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The Politics of Antitrust and Merger Review in the European Union: Institutional Change and Decisions from Messina to 2004

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Abstract

Antitrust regulation and the related merger review are essential for making a market economy work. Merger review is also among the most prominent powers of the European Commission in the Common Market of the EU. How did this supranational actor come to acquire such power? And what explains the variation in the Commission's decisions in some of the trans-atlantically most controversial merger review cases in recent years? In this paper, we develop a modified neofunctionalist theory as a historical institutionalist theory of institutional change that integrates elements of rational choice and social constructivism. We argue that it provides a superior explanation of (1) the institutional development of the European Commission's competence over antitrust matters and merger review from the 1950s negotiations over the Treaty of Rome through the changes of 2004 *and* (2) the Commission's decisions in some of the most prominent cases, where a high level of politicization makes a neofunctionalist explanation least likely.

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Just as independent courts symbolize the rule of law, so a competition agency symbolizes commitment to the free market. It is an important ideological statement which lies at the heart of the European project. — Wilks with Bartle, 2002: 157

1. Introduction

Effective competition is crucial for making a market economy work: it creates a continual incentive for innovation in order to boost efficiency, lower prices, or raise quality. It also ensures that the equilibrium between supply and demand is approximately socially optimal. If a firm attains a monopolistic or oligopolistic position, where it is no longer a price-taker, these key benefits of a market economy are called into question.¹ To safeguard the benefits of competition, governments have asserted the authority to regulate or break up monopolies and cartels—and to review and potentially restrict or prohibit mergers that would distort the market. It is one of the few regulatory powers of the state that now enjoys broad support across the political spectrum of advanced capitalist democracies, even if practice still varies greatly.²

Accordingly, article 3(1)f of the 1957 Treaty of Rome, which created the European Economic Community (the core of today's European Union, EU), identified "ensuring that competition in the Common Market is not distorted" as one of the objectives of the new institution.³ But notwithstanding the explicit recognition of the importance of ensuring effective competition, the specific powers of antitrust enforcement and merger review delegated to the Commission in Articles 85 and 86 of the Treaty of Rome were quite limited and in fact weaker than the power granted to the High Authority of the European Coal and Steel Community (ECSC) under the 1951 Treaty of Paris (see, e.g., Majone 1996: 51). Moreover, the Commission could not even begin to exercise these powers until 1962, when the necessary procedural rules were finally adopted through "Regulation 17" (Council 1962). Today, by contrast, antitrust regulation and the related review of mergers are among the most prominent functions of the European Commission for the Common Market. A supranational institution thus has power over firms from all member-states—and over foreign firms operating in Europe.⁴

How did a supranational institution, specifically the European Commission's Directorate General Competition (DG Comp, formerly DG IV), come to acquire such power over matters

¹For a more relaxed view of imperfect competition, see Coase (1960). Farrell (1987), however, points out that Coase's theorem requires rather strong assumptions, which essentially amount to assuming the absence of transaction costs—somewhat curiously, given Coase's earlier and later work.

²We focus in this paper on the merger control component of antitrust policy and leave aside the important competition policy issues of state aid, public monopolies, and public procurement. "Mergers," in this paper as in EC practice, refers not only to mergers in the strict sense of U.S. securities law, but also to acquisitions, joint ventures and other equity investments involving two or more firms. In EC/EU law they are formally called "concentrations."

³The article was re-numbered in the Maastricht Treaty revision as 3(1)g.

⁴Such supranational regulatory power is sometimes criticized as undemocratic. Zweifel (2003), however, shows EU regulatory practice in the realm of merger control to differ little in "democratic-ness" from practice in federal states, and Wolf suggests that compliance rates with DG Comp decisions in other issue areas of competition policy indicate a higher level of legitimacy than for national-level competition regulators (Wolf 2004). DG Comp was ranked as the most highly respected competition authority in a recent survey among private-sector legal expert and public-sector practitioners (Cavendish 2006).

of competition, especially antitrust and mergers? What explains the institutional evolution of the European Community in this realm? And what explains the variation in DG Comp's decisions in some of the most controversial recent cases of merger review?⁵

To answer these questions, we develop a modified neofunctionalist argument in the historical institutionalist tradition. Neofunctionalism has often been reduced to, if not caricatured as, a theory about supranational elites run amok (e.g. Moravcsik 1998; Gillingham 2003: 86f; though cf. Rosamond 2000: 50ff). A close reading, especially of Ernst Haas's recently republished *Uniting of Europe* (2004 [1958]), however, reveals a much more nuanced theory, which emphasizes subnational actors and transnational contacts among organized interests. We clarify some of the assumptions underpinning neofunctionalism, address some of the valid criticisms of the approach in ways that are consistent with those assumptions, and contrast it with three variants of intergovernmentalism.

We then bring these alternative approaches to bear in the analysis of two sets of empirics. First, we examine the institutional development of the European Commission's competence in matters of antitrust and merger review from the 1955-1957 "Messina" negotiations preceding the Treaty of Rome through the latest changes of May 2004.⁶ We show that an intergovernmental narrative – while it provides a seemingly convincing account of most of the major events – leads the observer to misinterpret some of those events, misses important aspects of the larger process of institutional change, and ultimately gets the causal story wrong. A neofunctionalist narrative provides not only a more accurate account, but leads to an understanding of specific events as well as the process of institutional change. Second, we analyze DG Comp's decisions in two of the most prominent recent merger review cases, where a high level of politicization makes a neofunctionalist explanation least likely to succeed. We show that consistent application of DG Comp's legal doctrine, rather than the preferences of member state governments, explains the seeming puzzle that the merger between Boeing and McDonnell Douglas was approved (despite affecting the commercial interests of Boeing's principal competitor and European "champion" Airbus), while the General Electric (GE)-Honeywell merger was rejected (although no prominent European firms had a clear stake in it).

The research presented here seeks to contribute to several theoretical and policy debates. First, we seek to contribute to the debate about the relative scope and explanatory power of alternative theories of European integration. We do so by deriving specific hypotheses about the institutional evolution of EU competition authority and merger review decisions from various theoretical perspectives and testing them empirically. We focus in particular on neofunctionalism. Notwithstanding the occasional sympathetic review (e.g., Tranholm-Mikkelsen 1991), neofunctionalism has largely fallen out of favor after many years of intergovernmentalist critique.⁷ But as Imre Lakatos noted, "the first stage of any serious criticism of a scientific theory [must

⁵A note on nomenclature: the European Community (EC) became the first pillar of the EU through the Maastricht Treaty, but antitrust and merger policy remained applicable to the realm of the EC only; we therefore refer to the EC throughout. The Directorate General for Competition, originally known as "DG IV" became "DG Comp" in 1999; we use DG IV to refer to it pre-1999; DG Comp thereafter.

⁶We do not analyze as such the antitrust regime of the ECSC, which remained in force for the coal and steel sector for fifty years without significant changes (see Bulmer 1994), until the current antitrust regime of the EC became applicable to those two industries as well in 2002 (Commission 2002).

⁷Some recent arguments in the neofunctionalist tradition seem to try to avoid the association (Pierson 1996; Stone Sweet and Sandholtz 1998).

be] to reconstruct, improve, its logical deductive articulation" (Lakatos 1974: 128). We hope to begin such a constructive restatement of neofunctionalism, not because neofunctionalism alone explains European integration—several approaches might be useful to analyze different aspects thereof—but because such a clear theoretical statement is a prerequisite for employing it in systematic empirical analyses and for assessing this approach vis-à-vis others.

Second, we hope to contribute to the literature in international and comparative political economy on the politics of regulation. We do so by providing an integrated analytical account of both the institutional development and recent regulatory decisions of the EC, one of the key sources of governance in the global economy. We focus on merger review, which is "probably the most widely known area of antitrust" (Salop 1987: 3), but hardly covered by some of the leading analyses of European and international regulatory politics and policy (e.g., Egan 2001; Braithwaite and Drahos 2000). The substantive importance of competition policy in general and merger review in particular also motivates our case selection. By analyzing highly politicized instances of actual merger review decisions (in addition to the institutional evolution of EU merger review authority) we test the argument on what should be hard cases for our argument to explain. Finally, we contribute to current policy debates over the EU's continued ability to safeguard competition in the common market by showing that recent changes in the institutional structure of monitoring and implementing EU competition rules do not amount to a weakening (Dombey 2004), but rather should be understood as a strategic strengthening of those institutions.

2. Argument

Originally "a sleepy, ineffectual backwater of Community administration" (Wilks with McGowan 1996: 225), the European Commission's DG Comp (formerly DG IV) has acquired over time substantial powers in the name of competition and antitrust. These powers include the right to investigate—intrusively—almost any firm operating or selling in the EU. If the firm is found to distort competition in the Common Market in ways that violate EC rules, DG Comp is empowered to require changes in the structure or commercial practices of the firm. Most prominently, DG Comp has the right to approve, impose conditions upon, or completely prohibit the merger of firms, based on the same criteria (see, e.g., Dutilh, Woude, and Landes 2003; Goyder 2003: 335-397). How can we explain this institutional evolution, this shift of authority to the supranational level, which is an important part of the process of European *political* integration?⁸ And how can we explain the specific regulatory decisions taken by DG Comp in the

⁸Many students of the politics of integration have found it useful to make an analytical distinction between negative and positive integration (e.g. Scharpf 1996). Often, however, negative and positive integration go hand in hand. The common European market has been created in part by agreement among the member-states that they will forego their right to adopt policies that discriminate against producers from other member-states but, to be effective, such negative integration requires at a minimum agreeing on mechanisms for monitoring, adjudicating, and enforcement, to ensure that the member-states comply with these obligations *not* to intervene in the market. That is, it requires some degree of positive integration. Moreover, scholars such as Steven Vogel have shown that opening or "freeing" markets tends to create the need for a stronger regulatory framework (Vogel 1996; see also Haas 2004(1958): 12; Majone 1990; Tim Büthe also thanks the late Vincent Wright for insightful discussions of this issue). Accordingly, as the market becomes more European in scope, thanks to negative integration, we should also see more positive integration on matters such as competition policy and regulatory policy. When we speak of integration in this paper, we therefore mean the pooling or delegation of public authority to make decisions at

realm of merger review? We present our own answer, grounded in Haas's original formulation of neofunctionalism, in this section and briefly review alternative approaches in the next.

2.1. Neofunctionalism and Institutional Change

Neofunctionalism was developed to provide a theoretical account of the *process* of European integration, starting with Ernst Haas's analysis of the ECSC from 1952 to 1957 (Haas 2004 [1958]). Flowing in part from Haas's more general interest in change in world politics (Ruggie *et al.* 2005: esp. 274), neofunctionalism therefore is in essence a theory of institutional change, which makes it a promising starting point for our analysis. We present here a restatement of the core logic of neofunctionalism, based first and foremost on a close, critical reading of Haas's original work, but also drawing on more recent work in the historical institutionalist tradition. From this modified neofunctionalist account, we derive a set of hypotheses regarding the institutional evolution of EU-level antitrust authority and its merger review decisions.

Neofunctionalism has been fairly criticized for not spelling out its assumptions clearly.⁹ We seek to remedy this weakness: a close reading suggests that neofunctionalism combines the methodological individualist assumption of procedural rationality (individuals pursue their self-interest in instrumental ways) with the pluralist assumption that a multitude of subnational interests are salient in structuring domestic and potentially transnational politics.¹⁰ At the same time, it views interests as a function of, or at least constrained by, identities and loyalties that have a high degree of persistence but are malleable over the course of time.¹¹ Neofunctionalism may thus be read as one of the earliest attempts to systematically integrate rational choice and social constructivism (see Haas 2001) in a quintessentially historical institutionalist theory. In this sense it already answers the call for combining sequentially rationalist and constructivist approaches (Jupille, Caporaso, and Checkel 2003: 22f; see also Checkel 2001; Fearon and Wendt 2002). Substantively, neofunctionalism assumes liberal democracy, voluntary cooperation, and some initial level of economic interdependence (or at least economic structures that are sufficiently complementary to make economic integration beneficial to each country involved).

Based on these assumptions, neofunctionalism identifies three general paths toward greater integration: one that amounts to integration driven by governments, each acting in the aggregate economic interest of their respective states, and two variants of a path to integration driven by subnational economic interests acting in concert with the supranational institutions.

the supranational level, where we define supranational authority as one whose decisions are binding even on a member-state that may not agree with the particular decision. Any form of majority voting in the Council or decision-making by the Commission (as well as any shared competence not subject to a national veto) qualifies as supranational by this definition.

⁹Recent notable exceptions are Niemann (1998: 429), Rosamond (2000: esp. 54ff), and Schmitter (2004).

¹⁰Understood in this way, neofunctionalism recognizes transnational non-state actors *as actors*, with power and interests of their own (cf. Cowles 1995: esp. 502, 522f). Other scholars (e.g., Sandholtz and Zysman 1989) have also emphasized subnational interests and their transnational coalitions, but mostly as important factors in theoretical arguments contrasted with neofunctionalism; part of our contribution in this restatement of neofunctionalism is to clarify the essential role of subnational actors in neofunctionalism itself. Note relatedly Schmidt's critique of an approach that relies on a coalition of subnational and supranational interests to explain EU liberation decisions (Schmidt 1998:303).

¹¹For a similar argument about the pursuit of economic interests channeled by loyalty to a social institution, see (Hirschman 1970: esp. 76ff).

Regardless of the particular path, greater integration is never automatic. To the contrary, integration implies and arises out of political conflict—although those who seek further integration may seek to minimize opposition by framing integration as the most efficient solution to an economic or technical administrative problem rather than a change in political structures and the distribution of power.

The first, state-led path is expected when governments themselves find that greater depth of integration (i.e., more supranational decision making in a given issue area) and/or increased breadth of integration (i.e., shift of decision making from the national to the European level in issue areas previously decided entirely at the national level) would improve the efficiency of resource allocation.¹² Under these conditions, neofunctionalism would expect member-state governments, acting in the aggregate economic interest of their respective countries, to take the initiative and, subject to agreement among them, bring about institutional change (see Figure 1).

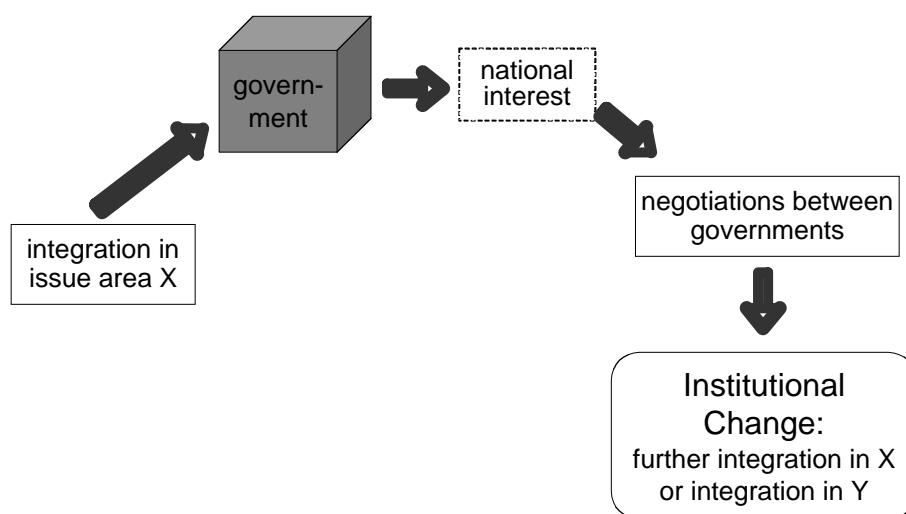


Figure 1:
Government-Driven Institutional Change in Neofunctionalism

This statist path is explicitly recognized by neofunctionalists but is not neofunctionalism's original contribution (Realist intergovernmentalism, discussed below, may make a similar prediction). Moreover, the theory tells us little about the conditions under which states, without demand from "below," should be expected to conclude that there is a functional need for integration, instead of intergovernmental cooperation through traditional diplomatic channels.¹³ However, neofunctionalism does identify a particular reason why governments might decide to broaden the scope of EU decision making, i.e., pool decision making in a previously nonintegrated issue area: to achieve agreed objectives in another issue area (Haas 2004 [1958]: esp. 297, 304f, 313). Given interdependence between economic sectors and governance functions, governments might find it necessary, for instance, to pool decision making on some social policy issues

¹²On the distinction between depth and breadth of integration, see e.g., Börzel (2005).

¹³Principal-agent models may be useful in identifying such conditions, but are beyond the scope of this paper; see Pollack (2003) and Ballmann, Epstein and O'Halloran (2002).

in order to achieve the agreed-upon objectives of having a well-functioning common market (Leibfried and Pierson 1995). This of course is the famous functional spillover mechanism, which in our assessment has been greatly overemphasized (see also Rosamond 2005: 244f).

The second and third paths are more interesting. Both start from the assumption that limited supranational institutions have already been put in place. The presence of these institutions, according to neofunctionalism, will lead to further integration in a particular issue area if limited supranational governance of that issue, or more extensive supranational governance of another issue, provides a model that suggests to (some) *subnational* actors that they might achieve their goals through further integration. More specifically, subnational actors are expected to demand increased scope of supranational decision making within a given issue area or the extension of supranational governance to new issue areas for any of three reasons. They may demand such an increase (1) because they infer from the effects of prior integration that further integration would be beneficial to them;¹⁴ (2) because they seek a solution to a problem that has no effective national solution;¹⁵ or (3) because they hope to achieve with a different political coalition at the European level what they were politically too weak to achieve at the domestic level.¹⁶

These subnational actors might engage in traditional domestic politics and each lobby their respective national governments to bring about the sought-after institutional change (or to block it, in the case of opponents). Given its above assumptions, however – and contrary to liberal intergovernmentalism, which treats subnational interests as actors in the domestic (national) polity, only – neofunctionalism also expects them to form transnational coalitions and engage in transnational politics (thin diagonal arrows and long horizontal arrow in Figure 2).

It is important to note here that, unlike Mitrany's functionalism, neofunctionalism explicitly recognizes that supranational integration engenders opposition as well as support. In fact, not only overtly political proposals, but also mundane, seemingly technical economic integration might evoke opposition (Haas 2004 [1958]: 288f, 296f). This opposition might explain periods of stasis in European integration (Corbey 1995). Opponents, however, are unlikely to form lasting coalitions, because they tend to lack a common interest beyond their momentary opposition to supranational governance of specific issue.¹⁷ Consequently, neofunctionalism expects the

¹⁴These perceived benefits of integration may be a consequence of prior integration having increased interdependence (sectoral functional spillover), such as when the establishment of a common market and supranational governance for coal under the ECSC brought about calls for a common market for the products made by industrial *consumers* of coal, lest the higher profits of coal consumers in national markets without much competition (for their products) led them to distort the market for coal (by driving the price above where it would be in perfect competition equilibrium) and thus undermine the effective operation of the ECSC; it also brought calls for the supranational governance of other sources of energy, labor conditions, etc. (Haas 2004 [1958]: 103, 291ff).

¹⁵Transnational environmental pollution is a prominent example of such a problem. See also Stone Sweet and Sandholtz (1998:esp. 11f).

¹⁶Witness the transformation of British labor in the late 1980s and early 1990s from a Euroskeptic into a pro-integration group (see, e.g., Tindale 1992).

¹⁷Opposition to trans-/supranational governance provides a poor normative foundation for establishing lasting transnational political coalitions, so opposing coalitions should likely dissolve once the particular issue has passed on which they had a common interest. By contrast, given neofunctionalism's emphasis on the fluidity of norms and identity, support for greater transnational governance through supranational

direction of change to be generally toward more integration, even though there might be periods of stalemate and conceivably even reversals.

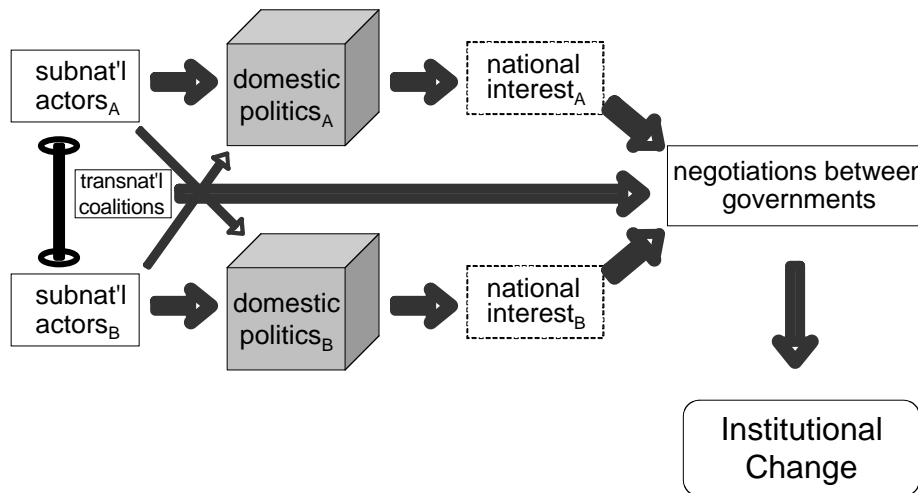


Figure 2:
Subnational Actor-Driven Institutional Change
via Domestic and Transnational Politics

The third path to institutional change starts by deriving, from the assumption that individuals will seek to advance their own interests, the expectation that those working in existing supranational institutions generally to favor greater integration because, within the constraints of identity and loyalty, it enhances their power and ensures them of more interesting, more substantively important work.¹⁸ These supranational actors are unlikely to succeed if they put forth grand proposals for comprehensive institutional change, because such overtly political attempts to change the institutions are bound to engender opposition (Haas 2004 [1958]: xxiv, 26, 106ff). They may, however, pursue incremental change through a number of avenues. The supranational institutions can create a “shield” of legal doctrine (Burley and Mattli 1993:72f), which allows them to insist on strict application of established doctrine when doing so is politically expedient for safeguarding their autonomy from the member-states, but also to engage in legal entrepreneurialism to expand their influence when an opportunity arises to do so safely. The appearance of the apolitical application of rules should thus be quite political, but in service to the interests of the supranational institutions, not member-states (Mattli and Slaughter 1995).¹⁹ In addition, supranational actors may seek to actively foster subnational groups and transnational

institutions is seen as potentially leading to a commitment to integration as a goal in its own right, making it more likely that pro-integration coalitions last beyond the particular issue that led to their formation.

¹⁸See, e.g., Mattli and Slaughter (1998); the importance of identity and loyalty has been shown, e.g., by Liesbet Hooghe (2005), who finds that about one-third of EU senior civil servants are committed to a confederate intergovernmental ideal of the EU rather than a federalist, supranational ideal.

¹⁹The emphasis on legal doctrine elevates the principles of EC competition policy to something of a “sacred text,” whose interpretation and application is strictly reserved for the Commission and Court. Their interests might of course coincide with the interests of the member states; instances of divergent interests provide the real test.

communities in favor of greater integration (e.g., Alter 2001; Sandholtz and Zysman 1989). Most importantly, the supranational institutions—such as the Commission and the Court—may provide “political opportunity structures” (Kitschelt 1986) that allow subnational groups to pursue their interests at the supranational level and adopt policies that create among those groups the expectation that more supranational governance would be in their interest (Haas 2004 [1958]: xxxiii, *passim*). So if, for instance, the treaty grants some weakly defined powers to the Commission to constrain trade-distorting subsidies from member-state governments to firms, and the Court provides the opportunity for competitive firms in one member-state to challenge the subsidies of another member-state to the firm’s competitors, neofunctionalism would expect firms to attempt such a challenge and to support an expansive interpretation of the Commission’s power over subsidies so as to achieve this private, material objective.

If supranational institutions provide such opportunities, then groups concerned with the content of those policies—including opponents—should be expected not only to voice their preferences vis-à-vis their respective member-state governments but also to “organize across national state boundaries in order to be able to influence policy” directly at the supranational level (Haas 2004 [1958]: xxxiii). If those subnational actors who seek to increase depth and/or breadth of European integration make use of the political opportunity structure(s) at the European level (for entirely self-interested reasons), then they provide the supranational institutions (Commission and ECJ) with an opportunity to increase their own powers (see Figure 3).²⁰ The result is institutional change *even without prior bargaining and agreement among the member-states*. Explicit delegation of authority from the Council to the Commission might then merely formalize institutional change that has effectively already occurred (see also Farrell and Héritier 2005).

Note that the political mechanisms of the second and third paths open the door for possibly more fundamental changes in the long run: there will be, Haas suggested, a slow shift in political activity and political organization, as well as an increasing expectation that values will be provided or assigned through supranational decisions. Cumulatively and over time, these political changes may bring about a change in identity and create political loyalties to the supranational (European) polity in addition to, or in lieu of, the national one. Thus, a perception by various actors that supranational governance serves their interests may provide a foundation for a pro-integration coalition that lasts beyond the attainment of the particular goals that caused the actors to adopt a pro-integration position in the first place.²¹

²⁰Note Martin and Simmons’s observation that “earlier studies of transgovernmental organizations” suggest that actors other than states “might use [international] institutions” (Martin and Simmons 1998: 747).

²¹A proper analysis of the long-term dynamics of identity is beyond the scope of this research. It seems clear, however, that Haas was unrealistic about the speed with which such a change in identities and loyalties might occur, though Philippe Schmitter correctly notes that Haas did not specify a time frame for this transformation (Schmitter 2005: 257f, 261). Yet, the general argument (with an adjusted time horizon of many decades) is fully consistent with broader arguments about state formation (e.g., de Swaan 1988: esp. ch. 3) and a sophisticated understanding of temporality in macro-social processes (Büthe 2002). Recent research suggests that the process of identity change is quite complex and more likely involves layering than replacement (e.g., Herrmann, Risse, and Brewer 2004; Risse 2005).

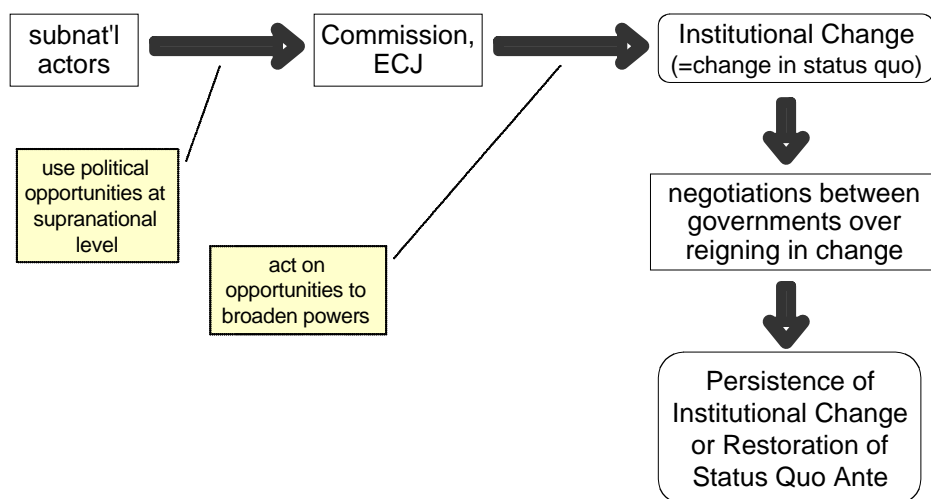


Figure 3:
Subnational Actor-Driven Institutional Change
via Supranational Institutions

Why would national governments agree (formally) or acquiesce (informally) to such a supranational European-level sharing or even transfer of power, rather than restore the *status quo ante*? This aspect of the process of European integration remains theoretically underdeveloped in neofunctionalist theory, but at least three conditions can be derived from the theory's assumptions suggesting why states may (under the above conditions) allow or not undo such a transfer of authority. First, given the assumption of democratic regimes, governments should be responsive to the interests of their citizens. Consequently, we might expect to see an increase in supranational governance when it is demanded by, or seen as being in the interest of, a majority of the population—even though in the short run “national governments ... may [still] on occasion attempt to sidestep, ignore, or sabotage the decision of the federal authority” (Haas 2004 [1958]: xxxiv).²² Second, interdependence as a consequence of market processes (potentially facilitated by prior integrative measures) might render national political solutions of economic problems ineffective—such as national regulatory responses to market failure when the market is no longer national but largely European. Here, of course, traditional intergovernmental solutions are feasible, but supranational governance might be preferred if it is more efficient or more effective in overcoming problems of credible commitment (Majone 1994:89f). If governments consider a particular issue to be sufficiently technical and apolitical, then the efficiency gains from supranational governance may outweigh the short-term political costs.²³ Finally, if an increase in supranational power comes about not as a consequence of an intergovernmental bargain but as a consequence of institutional development that is largely endogenous, then this new status quo (which might have been unachievable via an intergovernmental bargain) can be maintained with support from only a minority of the member-states. This point deserves to be

²²Haas uses “federal” and “supranational” interchangeably.

²³This implies that governments discount the long-term sociological effects of institutional change (i.e., shifting authority to the supranational level), which might be puzzling from a statist perspective (e.g., Hoffmann 1966) but is quite rational given the short-term incentives of democratic politics (Mattli 1999; Pierson 1996).

emphasized. When it comes to institutional change and the myriad measures in the Treaty of Rome that, in hindsight, allow it to occur informally, it is not correct that governments, "should [they] agree to a proposal whose long-term effects they do not understand at the time of adoption, they can always re-legislate" (Tallberg 2002:30). Once institutional change has occurred, institutional retrenchment to the previous status quo via intergovernmental bargaining would require a supermajority or even unanimity.²⁴ This should lead to the persistence of the new status quo, as long as it is supported by a blocking minority of member governments.

2.2. A Neofunctionalist Theory of Increasing EC Competition Authority

Neofunctionalism understood in this way suggests several testable hypotheses regarding the institutional evolution of EU competition authority and merger review decisions: first, the period of relative obscurity of DG Comp should be characterized by a lack of economic actors within the member-states who could benefit from European-level antitrust and merger review, by a failure of the Commission to make itself available as an avenue to pursue such interests, or both. Second, if the Commission provides political opportunities, then firms (or other groups) that feel threatened by the monopolistic behavior of a dominant competitor, supplier, or customer should be expected to seek supranational antitrust enforcement if the threat is transnational, if it arises out of the European common market structure rather than the national market, or if national competition authorities are less likely to correct the asserted market distortion. Similarly, third, firms that want legal certainty for mergers – mergers that might be considered to affect competition in the European market – as well as firms that feel threatened by the concentration of market power that would result from a proposed merger, should be expected to push for supranational governance of mergers. And fourth, we should expect such demands by sub- and transnational actors (directly and/or indirectly via member-state governments) to result in increased Commission authority over mergers as long as some governments oppose reigning in an entrepreneurial Commission or Court (*de facto* increases of authority) or all member-states prefer increased authority for the reasons specified above (formal increases in authority).²⁵

2.3. A Neofunctionalist Theory of Merger Review Decisions

Neofunctionalism suggests that those who act on behalf of the supranational institution, wary of stoking opposition to supranational governance, will seek to appear maximally apolitical. Like international regulatory or juridical institutions in general, the Commission's DG Comp can command voluntary compliance (and thus hope to gain the long-term benefit of legitimacy and loyalty) only if it is seen as independent of member-states. We would therefore expect the Commission to administer merger review in a very rules-based manner, using formal and legalistic procedures as a "shield" against member-state influence. DG Comp should be

²⁴For a similar argument specifically regarding legal integration, see Stone Sweet and Caporaso (1998: esp. 127).

²⁵Similarly, recognizing that institutional change also engenders opposition, we would expect member-states to rein in the Commission and potentially reduce its authority if that opposition was politically powerful in all (or a vast majority) of the member-states, but such a prediction is less pertinent in the realm of competition policy, where the overall trend has clearly been an increase in the Commission's power over the past fifty years.

quite willing to change or break with legal doctrine, though, when doing so allows it to advance its supranational authority.

3. *Alternative Approaches*

Various aspects of European integration have attracted the attention of numerous theoretical approaches over the years (see the reviews in, e.g., Burley and Mattli 1993: 46ff; Mattli 1999: 31ff; McNamara 1998). Some of these approaches hardly address the political dimension of economic integration, but several do. Most interesting as alternatives to our argument are theories of international relations and foreign policy, from which we can derive intergovernmentalist explanations of the evolution of EU competition authority and merger review decisions. Intergovernmentalists conceive of the process of European integration as a series of bargains between states, which resolve specific cooperation problems through the creation or modification of an international organization, in which agents—such as the European Commission or the Court—interact on behalf of their principals, the EU member-states (e.g., Lange 1993; Milward 1992; Taylor 1982; Wallace, Wallace, and Webb 1977). We distinguish three such intergovernmentalist approaches.

3.1. *Traditional Realist Intergovernmentalism*

Traditional Realists emphasize the deeply political character of integration, but focus their political analysis on the interaction between unitary states, which they see as the primary (though not necessarily only) actors in international politics (Cornett and Caporaso 1992: 229ff). Due to the primacy of security considerations, states should want to maintain strict control over all aspects of economic integration (even if doing so may come at an economic cost, see Krasner 1978). Integration therefore should be a firmly intergovernmental process for Realists. Any true pooling of sovereignty or delegating of authority to a supranational entity can, under these conditions, be acceptable only if an issue area is strictly positive-sum, so that cooperation reliably brings gains for all (Hoffmann 1982:29). Some Realist intergovernmentalists see issues as inherently either positive-sum or zero-sum, with defense issues clearly in the latter category but substantial economic integration potentially also included among zero-sum issues, because economic activity has what Joanne Gowa calls "security externalities." Others see the categorization of issues into positive-sum and zero-sum issues as a function of the salience that states, at a given point in time, attribute to the issue for the "survival of the nation or [the government]" (Hoffmann 1982: 29f). This salience may in theoretically parsimonious terms be seen as determined by the extent to which the issue threatens the national identity that is the foundation of citizens' loyalty to the post-French-Revolution nation-state (Hoffmann 1966: esp. 867f).²⁶

The implication in either case is that supranational authority for Realists only masks the distribution of power among the states involved—currently (Garrett 1992: esp. 546ff; 1995) or at

²⁶Alternatively, salience may be a function of a socio-political process at the domestic level that might itself warrant analysis (see the discussion of liberal intergovernmentalism below). Some Realists explicitly recognize that new and changing national identities are possible, but consider such changes in the units of the international system possible only through the use of force, which has not occurred and has usually been considered highly unlikely among the states engaged in European integration (Hoffmann 1966: 864f; see also Gilpin 1986: 313ff).

the time of the creation of the institutions (Gilpin 1981).²⁷ In the most recent and explicitly classical realist interpretation, European integration is therefore presented as part of Germany's "grand strategy" for dominating Europe without resort to the use of force or overt coercion (Pedersen 1998: 3, *passim*).²⁸

A Realist intergovernmentalist account of institutional change in the EU thus starts from national interests, the sources of which are not a matter of systematic theoretical interest,²⁹ and focuses on the negotiations among governments (see top portion of Figure 4). The "low politics" issues of regulating competition and merger review might be delegated to the Commission if there is a harmony of interests, i.e., if supranational regulation of competition and mergers were somehow seen as strictly positive-sum.

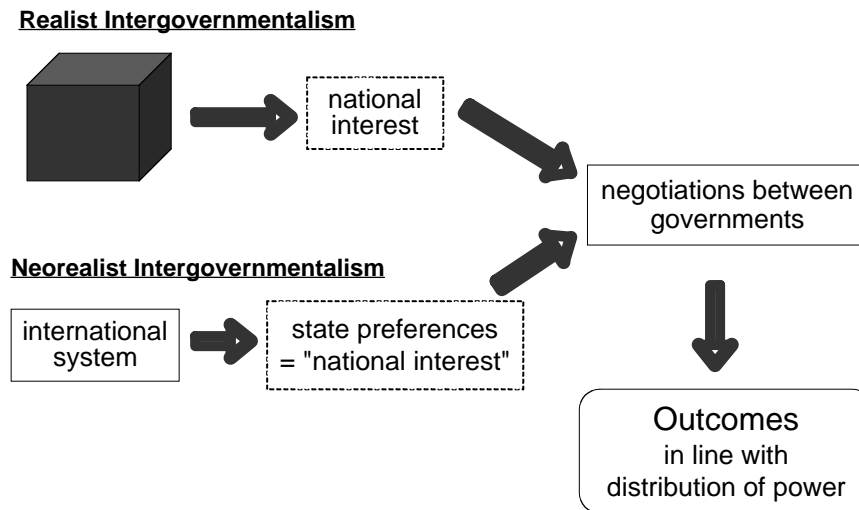


Figure 4:
Institutional Change in Realist & Neorealist Intergovernmentalism

²⁷A strictly limited pooling of sovereignty, which advantages weaker states, might also be agreed by the strongest state if it serves to forestall balancing against it (Garrett 1993: 115f).

²⁸To render the grant of authority to the EU compatible with the Realist premise that states will resort to balancing if faced with an attempt to dominate them, Pedersen argues that Germany, the "comparatively weak big power with an exposed geopolitical location," has acted as a "cooperative hegemon" (1998: 39, 37; Germany, of course, also is associated with a recent historical experience that tainted the option of controlling the continent coercively...). Such a cooperative hegemon induces a voluntary transfer of authority by other states to the (seemingly) supranational institutions through a "strategy [of] reducing anxiety amongst its neighbors." That strategy consists of making side payments or offering to share power in certain, low-politics issue areas with those willing to "accept the hegemon's leadership" (1998: 55f). A special (though clearly secondary) position is reserved in Pedersen's model for the "great power in decline," France (1998: 37), and the UK and Italy are inductively recognized as having enjoyed "occasional leadership" status (Pedersen 1998: 195f). The acceptance of this arrangement by "minor member states" is simply recognized as a theoretical and empirical "problem" (1998: 201f).

²⁹The nation-state or, more precisely, the process of defining national interests is therefore depicted as the proverbial "black box" in Figure 4.

Otherwise we should observe delegation of authority to the Commission only if such delegation is sought by the most powerful member-states and therefore becomes the outcome of the negotiations between the governments. This implies that a grant of antitrust and merger review authority to the Commission should be circumscribed by rules according to which the "major powers" in the Council may veto Commission decisions in this area (ensuring member-state control through a formal intergovernmental mechanism). Alternatively, we should observe actual merger review decisions to reflect the preferences of the member-states weighted by their relative power (indicating the effectiveness of some informal mechanism of intergovernmental control).

Given that institutional change here requires prior negotiations between governments, we should find the Commission exercising effective authority only after such authority is explicitly delegated to the Commission by the member-states (where effective means that its decisions are obeyed by economic actors even in states whose governments oppose the particular decision). Traditional realist intergovernmentalism's emphasis on national distinctiveness also leads us to expect that states will guard their national sovereignty jealously, so that they will seek to reclaim regulatory authority promptly in the event that it is informally absorbed by European supranational institutions.

3.2. Structural Realist ("Neorealist") Intergovernmentalism

Structural Realism may be said to make no predictions regarding European integration, given that it is a theory about the relationship among the great powers under conditions of anarchy, which—according to Kenneth Waltz (e.g., 1996)—makes no prediction about foreign policy (though cf. Elman 1996). Joseph Grieco has nonetheless suggested that neorealism might be adapted such that it makes predictions about European integration, during and after the end of the Cold War. Grieco emphasizes two assumptions, namely, that states are the only significant elements of the international anarchic structure, and that states remain concerned first and foremost about their safety and independence and therefore about relative gains. Retaining these assumptions, he suggests that "weaker but still influential" states—i.e., France, Italy, and (post-1972) Britain in the EC context—will seek to organize cooperation on matters of mutual interest through institutions whose rules "provide sufficient opportunities for them to voice their concerns and interests and thereby prevent or at least ameliorate their domination by stronger partners," i.e., Germany (Grieco 1995: 34). This benefit might explain the interest of some countries in increasing majority decision making in the Council or delegating authority to the European Commission, Court, and Central Bank (ECB). The strong and potentially dominant state (Germany) would agree to such an arrangement if it can enshrine its own policy preferences in those institutions (such as the anti-inflation bias written into the statutes of the ECB) and/or if an external challenge (such as from Japan in the 1980s) renders it more important for the regional hegemon to foster regional economic cooperation than to retain formal political independence (Grieco 1995: 38).³⁰

³⁰Empirically, Grieco also attributes German acceptance of European integration in part to its domestic institutions.

This reformulation of neorealism suggests several testable hypotheses regarding EC competition authority.³¹ If we observe any delegation of authority for antitrust enforcement and merger control to the Commission as the outcome of the negotiations between governments (lower portion of Figure 4), it should be favored and advanced by France, Italy and Britain, and the grant of authority should enshrine German government policy preferences on these matters. Moreover, German influence should increase over time, as Germany has become economically and politically stronger vis-à-vis France, Italy and Britain since the 1950s, though the objective of fostering a competitive and truly common market might also have become more important over time as other regions (Southeast Asia, maybe NAFTA) became more serious multinational economic competitors. Specific merger review decisions might be expected to be favorable first and foremost to the interests of German firms and, secondly, to the interests of French, Italian and British firms. The economic interests of the smaller member-states should play little role in the institutional development or in the decisions of DG Comp.

3.3 Liberal Intergovernmentalism

Liberal intergovernmentalism is "liberal" in that it rejects realism's assumption that the analysis of world politics must start from the distribution of power among states but instead considers the interests of individuals and groups *within* states as the necessary starting point for the analysis of developments in world politics, such as European integration (e.g., Bulmer 1983; Wallace 1981; Moravcsik 1997). Moreover, these individuals and groups will be primarily concerned with the economic effects of integration, because they experience them directly and immediately, whereas geopolitical effects are indirect at best (Moravcsik 1998: 50). At the same time, the approach remains "intergovernmental" because it assumes that individuals and groups seek to influence institutions and outcomes above the national level *only through their own domestic political institutions*. Domestic politics (as an essentially closed system, devoid of transnational politics) thus determines the "national interest" for the "nation-state, which acts externally as a unitary and rational actor on behalf of its constituency" (Moravcsik 1998: 22).³²

When the national interest calls for cooperation with another state, governments seek to establish such cooperation through an intergovernmental bargain (the only analytically pertinent form of *political* interaction across borders). The outcome of these bargains is, for liberal intergovernmentalists, a function of the relative power of the countries involved in the negotiations; institutional change in the EU should therefore come about if it is the conscious choice of

³¹One might question whether the argument remains consistent with the core Realist argument that institutions have no effect in shaping the interests or constraining the actions of states beyond the coinciding distribution of power (see Mearsheimer 1994/95), but that issue is beyond the scope of this paper.

³²Notwithstanding its emphasis on domestic politics as the source of the "national interest," liberal intergovernmentalism's *theory* of domestic politics remains largely implicit and surprisingly underdeveloped. While recognizing other groups as sometimes politically salient, Moravcsik focuses almost exclusively on industry/producer groups, which he sees as the organized groups with the most concentrated, clearest and, often, intensely held preferences over economic matters. Standard assumptions of political economy then suggest that the national interest will be a function of the preferences of these groups, weighted by size and by the extent of the expected gains or losses (1998: esp. 36, 39f, 50). Yet, since transnational politics have been assumed away, the "national interest" that results from domestic politics can be safely inferred from the (preferably private or internal) statements and documents of political leaders (similar to Krasner's (1978) strategy, though Moravcsik goes to considerable lengths to show that there were indeed domestic industries supporting the government's position).

the member-states that prevail at the bargaining stage (Figure 5). Unlike realist intergovernmentalists however, liberal intergovernmentalists see relative power in economic matters not as a function of military resources but of "asymmetrical policy interdependence," which may vary across issue areas, because it is based primarily on "credible threats to veto, [to] exit, [or to] exclude other governments as well as, secondarily, linkages between issues and offers of side-payments" (Moravcsik 1998: 52, 60ff). Nonetheless, it is assumed that examining the preferences and inter-state politics of Germany, France and Britain (only) is sufficient to understand and explain the EU and the process of European integration.

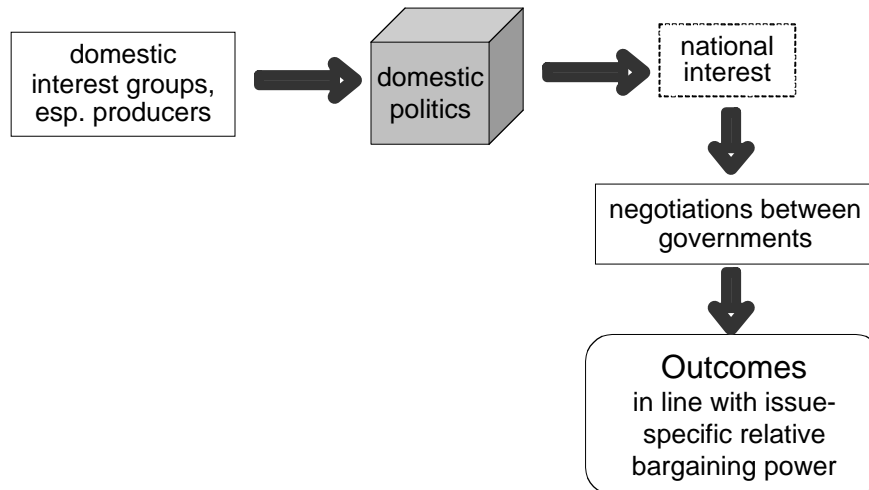


Figure 5: Institutional Change in Liberal Intergovernmentalism

In this context, governments may choose to pool sovereignty (by agreeing in advance that decisions in a particular issue area will be taken by majority vote rather than requiring unanimity), or they may delegate authority partly or entirely to the supranational institutions (primarily the Commission and the Court). Governments may do so to make credible commitments on issues where technical or informational complexity makes the writing of complete contracts practically impossible, and the overriding objective of assuring lasting policy coordination outweighs the risk of being "outvoted or overruled on any individual [future] decision" (Moravcsik 1998: 73, 75). Alternatively, they may delegate authority to obscure political responsibility or shift blame for unpopular policies that they consider nonetheless necessary to pursue (1998: 74); to gain leverage vis-à-vis domestic interest groups in typical two-level games fashion (Moravcsik 1994); or to gain various other benefits of delegation identified in the principal-agent literature (see Pollack 1997; 2003). Since governments seek to retain tight control, however, we should expect them to *delegate* only the implementation of, and oversight over compliance with, rules and laws on which they have themselves agreed in considerable detail (Moravcsik 1998: 76).³³

³³Rule-making powers are expected to remain intergovernmental, though QMV might be agreed for clearly delimited issue areas.

3.4. Intergovernmentalist Predictions Regarding EC Competition Authority and Merger Review Decisions

Notwithstanding their important differences, all three intergovernmentalist approaches make quite similar predictions. Any significant increase in supranational authority should occur only if—and after—the largest member-states agree on such a change in an intergovernmental bargain (potentially upon German prodding and in exchange for side payments). If delegation takes place, we should expect the Commission's decisions regarding particular mergers to reflect the distribution of power among the member-states, possibly via fairly detailed rules that can be straightforwardly applied. Attempts by the Commission to increase its authority or otherwise deviate from the preferences of the member-states (weighted by the distribution of power among them) should be reined in quickly. Consequently, specific merger review decisions should depart from member-state preferences only rarely and exceptionally, unless there is (at least among the most powerful member-states) unanimous agreement at the time of institutional creation that real delegation of power is needed to achieve the gains from cooperation in a strictly positive-sum issue area.

4. Development of EC Competence for Antitrust and Merger Review, 1955 - 2004

The Treaty of Rome devoted articles 85 through 94 to ensuring undistorted competition in the envisioned common market. The key articles for antitrust matters involving private firms were articles 85 through 87 (re-numbered articles 81 through 83 by the Amsterdam treaty revision of 1999). Article 86 established the principle that the EC could and would intervene against "any abuse ... of a dominant position," i.e., anticompetitive behavior by a "dominant" firm (now: firms), including distortion of supply and dumping products in order to bankrupt competitors. More controversially, article 85 established that (1) agreements or decisions that have as their "object or effect" the "prevention, restriction or distortion of competition" are prohibited; (2) any such measures are "automatically void" (and any such contracts therefore unenforceable); and (3) exceptions can be granted if an agreement advances technological or economic "progress" without substantially reducing competition. These articles also assigned to the Commission the task of ensuring compliance with these competition rules—subject to secondary legislation in the form of EC "regulations or directives," for whose initial adoption article 87 gave the Council of Ministers three years.

We provide in this section two narratives of institutional change in the EC from the 1955-1957 "Messina" negotiations that resulted in the adoption of the above articles in the Treaty of Rome to the most recent institutional changes in 2004. The first narrative illustrates the possibility of telling the story of EC merger review authority in intergovernmentalist terms, emphasizing the preferences of the member-state governments in negotiation with each other. It leads us to see important elements in that process but, to remain consistent with the theoretical model, does not explain changes in governments' preferences and must omit important parts of the history and politics of EC merger review. The second narrative, based on the modified neofunctionalist model presented in this paper, will then not only offer a richer account of that history, but also show that neofunctionalism provides—in a Lakatosian sense—a better explanation of the politics of institutional change in the EC. While such a use of alternative narratives—in the tradition of Graham Allison (1969)—may be problematic in some respects (Büthe 2002:

489), the lack of a comprehensive intergovernmentalist account of EC competition policy in the existing literature³⁴ warrants this approach to allow the reader a comparative assessment.

The other substantive area ... where Germany succeeded in imposing its view [in the Treaty of Rome] was competition (antitrust) policy. – Andrew Moravcsik 1998: 149

The story of the 1989 Regulation is one of twelve states' struggle to keep the merger control tool from Brussels, mixed with nominal devotion to the virtue of a common policy.
– Ethan Schwartz 1993: 610

4.1. Institutional Change I: An Intergovernmentalist Narrative

The Treaty of Rome was broader than the Treaty of Paris, which had established the ECSC, in that it applied to all industries. The powers given to the supranational Commission over antitrust matters, however, were narrower than the powers that had been granted to the High Authority in the coal and steel sectors. In particular, the Treaty of Rome did not explicitly establish the authority to review, restrict or prohibit mergers, which had received prominent treatment in article 65 of the Treaty of Paris (Gerber 1998: 339-342; Gillingham 1991: 282f, 313f). And the omission of this topic was hardly accidental (Gerber 1998: 361; Goyder 2003: 25ff, 335). West European economic recovery and the restoration of German "semi-sovereignty" in 1955 reduced U.S. influence, which had accounted for much of the strong antitrust regime in the ECSC (Gillingham 1991: 110f, 173). Consequently, the EEC approach to regulating or safeguarding competition among private firms in the market economy was limited to the lowest common denominator of the largest member-states' preferences – which can be inferred from their domestic policies: France had passed antitrust legislation in 1953; Germany in 1957. Although "acceptance of the competitive market concept was considerably less pronounced" in France than in Germany (Dumez and Jeunemaître 1996:219), the legislation in both countries created specialized agencies with some autonomy to investigate abuses of monopoly positions and cartels, but no power over mergers, which most governments saw no reason to regulate at the domestic or at the European level (e.g., Bulmer 1994: 429; Quack and Djelic 2005: 266). Competition policy hardly evoked great passions as a threat to national identity (see Hoffmann 1966 and discussion above) and was a limited, technical domain in which "a large number of smaller decisions over an extended period of time" made mutual commitment to the consistent application of agreed-upon rules the overriding objective (Moravcsik 1998:76). Integration was therefore easy, even though the six governments differed on some details. The German government "favored the pooling or delegation of sovereignty in ... competition (antitrust) policy" because consistent EC-wide enforcement of antitrust rules would favor German industrial interests; it promoted "an EC competition policy modeled on its own" and in the late stages of the negotiations for the Treaty of Rome "succeeded in imposing its view" on others (Moravcsik 1998: 90, 149, 204).³⁵

³⁴Schwartz (1993) provides a detailed intergovernmentalist account of merger review, but focuses almost exclusively on 1973-1989.

³⁵The main opponents of strong EC antitrust policy were France and Italy, although strong economic performance notably eased the concerns of French industry in the late 1950s (Moravcsik 1998: 154, 181).

While some in the newly created Commission might have hoped soon to use their new antitrust powers to stimulate market competition (Hentschel 2002: 279; Manow, Schäfer, and Zorn 2004), the first three years of the EEC passed without the Council even drafting the enabling regulation. Advocates of European antitrust authority, including Commission President Walter Hallstein, were forced to sit it out. Under the terms of the treaty, the Commission was allowed, at the end of three years, to submit proposals on competition policy to the Council. However, those proposals only succeeded, when they did, in the intergovernmental Council of Ministers because they had been "previously or simultaneously initiated by the most interested national governments" (Moravcsik 1998: 233). Even then, German support was, in the face of French objections, "insufficient to generate more than marginal progress" (Moravcsik 1998: 184, 218). When the famous "Regulation 17" was finally passed in February 1962 (Council 1962), it nominally provided for a strong antitrust regime, but hardly gave rise to a burst of antitrust activity.

During the remainder of the 1960s, the Commission remained loath to enforce articles 85 and 86 stringently, since the few attempts it made to do so "sparked considerable criticism in France, Germany, and Belgium over what was considered an unduly strict application of EC law" (Moravcsik 1998: 219). The member-states, especially the largest ones, continued to exercise control in formal and informal ways. Low budget allocations ensured that DG IV was understaffed to keep up with the rapidly growing amount of transnational mergers, acquisitions, and market integration (Goyder 2003: 531). At the same time, the preeminence of the most powerful member-state was institutionalized by the "unwritten rule" that the Director General of DG IV was to be a German national (Wilks with Bartle 2002: 165). The Commission's memorandum of 1966, which implied a broadening of Regulation 17 to give DG IV the right to apply article 86 to mergers, went nowhere.

Indeed, proposals for European supranational merger review consistently failed in the Council throughout most of the 1970s and 1980s as long as the member-states had no interest in delegating such authority to the Commission. A December 1971 Commission decision (without Council support) to prohibit the acquisition of the Dutch manufacturer Thomassen & Drijver-Verblifa (TDV) by its German competitor Schmalbach-Lubeca (SLW, itself owned by the U.S. Continental Can Company) was immediately challenged by SLW in the European Court of Justice. The ECJ overturned the Commission's decision in 1973 (*Continental Can*, ECJ case no. 6/72, 1973 ECR 215). While it acknowledged that DG IV had antitrust authority over market-dominant firms—and therefore implicitly also over their bids to acquire or merge with a competitor—the ECJ did not speak to the question of whether or not the Treaty of Rome gave the Commission authority to regulate mergers in general.

Having failed to win authority for merger review from the ECJ, the Commission started in October 1973 to put forth a series of proposals to the Council for a new or revised regulation to establish merger review authority for DG IV. The member-states were unable to reconcile the differences in their approaches to competition policy (Allen 1977), and "several ... did not want to cede any authority to the Commission" (Schwartz 1993: 624). In general, many European governments continued to view mergers as desirable throughout the 1960s and into the 1970s, not least to allow their firms the same benefits of scale as their often much larger U.S. (and, increasingly, Japanese) competitors in international markets (Dumez and Jeunemaître 1996: 223f, 232; Shonfield 1965: 376). The U.K. and Germany had just established, in 1965 and 1973 respectively, merger control authority at the national level (with many exceptions and with the pro-

vision that allowed the Secretary of Trade and Industry and the Bundeswirtschaftsminister, respectively, to override the competition authority's decisions, see Baake and Perschau 1996: 135-138, 142ff; Drahos 2001: 260f; Wilks with Bartle 2002: 158-160). They were therefore unwilling to cede this power to an independent European agency; other member-states were uninterested since they had not yet even recognized any need for a merger review authority at the domestic level (Bulmer 1994: 429). Revised Commission proposals for European supranational merger review in 1981/82, 1984, and 1986 similarly failed to gain member-state approval (Bulmer 1994: 430; Goyder 2003: 337f; Schwartz 1993: 624-638), and the related treaty provisions remained unchanged in the 1985 revision known as the Single European Act.

At the same time, member-state preferences *did* change in the course of the 1980s. Germany, France and Britain all made their competition authorities more independent, and some of the smaller member-states did the same or created antitrust and merger review authorities for the first time. Having thus effectively lost the power to intervene in the market by denying or granting mergers for political gain (Dumez and Jeunemaître 1996: 224-228), governments had few reasons not to transfer part of this authority from the domestic to the European level. They did so by passing Regulation 4064/89 (the "Merger Regulation") in December 1989. This regulation explicitly provided for a review by the Commission of all mergers of firms above a certain threshold and with substantial sales in the EC. Whatever the reason might have been for the change in member-state preferences,³⁶ it was only after the major member-states had changed their preferences and institutionalized them at the national level that the powers of merger review at the European level were granted to the Commission in Regulation 4064/89 (e.g., Gillingham 2003: 253).

In the 1990s, largely satisfied with the arrangements they had made for the regulation of anticompetitive behavior, the member-states left the treaty provisions for antitrust and merger review mostly unchanged in the treaties of Maastricht, Amsterdam and Nice. A revision of the Merger Regulation (Council 1997) introduced only minor changes.

The late 1990s then saw an explosive increase in merger activity in the EU (and beyond). Partly as a consequence of this increase, the number of mergers rejected by the Commission increased rapidly in the later 1990s and early 2000s.³⁷ Whereas the (in)famous *deHaviland* merger had been the only one blocked by DG Comp between the adoption of the Merger Regulation in 1989 and the end of 1993, DG Comp had blocked ten mergers by the end of 1998, and eighteen by the middle of 2002 (F. McGowan 2000: 137; Bergman, Jakobsson, and Razo 2003: 7; Ross 1994: 176ff). Many of these decisions went against German, French and British firms, who complained

³⁶There may have been a broader ideological shift toward neoliberal ideas underway across Europe or even globally in the 1980s and 1990s (Blyth 2002; McNamara 1998), contributing to a change in government preferences for strengthening EC antitrust and merger review. Schwartz offers several other reasons for the change in government preferences to explain the adoption of the Merger Regulation in the Council in 1989. These reasons include German unification (1993: 652); the demand from firms and the desire of governments to keep other EC governments from using their national competition authorities in ways that would bias mergers in favor of those other governments' domestic firms (1993: 645-649); the perceived need to show that they were doing something about the issue, even if only creating a hollow authority (1993:650); and the French desire to show progress on a range of issues over the six months during which France held the EC presidency (1993: 651f).

³⁷As did the number of mergers that were "withdrawn," usually in anticipation of rejection or stringent conditions.

bitterly to their governments. In addition, DG Comp only rarely and at best "grudging[ly]" granted the requests of national competition authorities to transfer merger review authority to the member-state most affected by a given merger (Wilks with McGowan 1996: 253).³⁸ Contrary to member-states' earlier expectations (Pollack 2003: 285ff; Schwartz 1993), DG Comp appeared to have acquired in the 1990s real power and a willingness to exercise it without due regard for the distribution of power among the member-states. After increasingly expressing their unhappiness with DG Comp's application of the merger rules, the member-states in November 2002 and January 2004 repealed Regulation 17/62 and its revisions, as well as the 1989 Merger Regulation, and replaced them with a system that "decentralizes" antitrust and merger control, returning enforcement powers to the member-states (e.g., Dombey 2004).

The corporate uncertainty that was created, in part orchestrated by the Commission, resulted in ... an unstoppable alliance of the Commission, ECJ jurisprudence, corporate actors and their interest groups, together with support from the EP and Ecosoc, for the establishment of a clear set of supranational rules.
— Simon Bulmer 1994:432

4.2. Institutional Change II: A Neofunctionalist Narrative

The above narrative provides a parsimonious account of major institutional changes in EC competition policy, especially merger review, from the Treaty of Rome to the institutional reorganization of May 2004. It illustrates the possibility of telling the story of the broad patterns of this institutional evolution in intergovernmentalist terms, emphasizing the preferences of the member-state governments in negotiation with each other. It leads us to see important elements in that process—such as the lack of support for a strong antitrust and merger review regime in the 1950s, once the U.S. lost its initial post-WWII leverage. We submit, however, that it provides little insight into why the "national interest" pursued by the member-state governments changed over time, it must omit important events to remain consistent, and it gets crucial parts of the history and politics of EC merger review wrong. A neofunctionalist narrative, focusing on subnational and supranational actors, as well as their interactions, can account for the same broad pattern of EC institutional history, gets the details right, and provides a better understanding of the causal mechanism involved.

The Treaty of Rome was drafted and negotiated over two years in a series of committees of national policy specialists, delegated to these tasks by their governments. The negotiations coincided with the final years of the 1949-1957 "*Kartellschlacht*" in Germany, a sometimes vicious domestic political fight over antitrust legislation, in which industry groups repeatedly frustrated the attempts of Ludwig Erhard's ministry for economic affairs to get the legislature to adopt an antitrust law that was something more than a sham (Baake and Perschau 1996: 132f; Berghahn 1985: 152-179; 1986: 155-181; Djelic 1998: 228ff; Drahos 2001: 243ff). The fierce opposition to any German domestic legislation that would have meaningfully prohibited (and allowed for the breakup of) cartels, trusts, and similar anti-competitive arrangements was led by the *Bund der deutschen Industrie* (BDI, the umbrella organization of large manufacturing firms, see Berghahn and Karsten 1987: 14-16, *passim*) and supported by all but one organization of small

³⁸Such requests were allowed under article 9 of the 1989 Merger Regulation.

and medium-sized firms (e.g., Hentschel 2002; Quack and Djelic 2005:260f).³⁹ At the European level, these groups had vigorously opposed the antitrust provisions in the 1951 Treaty of Paris and had acquiesced to them only after U.S. High Commissioner McCloy threatened to impose de-cartelization directly on German industry if the provisions were removed (Berghahn 1986: 132-154; Gillingham 1991: 285f; Parsons 2003: 61). The BDI also strongly objected to the competition provisions in the (draft) Treaty of Rome in a detailed letter of March 8, 1957. Its opposition, however, came too late to result in changes in the treaty, which was signed in Rome on March 27, 1957. The opposition came too late for several reasons. The BDI expected the negotiations to fail, and there was a general lack of public attention to the technical details of the treaty (Groeben 2002: 12, 21). Most importantly, however, the government had consciously left industrial interests in the dark about the treaty negotiations until the last moment. Consequently, the BDI had too little time to formulate a common position on the numerous complex issues covered in the treaty and to orchestrate an effective lobbying campaign against the antitrust provisions (Küsters 1982: 427f).

Divisions within the German government and within the leading government party, the CDU, appear to have been the most important reasons for the government's attempt to avoid public debate of the specific provisions of the treaty during the negotiations (e.g., Müller-Armack 1971: 97-101, 110f).⁴⁰ The *ordo*-liberals within the CDU, such as Karl Böhm and Hans Ilau, for whom ensuring truly competitive markets through forceful antitrust regulation in the tradition of the *Freiburger Schule* was an article of faith, had strong sympathizers among many officials in the Erhard-led ministry of economics.⁴¹ At the same time, the CDU also had strong ties to industry and its organizations (such as the BDI), which sought to safeguard cartels and other arrangements that shielded producers from competition, though they generally supported free trade and the EEC as a means to ensure access to export markets (cf. Oswald 2001). Chancellor Adenauer was committed to advancing Germany's integration into the West via the EEC, but tended to side with industrial interests against liberal ideas; economics minister Erhard generally opposed plans for the EEC since he feared it would impede more general free trade arrangements, but he was committed to strong antitrust. It is unclear whether the antitrust provisions in the Treaty of Rome were demanded by Erhard in exchange for his tenuous acquiescence to the EEC project. But officials like Josef Rust, Franz Etzel and Hans von der Groeben clearly saw the negotiations over the treaty as a political opportunity to establish at the European level the competition and antitrust rules that they could not get through at the domestic level (Rust memorandum of April 18, 1955, reproduced in Groeben 2002: 66-71; Hentschel 2002: 279).

³⁹The sole association supporting antitrust legislation was the *Arbeitsgemeinschaft selbstständiger Unternehmer* (ASU), a relatively small organization of mostly independent entrepreneurs leading family businesses.

⁴⁰Those divisions were quite apparent to Germany's European partners; even the official German delegation to the treaty negotiations was far from acting "like" a unitary actor, i.e., speaking with a single voice on competition issues.

⁴¹Ordo-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. Few of the classic works in this tradition are available in English, but the key ideas of the main representatives of ordo-liberalism are summarized by Nicholls (1984).

In sum, key German representatives on the committees drafting the Treaty of Rome – perhaps most importantly Hans von der Groeben⁴² – clearly favored forceful competition and especially antitrust provisions. But German supporters of strong EC antitrust authority hardly took this position on behalf of German producer groups, as liberal intergovernmentalism would have us believe. Nor did they take this position because it was the unambiguous policy preference of the German government, as realist intergovernmentalists assume. Rather, this subnational group saw in the emerging EEC an opportunity to achieve political goals for which they lacked the necessary political power at the domestic level, just as neofunctionalism would predict.

Exclusive emphasis on Germany, however, would be very much misplaced. The French government was generally skeptical of antitrust provisions. French representatives on the treaty-negotiating committees therefore tended to oppose strict antitrust provisions and strong supranational enforcement, though there were conflicts of interest over this issue within France and divisions within the French government, too, and some might have expected that tough-sounding European rules could be safely adopted since they would not be enforced, as had been the domestic understanding in France since the passage of the 1953 French competition law (see Dumez and Jeunemaître 1996: 221). When asked to submit a proposal of their own, the French representative effectively proposed many of the arrangements that they had previously opposed (Küsters 1982: 364f, 419ff; Müller-Armack 1971: 114; Willis 1968: 253f, 262f). Contrary to the intergovernmentalist account, the Italian government cautiously supported the liberal approach to competition (Küsters 1982: 366). But perhaps most importantly, the government of Belgium, as well as the government of the Netherlands (cautious about political integration but a strong supporter of supranational governance of clearly specified realms, Harryvan 1992), strongly favored a tough antitrust and competition regime with strongly supranational enforcement (Milward 1992: 217f). The importance of the Dutch and Belgian position became apparent in December 1956, when Müller-Armack, speaking on behalf of the German government, suddenly suggested at this late stage of the negotiations that the treaty should only contain statements of intent on competition policy, without monitoring or enforcement power for EC institutions. It was the forceful insistence of Belgian and Dutch officials on powerful competition rules and institutions that allowed von der Groeben (as chair of the committee) to propose his compromise: delegation of authority to the Commission, based on the somewhat vague but comprehensive provisions that became articles 85-94 of the treaty (Groeben 2002: 17).⁴³ In sum, strong EC antitrust authority was not consistently the official policy preference of the internally divided German government. And German supporters of such EC authority got their way in the intergovernmental negotiations not because they could muster Germany's power but because they succeeded in building coalitions with the smaller member-states.

During the early years of its existence, the newly founded DG IV was a small, unremarkable part of a supranational administration that had to deal with a wealth of new issues arising out of the treaty (Goyder 2003: 31ff). Nonetheless, when the member-states failed within the three-year time frame specified in article 87 to take up writing the regulation that would specify DG IV's powers and procedures for enforcing articles 85 and 86, the Commission swiftly moved

⁴²With his French colleague Pierre Uri, von der Groeben co-authored the competition policy section of the Spaak Report and later chaired the committee in charge of the economic policy section of the treaty.

⁴³A German national, von der Groeben was at this point acting independently of the German delegation, because he was chair of the committee charged with finalizing the market provisions of the treaty.

to propose what became Regulation 17/62, effective March 13, 1962.⁴⁴ It gave DG IV the right to conduct extensive as well as, if necessary, invasive and unannounced investigations; it authorized the Commission to impose heavy fines and penalties for violations of articles 85 or 86; it obliged the member-states to cooperate and support all related work by the Commission—and it gave exclusively to the Commission the power to grant exemptions under 85(3) or to state (upon firms' request) that a given agreement, decision or practice was not violating articles 85 and 86 (see, e.g., Goyder 2003: 34-40). It thus gave the Commission real supranational power, 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 with Bartle 2002: 164).

Aware of the tenuous support for EC competition authority in some of the member-states, DG IV proceeded cautiously in the early years. It may even have seemed as if EC competition policy was just an exercise in declamatory politics, where regulatory governance is delegated to some agency in order to give to a certain constituency group the appearance of addressing the issue, while ensuring that little or nothing is done by the understaffed, divided regulator (Mitnick 1980: 335f; Wilks with Bartle 2002: 157). But even while it undertook few antitrust enforcement actions, DG IV was by no means passive. By the mid-1960s, it even turned its attention to the issue of merger control, which—unlike in the Treaty of Paris for the ECSC—was not mentioned in the Treaty of Rome as an issue over which the Commission had authority. DG IV established expert groups to study the applicability of article 86 to mergers (McLachlan and Swann 1967: 219ff) and commissioned a series of academic studies on whether and, if so, how it should carry out merger control under article 85 of the Treaty of Rome (Ritter and Braun 2004: 494). It thus began to foster a transnational community of legal experts with a special interest in EC competition law,⁴⁵ most of whom advised DG IV that article 85 must be applicable to mergers, given the overall thrust of the treaty and the article. In its 1966 summary report of the studies, DG IV nonetheless concluded that, for the time being, it would apply the article to mergers only under special circumstances (CEE 1966). Yet, it claimed for itself the power to apply Art. 86 to mergers that affected competition in the European market, "in spite of considerable doubts even within DG [IV]" (Goyder 2003:336; see also McLachlan and Swann 1967: 253f).

The Commission's claim to having authority over mergers was exercised—and challenged—for the first time when the Commission prohibited the acquisition of Dutch TDV by its German competitor SLW in December 1971. SLW's American parent, Continental Can Company, appealed this decision to the European Court of Justice in February 1972, arguing *inter alia* that the Commission had no authority to apply article 86 to this merger. In its 1973 decision (ECJ case 6/72), the court held that the overarching intentions of the treaty, especially article 3(1)f and the provisions in articles 85 and 86, logically required that article 86 should also be applicable to mergers in which a company increased its dominant position in a market (which was the ration-

⁴⁴Art. 87 explicitly provided for the adoption of the regulation by majority vote, should the Council fail to adopt the regulation unanimously within the first three years.

⁴⁵No systematic analysis has been conducted of the academics who conducted these studies; we strongly suspect, however, that some of them subsequently became important experts on EC competition law. And while there is so far no European equivalent of the Antitrust Law section of the American Bar Association (Laudati 1996:234), there is—fostered by DG Comp itself—a robust and growing legal community around DG Comp whose focus of work, interests and, maybe, loyalties are shifting away from the nation-state (e.g., Goldhaber 2002).

ale for the Commission decision). The ECJ thus advanced the cause of integration, having been given the opportunity to do so by the actions of private actors from several member-states, pursuing their private, commercial interests through shifting political activity to the supranational level. The court did so even as it decided against the Commission on the facts and let the particular merger proceed, since the Commission had in the ECJ's assessment failed to show that Continental Can Company held a dominant position in the relevant market (Goyder 2003: 336f, 534ff).

This judgment increased the Commission's explicit authority, though it did not fully clarify the scope of that authority with respect to merger review and did not establish a procedural framework for DG Comp's exercise of merger review powers. In 1973, the Commission therefore proposed to the Council a revision or addendum to Regulation 17, which would have explicitly delegated to the Commission the authority to review and block mergers based on the broad logic of articles 85 and 86. The proposal was an overt attempt by the Commission to increase its power vis-à-vis the member-states; it was recognized as such by the member governments (Allen 1977: 101ff; 1983: 224ff) and rejected, as neofunctionalism would expect. After several years of negotiations (and while the Council rejected revised proposals for a merger review regulation in 1981/82, 1984 and 1986), the Commission let it be known that it considered article 85 and 86 to be directly applicable to mergers.⁴⁶

In the meantime, private subnational actors responded to the new opportunity to pursue their own interests, created by the *Continental Can* decision. Most important for the evolution of EC merger review authority was the 1981-1987 attempt by several competitors to block Philip Morris's equity investment in Rothmans, which eventually led to the *Philip Morris* decision by the ECJ.⁴⁷ The episode has been widely understood as a major turning point in historical accounts of EU merger control authority (e.g., Bulmer 1994; Pollack 2003: 285-287), but warrants being recounted in some detail to clarify the crucial role of sub-state actors.⁴⁸ It starts with the high drama of U.S. tobacco manufacturer Philip Morris snatching, right from under the nose of its arch-rival R.J. Reynolds, an agreement with the secretive founder and main shareholder of the South African conglomerate Rembrandt, Anton Rupert, to acquire a large stake in cigarette manufacturer Rothmans (see Kinkead 1981).

⁴⁶Particularly outspoken on this point was Commissioner Sutherland, who threatened in various contexts that if the Council continued to fail to adopt a merger regulation, the Commission would proceed to full-blown merger review on the basis of its own interpretation of the applicability of articles 85 and 86 (see e.g., the excerpts from speeches reprinted in Advokaterne Bredgade 3 *et al.* 1988: 285ff).

⁴⁷The Commission intervened in several other mergers between the *Continental Can* case and the Philip Morris-Rembrandt/Rothmans case, albeit on the basis of Art. 86.

⁴⁸Most existing accounts focus nearly exclusively on the Commission and the Court. The analysis presented here was made possible in large part by research in the British American Tobacco Documents Archive, an electronic version of the Guildford Depository, established as part of the settlement of litigation brought by the State of Minnesota and Minnesota Blue Cross Blue Shield (<http://bat.library.ucsf.edu>). I reviewed 1,047 documents identified through a search for "Philip Morris' and Rembrandt" in the (still evolving) archive, which was searched between July 27 and August 11, 2006, when it contained 1,188,683 documents. The original sources are referenced for these documents whenever possible. Commission documents were obtained directly from the European Commission.

The \$350 million equity investment, which involved Philip Morris (PM) acquiring a large stake in Rothmans (widely seen as the first step in an eventual takeover)⁴⁹ was agreed on a handshake on April 22, 1981, and effected in subsequent months. It attracted immediate attention from financial market and competition regulatory authorities in the U.S., Canada, and Europe, where PM and Rothmans were major competitors in the already oligopolistic tobacco market. Within Europe, it was primarily the German domestic *Bundeskartellamt* whose investigation was seen as a serious potential threat to the deal, since PM and Rothmans jointly had more than 30 percent market share, as promptly pointed out by their competitors (BAT 1981; Mussey 1981). But U.S. and UK regulatory authorities soon cleared the deal as expected (FT 1981, de Zoete & Bevan 1981), and it became clear that the German regulatory authorities could probably do no more than prohibit managerial cooperation for the German market (Long 1982; Mussey 1981).⁵⁰ When they thus were unable to get regulatory authorities at the domestic level to block the deal, three of Philip Morris's major competitors—British-American Tobacco (BAT), R.J. Reynolds (RJR) and Reemtsma—turned to the European level.⁵¹

Separately, but in coordination with each other, they submitted to the Commission complaints about infringement of Articles 85 or 86 of the Treaty and formal applications for a full investigation by DG IV, which had previously shown little interest in the deal. Thus, it was sub-national actors in transnational coalition who demanded supranational governance of the PM-Rothmans merger and triggered the investigation of the Philip Morris-Rembrandt deal by DG IV, because it promised to allow them to advance their own narrow commercial interest (BAT 1982a, 1982b; Bulletin EC 3-84: 29f [point 2.1.43]). In May 1982, DG IV issued its initial assessment and indicated objections to some provisions of the Philip Morris-Rembrandt agreement, regarding management cooperation, voting share thresholds, etc. After Philip Morris and Rembrandt drew up a new agreement that addressed those objections in late fall 1983, the Commission effectively cleared the merger: in an Opinion of 22 March 1984, addressed to BAT, RJR, and Reemtsma, the Commission concluded that the revised agreement does not infringe EC competition rules. Closing the file, it thus rejected the competitors' request to block the equity investment altogether (Commission 1984, 1985: 81-83; Herrmann 1986). BAT and RJR then took the Commission to the ECJ in separate but subsequently joined cases, which were decided in November 1987.⁵² In its ruling, the ECJ sided with the Commission and affirmed its decision to let the equity investment under the revised 1983 agreement go ahead. But most importantly, the ECJ confirmed the general right of the Commission to apply article 85 (as well as article 86) to merger agreements and *to void any such contracts if they were found to violate the treaty*. It also ex-

⁴⁹PM acquired 22 percent of the shares but a much larger share of the voting rights in Rothmans, along with convertible debt and certain other rights. Various forms of cooperation in marketing and manufacturing were also envisaged.

⁵⁰The German cartel office did eventually try to block the deal, a decision that a superior court judge restricted to the German subsidiaries of the companies and the supreme court (*Bundesverfassungsgericht*) overturned altogether (Batchelor 1985; WSJ 1983).

⁵¹BAT's and RJR's roles became apparent from their later willingness to take the Commission to the ECJ for failing to block the PM-Rembrandt/Rothmans deal. Reemtsma's role is shrouded in surprising secrecy; most accounts, including EC documents only refer to a "third major tobacco manufacturer." Reemtsma is identified as that third competitor in contemporary news reports (see DT 1984).

⁵²The proper name of the joint case is "British-American Tobacco Company Ltd and R. J. Reynolds Industries Inc. v Commission of the European Communities," joined cases 142/84 and 156/84. It also is known as "the Philip Morris case."

plicitly extended that right to investment agreements that fell short of full mergers (see also Ritter and Braun 2004: 499f).⁵³

The ECJ thus held that the Commission already had the merger control authority that many member-state governments were unwilling to delegate to the Commission explicitly. In doing so, the ECJ sided with legal arguments for an expansive reading of the treaty, advanced by Philip Morris's competitors in pursuit of their own interests. At the same time, the judgment did not specify thresholds for EC jurisdiction and did not provide any guidance as to proper procedure. It therefore had the primary effect of creating great uncertainty among firms: any merger involving European firms or European commercial interests could now be prohibited *ex post*, but no procedure had been established to gauge whether a given merger might be affected or to get it cleared *ex ante* (Green 1987; Korah 1987). While some commentators emphasized that the case had only been heard and decided by a five-judge panel described as the "most junior chamber" of the court (Hermann 1987), the decision was immediately recognized by most observers as having momentous implications. A Council agreement in principle to pass a merger control regulation followed within days of the decision (Dawkins 1987), though the actual passing of the regulation did not occur until December 1989.

During the two years between the ECJ decision and the adoption of the Merger Regulation, it was again subnational actors (often acting in transnational coalitions) that kept up pressure on governments. Most importantly, companies planning mergers or acquisitions – including major corporations from Germany, France and Britain – began to notify the Commission of those intentions and ask them for review, in order to reduce the uncertainty hanging over reviews not cleared by the Commission (Bulmer 1994; Pollack 2003: 287). Firms thus accepted supranational merger control authority. This in turn gave firms economic incentives to demand supranational governance instead of, rather than in addition to, national governance (McGowan and Cini 1999: 179f). A classic example: when Siemens sought to acquire Plessey in 1988, it found that it had to notify merger regulators in France, Germany, Italy and the UK, in addition to the EC Commission (and four national authorities outside the EC, see Woolcock, Hodges and Schreiber 1991: 16). With the increase in merger activity in the later 1980s (largely in anticipation of the completion of the Common Market by 1992), companies became vocal supporters of a "one-stop shop" for merger approval/regulation throughout the EC. More and more "corporate actors [thus] joined the ... alliance for supranational regulation" (Bulmer 1994: 431; see also Dumez and Jeunemaître 1996: 233).⁵⁴ They began to lobby aggressively for the delegation of authority to the Commission, and they lobbied both directly vis-à-vis their national governments and indirectly through their domestic and transnational associations. UNICE, the European umbrella organization of national industry associations, led the lobbying campaign vis-à-vis the Council in Brussels with regular proposals and press releases from 1987 until eventual passage

⁵³The equity investment thus allowed never ended up leading to a full merger, although it appears to have been profitable: PM sold its 24.9 percent stake in Rothmans back to Rembrandt in late 1989, for \$860 million; ten years later, in 1999, it was ironically BAT that successfully took over Rothmans altogether; Commission clearance of the merger was said to have been "swift" (DPZ 1996; ET 1999; Taik 1989).

⁵⁴In fact, the German BDI, the key German industry association, had already since the early 1970s called for merger control to be instituted at the European level (if at all), rather than at the national level. However, it had not succeeded in shaping the "national interest" as pursued by the government (Drahos 2001: 259f).

of the EC Merger Regulation in 1989 (Bulmer 1994: 432f, 444).⁵⁵ As David Allen (1996: 171) summarizes the episode: "By a combination of luck and skill the Commission had managed to create a problem which the Council felt could be eased only by passing the legislation it had previously refused to consider." Yet, the Commission primarily provided a political opportunity; the change was driven first and foremost by the self-interested actions of subnational actors; their success in the Philip Morris case effectively changed the status quo (see also Pollack 2003: 297), and their transnational political coalitions in the aftermath of the ECJ decision were crucial in putting pressure on the Council and the member-states to pass the secondary legislation long sought by the Commission.

Regulation 4064/89, the so-called "Merger Regulation" (Council 1989) was adopted with unanimity in the Council in December 1989—despite the persistence of considerable difference among the member-states over several aspects of the regulation of mergers⁵⁶—and entered into force in September 1990. To carry out the now official merger control tasks, the Commission created a new unit within DG IV, the "Merger Task Force." This agency within the Commission was to carry out merger reviews for any merger of firms with a combined turnover of at least 250 million Ecu within the EC and at least 5 billion Ecu worldwide (lower than sought by Germany and Britain, though also higher than sought by the Commission, Bulmer 1994: 435).⁵⁷ Mergers in which all of the firms had more than two-thirds of their turnover in the same member-state would be excluded from DG Comp's jurisdiction and would be subject to domestic review.

In sum, in the course of the 1970s and 1980s, DG Comp successively acquired comprehensive merger review authority. This institutional change would have been perfectly consistent with intergovernmentalism if the member-states had weighed the trade-off between the loss of control that is inherent in delegating authority and the gain in economic efficiency expected from a rules-based merger review regime, and had then consciously decided in favor of delegation. Yet that is not what happened. The member-states did not delegate the power of merger review to the Commission, even when the Commission asked them to do so in 1973, 1981/82, 1984, and 1986. Though the increasing number of mergers in the 1980s increased the demand for their uniform regulation throughout the member-states without national bias (Neven, Nuttall, and Seabright 1993: esp. 163-213), some governments remained outright opposed to supranational governance of mergers with a European "Community dimension" until 1989. By the time the member-states "agreed" that the Commission should have the power of merger review (as specified in the 1989 Merger Regulation), the Commission had already acquired this power anyway. It had acquired supranational authority thanks to private, subnational actors who had calculated that they had a better chance of getting a competitor's merger blocked (as they wanted) if the EC had authority over merger review than if member-states did, and who therefore pushed for an application of EC authority in their favor—just as neofunctionalism would predict.

⁵⁵UNICE was founded in Brussels in 1958 as the successor to the transnational European industry association for the ECSC; see www.unice.org (accessed March 8, 2005).

⁵⁶For a detailed discussion of the positions of the national governments, see Pollack (2003: 287-291).

⁵⁷The Ecu was later renamed the Euro—the EC's accounting unit based on a basket of currencies, which existed long before a common currency. Mergers not meeting the turnover threshold could still be reviewed by DG Comp upon the request of any member state (Art. 22(3) of Regulation 4064/89).

The willingness of the merging firms' competitors, BAT and R. J. Reynolds, to take their case to the ECJ provided the court with an opportunity to assert that DG IV in fact already had the power of merger review, based on the doctrine of direct effect. The ECJ made this 1987 decision regardless of the fact that the member-states at the time did not agree whether or not they had granted DG IV merger review authority in the original treaty. Yet, given this shift in the status quo due to ECJ jurisprudence, there was no way for the member-states to reappropriate this authority as long as some member-states were in favor of supranational decision making on mergers. So the member-states did not reappropriate merger review authority and in 1989 gave in to demands from firms from across the EC to a merger regulation that clarified how this power was to be exercised. While Regulation 4064/89 was important, not least because it resulted in an increase in DG IV's resources, it mostly just formally assigned to the Commission powers that it had already acquired informally.⁵⁸

The 1990s then brought few further formal changes, but led to a consolidation and further increase in the scope of the Commission's power over mergers. The number of mergers notified to the Commission increased steadily, from twelve in 1990 to 150 or more per year by the end of the 1990s (McGowan and Cini 1999: 186). Private, subnational actors continued to play an important role. While From (2002) shows that the openness of the review process to input from third parties decreases as the review proceeds through the various stages to the final decision, competitors can drive that process from early demands for a full review to threatened or actual ECJ challenges of DG IV's decision to allow a given merger (Cini and McGowan 1998: 216f). The number of mergers on which DG IV delivered a negative verdict also increased during the 1990s, though in fact much more slowly than the number of cases before it (F. McGowan 2000: 137). The rarity of such decisions, however, should not be misread as a sign of political weakness. Rather, the Commission rarely has to block a merger because it usually is quite effective (and powerful vis-à-vis member-states) in getting merging companies to amend (or even drop) their merger agreement to address the Commission's objections well prior to the Commission having to give its final assessment. A 1993 study found that, even during the early years, about one-third of firms with a pending merger made some modifications in the terms of their merger agreements (including some "major" ones) as a consequence of their preliminary discussions with DG IV (Neven, Nuttall, and Seabright 1993: 140f). And the Commission's tendency to exercise power over mergers by getting merging companies to change the terms of a merger rather than by blocking it altogether has continued in more recent years.⁵⁹

In addition, the range of mergers over which the Commission has authority increased, albeit only modestly. Regulation 4064/89 had specified in Art. 1 what might be called a "finan-

⁵⁸While some EC member countries moved in the direction of independent competition authorities at the national level prior to the adoption of Regulation 4064/89 (Council 1989), this was part of a broader trend that continued *a fortiori* after 1989. In other words, the establishment of independent antitrust authorities at the national level appears to have at least in part *caused by*, rather than been the cause of, developments at the European level (Laudati 1996: 229). Italy and the Netherlands, for instance, have institutionalized antitrust and merger review authorities modeled on DG IV/Comp in 1990 and 1992-97, respectively (Gerber 1998: 408f; Drahos 2001: 373ff); and many of the countries that joined the EU in 1995 and 2004 have modified or in some cases created national practices and institutions to mirror those of the EU (e.g., Sweden in 1993, Gerber 1998: 411f; Czech Republic in 2001, Finland in 1998, Hungary and Poland in 2000; Verloop and Landes 2003: 105, 127, 225, 313). See Partan (1993) for a discussion of jurisdictional ambiguities *not* resolved by the 1989 Merger Regulation.

⁵⁹See, for instance, the examples discussed by Schumann (2003: 339-342).

cial size" threshold of Ecu 5 billion combined annual worldwide turnover and Ecu 250 million turnover for each of the merging firms within the EC. Mergers of firms above this threshold were considered to have a "Community dimension" (as long as no more than two-thirds of the merging firms' EC turnover was in a single member-state), which rendered them subject to Commission merger review, regardless of whether the merger itself was transnational. Regulation 1310/97 (Council 1997) expanded the possible ways in which a merger might attain a "European dimension," effectively lowering the threshold, as sought by the smaller member-states.⁶⁰

Starting in the 1980s and continuing in the 1990s, DG IV also increased its efforts to build a constituency among EU citizens through increasing consumer group involvement and outreach campaigns that explained the work and relevance of competition policy in layman's terms (e.g., European Commission 2000, Monti 2002). Moreover, it increased its efforts to build the kinds of transnational networks that neofunctionalism emphasizes. Very important among them was the "transgovernmental" (Keohane and Nye 2001 [1977]) network of competition regulators, both within the EU and internationally (Slaughter 2004: 21). Probably most important among the latter were the creation of the International Competition Network (ICN)⁶¹ and the 1991 transgovernmental agreement between DG IV and its U.S. counterparts at the DoJ and FTC, which appears to be part of a broader trend of transgovernmental regulatory cooperation (Slaughter 2004: 36).⁶² The U.S.-EU agreement sought to "promote cooperation and coordination and lessen the possibility or impact of differences between the Parties in the application of their competition laws" (Article 1). Despite continuing differences in philosophical approach, the institutionalized and informal cooperation that flowed from the agreement has been credited with resulting in "a growing convergence in the application of the policies of both Parties" (Jacquemin 1993: 99).

Within Europe, one of the early steps toward increasing regulatory cooperation was the 1982 conference at the German *Bundeskartellamt* on the occasion of its twenty-fifth anniversary, to which the *Bundeskartellamt* invited representatives from antitrust agencies across Europe (and the U.S.), and which led to a biannual symposium of antitrust agencies (Dumez and Jeune-maître 1996: 227). DG IV/Comp soon took the lead in this network, providing for information exchange and training opportunities, especially for the competition regulators from the member-states that had only recently created such institutions at the domestic level. This system of European regulatory cooperation or "informal governance in Single Market regulation" (Eberlein 2003) has recently been formalized on DG Comp's initiative as the European Compe-

⁶⁰The revision declared mergers to have a "Community dimension" when, alternatively to the above conditions, the merging firms' combined worldwide turnover is greater than Ecu 2.5 billion, the combined turnover of the merging firm is greater than Ecu 100 million in each of at least three member-states, the aggregate turnover of each of at least two of the merging firms in those three member-states is more than Ecu 25 million, and the aggregate Community-wide turnover of each of at least two of the firms is Ecu 100 million. In addition, EU enlargement in 1994 had effectively lowered the threshold by increasing the number of countries in which the cumulative EC turnover might be achieved.

⁶¹ICN, founded by a 2002 Memorandum of Understanding among the participating national and transnational competition agencies from now seventy-two countries and three regional-transnational groups, seeks to bring international antitrust enforcement "into the 21st century" by "enhancing convergence and cooperation" between its members (www.internationalcompetitionnetwork.org, accessed March 8, 2005).

⁶²The 1991 U.S.-EU agreement was followed in 1998 by another one, which went further in institutionalizing transgovernmental cooperation.

tition Network (ECN, modeled on the ICN), linking national competition authorities with DG Comp and each other.⁶³

In sum, through building transgovernmental and transnational networks, as well as consistently applying the formal rules of Regulation 17, DG Comp has over the years sought to create a "culture of competition" (European Commission 1999). Having had considerable success doing so, and facing ever greater demands on its resources due to the increase in merger activity and the expansion of its merger review tasks under the 1997 revision (Council 1997), DG Comp began in the late 1990s to seek institutional changes that would allow it to strike a better balance between the essential mission of antitrust enforcement, the Commission's resources, and the preferences for a one-stop-shop, so adamantly expressed by subnational actors.⁶⁴

The result was the so-called "Modernization Program," developed "pretty much without any external prompting"⁶⁵ by the Commission in a series of White Papers and Proposals (e.g., Commission 1999; 2000; DG Comp 2000) and adopted by the Council in Regulation 1/2003 in November 2002, followed by the revision of the merger review procedures in Regulation 139/2004 (Council 2003; 2004).⁶⁶ The core of the Modernization Program is a new institutional arrangement that continues DG Comp's control over competition policy throughout the common market by expanding DG Comp's coordination and oversight powers over member-state competition authorities, while decentralizing much of the enforcement of the common rules through a system of referral to and from those national competition authorities (see Ritter and Braun 2004: 530-544). The new Regulation 1/2003 requires domestic authorities and courts to enforce articles 81 and 82 of the Treaty of Rome, cooperate with DG Comp and other member-states' competition authorities (via the ECN or a mechanism like it), and notify DG Comp of national cases involving articles 81 and 82. It also encourages them (and at the request of DG Comp requires them) to notify DG Comp of antitrust cases that they review under national competition law, and it gives DG Comp the ability to intervene in cases brought by national competition authorities under Community law before national courts.

The implementation of merger control was revised separately, in Regulation 139/2004 (Council 2004).⁶⁷ This reform has been criticized for increasing the complexity of the review process, potentially allowing firms to forum-shop, and generally for "fail[ing] to improve competence allocation in EU merger control" (Budzinski 2006:140). Yet, given that the Commission

⁶³The ECN is discussed in greater detail by Wilks (2005b). An informal transgovernmental network of European competition regulators had existed for several decades, see e.g. Allen (1977: 96). Eberlein and Grande (2005: esp. 99ff) analyze "informal Europeanization" of policy through transgovernmental networks as feasible in issue areas where there is no formal shift of authority to the EU level (and thus explicitly in areas *other than* competition policy); we show that it also matters in competition, where it was in part orchestrated by the supranational institution as an actor.

⁶⁴Early proposals along these lines are noted by McGowan and Wilks (1995).

⁶⁵Not-for-attribution interview with EU Commission Legal Services official, April 20, 2005.

⁶⁶The reform of Regulation 17 under 1/2003 and concerns about the effect of decentralization of enforcement are discussed in greater detail, e.g., in McGowan (2005: 992ff), Nicolaïdes (2004: 613f); Riley (2003a; 2003b); Ritter and Braun (2004: 501ff); and Wilks (2005a).

⁶⁷Other, more informal changes internal to the Commission, such as the integration of merger review into DG Comp's industry-specific Directorates B through E and the strengthening of economic analysis with DG Comp have been long planned and by now at least in part been implemented (see Pons and Sautter 2004: 54ff).

had repeatedly used its power of merger control contrary to the express wishes of the largest member-states in the 1990s and early 2000s, Regulation 139/2004 may be noteworthy first and foremost for *not* bringing renationalization or a reduction of Commission authority. "Concentrations" that pass the threshold for a "Community dimension" may now be reviewed by national authorities, though only if the Commission decides to refer the matter to those national authorities. Such referrals require that (i) the merging or acquiring firm(s) make a reasoned request for national-level review prior to the formal notification, (ii) the national authorities agree to review the merger in question, and (iii) the Commission considers the national authorities "competent" (Art. 4(4)); and the referral remains at the Commission's discretion even if these conditions are fulfilled. Importantly, the threshold for mergers with a "Community dimension," over which the Commission automatically has supranational authority, was kept unchanged (Art. 1), which in effect lowers the thresholds further, as extant and ongoing firm and industry consolidation, economic growth and inflation continue to increase the financial size of mergers. In addition, the Commission was given the right to invite any affected member-state to request Commission review of mergers below the threshold, in which case the Commission may review the merger at its discretion even if other member-states would prefer national review (Art. 22, esp. 22(5)); and firms may request Commission review of below-threshold mergers, unless an affected member-state objects (Art. 4(5)). While puzzling from an intergovernmentalist perspective, these changes—which had been proposed by the Commission and supported by firms across the European Union—are consistent with neofunctionalist expectations in that they create further political opportunities for sub-state actors to advance their interests via increased EC supranational governance.

While there are some legitimate concerns about the uniformity of application (e.g., Mestmäcker 1999), the network of competition authorities discussed above and the extensive provisions for the uniform application of Community law and for institutionalized cooperation between DG Comp and national competition authorities (as well as among the national competition authorities) should minimize the risk of divergent practices across member-states (see Reg. 1/2003, Art. 11-15, 16, 22; Reg. 139/2004, Art. 19). Consistent judicial practice, in addition to administrative practice, is also made more likely by Commission sponsorship of training courses for national judges in EC competition law, to prepare them for the implementation and enforcement of EC competition law after the changes of 2003/04.⁶⁸ In sum, a closer look makes clear that the changes do not constitute a reappropriation of authority by the member-states, as it might seem from an intergovernmentalist perspective. Not only were these changes proposed by the Commission, they introduce "decentralization without renationalization" (DG Comp 2000). They should strengthen DG Comp's ability to arrive at thorough legal and economic assessments of antitrust cases and proposed mergers in a still timely manner (see Goyder 2003: 394f).

4.3. Key Differences Between the Two Narratives

Neofunctionalism, especially the modified historical-institutionalist variant presented here, emphasizes the *process* of change, rather than strictly separable moments of treaty (re)negotiation (see also Pierson 1996). At the same time, as historical institutionalist theories tend to

⁶⁸Such training courses are held, for instance, at the Centre for Competition Law and Policy at Oxford University, see http://www.competition-law.ox.ac.uk/competition/conferencedetail.php?events_ID=1032 (11/15/06).

do, it recognizes the special importance of "critical junctures" and focuses our attention on the importance of agency at those moments and on identifying these junctures precisely in the sequence of events (Hall and Taylor 1996: 937-942; Thelen 2003). This makes it possible to summarize the key differences between the intergovernmentalist and neofunctionalist narratives in Table 1, though the table does not substitute for a comparative reading of the narratives themselves. We discuss our reasons for preferring the neofunctionalist narrative in the conclusion.

Table 1: Narratives Compared

	Intergovernmentalist Narrative	Neofunctionalist Narrative
Establishment of supranational competition authority in the Treaty of Rome, 1955-1957	low-profile issue, Germany imposed its national interest on EC-6	transnational/-governmental coalition of German, Belgian, Dutch officials
Divisions within German gov.	omitted	emphasized
Limited antitrust activity in 1960s	due to government preference	due to limited resources; constituency-building to overcome/change government preferences
1973 Continental Can case	minor importance, given member-state governments' opposition to EC merger review authority	expands reach of DG IV competition authority based on general principles of Treaty of Rome
Open demands by Commission for explicit authority over merger review 1973, 1981, 1983, 1986	rejected due to divergent government preferences	rejected as overtly political attempt to increase power of supranational institutions
BAT/RJR v. Commission cases of 1984-87	omitted	critical in that ECJ expands the power of Commission by granting full-scale merger review authority when actions of self-interested subnational actors provide opportunity
1989 Adoption of Merger Regulation	major change due to change of government preferences	due to lobbying of transnational business coalition for legal certainty in implementation; largely confirmed already changed status quo
change of preferences 1989	exogenous	endogenous
1990s increase in DG Comp transnational constituency & transgov. competition network	omitted	emphasized
1990s merger reviews	attempts by Commission to extend powers against preferences of member-state governments	consolidation of Commission power & prestige in merger review
2003/04 Reforms (Council Regulations 1/2003 & 139/2004)	partial reappropriation of anti-trust and merger review powers by national governments	Commission-initiated reorganization to increase DG Comp effectiveness

5. Explaining Recent Controversial Merger Review Decisions

Intergovernmentalism, as any theory that leads the analyst toward taking snapshots of a macro-historical process, may have difficulty explaining institutional change (Büthe 2002; Pierson 1996; 2004; Steinmo, Thelen, and Longstreth 1992). The process of change in the antitrust and merger review authority of DG IV/Comp might therefore be a difficult phenomenon for intergovernmentalism to explain. Specific merger review decisions, by contrast, should be easy to explain for intergovernmentalism, especially when they are politically contentious, which strengthens intergovernmentalists' expectation that the Commission will act in accordance with member-state preferences.

We examine two such decisions—in the Boeing–McDonnell Douglas merger and the GE–Honeywell merger—which should be especially hard cases for neofunctionalism. While two cases cannot provide conclusive evidence, they constitute a serious test of the competing theories. Both of these high-profile cases involved a proposed merger between two U.S. companies with significant business in Europe. In both cases, European governments appeared to be largely unified in their position. The common position of the governments means that, under intergovernmentalist assumptions, the Commission should definitely act in accordance with the clearly stated preference of the member-states.⁶⁹ And the high level of politicization should make these merger review decisions easy cases for intergovernmentalism and hard cases for neofunctionalism.

5.1. The Boeing–McDonnell Douglas Merger

The main events in the merger between Boeing and McDonnell Douglas can be summarized briefly.⁷⁰ On December 15, 1996, the two companies announced that they had reached an agreement under which Boeing would acquire McDonnell Douglas, in a transaction valued at U.S. \$13.3 billion (Boeder 2000: 140; Boeing 1996). The merger was to create a company of substantial economic and political importance, particularly to the United States, where both companies were important defense contractors and their combined revenues for 1996 were equivalent to about 0.5 percent of GDP (www.bea.gov, accessed March 19, 2005). According to the Federal Trade Commission, the merger “appear[ed] to raise serious antitrust concerns” (FTC 1997): at the time, Boeing was the largest provider of aircraft in the world, and McDonnell Douglas its largest American competitor (Kovacic 2001: 815). The merged company would be the “largest integrated aerospace company in the world” (Boeing 1996), with a combined market share in the global market for commercial aircraft (based on 1995 numbers) of 70 percent (Kovacic 2001: 815). It was thus going to dwarf its nearest competitor—the European conglomerate Airbus—by more than two times. Boeing and McDonnell Douglas notified the U.S. Federal Trade Commission (and the DoJ) of their intentions on January 29, 1997, and the EU’s DG-IV on February 18, 1997 (Kovacic 2001: 817).⁷¹ On February 28, the FTC responded with a request for additional

⁶⁹As a consequence, the cases do not allow us to test arguments about the relative power of different member-states.

⁷⁰For detailed accounts, see, e.g., Devuyt (2001: 141-146) or Kovacic (2001).

⁷¹Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, companies had to notify both the FTC and DoJ Antitrust division of a merger agreement, and the agencies would work out between each other who would lead the investigation on behalf of the U.S. government (now governed by the 2002 inter-agency understanding: <http://www.ftc.gov/opa/2002/03/clearance.htm>, accessed March 19, 2005). In the Boeing-MDD case, the FTC took the lead.

information (an expanded investigation); based in part on information exchanged with their American counterparts, the case officers at DG IV followed suit on March 19.

The merger was understood to represent as substantial threat to Airbus, Boeing's largest and only global competitor and a major supplier of military hardware to European governments (Kovacic 2001: 811ff; USTR 2004, ¶14-21). A state-owned enterprise and important employer, heavily subsidized by EU member-states, Airbus was of immense political and strategic importance to the governments of Germany, France, the UK and Spain. Airbus executives aggressively lobbied the Commission to block the deal or require major divestitures (Pearlstein and Swardson 1997: 13; Boeder 2000: 142). Governments of several large member-states lobbied DG IV to reject the merger outright, and some called for it publicly (Swardson 1997). French President Chirac made it clear that he wanted "to see a very firm line followed on this issue, which we consider crucial for European interests" (Chirac quoted in Pearlstein 1997). The U.S. government also attempted to exert political pressure, with both President Clinton and Vice President Al Gore making clear in public statements that they wished the merger to be cleared by DG IV, and threatening economic retaliation if it were blocked (Andrews 1997; Field 1997; Mitchell 1997). The European governments, however, seemed unwavering in their opposition.

Upon close review of the case, the U.S. FTC granted clearance of the merger on July 1, 1997. DG IV similarly conducted a close review, in the process remaining "in close contact" with its U.S. counterparts through the transgovernmental network described above. DG IV and the FTC continued "to exchange viewpoints and analysis," despite some differences (Devuyst 2001: 143). DG IV held several hearings on the proposed merger in May and June and issued objections that it asked be addressed through changes in the merger agreement. Those remedies were designed to reduce the likelihood that the merger would lead to greater market distortion. DG IV came close to rejecting the merger, after Boeing initially thought that U.S. political intervention "would enable it to ignore the essence" of DG IV's objections (Devuyst 2001:144). At the end of July, however, Boeing offered changes in the agreement in response to the Commission's demands, and DG IV allowed the merger to go forward, subject to the implementation of those changes (Kovacic 2001: 817-839, 852ff).⁷²

5.2. The General Electric-Honeywell Merger

The main events of the attempted merger between GE and Honeywell are also quickly told.⁷³ General Electric and Honeywell, two U.S. companies, entered into a merger agreement on October 22, 2000. As required, GE and Honeywell notified U.S. antitrust authorities of their intent to merge in October 2000. The U.S. Department of Justice (DoJ) took the lead in the merger review. Four months later, in February 2001, the companies officially notified the European Commission (Schmitz 2002: 364). In March of 2001, DG Comp notified GE and Honeywell that it would undertake a "phase two" review. Only 5 percent of proposed mergers are subject to this review, which involves much more detailed scrutiny of the proposed merger but does not in itself indicate that the Commission is leaning toward rejection (Schmitz 2002: 364).

⁷²The conditions were significant but at no point appear to have caused Boeing and MDD to reconsider their merger.

⁷³For detailed accounts, see e.g., Monti (2001) Schmitz (2002).

Close scrutiny of the merger was to be expected, arguably even more so in the U.S. than in Europe: had the GE-Honeywell merger gone through, the joint company would have had annual revenues of about US\$155 billion dollars (Monti 2001), equivalent to approximately 1.6 percent of U.S. GDP, in 2000 (U.S. economic figures from www.bea.gov, accessed Dec. 2003). Their combined profits for 2000 were approximately US\$41 billion (General Electric 2003; Honeywell International 2003). Without taking into account the expected cost savings from the merger, their profits thus accounted for approximately 5.6 percent of total U.S. corporate profits in that year (www.bea.gov). In sum, these were nontrivial companies in the U.S. economy, and their merger was viewed with unease by fellow U.S. corporations such as United Technologies and Rockwell.⁷⁴ In Europe, the merger had the potential of affecting European companies across a range of industries (such as Rolls Royce in aircraft engines), since both GE and Honeywell were diversified multinationals. At the same time, it did not constitute an obvious threat to more than a few, if any, particularly prominent European companies, and certainly not a threat to any firm recognized as a "European champion." Yet, whereas the U.S. DoJ cleared the GE-Honeywell merger subject to certain conditions on May 3, 2001, DG-Comp provided GE and Honeywell with a detailed statement of objections to their proposed merger on May 8 (Schmitz 2002: 364). U.S. political leaders and officials, including President Bush himself, then repeatedly raised the issue with their European counterparts and called for approval of the merger (Fidler and Hargreaves 2001; Seiberg 2001). Unlike in the Boeing case, there were no indications that European political leaders or national competition authorities lobbied DG Comp to block the deal.

Following intense negotiations between DG Comp and GE on possible remedies (Elliott 2001; Monti 2001), GE rejected the remedies proposed by DG Comp. On July 3, 2001, DG Comp in turn formally rejected the GE-Honeywell merger (Monti 2001). GE and Honeywell, supported by U.S. government officials all the way up to President Bush, cried foul and accused the EU of being engaged in "naked economic nationalism" (Kovacic 2001: 808)—but DG Comp's decision stuck; the merger agreement was torn up.⁷⁵

5.3 Explaining the Merger Decisions

At first sight, economic nationalism seems to explain the GE-Honeywell decision well, supporting Realist and neorealist arguments: GE (and its chairman Jack Welch) were icons of American industry (*Business Week* "Global 1000," July 9, 2001: 75ff), and many U.S. officials accused the EU of having chosen an economically and symbolically important means to thwart U.S. economic interests (Elliot 2001; Schmitz 2002: 326). Such an interpretation may have been justified if a consolidated position for the largest company in the U.S. had given it comparative advantages vis-à-vis foreign competitors and thereby had advantaged American economic interests.

⁷⁴In fact, it was these U.S. competitors that realized the political opportunities offered to them by the EC merger control process and led the lobbying effort to get DG Comp to block the deal.

⁷⁵GE immediately appealed the decision to the Court of First Instance. In its December 2005 decision, the CFI found DG Comp's analysis of the merger's vertical and conglomerate effects to have been deeply flawed, but upheld the Commission decision because it found the horizontal effects of the merger (strengthened dominance in three major product markets) to have been sufficient cause for the negative decision. For a more detailed analysis, see Baxter, Dethmers and Dodoo 2006.

On closer inspection, however, the realist explanation raises more questions than it answers. How could the EU have—effectively and conclusively—challenged the interests of the sole superpower if international outcomes are to be explained by the distribution of power in the international system? How could a supranational *non-state* actor exercise extraterritorial control over U.S. firms in an international system defined by state sovereignty?⁷⁶ Most importantly, how could the Commission, if it were simply acting in the economic interests of the member-states, have approved the earlier Boeing merger, which threatened the economic interests of the most powerful member-states much more clearly than the GE merger? The divergent outcomes of the two cases (approval for Boeing, rejection for GE) also creates a puzzle for liberal intergovernmentalism. Given the earlier approval of the Boeing merger and the lack of a clear cause for organized opposition from producer groups at the national level within the major member-states, liberal intergovernmentalists should expect the GE-Honeywell merger to be approved by the Commission without major problems. But it was not. What the U.S. approved, the EU denied, and the EU's word was final. While such an outcome is a problem for intergovernmentalism, it is not for neofunctionalism: authority that shifts transnationally and supranationally is precisely what we would expect in a neofunctionalist world.

In fact, DG Comp appears not to shy away from strict antitrust enforcement against European companies, either, even from the largest member-states and sometimes to the advantage of European firms' non-European competitors. A complaint by United Parcel Service of the U.S. against *state-owned* Deutsche Post (for distorting competition through the subsidizing of parcel delivery from profits gained from its postal stamps monopoly) led to the 2001 ruling against Deutsche Post, in which DG Comp levied substantial fines and forced the German postal service to restructure its operations (American Shipper 2001; BBC 2001; European Commission 2001). Similarly, when Aérospatiale-Alénia, a European conglomerate of aerospace companies, sought to acquire Canadian competitor de Havilland in 1991, DG IV blocked the deal, because it would have created a dominant supplier in the global market for regional (i.e., short-haul) aircraft (Fine 1993). Moreover, a statistical study of a sample of ninety-six EU merger decisions from September 1990 to October 2002 (including GE-Honeywell and Boeing-McDonnell-Douglas) found that "the probability of a phase 2 investigation and of a prohibition of [a] merger increases with the parties' market shares," barriers to entry in the companies' market, and the facility of post-merger collusion, but it found *no* significant effect for "'political' variables, such as nationality of the merging firms or the identity of the commissioner" (Bergman, Jakobsson and Razo 2003). Indeed, legal research suggests that the Commission consistently applied well-established doctrine in its decisions on the GE and Boeing mergers, which we have argued we should expect precisely because it provided a shield against political demands. In both of our cases, the legal doctrine applied by DG Comp was consistent with its prior practices (Kovacic 2001: 831-842, 846-863; Schmitz 2002: 585f). Such seemingly apolitical, technical authority and legalistic judgments that are impartial to the national "identity" of the firms in question—contrary to intergovernmentalist predictions—is precisely what a neofunctionalist approach would lead us to expect.

The only puzzle for neofunctionalism is why the transgovernmental network of competition experts beyond the EU—in particular the well institutionalized network of EU and U.S. merger regulators, which is part of a broader pattern of transatlantic regulatory cooperation (Pollack and Shaffer 2001; Vogel 1997; Whytock 2005)—failed to prevent the divergence be-

⁷⁶For a more nuanced treatment of sovereignty by a classic Realist, see Krasner (1999).

tween the U.S. and European decisions on GE-Honeywell. Differences in legal doctrine regarding mergers persist and may have played some role (Evenett, Lehmann, and Steil 2000; Fligstein 1990; Fox 2002: 460ff; Giotakos 2002: 506-510; Patterson and Shapiro 2001:1,9), although they clearly had not kept U.S. and European competition authorities from reaching common positions in previous merger cases. In part, the divergent conclusions appear to have been an accidental consequence of the absence of the head of the U.S. DoJ antitrust unit, such that EU Commissioner Monti had no counterpart at the head of the corresponding U.S. agency during most of the proceedings: the Bush administration's nominee, Charles James, was not confirmed until May, and the acting Assistant Attorney General for Antitrust, John Nannes, had recused himself due to possible conflicts of interest (De Jonquieres 2001; Schmitz 2002: 567). But even more important seems to have been the misaligned timing of the U.S. and EU merger review. Submitting the merger notification to the EU only after the U.S. review was well underway (and a positive outcome appeared likely) may have been a strategic gamble on GE's part;⁷⁷ but rather than leading the EU to yield to the U.S. decision, it heightened DG Comp's suspicions.

6. Conclusion

6.1. Summary of the Findings

This paper has presented a restatement of neofunctionalism grounded in Haas's original work of 1957, emphasizing transnational and sub-state actors, as well as their use of the political opportunities offered by supranational institutions to seek increased authority for EC competition policy in pursuit of their interests. We derived a number of observable implications from our restatement of neofunctionalism and suggested that this theoretical perspective provides a better understanding of important aspects of European integration than an intergovernmentalist perspective. In particular, the explanation that it provides of the process of institutional change—the process by which the supranational European competition regulator, DG Comp (formerly DG IV), gained antitrust and merger review powers far beyond what any of the member-states had intended at the outset and repeatedly beyond the then-current preferences of the largest and most powerful member-states—is superior on Lakatosian grounds (Lakatos 1974: esp. 115ff): neofunctionalism first leads us to see "novel facts" not even observed by intergovernmentalist approaches, such as subnational actors forming transnational coalitions and the important role they played in changing government preferences, and it is then able to explain aspects of the institutional development of the EC that remain anomalies for other theories. In the final empirical section, we have shown that the neofunctionalist perspective also provides a compelling explanation of specific high-profile merger review decisions, which are a puzzle for other approaches.

Each of the alternative explanations discussed in section 3 encounters substantial difficulties in similarly providing a consistent explanation for the multitude of observations in our empirical analysis. Given that antitrust cases arise out of developments in the market, which is inherently not fully controlled by states, it is hard to see how antitrust and merger review could have been perceived as strictly, reliably positive sum. This makes it difficult for Realist intergovernmentalism to explain why we see delegation of authority to the supranational DG Comp

⁷⁷Commenting on the thinking at GE afterwards, an executive noted, "we thought it would be impossible that the Europeans would try to block a U.S.-U.S. deal that had been given the go-ahead by Washington" (Sorkin 2001).

without a national veto right or any indication that DG Comp has consistently acted in the interest of the bigger member-states. And the seeming reappropriation of authority by the member-states in 2004 on closer inspection turns out to be something else. While formally adopted by the member-states (acting by qualified majority in the Council though after consulting the European Parliament), the most recent institutional changes were initiated by the Commission and advanced by transnationally organized sub-state actors. Far from reversing integration, the member-states did not reappropriate authority, but agreed to new regulations that contain all the key elements of the Commission's initial proposals and seem likely to strengthen DG Comp further.

Given the early divisions within the German government, interpreting the EC antitrust regime as enshrining German policy preferences (as suggested by neorealist intergovernmentalism) also seems a stretch. And the failure of German demands in more recent years, when German relative power should have been higher than in the early years, also raises questions about the explanatory leverage of neorealist intergovernmentalism.⁷⁸

Liberal intergovernmentalism provides a more nuanced picture and rightly notes that intergovernmental treaty renegotiations face few institutional constraints (and can therefore conceivably result in radical change). But here, too, changes in government preferences over institutional design just "happen," because the transnational politics that brings them about are ruled out by assumption. And like other intergovernmentalist approaches, liberal intergovernmentalism does not allow for the possibility of significant changes in the status quo without or between major treaty revisions. Consequently, liberal intergovernmentalism must underestimate the resilience of such changes in a setting for intergovernmental bargains where change in this new *de facto* status quo requires unanimity (in the case of treaty revisions) or at least a supermajority (in the case of Council decisions), whereas the new status quo may be preserved by a minority or even a single veto. The importance of subnational actors using supranational institutions to change EC antitrust and merger review practice—and more generally the fact that virtually all significant changes in EC antitrust and merger review policy took place outside the "grand bargains"—raises serious questions about liberal intergovernmentalism's explanatory scope.

The dangers of an intergovernmentalist (mis)understanding of European competition policy are illustrated by the predictions that Ethan Schwartz derived from his analysis: due to continuing disagreements among and within the governments of the largest member-states about the proper trade-off between pure-competition and industrial-policy considerations in merger review decisions and even about the delegation of merger control to the Commission as such, Schwartz predicted in 1993 that EC merger review in the 1990s would be feeble, inconsistent and—for most European transnational mergers—irrelevant. He interpreted the 1989 merger regulation largely as a failure to consolidate authority over industrial concentration in the Commission and thus create the "one-stop shop" sought by multinational firms. National governments and national competition authorities would remain the central players in transnational mergers in Europe (Schwartz 1993: 653-656); EC merger control would operate in a traditional intergovernmental, *not* a supranational, fashion (1993: 645). Developments in the twelve years since these predictions were published clearly contradict Schwarz's liberal intergovernmentalist expectations: the Commission's DG Comp has become the central regulator of mergers in Eu-

⁷⁸One example is the demand for a fully independent cartel agency, see Wilks with McGowan (1995).

rope, which undisputedly exercises supranational authority. For good or ill, it also has become one of the most important regulatory agencies for market competition worldwide and therefore an important player in the international political economy.

6.2. Caveats and Avenues for Further Research

We have shown that neofunctionalism provides a superior explanation for the process of European integration in the realm of competition policy and, especially, the institutional evolution of merger review; and we have suggested that it is a promising framework for the analysis of institutional change in general, at least within trans-/supranational organizations. We urge scholars to study more of the changes in political institutions that occur outside of the "grand bargains" among states – which may in fact only be codifying the status quo of existing practice, as shaped by subnational and supranational actors (see also, e.g., Lindner and Rittberger 2003). Our findings suggest that neofunctionalism warrants further theoretical and empirical analysis as a theory of institutional change. Understood in this way, it may well be generalizable to other instances of regional integration (Mattli 2005; see also Rosamond 2005). At a minimum, our findings caution against any presumption that analyses of integration must start from the distribution of power among states or end with the bargain between them: power, to be sure, matters in world (and European) politics, and EC merger decisions tend to be hotly contested (Ross 1994: 129ff, 132f, 186ff) but power is not necessarily state/government power.

We do not, however, claim that neofunctionalism explains all of European integration, or regional integration in general. Where no supranational institutional mechanism for increased integration exists and where there are few domestic distributional conflicts over policy, such as in the realm of defense, intergovernmental approaches may be more appropriate. The broader point is that we should not just examine how much explanatory leverage we can get out of alternative theoretical approaches for explaining a specific phenomenon (such as competition policy), but also seek to establish the scope of each of the approaches (sometimes by applying them to questions that they were not originally designed to answer). Our research on competition policy seeks to contribute to this larger objective for neofunctionalist and intergovernmentalist perspectives, but more studies across a range of issue areas are required to tease out the boundaries of applicability for each of these approaches.⁷⁹

Finally, like most theories of institutional change, neofunctionalism at best predicts the direction of change; it has difficulty making point predictions (without considerable contextual knowledge that goes beyond the analytical framework as it is currently developed), and it either depends upon exogenous factors or has to be supplemented by other theories to explain the timing of specific changes. The benefits and pitfalls of such a combination of theories is a rich area for further research on European integration and beyond.

⁷⁹Büthe (2007) applies it to antitrust enforcement and the control of state aids/subsidies and finds that the argument presented here is very effective in explaining the institutional development within these other issue areas of competition policy as well as the temporal differences across them.

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