



## INTRODUCTION

In June 2000, a German Socialist member of the European Parliament (MEP) criticized the European Commission's relentless push to extend liberalization of public services in successive steps. "Salami tactics are all very well," commented the MEP, "but we want to know how long the sausage is."<sup>1</sup> The MEP's concern mirrors the scholarly debate taking place in comparative political economy: what are the limits to processes of economic liberalization that have continued to spread across West European countries for two decades? What does the paring away of slices of political regulation and public sector functions suggest about the ultimate impact of the liberalization process? Governments operate in an international environment in which the free flow of capital generates conditions highly conducive to economic liberalization. European integration has intensified these pressures for EU member states. As competition spreads to encompass areas formerly monopolized by public services, to what extent do governments lose discretion over their use of the public sector to achieve political objectives?

From the perspective of many policy makers, the fluidity of global capital and intensity of international competition have created conditions in which economic growth can be secured only by relaxing political constraints on the operation of markets. This process affects all of the regulatory structures of national political economies, including social insurance systems; structures of industrial relations and corporate governance; and the operation of public services such as transportation, telecommunications, and energy supply and distribution. Evidence of reforms across these policy regimes in West European political economies ultimately invokes the current debate in comparative political economy between those who see an ineluctable process of convergence between national economic policies and institutions and those who believe in sustained diversity. Assessments of the

## 2 States of Liberalization

relative degree of convergence and diversity vary with convictions about the sources of the most critical forces shaping national political economies. Are these forces internal or external to national systems? To the extent that forces outside the national system drive policy and institutional restructuring, markets overwhelm politics and there is only limited latitude for continued political regulation of markets. Where internal factors bear more causal weight, political regulation may be more resistant to market forces and therefore more stubborn and enduring.

The first approach, which may be termed a “globalization” perspective, indicates that the forces shaping national political economies increasingly are external rather than internal. Adherents of this globalization perspective believe that global economic forces have produced a market liberalization process that leaves little discretion to national political economies (Cerny, 1997; Strange, 1996). Summing up this approach, Alberta Sbragia points out that “the underpinnings of comparative politics which assumed that domestic politics was the crucial variable in explaining policy change are being challenged as never before” (Sbragia, 1998a: 2). The globalization perspective asserts that the potency of international economic factors, especially intensified competition for markets and the mobility of financial capital, undermines the effectiveness of government efforts to determine the contours of the national economy. National systems are punished for sustaining policies or institutional arrangements that are unattractive to investors; national systems of economic regulation compete, inducing emulation of best practice; and the liberalization of international trade increasingly exposes domestic arrangements for economic policy making to pressures for reform from trade partners and multilateral institutions. International integration of markets and the unrestricted mobility of financial capital severely constrain domestic policy choice and foster convergence of policies and institutional forms.

The globalization perspective reflects what Linda Weiss terms “state denial”—the notion that states have been displaced as powerful actors both in domestic and international politics. Taking a critical perspective on that position, Weiss argues that external economic pressures are mediated by domestic factors; the strength of these factors determine the relative intensity with which external pressures are felt.<sup>2</sup> From this domestic institutional standpoint, the ability of external forces to foster redesign of domestic policy regimes is severely restricted.<sup>3</sup> National political economies are highly functional interlocking systems of formal and informal institutions

rather than simply efficient solutions to economic problems that may be re-configured in response to market signals. The path-dependence of institutional arrangements and the policies they generate constrain, if not determine, future choices. The factors that determine the degree of liberalization undertaken by national systems therefore are predominantly internal, and national governments retain substantial capacities to shape domestic economic outcomes (Wade, 1996). Mediated by national institutional structures, exogenous forces for fundamental change are likely to be muted, mutated, and resisted. Confronted with common external shocks, national political economies respond in different ways.<sup>4</sup> Moreover, forms of economic governance are not easily transferable from one political economy to another, so that “best practice” does not diffuse readily across systems. This perspective explicitly rejects the notion that institutional arrangements emerge through market selection (Hollingsworth, 1997; Hollingsworth and Boyer, 1997: 49–54).

This study enters the debate by exploring the impact of forces of economic liberalization in western Europe on public sector activities. The book examines how the focus of European economic integration on deepening competition encroaches on the ability of governments to use public sector resources to achieve political objectives. What is the significance of the transformative impact of these forces on the public sector?

To begin with, European Union member countries, though varying considerably in their institutional configurations, are politically regulated market economies with wide-ranging public sector activities. Even in the first decade of the twenty-first century, the defining feature of the political economies of western Europe—of the “European model” of society—remains widespread, if varied, political regulation of the market economy. For several decades, public resources have been used to achieve a range of objectives by West European governments, from protecting jobs (most West European countries) to securing ties between government ministries and critical segments of the business sector (France), to undergirding federalism (Germany), to fostering redistribution of economic resources across regions (Italy). These functions are the product of deeply embedded institutions and norms not given to easy or rapid change. Moreover, as Fritz Scharpf reminds us, the “market-correcting” policies pursued by West European governments in the postwar era have been anchored by popular support as well as a belief that the ends sought through these measures represent legitimate policy goals of national governments (Scharpf, 1999).

#### 4 States of Liberalization

Therefore constraints imposed on these policies by the single market process at the center of European integration may “reduc(e) the capacity of national political systems to pursue democratically legitimized political goals” (Scharpf, 1999: 49).

Moreover, like systems of social welfare and industrial relations that are considered defining components of national models of political economy, public services are vital to national conceptions of the state and of economic management. French republicanism, with its ethic of *service publique*—the notion that the equal access of all citizens to quality public services is a vital component of the republican tradition—is but the most immediate illustration of this point. The application of European Union competition rules to Germany’s public law banks, the subject of chapter 7, powerfully illustrates this point. The case demonstrates the critical role of European Union institutions in altering domestic political relationships. It also reveals the significance of resulting constraints on the ability of governments to pursue policy objectives through the public sector.

The system of public law banks—which dates to the nineteenth century—was reestablished as a core element of Germany’s federal structure after World War II. Also conceptualized as a central component of the social market economy, the state Landesbanken and local Sparkassen (savings banks) were charged with a series of public service functions, including regional economic development and support for small and medium enterprises—Germany’s vital *Mittelstand*. As a consequence, the public sector banks have developed close political linkages with local and state-level political party organizations. Throughout the postwar era, the public sector banks have been an integral part of the social market economy, recipients of extensive support from state and municipal governments that value their role as promoters of regional economic development. The public law financial institutions came under the scrutiny of the European Commission beginning in the early 1990s when Germany’s private sector banks raised questions about the impact on competition of the financial support accorded the public law banks by the state and municipal governments that own them. Because this financial support affects competitive conditions within Europe’s unified internal market, it falls within the jurisdiction of European Community competition law.

By the end of 2001, this process culminated in fundamental reform of the public law banking system marked by dissipation of the financial privileges from which they had benefited for more than a half-century. Only the

gradual extension of European Community competition law to the public sector, a process traced in chapter 4, made this change possible. Attesting to the significance of the European Commission's role in the reform of the Landesbanken and Sparkassen in the face of powerful domestic political opposition, one representative of Germany's commercial banking federation asserted that "without Brussels, we would have achieved nothing here in Germany."<sup>5</sup>

But why does such restructuring of a public sector regime matter? In the case of Germany's public law banks, the impact is potentially dramatic for German federalism, the social market economy, Germany's overall economic performance, and public sector institutions throughout European Union member countries. The German federation of public savings banks (DSGV) has warned that the European Commission's application of Community competition rules to the public law banks in effect establishes minimal capital return requirements—and not only for public sector banks, but for public law institutions generally. This endangers the provision of public services by shifting the focus of these institutions toward profit maximization. Dramatizing the perceived threat to the public sector posed by the progressive extension of competition law to additional sectors by the European Commission, Germany's largest public law bank warns that "the Commission puts in jeopardy the future viability of all public-sector enterprises throughout Europe."<sup>6</sup> If this is true, such an approach to competition policy promises to fundamentally recast the European social model, characterized by the extensive and varied use of the public sector to sustain social cohesion.

European Community<sup>7</sup> competition policy can impinge on modes of national economic management and redefine the tools available to governments in their pursuit of prosperity. The public law banks, for example, also make a substantial contribution to the constitutional obligation of the German government to equalize living conditions across regions. By inhibiting the regional development functions of the public sector banks, the Commission's application of Community competition law potentially undermines this federal principle of equality of economic opportunity for all regions [German Savings Bank and Giro Association (DSGV) and Federal Association of Public Banks (VOeB): 13; and German Savings Bank and Giro Association (2000): 11]. Furthermore, public savings banks are the primary bankers for Germany's *Mittelstand*, and finance a large share of business start-ups. To the extent that compliance with Community competition law diminishes the ability of the public law savings banks to

## 6 States of Liberalization

perform this public service function, the single market imposes substantial constraints on a crucial dimension of the German strategy for promoting economic growth and employment (German Savings Bank and Giro Association and Federal Association of Public Banks: 5).

When the European Commission ruled in July 1999 that Westdeutsche Landesbank (WestLB), the largest of Germany's public sector banks, would have to repay a very substantial sum to the state of Nordrhein-Westfalen because it had not paid a market rate of return on assets transferred to WestLB by the state (Land) government, WestLB promptly challenged the Commission's decision in the European Courts. Justifying its action, WestLB asserted that "it is imperative that the Commission's decision be tested in the courts, given that it has far-reaching implications for any economic activity performed by the public sector" (Westdeutsche Landesbank: 1). Speaking in the German Bundesrat the day following the Commission's decision, the Economics Minister of Nordrhein-Westfalen proposed that the Commission's decision could have dire implications for the public sector: "in the future every investment—literally every investment—by the public sector on behalf of public-law enterprises could be declared to be unlawful aid."<sup>8</sup> Explaining the robust political defense of Germany's public law banks from a scholarly perspective, Richard Deeg writes that "the historical coalitions supporting this model of banking remain firmly committed to it, for its undoing would shock the very institutional core of the German political economy" (Deeg, 1999: 33).

The conflict between the European Community and Germany's public law banking system therefore underscores the core question of this study: If the competition rules embedded in the single European market can bring about fundamental reform of such purposefully designed, politically entrenched, and staunchly defended public sector institutions in the most powerful EU member state, are there any limits to the transformation of the public sector wrought by Europe's single market process? Considering the concerns of the German Member of the European Parliament, just how much of the public sector "salami" will be kept from the knife of economic liberalization?



The robust debate in comparative political economy about convergence and diversity in capitalist democracy in recent years has been closely related

to analyses of the changing role of the state in the economy. Much of the scholarship in this genre has focused on either of two aspects of the state's role: privatization of public enterprises and reform and retrenchment of social welfare policy. The privatization literature has explored the impact of privatization on the role of the state—how does a reduction in state ownership alter the state's control over the marketplace? In general, the literature suggests that privatization does not simply imply a retreat of the state, but represents a shift in the way states exercise control over markets.<sup>9</sup> In the study of social welfare policy, scholars debate the extent to which reforms that have taken place in West European political economies over the past decade or two represent a fundamental departure from the postwar social welfare model—that is, welfare state retrenchment—or simply a quantitative change in social welfare benefits in the face of severe fiscal pressures that in fact indicates relative welfare state resilience.<sup>10</sup>

Both literatures focus on questions of change in public sector objectives and the relative autonomy with which states choose policy tools. Though less studied in the political economy literature than issues of privatization and welfare state reform, examination of the relationship between states and public services complements the way privatization and welfare state studies approach the changing relationship between state and market by asking whether states exhibit a reduced capacity to use public resources to pursue economic, political, and social objectives. Like shifting forms of state control over enterprises and changing social welfare policies, the recasting of how states use public services is a crucial measure of continuity and change of national patterns of political economy. To the extent that governments must establish competition as the guiding principle for the activities of the public sector, they relinquish opportunities to use the public sector to sustain networks of political elites or party-constituency ties, secure jobs, reduce inequality, or promote regional redistribution. The result may or may not be a more efficient, more meritocratic, more transparent, or more democratic system, but it certainly is a different one, with significant implications for the distribution of economic and political opportunities and resources.

### *The Emerging Focus on “Europeanization”*

A central emerging focus of European Union studies concerns the impact of European integration on domestic policies and institutions. Among others,

## 8 States of Liberalization

Simon Hix and Klaus Goetz suggest this debate is overdue, its emergence retarded by the long immersion of EU scholarship in efforts to explain the dynamics of the integration process.<sup>11</sup> Domestic politics have long served as an explanatory factor in accounts of the integration process, but only recently have they been viewed as a dependent variable.<sup>12</sup> Efforts to assess the relationship between the construction of Europe and domestic political change in the states and societies that constitute the European Union are in their infancy. As Markus Haverland notes, “the shaping forces and dynamics of national adaptation to European legislation are still poorly understood” (Haverland, 2000: 84).

In a sense, the study of Europeanization constitutes a microcosm of the debate over globalization and its impact on national political economies. A crucial difference—and one that makes European integration a productive laboratory for studying the impact of external forces for domestic political adaptation—is that the forces promoting domestic adaptation appear to be much more direct and “concentrated” in the EU. This is so for two reasons. First, for the countries of the European Union, economic integration represents a conscious attempt to foster increased competition within Europe’s internal market in order to promote prosperity. Second, to accomplish this, Europe’s single market process embodies a potent set of market-making mechanisms. The single market, in short, may be conceptualized as an efficient mechanism for transmitting forces of economic liberalization.

The theoretical approaches that have dominated efforts to explain European integration (i.e., integration as the dependent variable) offer conflicting answers to the question of limits to domestic political transformation wrought by the integration process. Liberal intergovernmentalism, which views integration as a sequential process involving first preference formation at the national level and then bargaining between governments, implies that national preferences represent firm limits to the transformational capacities of European-level policies. National executives may embrace European policies as a means of achieving desired political adjustments at diminished domestic political cost. However, if the adjustment costs imposed on a government exceed the benefits generated by the existence of institutionalized arenas that lower the transaction costs of bargaining with other governments, the government will reject efforts to impose adjustment, and may eventually reject the bargaining forum itself. Aware of this danger, the European Commission, which nominally sets the policy agenda



for European integration, will be careful not to put forward proposals that may impose excessively costly adjustments on states.

Neofunctionalism represents the principal alternative to liberal intergovernmentalism as an explanation of European integration. While neofunctionalism experienced a revival with the renewal of European integration beginning in the mid-1980s, it was vulnerable to criticism for failing to provide an explanation for the preceding period of stagnation. In other words, neofunctionalism provides an insightful account of the mechanisms that foster integration. However, it is less useful for establishing limits to the process. Approaches to the dynamics of integration that build on neofunctionalist theory emphasize the growing autonomy of the supranational institutions of the EU—especially the European Commission and Court of Justice. From this perspective, the capacity of European integration to transform domestic political economies is defined by the limitations of supranational entrepreneurship. Policy networks effectively organized by the European Commission or in response to the activities of EU institutions can have a dramatic impact on domestic preferences, policies, and even institutions. However, as the empirical material presented in this book makes clear, it is not difficult to find pairs of cases in which similar levels of Commission entrepreneurship produced very different results. This is true, for example, of frustrated efforts to liberalize European postal services in the late 1990s, in contrast with successful liberalization of telecommunications services earlier in the decade, as demonstrated in chapter 6. Such a comparison suggests that while supranational entrepreneurship may at times contribute to the transformation of a sector, it is not necessarily a decisive independent variable in the explanation of outcomes.

European economic integration may be seen in part as a reaction by policy makers against the deeply entrenched defense of political regulation of public services by its beneficiaries—a way to transcend the multiple veto points that block institutional change. The initial impetus behind economic integration may be understood in terms set forth by liberal intergovernmentalist theory: integration serves as a means through which national executives can oversee an orderly process of economic liberalization (Moravcsik, 1994; 1998). Governments gain leverage to implement desired economic reforms while keeping the social and political costs of liberalization within acceptable margins. This reveals why economic integration accelerated after national executives in West European states converged in the mid-1980s on a general preference for fiscal and monetary prudence

and liberalization of markets for goods and services: European integration enabled them to lower the political risks of pursuing these ends by locking in commitments to liberalization and neutralizing domestic political opposition. This made it possible for national executives to “harden” their states, rendering them less susceptible to rent-seeking by particularistic interests.<sup>13</sup> European economic integration therefore can be expected to constrain public sector activity because the single market has been consciously embraced by governments of EU countries; it is not simply an exogenous shock to national political economies.

But just how high is the price for this commitment? To what extent have governments bought added discretion to harden the state by ceding control over the scope of domestic political regulation? Embedded in the institutional apparatus developed to implement and regulate Europe’s internal market is a competition policy regime with strict provisions for the regulation of government subsidies to industry. Moreover, the internal market and competition policy units (DGs, or Directorates General) of the Community’s administrative bureaucracy, the European Commission, are firmly committed to market liberalization as a means to deepen European integration, and therefore are anxious to exploit opportunities to broaden the applicability of the competition rules to new cases or sectors. As Susanne Schmidt puts this, “the Commission has the potential to seriously interfere with those parts of the national economies that are *not* predominantly *structured by market principles*” (Schmidt, 2000: 45). In other words, economic integration produces substantial pressures on domestic political structures to adapt—sometimes in ways unforeseen in the original bargain that set the single market process in motion. Pressures for change in the scope of the public sector represent one such consequence.

Chapter 4 depicts the process through which the institutions of the European Union, particularly the European Commission and the European Court of Justice, but also the European Council representing heads of state and government of member countries, gradually brought the public sector within the remit of the single market program. As this occurred, competition rules governing state aid to industry were extended to public enterprises, and government restrictions on competition designed to protect public sector services providing for the “general economic interest” progressively became incompatible with single market competition law. As a consequence of these developments, the European integration process represents fertile territory for probing political limits to economic liberalization and

constraints on the ability of governments to continue to define the scope and purpose of the public sector.

*The Political Significance of Competition Policy*

The book explores the complex fate of economic liberalization in European Union countries by examining attempts to constrain the use of public sector resources to achieve political objectives in three areas: markets for the procurement of goods and services by public authorities; sectoral liberalization of postal services; and government aid to public enterprises, with a particular focus on a single national case in which the form of aid is deeply institutionalized and the public service function broadly supported—Germany’s system of public sector banks. All three areas are highly politicized because, from the perspective of domestic politics, they represent areas of high political sensitivity that justify political regulation, while from a European Union perspective, they comprise protected sectors that undermine the economic objectives of Europe’s single market.

The importance of this goal to the integration project can not be overstated. The European Union’s effort to construct a single market for goods, services, capital (and, in theory, labor) has focused on breaking down barriers to free competition. The ongoing pursuit of the tantalizing end of a single market—to which Europe can draw ever closer but never entirely achieve—has been the core objective of the European integration project for two decades. The duration of this project, along with its force and pervasiveness have, as in the case of the governing institutions shaping twentieth-century British industrial policy studied by Peter Hall in *Governing the Economy* (1986), “imparted a consistent bias to policy” in the institutions of the EU and, in many instances, in domestic institutions of member states as well. It is unsurprising that the consuming occupation of the past twenty years of European integration has had crucial institutional consequences. Following its mid-1980s launch, the single market project elevated components of the EC institutions responsible for pursuing the completion of the single market to a privileged position in the policy making machinery, rendering the competition and internal market segments of the institutional apparatus *primus inter pares*. From the late 1980s, competition within Europe’s internal market took on hegemonic status within EU institutions as the most effective means of promoting competitiveness of

European industry. As a result, the expanse of Community competition policy increased and mechanisms of enforcing competition rules became increasingly robust.

As explained in more detail in chapter 2, the expanded application of EC competition policy associated with implementation of the single market fostered and in turn has been reinforced by four developments. The first is the institutional bias toward liberalism previously described. Second is the Community's penchant for regulatory governance. The significance of the European Commission, the EU's administrative bureaucracy and executive branch, resides in its role as a neutral arbiter and enforcer of rules rather than as an initiator of major spending programs (Majone, 1994). Employing this comparative advantage in regulatory governance, the Commission has elaborated a series of rules for the application of competition policy. These rules were designed to bind other actors, such as national governments and state-owned enterprises; over time, articulation of rules also increasingly has bound the Commission itself. Even where the European Commission hoped to exercise political discretion in the application of rules governing competition, other actors—especially existing and potential private sector competitors of public enterprises—relied on the rules to demand their consistent application by the Commission. In other words, there was significant private sector mobilization on behalf of competition policy goals. Thus, the third development undergirding the strengthening of competition policy is the emergence and growth of a constituency for enhanced competition. Private sector actors seeking opportunities to step outside the confines of domestic politics in order to challenge the market dominance of public sector monopolies and national government subsidies to industry, including both private sector competitors and public enterprises, increasingly became constituents of the Commission—but constituents who at times demanded stricter application of competition rules than the Commission itself was prepared to undertake.

Finally, policy entrepreneurs in national governments seized on the opportunity provided by Community competition policy to firm up their resistance to demands from particularistic interests and strengthen their position relative to patrons of subsidized public enterprises (Smith, 1997). This fourth development may be described as “state hardening,” in which governing institutions become “less permeable to penetration from interests and demands emanating from civil society” (Della Sala, 1997: 15).

Hardening is characterized by a depoliticization of policy making that reduces opportunities for rent-seeking.

These developments provide the context for the rising political significance of struggles between protection and competition in the areas of industrial aid, government procurement, and public services such as telecommunications, electricity, and postal services. Industrial aid takes many forms, from direct subsidies to tax exemptions to loan guarantees, and has been pervasive across western Europe for several decades as a means of protecting jobs, promoting industrial restructuring, and selecting national champions. Similarly, purchases of goods and services represent vast expenditures of resources by public authorities (an estimated 15 percent of European Union GDP), constituting a core function of all levels of government. While economic efficiency is an essential guiding principle of such expenditures, public procurement also has served as an important instrument of social, industrial, and regional policies. Finally, the political sensitivity of postal services—an 80 billion euro market (equal to 1.4 percent of GDP for the older EU 15)—derives from both the central economic role of postal communications and the social role of postal networks, which often provide services extending beyond mail delivery, especially in rural areas. These range from the payment of old age pensions to the doorstep delivery of basic provisions to providing a venue (the local post office) for a municipal council meeting. In the postal services sector as in each of these policy areas, European economic integration has brought powerful market-making forces to bear, and the cause of competition has advanced as a consequence of Europe's single market project.

The focus on competition policy is not intended to be representative of European Union policy making. Indeed, the powers of the European Commission in competition policy are unique. These powers include authority to regulate assistance to industry, which has the potential to distort competition within the European market, as well as jurisdiction to review potential abuses of market position. The original EC Treaty acknowledged the disjuncture between individual and collective national economic interests, and accordingly vested substantial authority to regulate competition in the supranational European Commission. This disjuncture made it inappropriate for national governments to regulate a European market. Accordingly, the methodological advantage of a focus on the application of EU competition policy is precisely the significant role of supranational institutions and processes in policy making. Nonetheless,

with a few exceptions (Cini and McGowan, 1998; McGowan and Wilks, 1996; Scharpf, 1999), the political implications of Community competition policy have been neglected in the political science literature. Instead, the subject has been dominated by legal scholars who analyze changing interpretations of the meaning and scope of competition law (Gardner, 1995; Gerber, 1994; Goyder, 1998; Hancher, 1993; Page, 1982; Pappalardo, 1991).

One aspect of the development of competition policy most carefully studied by legal scholars—but understudied by political scientists interested in the changing role of the state in capitalist democracies—concerns the gradual extension of competition rules to the public sector. In the early evolution of the European Community, participants widely assumed that application of the competition rules was confined to the private sector. But the inception of the single market project ushered in a new era in the relationship between national governments and EU institutions, especially the European Commission and Court of Justice. The European Commission became much more ambitious in its pursuit of economic integration; both bodies figured prominently in the increasingly active application of competition rules to relations between governments and public enterprises. Moreover, as the European Commission began to apply its Treaty powers in the area of competition policy to public enterprises, successive decisions of the European Court of Justice narrowed the scope of exclusions from Treaty rules for undertakings charged with providing public services. This empowered the European Commission to attack public sector practices that restricted competition, and raised the prospect that European Community competition law could impose liberalization across the public sector landscape in EU member states. Subsequent developments also have raised the question of the limits to that process.

### *Organization and Argument*

Given the treatment of competition policy in the EC Treaty, we should expect Community-level mechanisms to play a formative role in the expansion of competition. To put this in the language of recent studies of “Europeanization,” defined as the impact of emergent European level governance on domestic political structures (Cowles, Caporaso, and Risse, 2001), the pressures for domestic adaptation to European governance, though they

vary across countries, generally are intense. Indeed, the examination of Europe's extensive market-making mechanisms presented in chapter 2 creates a strong *prima facie* case for expectations of convergence around free market outcomes with depoliticized regulation.

However, the central puzzle explored in the book concerns the existence of powerful forces of liberalization alongside the uneven, incomplete, and sometimes halting nature of liberalization actually attained. Table 1.1 provides an overview of the state of liberalization in the sectors analyzed in this book. It details the timing of steps toward liberalization at the European Community level, the substance of the liberalization regime proposed, and the actual extent of competition in the sector. As the table illustrates, the gap in time between initial efforts to expand competition and the achievement of a competitive environment, and the distance between aspirations and scope of competition realized vary across sectors.

In the public procurement sector, the extent of competition has fallen far short of bold aspirations for an open, competitive, European market dating back more than a decade. Competition has been introduced into postal services markets in EU member states, but its scope will remain quite limited even two decades after the inception of the liberalization debate. Finally, in the case of Germany's public sector banks, protectionist practices have been overturned, but only through a protracted process spanning well over a decade. The ensuing discussion offers an overview of each sector as discussed in the empirical chapters.

Through the case studies, the book analyzes empirical evidence of the gains and constraints of competition in the public procurement, state aid, and postal services regimes. The powerful drive toward liberalization or "market-making" built into the integration process is the focus of chapter 2. As the chapter asserts, Europe's single market project efficiently transmits forces of economic liberalization to the EU member state governments and other economic actors. Chapter 3 sets out the logic of alternative hypotheses concerning the impact of Europe's forces of liberalization on the public sectors of EU countries. How extensively are public sector arrangements remolded by pressures for economic liberalization? What is the impact on protected public sector monopolies of private sector actors using European Union law as a fulcrum for the introduction of greater competition? To what extent are outcomes determined by these private actors; to what extent by public sector managers or national regulators that may wish to control the expansion of competition?

TABLE 1.1: States of Liberalization

Sector	Inception of Substantial Liberalization Process at European Level	Scope of Early Proposed Market Opening	State of Liberalization
Public Procurement	<p>First legislation dates to 1970</p> <p>Major ECJ cases in mid-1980s</p> <p>Updated liberalization legislation completed in 1993</p>	<p>Contracts offered by public authorities at all levels to be awarded based on value for price; no discrimination in favor of regional or national firms</p>	<p>Relatively little cross-national market penetration; only limited evidence of price convergence across markets</p>
Postal Services	<p>First discussions of a European-level regulatory regime in 1989</p> <p>First liberalization measure agreed in 1997; effective February 1999</p> <p>Second liberalization measure adopted in May 2002; took effect in 2003</p>	<p>Proposals ranged from marginal opening to competition (3% of market) to full sectoral liberalization</p>	<p>Letter delivery services representing three-quarters of revenues still reserved to national postal services operators even after second legislated phase of liberalization in 2006; no date established for full liberalization of postal services market</p>
Public Sector Banks (Germany)	<p>1992: Complaint by German Banking Federation to European Commission concerning transfer of housing funds to Westdeutsche Landesbank</p> <p>1999: European Banking Federation complaint to Commission concerning state guarantees</p>	<p>Elimination of competitive distortions, initially by restricting public sector banks' use of capital provided by state governments; later by ending state guarantees</p>	<p>State governments were required to phase out by 2005 existing liability guarantees extended to public sector banks; newly created liabilities may be guaranteed until 2015</p>



Chapter 4 analyzes the political process through which the European Community's competition policy regime progressively became extended to the public sector in the 1980s and 1990s. Beginning from the premise that the EU's commitment to a liberal economic order is firmly grounded in the 1957 Rome Treaty, the chapter points out that the Community began to fulfill this commitment as national and European level factors coalesced around the 1986 Single European Act that set in motion Europe's single market project. In addition, the chapter examines several cases that came before the Court of Justice that established legal precedents important to efforts to broaden the scope of competition. Yet the chapter also demonstrates that legal outcomes, however favorable to the cause of sectoral liberalization, were by themselves insufficient to infuse with competition markets served by the public sector.

Beginning the empirical section of the book, chapter 5 explores the frustrated efforts of the Commission of the European Communities to create a single market in public procurement. In this sector, a full-fledged competition regime has been legislated at the European level. Nonetheless, restrictive practices persist at national and regional levels, so that the share of public sector contracts awarded across borders remains small. The ineffectiveness of efforts to broaden competition appears overdetermined. On the one hand, the public authorities expected to follow single market procurement rules view the regime as antithetical to their interests, explaining their inclination to skirt the rules. On the other hand, prospective beneficiaries of competition perceive weak incentives to lodge complaints with the European Commission, undermining the prospects for enforcement of the competition regime. The chapter therefore reinforces and extends the lesson of chapter 4, demonstrating that Community legislation by itself can not enhance competition in sectors served or governed by the public sector.

Chapter 6 analyzes the European Commission's efforts to advance postal services liberalization within the EU, and places this case in comparative context with liberalization of the telecommunications and electricity sectors. The chapter demonstrates that telecommunications liberalization was a product not only of Commission leadership, but also of the receptiveness to liberalization of actors in entrenched market and political positions in the member states that supported the liberalization program. Electricity provides an interesting comparison with postal services; until 1996, critical actors in domestic political economies had not yet redefined

their interests in ways compatible with sectoral reform, and electricity liberalization was stalled despite long and intense efforts by the European Commission to promote collective action. Postal services in 2001 were in precisely the position of the electricity sector in 1996; stalled, but with the prospect of an advance of liberalization contingent on a shift in the domestic regulatory environment in a member state whose support would be pivotal to the advance of sectoral liberalization at the Community level (Britain in postal services; France in the case of the electricity sector). Illustrating the dynamics of Europeanization, this took place in 2001–2002 as a consequence of changes in Britain's national regulatory structure for postal services that followed directly from the Community's initial steps toward sectoral liberalization. The altered regulatory environment in Britain changed the dynamics of interest articulation, shifting the British position in favor of increased competition in the postal services sector; agreement at the European level on a further modest step toward liberalization ensued.

Chapter 7 examines the development of the European Commission's regime of control of state aid to public enterprises. The chapter focuses on the case of Germany's public sector banks. In this case, public sector activities egregiously violated state aid rules; in such instances European Community competition law places powerful mechanisms for resolving the conflict at the Commission's disposal. Nonetheless, in the instance of Germany's public sector banks these mechanisms led only gradually and indirectly to a reduction in public sector privileges and the introduction of fairer competition. Institutionally and politically dominant domestic actors also brought substantial resources to bear on the struggle to determine how the sector was to be governed. Only after pressure from EU institutions that mounted over the course of a decade, and, critically, a significant shift over time in domestic political alignments, did Germany's public law banks lose their protected status. This shift took place as the application of EC competition policy made it possible for private sector competitors of the public sector banks first to enter, then to carry added weight in, the making of the regulatory regime for the sector. This occurred as national and then regional political elites in Germany acknowledged that the sector was subject to European-level jurisdiction, and as private sector competitors exploited opportunities to pursue their interest in market opening by invoking the provisions of Community competition law.

Drawing on the evidence presented in chapters 5 through 7, chapter 8 returns to the questions posed at the outset. This concluding chapter sets

out more systematically how European-level and domestic factors interact to determine the contours of change and continuity in the public sector across countries and market sectors. The analysis establishes that while European economic integration certainly has infused competition into several sectors previously controlled by state-owned monopolies, the process has been more modest and deliberate than a simple reading of Europe's market-making mechanisms would predict.

The chapter outlines the central findings that the timing and scope of liberalization in a sector depend on three factors. The first factor focuses on the stimulus for public sector reform induced by the increased scope of Community competition law. This factor concerns the extent to which the reach of EC competition rules into a public sector activity fosters formal complaints by competitors and potential competitors of protected public service providers. Since the administrative units of the European Commission do not have the capacity to police extensively each sector across EU member states, complaints from third parties typically are required to invoke Community enforcement mechanisms. However, in some sectors there may be few potential market entrants, or willing competitors may be discouraged from complaining to EC authorities because enforcement proceedings are cumbersome, and competitors therefore are unlikely to capture substantial direct benefits. A second question deals with the consequences when there are sufficient complaints to trigger the enforcement process. In some instances, public sector monopolists will adopt a strategy of reform and preparation for intensified competition in anticipation of, or in response to, real or threatened competition law enforcement proceedings. In other cases, public operators in dominant market positions may respond by battling Community institutions.

The second factor accounting for liberalization outcomes is the degree to which entrenched public sector monopolists and protectionist governments revise their assessments of the relative costs and benefits of liberalization. For example, protected public sector operators may promote sectoral liberalization in response to market opportunities, such as the chance to garner market share following the opening of a previously monopolized public service market in another country within Europe's single market. Conversely, concerns about asymmetries across member states in the opening of markets may raise the anticipated costs of liberalization, as public service providers fear foreign penetration of national markets without corresponding opportunities to expand market share abroad.

Finally, outcomes vary with the extent to which domestic political interaction with European-level policies and institutions fosters a reduction in the weight of public sector monopolists in national policy formulation. This shift in the relative weight of domestic political actors comes about as new actors enter the policy making process or the weights of existing actors are redistributed in response to the broadening of the political arena to the European level. This phenomenon is described as “participation expansion,” a concept borrowed from the wider literature on international pressures and domestic political change, particularly the work of Leonard Schoppa on international trade and U.S. demands for economic reform in Japan (Schoppa, 1993).

While participation expansion is a critical element of the process of liberalization, the injection of broader competition into markets served by the public sector may be constrained—both in scope and timing—even where participation expansion occurs. Even as the construction of Europe’s single market has drawn in additional private sector interests previously on the fringes of policy formulation, and has strengthened opponents of restrictive practices for these sectors, steps to introduce greater competition typically have had to accommodate the interests of public sector monopolists and their domestic political protectors.

In sum, this work shares common concerns with recent work in comparative political economy that addresses the impact of forces demanding adaptation of social welfare systems, systems of industrial relations, patterns of corporate governance, and national models of capitalist democracies generally.<sup>14</sup> Foremost among these is a focus on the nuanced interaction between international forces of change and domestic forces—some of which resist, and others that resonate with and are mobilized by the thrust of outside pressures. In analyzing the outcomes of this interaction, the study finds that the Europeanization process is indeed a clear determinant of far-reaching changes in the relationship between states and markets. Nonetheless, while we should not underestimate the potency of external forces such as globalization and Europeanization in provoking change, this book adds to our understanding of how reform, including its scope and timing, follows a path shaped largely by actors in dominant market positions and by existing institutional arrangements.