

The second causal mechanism suggested by neofunctionalism starts with sub-national actors (i.e. groups with distinct interests within a country, most often private actors but possibly including distinct groups within the government). If their observed or imagined experience with supranational authority in *some* issue areas leads a subset of these sub-national actors to expect that further integration would be to their benefit, then I would expect them to seek institutional change that shifts decisionmaking to the supranational level. Each sub-national actor may do so by trying to influence its national government's preferences through the normal course of domestic politics (thick short arrows in Figure 2), which may result in institutional change subject to inter-governmental negotiations.⁴

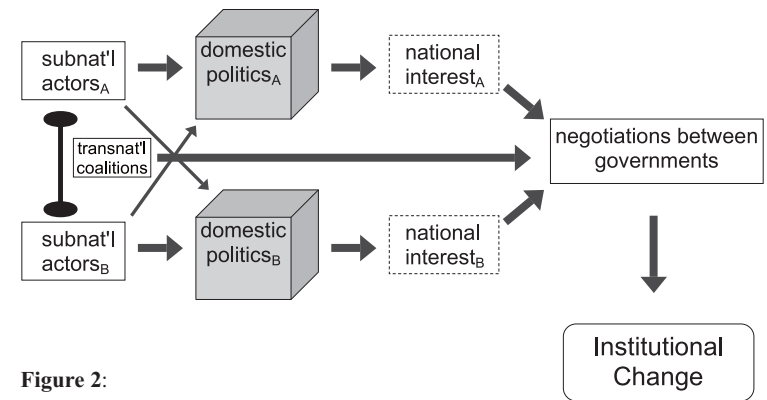


Figure 2:
Institutional Change in Neofunctionalism (2)

This second causal mechanism may appear to differ little from liberal intergovernmentalism. But unlike liberal intergovernmentalism, neofunctionalism does not treat domestic politics as a hermetically sealed

⁴ Neofunctionalism lacks a theory of domestic politics, but its basic (liberal IR) theoretical assumptions suggest that sub-national actors are more likely to succeed in re-defining the national interest the more economically powerful and numerous they are, and the more concentrated their interests.

system. Based on its assumptions, neofunctionalism expects sub-national actors not just to lobby their respective national governments but also to form transnational coalitions and engage in transnational politics to advance their interests (thin, diagonal arrows in Figure 2). This strategy should be particularly attractive to those who cannot build a sufficiently large political coalition to achieve their desired policies at the domestic level but see a chance of forming a majority at the EU level. Accordingly, neofunctionalism expects such sub-national 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.

Moreover, in many issue areas, the European Commission and the European Court of Justice (ECJ) themselves constitute “political opportunity structures” (Kitschelt 1986): Non-state actors can provide information, submit inquiries and petitions, bring cases against governments or Community institutions before the Court, etc. The third causal mechanism starts with sub-national actors using these opportunities to push for increased supranational governance whenever doing so promises to advance their interests (an expectation directly derived from the assumption of self-interestedness of economic actors). Their demands for increased integration give the Commission and/or the ECJ—understood as actors rather than just as structures—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 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, I generally expect the Commission and the ECJ 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 3).

Since any shift of authority is likely to engender opposition as well as support, member state governments might seek to undo any such changes. Their negotiations in this case, however, start from a very

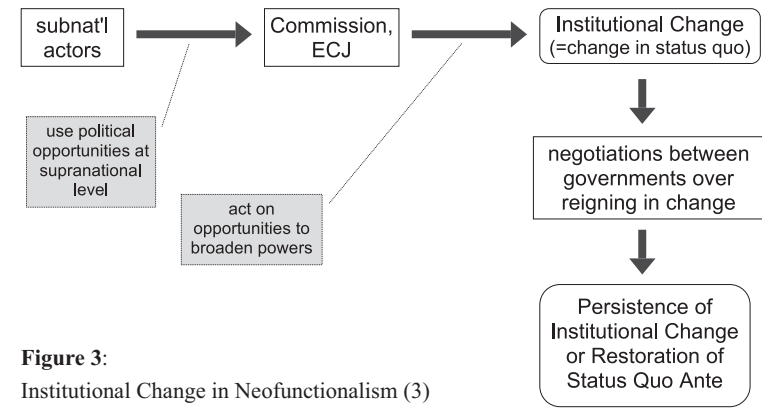


Figure 3: Institutional Change in Neofunctionalism (3)

different status quo than in a traditional intergovernmentalist scenario. The previous institutional arrangement may now be impossible to restore 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 as restated in my previous work (Büthe 2009) emphasizes sub-national actors and transnational coalitions pursuing their own material or ideological interests. These sub-national 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 I do not expect institutional change to occur automatically. Quite to the contrary, I expect it to arise out of political conflict. Supranational actors might, of course, foster groups that see further integration as being in their interest (Alter, 2001, Burley and Mattli, 1993), but institutional change is expected to occur

only if and when such groups exist and take the initiative. I expect 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—to be much more likely to fail since such overtly political attempts to shift authority will stimulate more pointed opposition, whereas incremental change with the support of (and at least in seeming response to demands from) sub-national actors will likely succeed (see also Haas, 2004 (1958):xxxiv, 26, 106ff).

In each of the two empirical sections that follow, I trace the institutional evolution of the EU competition policy from the provisions in the Treaty of Rome, negotiated in 1955-57, to the 2003/04 reforms of EU competition policy. I focus first on antitrust enforcement, then on EU governance of state aid.

Antitrust Policy: Restrictive Practices and Abuse of a Dominant Position in the Market

During the negotiation of the Treaty of Rome, it was hotly contested whether the treaty should address the issue of cartels and monopolies at all. It was even more contested whether it should contain the strong provisions for antitrust enforcement that had been written into the founding treaty of the European Coal and Steel Community (ECSC), the EEC's and EU's predecessor (Gerber 1998; Gillingham 1991:245-283; Rittberger 2001:695), even though the ECSC's High Authority had barely started to (timidly) exercise its antitrust enforcement power by the time the treaty of Rome was negotiated (Diebold, 1959:350ff, Haas, 2004 (1958):76ff, McLachlan and Swann, 1967:117ff). The prospective member states of the EEC had different visions of competition policy (see Gerber, 1998:346f; also: Motta 2004:17-24), and there were also conflicts of interest within their governments. 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 or-

do-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 (Groeben, 2002:17, 66-71, Hentschel, 2002:279, Milward, 1992:217f).⁵

Specifically, Art. 81 establishes that agreements among two or more "undertakings" (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. Contractual provisions to this effect are not enforceable.⁶ Somewhat more vaguely, Art. 82 establishes the principle that the EU may 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 enforce these provisions (Gerber, 1998:349ff).

The Commission's power of antitrust enforcement, however, was subject to an implementing regulation that was supposed to be passed by the Council within the first three years. When the implementing regulation 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

⁵ 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.

⁶ Exemptions could be granted in the interest of technological advancements or economic "progress" if the agreements did not substantially impede market competition.

of addressing an issue that is important to a certain constituency, while ensuring that little or nothing will be done by the under-resourced regulator (see 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 Art. 81 violations (Cini and McGowan, 1998:21ff). The action taken against “restrictive practices” that led to the first antitrust case before the ECJ, *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 (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. Even more importantly, it affirmed the Commission’s authority as a matter of principle. It thus ruled 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, sub-national actors pursuing their economic self-interest who provided the Commission with an opportunity to move from nominal to actual antitrust enforcement authority under Art. 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% of the European market for dye-stuffs (busted in 1969, with fines imposed for the first time on firms headquartered outside of the then-member states).

The provisions of Art. 82, against abuse of a market-dominant position, gained “teeth” only in the late 1960s and early 1970s. This is also consistent with the neofunctionalist argument emphasizing sub-national 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 Art. 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)⁷. 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 (exceeding €3 billion in 2007 and €2 billion in 2008 for cartels alone, see Commission 2009), and force

⁷ 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/competition/sectors/motor_vehicles/overview_en.html (last visited 4/10/2009).

changes in corporate structures or practices upon 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 (1985-88), Brittan (89-93), van Miert (93-99), and Monti (1999-2004). Its prominence was surely also aided by the increasing neo-liberal economic consensus in Europe (McNamara, 1998). But sequence matters: The key institutional change, the acquisition of real supranational power in anti-trust 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 anti-trust enforcement authority has not even been seriously discussed anymore in any of the treaty revisions since (and including) the Single European Act.

Two more recent developments warrant mention. The Court of First Instance (CFI), created in the wake of the Single European Act, attained responsibility for competition (anti-trust 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. Yet, it was created not to curb the power of Commission nor to restrict the ability of the ECJ to expand the scope of EU competition policy. To the contrary, it was the ECJ that had suggested to member states that they create the CFI and assign it responsibility for competition cases, since the case load of the ECJ had rapidly increased, and private interests (especially firms) called for faster judicial decisions (e.g., Cini and McGowan, 1998). Nonetheless, some observers have interpreted the entry of the CFI into EU competition policy as a curbing of EU-level competition authority because, 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 heretofore dominated by lawyers. Yet, as Harding and Joshua 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 [appeals] ... are rejected by the Court” (Harding and Joshua, 2003:179). Moreover, CFI decisions overturning DG Comp were limited to a few cases where DG Comp had made clear errors, and for much of the 1990s, “the 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* 4 Jan 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 re-nationalization 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 across national jurisdictions and reserves for DG Comp the power to take over any particular case (Riley, 2003a, 2003b). 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 (ECN; Slaughter, 2004:21, 36).⁸ 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.

State Aid: Subsidies, Tax Breaks, and Similar Special Provisions/Guarantees

Subsidies and other measures that grant exclusive economic benefits to (some) firms have become collectively known in the EU as “state aid.” They are addressed in articles 87-89 (originally 92-94) of the Treaty of Rome. Art. 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). Art. 87 is followed by criteria for statutory and discretionary exemptions. Art. 88 requires member states to notify the Commission of all planned state aid. Within two months the Commission has to either clear the aid—based on Art. 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 Art. 87. The power to review state aid prospectively or *ex post* and to grant exemptions is delegated exclusively to the Commis-

⁸ See http://ec.europa.eu/comm/competition/antitrust/ecn/ecn_home.html (last visited 6/12/2006). As recently as 1997, more than half of the member states were judged as lacking national competition authorities with the capacity to apply Arts. 81 and 82 (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.

sion, except that Art. 88 (2) para. 3 allows for the Council to unanimously grant an exemption in “exceptional circumstances.” Art. 89, finally, allows the Council to pass implementing Regulations.⁹

Notwithstanding these treaty provisions, which in many ways resemble those for antitrust, state aid has long been the competition area where Commission authority has been weakest and where the shift toward unambiguously supranational authority has been the most recent (and subject to repeated litigation). This might be explained in part by intrinsic differences. Since state aid policy involves external review of member state governments’ policy decisions, it 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 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 national governments’ decisionmaking autonomy is bound to be politically sensitive. Moreover, state aid need not just distort or reduce competition, as cartels do. Rather, state aid may help the EU and/or its member states achieve policy objectives such as reduced economic disparities within the EU or adjustment assistance to the losers of increased market integration and market efficiency. Subsidies have also long been a key instrument of industrial policy and a potential substitute for trade policy (Nicolaidis and Vernon, 1997:esp. 292ff). The Treaty accordingly exempts, as a matter of principle, aid to individual

⁹ The provision allowing 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 reasons that are beyond the scope of this paper, 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.

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 aid to underdeveloped regions within the EU, aid to facilitate economic adjustment, or (since Maastricht) aid to promote culture (87(3)) “compatible with the common market.”¹⁰ 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 limited 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 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 Art. 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 of state aid tend to be diffuse. This makes it very difficult to put together a self-sustaining coalition in favor of reduc-

¹⁰ Such a determination of “compatibility” by the Commission exempts the subsidies from state aid rules.

ing 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, and especially after the removal of a multitude of non-tariff barriers through the Single Market program (1986-1992), could the Commission hope to find and foster political allies among sub-state 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, therefore, the Commission has relied upon complaints from competing firms (or other governments) to make it aware of possibly illegal, un-notified state aid (Cini and McGowan, 1998:139). In the late 1980s, 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 un-notified 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 usually taken the form of complaints against the Commission for failure to formally review the aid program under Art. 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 sub-state 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% 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 Art. 88(2) investigation. The 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, member states’ compliance 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 bi-annual *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% 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, a Council regulation on state aid. Council Regulation 994/98 (*OJ* 1998 L 142/1) 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 2-months review of aid proposals) and 659/99 (*OJ* 1999 L 83/1) largely codified DG Comp’s review procedures. Since 2001, aid to small & medium-sized companies and training aid is categorically exempted, as is aid below a certain ceiling (*de minimis* rule). At the same time, private parties can now take complaints directly to national courts (thanks to the direct effect of EU law), if they feel that any government is abusing a block exemption (Rehbinder, 2004, Sinnaeve, 2001). Finally, the EU has increasingly sought to externalize its state aid policy vis-à-vis its trade partners, e.g., via the EEA and association agreements (see, e.g., Cremona, 2003, Rydelski, 2004).

Conclusion

I have analyzed the major developments in antitrust enforcement and state aid control since the Treaty of Rome as an out-of-sample test of my historical institutionalist restatement of neofunctionalism as a theory of institutional change in the EU, originally developed to explain the evolution of EU merger review authority. Each of these issue areas of EU competition policy is characterized by a common trend: increasing shift of authority to the EU level, with DG Comp attaining real supranational power over time, sometimes against the express preferences of the

member states. However, there are also significant differences in the timing of this shift of authority across the issue areas of competition policy. I have shown that we can understand and explain these dynamics by adopting the modified neofunctionalist theoretical perspective developed in Bütthe (2009). The key theoretical contributions of this re-statement of neofunctionalism are to clarify the centrality of substate actors engaging in transnational politics and to integrate key insights from historical institutionalism. This theoretical perspective yields a superior explanation for the evolution of the politics of EU competition over more than fifty years. Its analytical usefulness across several issue areas suggests that Haas' foundational neofunctionalist work deserves a second, close reading and that the theory can and should be developed further.

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