MOVING TARGETS:
INSTITUTIONAL EMBEDDEDNESS AND DOMESTIC POLITICS IN THE LIBERALIZATION OF EU ELECTRICITY MARKETS

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ABSTRACT

After ten years of controversial negotiations, the European Union finally took action to liberalize the electricity supply industry in 1996. Given that the longstanding debate on the organization of electricity supply was brought to an end through bilateral negotiations between France and Germany, the reform has been often presented as a straightforward French-German deal. This paper, however, argues that the French-German intergovernmental deal was only the tip of the iceberg. Perceptions of national interests evolved considerably in both countries. While France turned from initial support of the market opening to a much more defensive posture, Germany moved from scepticism to fervent support of the liberalization. The most important cause for these changes was at the EU, not at the national level. The substance and progress of the negotiations were fundamentally shaped by their embeddedness in the EU institutional context. The institutional context of EU negotiations induced several key domestic political realignments on the part of sectoral and state actors.

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I. Introduction

After ten years of debate, the EU took action to liberalize the electricity supply industry through a European directive that was passed in December 1996. The policy-making process that preceded this decision staged some of the most enduring and controversial negotiations that ever occurred amongst the members of the European Community in a single policy area. The discussions were brought to an end only by a direct bilateral settlement between France and Germany that took place at the highest level of government. While these two countries had jointly proclaimed their reluctance to the liberalization of electricity markets in the late 1980's, in the mid-1990's they consented to the agreement reached in the Council negotiations. The apparant preponderance of French-German intergovernmental bargains in the liberalization process poses a puzzle: why did France and Germany depart from the status quo ante?

The 1996 directive was often presented in the press as a straightforward Franco-German bargain – Germany wanted liberalization, France did not, so they cut a deal that satisfied both parties. This common diagnostic tends to vindicate conventional understandings of international political dynamics.[1] Even scholars who do not work in the IR tradition typically hold that the member states form their preferences on the basis of their national situations and will defend their national regulatory regimes at the EU level.[2] In such event, the EU policy-making process can be depicted as a give-and-take negotiating game that

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[1] The contemporary IR literature typically describes clear-cut bargaining dynamics in which domestic and international bargaining „games" are simultaneously played by well-identified actors with relatively fixed preferences. For a generic example, see Putnam 1988; for an application to the EU context, see Moravcsik 1998.

[2] Marks et al. 1996; Héritier 1996.

takes place among state actors – in this case, mainly France and Germany – who eventually reach an agreement that conforms with their respective basic economic interests.[3] The burden of proof for this type of interpretation is that the breakdown of the French-German agreement of 1989 should result directly from the underlying evolution of economic and group interests as they were aggregated within the French and German political arenas, or from a well-entrenched divergence in national regulatory regimes. The formation and the evolution over time of French and German positions on electricity reforms should then be understandable in national terms, with minimum attention devoted to the EU-level policy process.

We consider, however, that an explanation of electricity liberalization in terms of national interests can be misleading. This is surprising since the electricity sector seems to be a perfect case for reasoning on the basis of national interests. The sectoral governance arrangements belong in the hallmark of twentieth-century industrialization in both France and Germany. The sector was marked by a very long period of stability on the national level across all the member states. Since electricity supply was network-bound and regarded as a natural monopoly, competition was absent and there was a preference for national autonomy in the supply of energy sources to the sector. Furthermore, electricity is a relatively simple commodity and the level of uncertainty on electricity markets is relatively low – the industry is not subject to erratic changes in demand or fast technological change; its investments are highly capitalistic and carefully planned on a medium- to long-term basis. To be sure, important supply shocks and technological innovations have occurred since the 1980's, especially the considerable decrease in real-term oil prices and the advent of low-cost

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[3] Various elements of this basic interpretation inform the literature on electricity liberalization. For example, the slow pace of the policy-making process has been explained in terms of a lack of convergence between national interests (Padgett 1992, McGowan 1993). A more recent explanation consists in saying that a minimum intergovernmentalist consensus emerged on the need to liberalize electricity supply, both driven by

technology for gas-fired and combined cycle power generation. Yet these trends have been slowly progressing, and in terms of overall energy utility portfolios, their effects can only be felt over the long run.[4] The structural evolution of national interests – as based on market and technology factors - does not satisfactorily „explain" the changes in French and German preferences as expressed by the evolution of these countries' positions on the electricity directive proposals.

Thus, the paper will show that explanations centering on the pursuit of national interests rooted in domestic structures provide only a limited understanding of EC negotiations. Insofar as national interests resulted from the structural and institutional characteristics of longstanding French and German domestic economic models, these interests were quite resilient and do not permit to account for the occurrence of change. If anything, domestic structures of interests were a factor of inertia in the evolution of electricity regulation and supply at the EU level. While domestic interest structures certainly contribute to explain the relatively slow pace of institutional change, they do not permit to account for the advent of institutional change itself. The government of France, for better or for worse, remained wedded to the energy infrastructure built by the state-owned utility EDF in the postwar period – the supply of electricity by a state-owned monopolistic producer in accordance with national priorities such as the development of nuclear power. Likewise, the German government was bound to defend a certain institutional structure of energy supply that had profound historical roots – sectoral arrangements were characterized by the presence

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technological change and bounded by resilient national interests, which lay the basis for a compromise on a pan-European electricity regime (Matlary 1997, Levi-Faur 1998).

[4] One can only speculate if, over time, the predominance of nuclear energy in France and the German reliance on coal would have been challenged solely as as a result of market and technological trends. In the United Kingdom, the „dash for gas" in electricity generation resulted from the privatization of the electricity supply industry – it did not cause the sectoral reform (see McGowan 1993).

of a small number of large firms, several regional utilities, multiple local producers, both public and private ownership, and continued reliance on traditional energy resources such as coal. Much more central to the change in French and German attitudes was the evolution of national perceptions of EU-level energy liberalization and of the political stance adopted by various actors in anticipation or in reaction to that EU process.

Accordingly, our paper offers an explanation of electricity reform that centers on the logic of EU-level negotiations rather than on market or technological pressures. It argues that the institutional context of EU negotiations systematically induced preference changes on the part of state and market actors, which in turn fostered political realignments on both the European and the national level. The member states' involvement in EU negotiations opened the way for a reassessment of national electricity structures and to a redefinition of national interests. Changes in domestic actors' *political interests and strategies* are more clearly readable in terms evolving EU negotiations than if we only consider the slowly changing domestic economic and institutional structure that manifest French or German „national interests".[5] We suggest that negotiations within the Council of Ministers consistently led the member states to change their preferences and gave them important disincentives to pursue their initial „national interests" rigidly. The liberalization of EU electricity markets is thus best understood as a phenomenon of *institutionally embedded* change.[6] In this case, institutional embeddedness is manifested in two ways. First, the institutional dynamic of EU

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5 There is a huge body of scholarship on the topic of strategy, especially in the rational choice and game theory literature. As will become clear in the course of our argument, however, we mean something different than the rational pursuit of clear and objectively defined interests. Our understanding of *political* strategy hinges on the existence of a „thick" social context, in which concerned actors are collectively participating in and at the same time constrained by a given policy agenda.

6 Institutionalist arguments cast in terms of institutional embeddedness are plentiful in the contemporary social science literature. For generic examples, see: Granovetter 1985; March and Olsen 1989; Steinmo, Thelen, and Longstreth 1992. For recent examples in relation to the context of EU politics, see Scharpf 1988; Pierson 1996; Garrett and Tsebelis 1998.

negotiations, in which France and Germany were placed in the position of negotiating over an agenda that was set by the European Commission, heavily weighed on the general orientation and characteristics of the 1996 directive. Secondly, the continuing differences among national institutional structures of electricity supply shaped the relatively open-ended nature of the 1996 directive.

The rest of this paper develops in four steps. Section II briefly summarizes the main steps of the European electricity policy-making process over a decade. Sections III and IV successively examine the French and the German cases. In each case, the context of EU negotiations induced preference changes of certain key sectoral and state actors and domestic political realignments. The existence and the dominant mood of EU negotiations prompted certain French and German political actors to coalesce in favor of liberalization: some state actors and big consumers in Germany pioneered the drive toward liberalization and were supported, later in the process, by some big electricity consumers and marginal producers in France and even by some big German utilities. These coalitions acquired more weight thanks to EU-level leverage and were able to obtain a victory over more entrenched interests. Section V returns to the problem of EU-level policy-making. As it turns out, EU institutional mechanisms of consensus seeking did not leave France and Germany much choice but to agree to a European directive. In the late 1980s an early 1990s, France and Germany expressed converging interests in the status quo, when they opposed the liberalization of the electricity market. Thus, the breakdown over time of an intergovernmental equilibrium is explained in terms of national preference changes and political realignments in the context of EU-level negotiations.

II. The emergence of an EU framework for electricity markets

In substance, the 1996 European directive mandating „gradual liberalization" lays the basis for creating an Internal Energy Market (IEM) for electricity.[7] Until that directive, only the legally designated utilities in the member-states had monopolistic rights to engage in the supply and commerce of electricity. Typically, third parties (i.e., non-chartered electricity producers, consumers or distributors) did not have free access to the market and were not allowed to contract with suppliers or customer of their choice. The directive changed the status quo not only by mandating a certain level of „third-party access" (TPA) to the electricity networks, but also by ending the monopoly rights for the construction of power lines and power stations.[8] In the first phases of market opening, only certain „eligible" customers will be concerned, and the task of defining criteria of eligibility is left to the discretion of national legislatures.[9] In order to diffuse and postpone possible disagreements in implementing the European legislation, the Council has set the relatively remote date of 2006 for a review of progress toward the objective of an Internal Energy Market.

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7 Directive 96/92/CE of the European Parliament and of the Council concerning common rules for the Internal market in electricity, Official Journal of the European Communities, January 30, 1997.

8 Third-party access (TPA) means that networks are open to third parties, with freer entry on the supply side and the possibility for customers to choose from a variety of electricity producers.

9 Only big industrial customers consuming more than 100 GWh per year must initially be considered as eligible. But the member states may also designate other consumers – even household customers – and electricity distributors as eligible. To provide for an equivalent degree of liberalization in all of the member states, the degree of market opening is not based solely on the member states' definitions of eligible consumers. Instead, the directive requires the member states to conform to certain quotas at each stage of market opening. These quotas are based on the EU-wide annual consumption profile of various categories of industrial consumers (1999: >40 GWh, 2000:>30 GWh, 2003: >9 GWh). As a consequence of these incremental quotas, the member states must gradually open their markets from around 25 percent of national consumption in 1999 to around 33 percent in 2003.

A first difficulty resides in assessing the practical significance of the directive. Only the future evolution of energy markets will tell us whether the 1996 electricity directive was actually a landmark blueprint of change or a case of „much ado about nothing". Some skeptical observers note that that the result of the 1996 compromise was to legitimate rather than remove the pre-existing obstacles to market competition in various countries. Optimists within the European Commission and elsewhere believe nonetheless that, once the directive is implemented at the national level, market forces will be unleashed and will push electricity supply industry in the direction of greater openness. Several member states have already indicated that they will move greatly beyond the minimum thresholds and open their markets fully.[10] To be sure, the electricity directive contains a great degree of flexibility and has been described as „a la carte" when compared to other more sweeping examples of EU-level reforms. It delineates a careful and incremental schedule of market opening that is limited to particular segments of the market and subject to future review in 2006. It is safe to say, however, that even despite its limitations, the directive mandating for the liberalization of EU electricity markets represents a surprising outcome and a fundamental sectoral reform that hardly anybody expected in 1992 when the first Commission proposals were submitted.

In fact, the path to the final text of the directive in 1996 was neither straight nor uneventful. The directive proposal was introduced by the European Commission in 1992. This Commission initiative was in and of itself a rather surprising development and the result of a rather convoluted process. While liberalization in the electricity sector was only part of a broad movement of market-building encapsulated in the „1992" objective of a SEM, the electricity sector was deliberately not mentioned in the White Paper on the Single Market at

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[10] Finland, Germany, Spain, the Netherlands, Sweden and the United Kingdom will open or have already opened their markets fully to competition and Denmark will open its market to about 90 percent of national consumption.

the origin of the Single European Act (SEA). In the mid-1980's, the idea of a common energy market was not high on the agenda. On the contrary, there were bitter memories of failed attempts to build a common energy policy, since the early days of the European Community and through the oil shocks of the 1970's.[11] Under the goad of a 1986 Council resolution, however, a piecemeal approach to electricity liberalization began to emerge. In 1988, the European Commission introduced a „green" (working) paper about the Internal Energy Market, proposing price transparency and freer transit of electricity across borders.[12] Two directives were to be adopted, in 1990 and 1991, to fulfill these significant, yet relatively modest goals.[13] However vaguely defined at that stage, the Commission's objective to liberalize the electricity sector triggered already important reactions by both sectoral and state actors: In 1989, the member states' utilities and associations set up a trade association in Brussels – Eurelectric – with the mandate of defending their common interests. Also, the German and French governments passed a joint communiqué at their summit of November 1989 that included a protocol on energy policy, in which they tried to set strict boundaries for the liberalization dynamic – they accepted the principle of „free transit" of electricity across Europe, but only if mediated and controlled by the utilities; and they declared their opposition to the new concept of „third party access" as exemplified by the British electricity deregulation program.

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[11] In particular, Euratom, which was originally designed as the spearhead of a European energy policy, did not live up to the expectations of its early supporters like Jean Monnet. One analyst concluded, at that time, that there was a „general agreement that energy policy must be ranked as the Community's major failures." (Padgett 1992, p. 55). For a historical perspective on European electricity policy, see Matlary 1997.

[12] Commission of the European Communities, The Internal Energy Market, reprinted in Energy in Europe, special issue (Luxembourg: Office for Official Publications of the European Communities, 1988): 17-18.

[13] Council Directive 90/377/EEC (June 29, 1990); Council Directive 90/547/EEC (October 29, 1990).

In the early 1990's, it was far from clear, to many observers, that electricity liberalization would continue beyond the fairly limited steps which had already been agreed upon. Any attempt to further liberalize this sector was risky, if only because of the predictable political opposition to this process. After airing in 1991 a first concrete proposal for TPA and some internal hesitations about the best method to implement it, the Commission decided not to act under its discretionary competition law prerogatives (i.e., by way of an Article 90 directive). Instead, it submitted in 1992 a first directive proposal subject to the Council's and the European Parliament's approval (under the new co-decision procedure as defined by the Maastricht Treaty). Yet, in the face of huge opposition on the part of important players, the proposal seemed moribund. The Maastricht treaty, in the context of which energy policy seemed reaffirmed as a national prerogative, was interpreted by many as an important setback for proponents of a European energy policy, including electricity.

As it turned out, however, the liberalization process in electricity did not stop there. The Council expressed its intention to proceed with liberalization and the relevant actors continued to negotiate actively on this issue. The Commission's proposal was the object of heated negotiations and numerous important amendments by the Council of Ministers from 1993 to 1996. Germany incrementally adopted an official position that was much more favorable to liberalization. The French government mandated the Ministry of Industry to set up an expert commission in order to draft a report with policy recommendations on the sectoral governance of electricity in France.[14] Following this report, France proposed its own brand of liberalization, the „single buyer" (SB) concept -- while accepting the principle of market competition for electricity generation, the proposal reaffirmed the role of monopoly

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[14] The report was drafted and published in January 1994 by the French Ministry of Industry (see Ministère de l'Industrie 1994). (Hereafter, we refer to this report as the Mandil Report.)

utilities as the sole operator of the technical networks for transportation and distribution of electricity. This new proposal did not satisfy the Commission, but the Council decided to fudge the issue and mandated that the SB proposal be drafted into the legislation in conjunction with TPA.

For a while, the anti-TPA stance seemed reinforced by two unrelated ECJ rulings in favor of the principle of public service, in the 1994 Corbeau and Almelo cases. In March 1995, the Commission issued a Council-mandated report comparing the TPA and SB systems, concluding that the two systems could be adopted in conjunction only if they guaranteed „equivalent results" in terms of market opening. Thereafter, negotiations kept stalling on important questions of principle -- e.g., whether supplier competition was desirable for its own sake and thus whether it should be integrated (with binding force) into the directive. At the Kohl-Chirac summit of December 1995, the French and German governments had agreed to maintain cohesion and not let each other be isolated at the Council on the issue of electricity liberalization. Therefore the prospects of a denouement to the saga of electricity liberalization looked even bleaker, since the French and German governments held diametrically opposite position on the most contentious aspects of the proposal. Until very late in the process, it was not clear that there would be any genuine liberalization of electricity supply -- let alone one that was acceptable to all parties. Many had almost given up any hopes of ever reaching agreement on the Commission's proposal.

The situation dramatically changed in the first half of 1996, when France and Germany came up with a compromise proposal. Based on the extant version of the directive proposal, the governments of these two protagonist states in the debate agreed the directive also on a bilateral basis. The directive was accepted and unanimously adopted by the Council of

Ministers on June 21, 1996. The Council resolution was then sent to the European Parliament and definitively passed almost without any further amendments in December 1996. The dominant sentiment at the time of the second reading at the European Parliament was that the carefully crafted compromise was the object of a fragile political balance that any further amendments would seriously thwart the chances of a directive ever seeing the light.

III. The evolution of the French position in the EU electricity debate

France's official stance on electricity liberalization evolved from a rather aggressive pro-reform stance to a marked reluctance toward the EU directive. This change of position is better explained by the evolution of the debate at the EU level – as well as a better comprehension of this debate in France – than by the evolution of France's underlying economic interests. The EU debate first prompted certain hesitations in the process of defining a French strategy toward liberalization, and later indirectly provoked key political realignments, both in the French position at the EU and within France domestically.

Uncertainties and strategic hesitations in a dual institutitional context

The French position on the Internal Energy Market was not immediately clear. In 1986-88, the prospect of an Internal Energy Market stood at the intersection of two major concerns. On the one hand, the French government was eager to play an important part in the „1992" process. French government officials, like their colleagues in all other European governments, were trying hard to come up with concrete proposals which were intended to

show that they were „good Europeans" and that they participated actively in the collective effort to „build the Single Market". On the other hand, they were trying to identify areas where France had particular interests in the market-building process. At that time, electricity seemed a good candidate. The French nuclear program was planned in the 1970's at a time of intense fears of further energy shortages.[15] Yet, in the context of 1980's relative energy glut and improvements in energy efficiency, Electricité de France (EDF) – France's only electric utility, owned by the French state – was now producing more electricity than the French market could absorb. Thus, EDF executives were actively concerned with the search for new export outlets for this surplus capacity. At the same time, EDF was widely suspected of having the ambition to erect itself into the dominant supplier of electricity in Europe.[16] Not surprisingly perhaps, EDF was confronted with important barriers to trade when it came to selling is surplus capacity. Thus, in the late 1980s, Spain had blocked EDF's attempts to supply electricity to a Portuguese utility for more than two years (McGowan 1993).

In that context, the French government – EDF's ever-attentive shareholder – started to champion the cause of opening national electricity markets to competition at the Council of Ministers.[17] It seems unlikely that the French negotiators at the time measured the consequences of that tactical move. They were under strong pressure from EDF executives

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[15] According to an interview with EDF executives, this surplus was not a complete surprise, since the French government's approach had been based on a strategy that consisted in „minimizing the maximum potential regrets". In a situation of growing region-wide demand and energy shortages, the possibility of a national surplus of electricity was considered less problematic than the risk of a shortage.

[16] The problem was aptly summarized by an EDF executive: „Our problem is that the other European utilities are afraid of us." (quoted in the Financial Times' „Survey of Electricity," January 23, 1989)

[17] Interview with EDF executive. Judging from newspaper articles in the late 1980's, there was a period of hesitation on the part of the French government and EDF between 1988 and 1989. While the French government and EDF originally pushed very hard in favor of electricity liberalization, the decision was soon made to moderate, rather than openly champion, the Commission's plans for an Internal Energy Market. See Le Monde, „EDF veut vendre directement aux industriels européens," October 19, 1988; La Tribune de

who were focused on the relatively narrow problem of guaranteeing access to export markets. The traditional view within EDF rested on the notion that its legally guaranteed monopoly on the production, transportation, and distribution of electricity corresponded to a „natural" way of organizing a rational and economically efficient capital allocation and electricity supply mechanism. It took a while for EDF executives to realize that, however „rational", the very position of their company could be threatened by a political process that was taking place outside of the Parisian networks of political power and influence with which they were familiar.[18] The possibility that the fate of French energy policy could depend on the evolution of EC competition policy and the „1992" process did not register at EDF until late in the 1980's. Only around 1989 did EDF realize that a European directive also had the potential of jeopardizing the company's institutionally entrenched monopolistic status for the supply of electricity in France. By that time, a first series of economic studies were conducted internally by EDF to ascertain whether and how EDF could benefit from the creation of a regional energy market.[19] The studies concluded that there were gains to be made from increased trade with other European utilities and from a more market-based choice of energy portfolio options. But EDF economists also cautioned against the possibility for an inefficient duplication of production facilities and a price war that would jeopardize the profitability of

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l'Expansion, „Les électriciens européens ne sont pas murs pour la déréglementation," May 31, 1988; Le Monde, „Vers un marché commun de l'électricité," July 13, 1989.

[18] According to one EDF interview, this was due in part to the fact that EDF's top management was made of a socially homogenous group of *grands corps* engineers with very little understanding and experience of Brussels politics and European law. The fact that Brussels had a real say over the organization of French electricity supply is now reflected in the (arguably overstated) historical diagnostic established by EDF's team in charge of following the EU negotiations: „Few citizens of the European Union realize that the European Treaties grant *more power* to the European authorities in Brussels that the US Constitution to the federal government in Washington." (EDF 1996, p. 15)

[19] EDF, Service des Etudes Economiques Générales, „La Concurrence à la production," internal memo, 16 July 1993. See also a paper by two EDF economists: P. Lederer & J.-P. Bouttes, "Electricity Monopoly vs. Competition?" paper presented at the Financial Times World Electricity Conference (London, November 12-13, 1990).

previous investments, especially in nuclear powerplants.[20] From then on, EDF adopted the official line that the opening of electricity markets must occur in full cooperation and agreement with other European utilities. Within the European industry forum of Eurelectric, EDF began to promote the idea of increasing cooperation between utilities and accepting only a very controlled and progressive sectoral evolution.

There were several reasons for this change of mood within EDF. [21] An important rationale for this cooperative attitude was that EDF executives valued their cooperative relationship with other utilities, since EDF was developing a European fast-breeder reactor and the next generation of conventional nuclear reactors (European Pressurized Reactors) and was also involved in the reconstruction plans for the East German power network. EDF executives reasoned that the French cost advantage in electricity was only a short-term phenomenon, since German utilities would soon be able to produce cheap nuclear electricity with state-of-the-art equipment. Another factor was the realization that EC-level liberalization could yield unpredictable results. In this respect, the experience of telecom deregulation was an eye-opener for EDF executives and French state officials in charge of energy policy. The long tradition of state primacy in the regulation of public service could be jeopardized by EC-level attempts to liberalize the sector. Worst of all, the acceptance of nuclear energy in France could become a problem if the impression developed in the public that EDF was producing nuclear electricity mainly for export purposes. The contracts were already worth 70 billion francs and there was a perception that EDF could not go much further than that in terms of

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[20] This economic rationale was developed by longtime EDF chairman Marcel Boiteux who oversaw the reform of the utility's rate structure in the late 1970's. For a synthesis between the „old and the „new" thinking on competition at EDF, see for example Boiteux 1996.

[21] Interview with EDF executive.

exports.[22] The IEM, initially conceived as an expedient vehicle of French export interests, suddenly acquired a dynamic of its own – and not one that was necessarily consistent with French interests.

The realization that EDF was no longer on board dampened the French government's enthusiasm for the IEM around 1989. From then on, the French government adopted a defensive position on electricity liberalization.[23] In contrast to their initial stance on electricity liberalization, both EDF and the French Ministry of Industry now prioritized political and institutional considerations over short-term economic calculus. Meanwhile, however, Commission officials around the energy commissioner were busy drafting a far-reaching directive proposal for the liberalization of electricity supply. Despite the growing reluctance of the main concerned actor EDF, the French government could not easily renege on its earlier commitment to open European electricity markets. There were also some concerns, within the French government and EDF, that in the absence of a directive the European Court of Justice would rule in favor of ending the legal monopoly of EDF for imports and exports of electricity.[24] Finally, there was also the possibility that the Commission might be able to act to liberalize electricity supply under its competition law

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22 Interview with EDF executives.

23 Interview with French COREPER official.

24 Interview with EDF executives and French government officials. As it later turned out, these fears were probably exaggerated, since the ECJ's subsequent ruling (which was finally issued only in 1998) allowed the French government to preserve the most essential aspects of EDF's monopoly. Yet the threat of an adverse court decision acted as a powerful goad for the French government to be more accomodating with the Commission's demands, so as pre-empt a negative outcome. This threat is explicitly mentioned in the Mandil Report of 1994: „Absent a quick decision by the Council of Ministers, the French government must choose between postponing any [regulatory] evolution while awaiting progress in the Brussels process, or start implementing certain changes that are deemed possible and necessary without waiting for the end of a European debate whose outcome is uncertain. The first option increases the risk of seeing France penalized by European court decisions [...]" (p. 21)

prerogatives (article 90.3 of the Rome Treaty).[25] This evolution would have the effect of jeopardizing the position and role of EDF at the apex of French electricity supply.

For a variety of historical and political reasons, the very idea of a change in the monopolistic position and legal status of EDF in France was particularly sensitive. Since its creation as a state-owned public utility in 1946, EDF had become a political symbol. Among the French public, there is still a vivid memory of EDF's important role in the major economic choices of the postwar period, especially the task of collective economic reconstruction in the immediate postwar period and the development of nuclear power.[26] The successive French governments who dealt with the EU reform proposal were eager to avoid any change in the 1946 statute of EDF, which were considered by many as untouchable, especially within the CGT (a national labor union with historical links to the Communist Party and with a strong presence within EDF). They were also very worried about potential claims that the government was sacrificing the French model of public service on the European altar. Finally, state officials were concerned about the effects of opening electricity supply to market competition on the financial well being of EDF, which remained a cherished possession of the French state. The French state was eager to protect its recent and not yet amortized investment in the nuclear electricity program. The state had extended huge monies to that program since the 1970's and now expected its investment to pay off.[27] By the late

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[25] According to the Financial Times, several Commission officials made explicit statements to this effect (Financial Times, „Move to Break EU Power Deadlock," March 23, 1995). It was unclear, however, whether or not the Commission would prevail in court if it took steps to liberalize electricity supply under the competition policy procedure. For a discussion of the Commission's competition policy powers, see Schmidt 1998.

[26] For a historical perspective on the status of EDF within the French economic and political system, see for example: Picard et al. 1985; Wievorka and Trinh 19xx.

[27] Due to the complexity of governmental financing of industrial investment and the fact that EDF had access to various sources of financing at preferential rates, it is hard to calculate the exact investment of the French government in the nuclear program. Thus, the figure of 600 billion francs, which came back in several

1980's, EDF had become a cash cow and any change in the situation was considered dangerous. Record EDF profits were good for the French state because they translated into an influx of money for the owner-shareholder.[28] The balance of political power between EDF and the Finance Ministry was such that EDF would generally comply to the state's cash requests, however reluctantly.[29] Preserving this source of income as an instrument to preserve a balanced budget was especially important for the French government in the run-up to Economic and Monetary Union. Faced with the prospect of definite short-term costs, the hypothetical long-term welfare benefits of electricity liberalization did not appear as sufficiently tangible for any of the successive French ministers to seriously envision a rapid de-monopolization of French electricity supply.

Domestic political realignment

By 1995-96, however, everybody familiar with the EC debate in France acknowledged that the situation at the EU level had evolved and that some things would need to change in the governance of the French electricity sector. The French state was under growing pressure to change its intransigent position and to compromise. In Brussels, the Commission under the new energy commissioner Christos Papoutsis was becoming more accommodating, while the Council was maintaining its principled demand for a reform of

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interviews, is probably a low estimate of the state's investment in EDF's nuclear program. Throughout the 1980's, EDF's debt remained quite high in proportion to corporate earnings.

28 Interview with French finance ministry official.

29 EDF executives have always been testy about the state's periodic punctures of its financial resources. See for example the opinion of a former EDF chairman: „The company's logic must no longer be neglected. It is normal that the state be remunerated by a publicly owned company. The appropriate way to do this is by a dividend of the profits, not by an increase of EDF's contribution [to the public budget]." (Interview of Gilles Menage, Le Monde, April 8, 1996.)

electricity markets. This development it more difficult for the French to pursue a strategy of systematic opposition to an increasingly pragmatic reform proposal that could no longer be rejected as „ideologically liberal". In a sense, the Single Buyer proposal was a tactical move in a strategy designed to maintain a maximum degree of freedom – but without excessive illusions on the French side. When the Council-commissioned report comparing the SB and the TPA systems came out in April 1996, those French officials who were close to the negotiation realized that the French position must evolve, otherwise there was a risk of being outvoted at the Council of Ministers.

Meanwhile, the proponents of electricity liberalization in Paris were slowly gaining ground. Many thought that EDF officials, who unrelentlessly pointed to their technical and economic prowess and especially their record of cheap nuclear electricity, were too „arrogant". Upon the failure of the SB proposal, there were some tensions between French government officials and EDF executives, who blamed each other for the blunder.[30] In some government circles, especially in the competition directorate of the Ministry of Finance, the end of EDF's monopoly position was even seen as a rather desirable thing.[31] This was even more the case among the potential competitors of EDF, including the two big water utilities, Compagnie Générale des Eaux and Compagnie Lyonnaise des Eaux, as well as some city councils who resented EDF's production and distribution monopoly. Finally, big industrial electricity consumers were showing increasing signs of impatience with EDF's monopoly. To be sure, industrial consumers were for the most part satisfied with the electricity prices and

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30 Interviews with EDF and government officials.

31 According to an interview with a French official, the competition directorate acted objectively as the Commission's „ally" on the liberalization of energy supply: „We were in close contact throughout the negotiations. There is never a week, and sometimes not even a day, that goes by without a meeting between officials from DGCCRF [the French competition directorate] and DG IV [the Commission's competition directorate]."

level of service offered by EDF. Besides, the consumers' political clout was relatively limited in comparison to that of EDF, especially in the absence of a serious price problem such as in Germany.[32] Yet the French association of industrial electricity consumers, UNIDEN, was actively involved in trying to obtain that EDF's monopoly be at least modified so as to allow for more competition in energy services and give the consumers more „maneuvering space" in negotiating with their supplier.[33] The government and the negotiators were increasingly put on the defensive not only vis-a-vis their partners but also domestically.

In a nutshell, the context of EU negotiations revealed that the French model of electricity supply, with EDF at its apex, was no longer the object of an unquestioned consensus in France. Given French ambiguities vis-a-vis the Commission's directive proposal, the French government's position on this topic was becoming increasingly uncomfortable. At that point, a few key officials at the highest level of the French government decided to break the deadlock for the sake of quickly reaching a compromise. They picked up the remaining contention in the Commission's directive proposal, entered into a bilateral talks with their German counterparts, made important concessions in the Council debate, and finally agreed to the directive text as in the directive of June 1996 with the understanding that liberalization would be very progressive.

That was not quite the end of the process, however. The translation of the European directive into French law was then considerably delayed and has only occurred in January 1999. The debates on the new French electricity law at the national assembly were very controversial and

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[32] Interviews with French officials at the SGCI (Prime Minister's office) and at the Ministry of Industry.

[33] Interview with UNIDEN officials.

the government was forced to accept a number of amendments to its bill.[34] Despite a vocal opposition to the European directive, however, the bill was passed and the new law will come into force in accordance with the directive.

From a French perspective, what was at stake was the state's capacity to maintain a minimum say over the determination of the national energy portfolio, as well as the model of „public service" as embodied by EDF. The foremost objective of the successive French governments who were engaged in the EU negotiation on electricity liberalization was to preserve the integrity of that French model, in part for fear of strikes and other forms of protest.[35] Poll numbers clearly suggested that the French were strongly attached to the defense of „French-style public service" and this could play out in favor of EDF's monopoly. The wave of strikes in December 1995 only reinforced the government's perception of public service liberalization as a danger. The French government, however, never completely ruled out the prospect of electricity liberalization.[36] There was a feeling that France could live with a liberalizing directive, as long as certain key objectives were ensured – the continuation and integrity of EDF as a „public service corporation", in close conformity to its 1946 statute; the

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[34] In the face of potential opposition from the left to his bill, French socialist industry minister Christian Pierret had to promise that the French law would pave the way for implementing „the whole European directive, but nothing beyond the European directive" (Libération, February 15, 1999). According to many observers, the new French law could very well have the effect of undermining the prospects of energy liberalization in France in the future (see Le Monde, February 15, 1999; Libération, February 22, 1999). It is probably too early to make a prediction on these prospects, but it can already be said that the law exploited all the ambiguities of the 1996 directive.

[35] Several interviewees mentioned the fact that successive governments were very wary of provoking EDF's majority labor union, the CGT. The employment status of EDF personnel, as defined by a 1946 legal statute, was particularly sensitive.

[36] According to one French negotiator, the government never opposed the Commission's proposals categorically nor asserted its positions very strongly, „fundamentally because people agreed that liberalization was a good thing". The reasons for this attitude are open to speculation. The official and most commonly advanced reason consisted in saying that electricity was part of the 1992 process and that the French had to prove that they were a „good Europeans" in order to preserve political capital. Other reasons could include the personal networks that existed between certain French industry ministers and the CEO's of

preservation of state prerogatives in determining the broad outlines of energy policy; and, the preservation of nuclear power as a live energy option.

In the end, the evolution of the French position was due not so much to the economic interests of its industry or its consumers, but to the dual institutional dynamics of EU-level negotiations and French public sector governance.[37] This dual institutional embeddedness provided the context for political realignments that oriented the outcome in the direction of change. Once certain actors who positioned themselves in favor of liberalization understood that the institutional dynamic of EU negotiations could become a way to offset the institutional constraints of the French electricity supply model, they began to really push for liberalization in unprecedented ways. In the end, the fact that France accepted the liberal logic of the electricity directive reflected not only a continued French commitment to the EU's institutionalized bargaining framework, but also a changing domestic political balance between the advocates and the opponents of electricity liberalization.

IV. The evolution of the German position in the EU electricity debate

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EDF's would-be competitors, or the fact that the various governments were unwilling to defend EDF's monopoly in the broad context of the liberalizing trend throughout the French economy.

[37] Certain key passages of the Mandil Report suggestively demonstrate the dilemma of this dual institutional embeddedness. On the one hand, the Report makes it very clear that EC rules constitute imperative constraints and that France, like all its partners, must abide by these rules in order to stay abreast of the Community's economic and political evolution: „Needless to say, France must apply the rules of the Community. Whatever their future evolution may be, these rules currently lead in the direction of fewer monopolies and more market mechanisms." (p. 24) On the other hand, certain passages of the Report are unapologetic about the relevance of the „French model": „Electricity and gas supply networks do not only embody rational constructs – they are also the product of history, geography and geology. [...] There is no reason whatsoever to expect electricity and gas distribution to take on the same forms in a country that was built as a federation of cities (Germany) and in a country that owes its existence to the centralizing will of the Capetian kings (France)." (p. 26)

In contrast to France's initially push for the opening of European electricity markets, Germany was initially very skeptical about the Commission's liberalization plans. But during the course of the EU level negotiations, the German government came to endorse the Internal Energy Market agenda wholeheartedly. This change of preferences was mainly due to the Federal Economics Ministry's involvement in Council negotiations and caused major turnarounds in domestic interest coalitions.

Uncertainties and status quo orientations in the dual institutional context

In contrast to the nationalized structure of electricity supply in France, the organization of the industry in Germany evolved on a decentralized basis. The sectoral structure consists of a plethora of public, private and mixed ownership firms whose activities are coordinated by contracts and associations. There are three groups of utilities: some seven hundred municipal utilities, about sixty regional utilities, and nine interconnected utilities who dominate electricity generation and transmission.[38] Among the latter, the three largest utilities stand out: RWE Energie AG, PreussenElektra AG, Bayernwerk AG. Due to the close relations between municipalities and national political actors and to the large utilities' economic weight, the electricity sector's firms and associations carry great political weight. In the state apparatus, the German state (*Länder*) governments' economics ministries and the Federal Office of Cartels (Bundeskartellamt) have competencies in the economic regulation of the sector while the Federal Economics Ministry (Bundesministerium für Wirtschaft: BMWi) is mainly responsible for energy policy formulation.

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[38] For a good overview over the sectoral structure, see Schiffer 1997.

Until the EU initiative, the attitude of the state and sectoral actors alike was shaped by their embeddedness in sectoral institutions. The structure and the regulation of the sector had been informed by two leading goals: the security of supply and the economic provision of services.[39] Due to the natural monopoly characteristics of the sector, its exemption from competition was supposed to serve these goals. Two developments in the early 1990s are indicative of the preponderance of status quo orientations among state actors. First, the established structure of the sector was by and large transferred to the new German Länder during the reunification process. Second, the Federal Economics Ministry wanted, mostly for symbolic reasons, to upgrade environmental protection into a leading goal of German energy law. However, this reform was not intended to change regulatory standards of environmental protection, nor to introduce more competition in the electricity sector. As late as 1991, Economics Ministry officials considered that the German legal provisions needn't be changed in order to allow for more competition in the sector.[40] State actors aimed only at incremental reforms of the established sectoral structure and not at an overhaul of the whole electricity supply industry.

Thus, German political actors were generally very hesitant with regard to European proposals for an Internal Energy Market. The coalition government made up of the Christian Democratic Party/Christian Social Union and the Free Democratic Party, the opposition parties (Social Democratic Party, Bündnis 90/DIE GRÜNEN), and the different Ministries at the federal and regional level all took a rather negative stance.[41] They welcomed the Commission's decision to opt for the co-decision procedure and to refrain from

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[39] See Gröner 1975.

[40] Cronenberg 1991: 45.

[41] See Bundesrat 1992, Handelsblatt 15/16.11.91, 05.12.91, 02.04.92; Blick durch die Wirtschaft 05.11.91.

using EC competition law in order to liberalize the energy sectors. But with regard to the core elements of the Commission directive proposal, they emphasized the heterogeneity of the member states' sectoral structures and the need to maintain the longstanding principles of network-bound energies. In line with the position of German sectoral actors, they stressed the need for a reciprocal opening of markets in all the member states.[42]

Preference changes and multi-level games

Nevertheless, the Federal Economics Ministry gradually came to change its view on the electricity sector and increasingly regarded the EU reform as an opportunity to reform the German sector. The attitude of ministry officials, previously characterized by a close interaction with sectoral actors, shifted towards a more positive evaluation of competition in the energy sector. Their close interactions with other national officials and the decision-making process of the Council of Ministers triggered a reconsideration of the national settings.[43] Within the Ministry, an overall consensus for the introduction of competition gradually emerged. While ministry officials perceived that EU negotiations might strengthen their political position at the domestic level, their change of preferences cannot be interpreted merely as a bureaucratic-political move. Rather, it also reflected a fundamental re-assessment of the principles that had informed the organization of the German electricity supply industry.

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[42] The Federal Economics Ministry put it this way: „The Federal Government welcomes the fact that the EC Commission wants to discuss its plans for the introduction of more competition in the network-bound energies with the member states. The proposals require a careful examination. The Federal Government assumes that the path towards greater competition in the Internal Energy Market will be pursued reciprocally in the different member states. Equal opportunities for the different utilities must be guaranteed, and the attainment of security of supply, environmental protection and affordability must be ensured.„ (Bundesministerium für Wirtschaft 1991: 97)

Three ideational factors facilitated the Economics Ministry's acceptance of EU liberalization. First, the UK had already privatized its sector in 1990. The British reform was closely monitored by BMWi officials and had an important demonstration effect. It showed that competition could be introduced in the electricity sector without compromising the security of supply. As a consequence, it undermined the conventional wisdom that competition could not really work in the sector due to its economic and technical features. Second, the German deregulation commission (a body of economic expertise) presented a report on network-bound energy resources in March 1991.[44] That report advocated a liberalization of these sectors. Four of its proposals were then accepted by the Federal Government and officially introduced into the EC debate. Formally, the German position was based on the deregulation commission's proposals, but this input mainly gave additional support to the arguments that had been debated on the EU level and that had caused the initial turnaround of the Ministry. It provided additional independent justifications for the sectoral reform, as did further reports arguing in a similar line.[45] Third, electricity liberalization was linked to the broader debate about the competitiveness of German industry and of the „production site Germany" („*Standort Deutschland*") launched in the late 1980s by the national producers' association (Bundesverband der Deutschen Industrie, BDI).[46] This debate gained strong momentum in the 1990s due to the depression in the new German

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[43] During the negotiations on the electricity directive, the Council energy working group had intensified its contacts from three to four times a year to once or twice a week (Interview Bundesministerium für Wirtschaft).

[44] Deregulierungskommission 1991.

[45] E.g. Monopolkommission (1994). In part, these proposals had been put forward by the independent experts since the 1960s and 1970s (e.g. Emmerich 1978; Gröner 1975).

[46] In this debate, both industry and state actors emphasize patterns of economic globalization and growing pressures from international competition as factors justifying the reform of the estblished German institutional settings (e.g. Bundeskartellamt 1997).

Länder and also to the perception of growing global economic pressures. The acceptance of liberalization proposals was made much easier by this political and economic climate.

The revised position of the BMWi was increasingly supported by other important state and market actors. The Federal Cartel Office developed an active liberalization policy. In line with the Federal Economics Ministry and on the basis of German and EC competition law, the Office brought test cases on the sectoral monopoly rights and on third party access, which were important at the time even though the German courts later them turned down (Markert 1996). Important interest groups also supported the move towards liberalization and pressed for change. The industrial energy producers and consumers and their trade association VIK (Verband Industrielle Energie- und Kraftwirtschaft), the BDI and also smaller economic consumers in the German Federation of the Chambers of Commerce (Deutscher Industrie- und Handelstag, DIHT) demanded cuts in electricity rates to lower production costs. As the liberalization picked up political momentum in the early 1990's, the Federal Economics Ministry became an ever more active reform proponent. In 1994, the Ministry even put forward its own draft proposal to liberalize the German sector.[47] The intent of this proposal was to push forward the national debate and advance the EC discussion at the same time. The content of the proposal was heavily influenced by the involvement of ministry officials in the EC debate and by the proposals of the deregulation commission.[48]

The turnaround in the strategy of the Federal Economics Ministry provoked major realignments in the domestic interest coalitions and impinged heavily upon traditional cleavage lines within the sector. Early in the debate, the Association of German Electricity Utilities (Vereinigung Deutscher Elektrizitätswerke: VDEW) had managed to develop a

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[47] Bundesministerium für Wirtschaft 1994a, b.

[48] Interviews with officials of the Federal Ministry of the Environment and the Federal Ministry of Economics.

unifying concept for all of its members, namely, the reciprocity of market opening in the European Union. According to the association, the Commission's proposal had a discriminatory effect on the decentralized regimes such as Germany vis-a-vis state monopolies such as EDF.[49] Despite the fact that the internal agreement on the anti-liberalization stance of the association was less than perfect, state actors and political parties accepted the quest for reciprocity as an important fairness criterion.[50] As a consequence, the reciprocity argument linked the success of the national reform to the outcome of EC negotiations. Without an agreement at the EC level, a process of national reform would not have been pursued because it would have meant a unilateral opening of the German market.

But gradually, the combined pressure for reform at two political levels led to the erosion of consensus among sectoral actors. While the local utilities and their Association of municipal utilities (Verband kommunaler Unternehmen: VKU) ferociously opposed any kind of liberalization, the regional and the large utilities opted for the introduction of competition as a lesser evil. These two groups of utilities feared that the municipalities would be granted major exemptions from the liberalization due to their linkages with the political actors.[51] They also came to regard the EU liberalization as an opportunity to undermine the municipalities' control over local supply areas. Such an opening of municipal areas of supply was unlikely to come about in a national reform. Consequently, both the regional and the interconnected utilities and their associations demanded that municipalities be included in the liberalization process.[52] As a consequence of this move, the credibility of arguments denying

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[49] VDEW 1994a, b.

[50] Interviews in the Federal Ministry of Finance, the Federal Ministry of the Interior and the Federal Ministry for the Environment.

[51] Interview DVG.

[52] ARE/DVG 1994.

the potential of competition in the electricity sector was even more impaired. The new opportunities offered by EU reform and the strong support of the municipalities within the Federal Government and the Federal Council paved the way for a coalition between the interconnected and the regional utilities on the one hand and the Federal Economics Ministry and the major producers trade associations on the other hand. Thus, the localities were forced into a defensive posture.

Yet, in contrast to France where state power is highly concentrated, the interlocked and decentralized character of the German political-institutional structure, with its multiple decision-making and veto points, set the stage for controversial negotiations within the state apparatus, among the political parties, and between state and sectoral actors.[53] At first, the Federal Government did not even manage to agree internally upon the reform because the municipal firms voiced public-interest arguments against it.[54] Due to the local power of the municipalities and to their relays within the major political parties, municipal objections to electricity reform found some echoes at the national level within the parties, the Federal Council (Bundesrat), and several federal ministries. The Federal Ministry of Finance (Bundesministerium für Finanzen, BMF) and the Federal Ministry of the Interior (Bundesministerium des Inneren, BMI) were concerned about the financial consequences of

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[53] Katzenstein described Germany as a „semi-sovereign state" (see Katzenstein 1987) to characterize the low degree of autonomy that German state actors enjoy. For our purposes, three types of negotiation pressures within the political system can be distinguished: the co-ordination among the ministries within the Federal Government (bureaucratic politics), the co-ordination among the federal level and the *Länder*/Federal Council (territorial politics), and the co-ordination across parties not only within coalition governments (party competition). Territorial politics and party competition can interfere with one another in Germany because of the participatory rights of the Federal Council (Bundesrat) in the federal legislation, which in certain cases effectively grant opposition parties a say in federal legislation (see Lehmbruch 1976).

[54] The localities feared the „cherry-picking" of large consumers in their supply areas by the regional or inter-connected utilities, which could undermine the viability of their energy-efficient CPH (combined heat and power) electricity production. In addition, they argued electricity prices for „captive" consumers (i.e., households and small firms) might rise. The prospect of a substantial loss of income from their energy supply activities also endangered local subsidies to other activities such as public transportation (VKU 1994).

the reform. The Federal Ministry of Urban Planning and Construction (Bundesministerium für Raumordnung, Bauwesen und Städtebau, BMBau) feared the introduction of inter-regional price differences. The Federal Ministry for the Environment (Bundesministerium für Umwelt, Naturschutz und Reaktorsicherheit, BMU) even capitalized on the EC debate by putting forward its own model of „ecological liberalization".[55] Faced with the resistance of other ministries, the Federal Economics Ministry was no longer able to independently pursue its national reform plans and thus relinquished them to the 1994 governmental agenda. Its efforts to submit a compromise proposal at EU level during the German Council presidency in 1994 were also thwarted by the other ministries.[56]

It took the Federal Chancellor's backing of the compromise achieved at the EU level to broker an agreement within the Federal Government. After a series of negotiations with the other ministries and the sectoral interest groups, the BMWi presented a modified reform proposal in 1996 that proved to be acceptable to the other departments.[57] The EC directive effectively transformed the national debate into an implementation process. But as the directive included multiple alternatives and formed a framework rather than a detailed prescription, the „semi-sovereignty" of the German political system also shaped the implementation of the EU directive. Since the reform bill affected certain adminstrative prerogatives of the Länder, it still required at that stage the consent of the Federal Council which therefore effectively held a veto position. In contrast to the coalition government, the Social Democratic Party and the Green Party – who held a majority in the Federal Council – remained strongly supportive of decentralized energy supply and of environmentally friendly

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[55] See BMU 1992.

[56] Interviews with officials from the BMF, BMI, BMU, and BMWi.

[57] Bundesministerium für Wirtschaft 1996a, b.

ways of generation as proposed by the municipalities. Therefore, the Federal Council demanded major changes in the government proposal.[58] In order to avoid negotiations with Länder governments and opposition parties, the Federal Government further modified its proposal. In particular, it dropped certain provisions that mandated a detailed legal regulation of network access, and opted for self-regulation by market actors. From the government's perspective, a process of self-regulation by the sectoral association in conjunction with industrial generators and consumers presented the advantage of releasing some of the external political pressures. According to the Federal Government, the proposal then no longer required the consent of the Federal Council; unsurprisingly, however the latter vehemently opposed this interpretation. The recourse to self-regulation strengthened the position of the Federal Government vis-à-vis the Federal Council and the opposition parties.[59] Institutionally, the pressures arising from EU level negotiations that the Federal Economics Ministry could refer to throughout the debate and the disempowerment of the Federal Council were the important conditions of the reform. Both of them reduced the relevance of traditional veto points in the German state system.[60] Nevertheless, even the parliamentary parties of the coalition government added important changes to the proposal reflecting the negotiation pressures within coalition governments. It was mainly the CDU/CSU fraction in the Parliament (Bundestag), which changed the „industrial " character of the proposal to some degree and included several public interest provisions.[61]

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[58] See Bundesrat 1996.

[59] Detailed rules for network access have been worked out in an agreement of the sectoral peak association VDEW, the industrial energy consumers' association VIK and the Federal Association of the German Industry, the BDI.

[60] For the concept of veto points, see Immergut 1990.

[61] See Deutscher Bundestag 1997.

In sum, the German reform abolishes the long standing monopolies of the utilities and goes far beyond the minimum provisions of the EC directive. First, it does not restrict the range of eligible consumers. However, since the municipalities still maintain a large degree of control over their local supply areas and since there are no provisions that ensure market access for domestic customers, competition will be limited to industrial consumers and to distributors, at least for an interim period. Second, the reform covers both the electricity and the gas sector. However, it did not formulate explicit rules for network access in the gas sector which were left open until the content of an EC directive on the gas sector would be known. Thus, the embeddedness of German reforms in an EC context gradually changed the traditional views and orientations of German state actors. EC negotiations triggered learning processes within the Federal Economic Ministry. The institutional transformation of the BMWi and its central position in the EC and national debates also increased its autonomy vis-à-vis other ministerial departments and sectoral interest groups. To be sure, it took a lot of domestic compromising and politicking in order to pass the recent electricity reform in Germany. Without EC-level liberalization, however, it is highly unlikely that such a major reform could have come about.

V. The effect of the European Union on the definition of national interests

Our discussion of the French and German debates on the reform of electricity supply illustrates the fact that the member states do not necessarily hold on to fixed negotiating positions. This is not a trivial observation since many accounts of EU decision-making processes gloss over the fact that interstate negotiations are institutionally embedded in an EU

framework. In such context, member states can be led to significant changes in the ways in which they define their interests, primarily for two reasons. First, the incremental decision-making procedures within the Council generate certain negotiation dynamics that have substantive effects on the nature of EU policies. Secondly, these negotiations are situated in the context of a broad informal framework of institutionalized principles that contribute to the convergence of expectations and to the formulation of solutions that can be regarded as fair by all the member states.

Incremental negotiation dynamics in the Council

In the multilateral setting of Council negotiations, problems are debated in way that requires some degree of abstraction from the concrete national settings. Due to time constraints, the Council working groups, COREPER, and the Council of Ministers itself cannot discuss more than three to four aspects of the Commission directive proposals during a *tour de table*. Therefore, the multiplicity of national positions is synthesized into small bundles of controversial issues, where the common text is written in „brackets" that become relatively decoupled from the underlying national structures and interests. The name of the game is to erase as many brackets as possible in the course of the negotiation.

As a consequence of this method, the bargaining style at the Council is more often analytical than adversarial, which to a certain degree de-legitimizes the defense of concrete national situations. Those member states willing to defend their national settings are forced to come up with proposals that not only reflect their own domestic structure, but can also be applicable in and acceptable to the other member states. Thus, the embeddedness within Council debates limits the range of legitimate arguments available to the member states. The

Council presidency and the Commission are responsible for the isolation of problems and the generation of compromise proposals. In this line, even France and Germany had to put up compromise proposals. This dynamic is perhaps best illustrated by the debate on the French Single Buyer proposal. In order to defend the main institutional features of its nationalized electricity supply structure and win the support of member states with similar structures, the French Industry Ministry was forced to bring up a proposal that was conceived as an alternative model to the Commission's proposal. Then, based on a study commissioned to an independent energy policy think tank, the Commission was able to demand important changes in the French Single Buyer proposal.[62] The proposal's general elements were subsequently analyzed and accepted in principle by the Council, but in a substantially modified form.

Another consequence of isolating problem bundles is the Council's sequential approach to dealing with disagreements. Areas in which compromises seem forestalled are labeled as „political" and singled out for postponed resolution at higher political levels. The least contested („technical") issues are negotiated in an iterative process and settled by the six-monthly Council conclusions. The resulting solutions then become part of the „acquis of the dossier" and are no longer open for renegotiations. Backtracking behind interim agreements is generally not possible and the negotiations stay focused on open problems. The Council conclusions generate their own momentum because they include several specific solutions and point out remaining problem areas. For example, during the negotiations of the liberalization directive, the incremental negotiation techniques led to the deletion of the 185 national brackets. In the final phases of the negotiations, the Spanish and the Italian Council

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[62] See EWI 1995; Commission 1995.

presidency made compromise proposals that greatly aided the deletion of the last brackets and the final acceptance of the directive.[63]

Successive negotiation rounds generally lead the main actors to gradually re-evaluate both the Commission's proposals and the various national regulatory regimes. The continuous debate about the pros and cons of every single detail of each member state's regime induce a information-sharing and learning processes. This can, but does not necessarily lead to a greater acceptance of the EU framework. In the case of France, the Ministry of Industry turned from an initial short-term economic rationality that emphasized the gains from electricity exports to a more fundamental set of institutional considerations. It emphasized the principles of the French nationalized system of electricity supply in the EU negotiations but was also prepared to provide for a limited opening of the French electricity market as its Single Buyer proposal indicates. By contrast, the German Federal Economics Ministry did a full-swing turnaround in favor of the Commission's initiative. In the opinion of BMWi officials, the debate within the Council provided clear-cut evidence that the reasons for maintaining closed supply areas in the electricity sector were no longer acceptable.

Institutional environment and fairness criteria in EU negotiations

European negotiations also occur in a collective normative environment that operates largely outside the formal decision-making framework of the treaties. These principles inform actors' behavior and facilitate the convergence of their expectations.[64] Some of these

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[63] In the end, as the negotiations constituted a serious investment of time and manpower that did not leave much scope for other issues, the transaction costs themselves became an argument for joint solutions.

[64] More generally, Eising and Kohler-Koch argue that certain types of normative principles – institutional principles, policy concepts, and fairness criteria – are of particular importance in the European Union (see Eising and Kohler-Koch 1999).

principles derive from the historical and political context of the European agenda, others from certain general institutionalized understandings of what European integration is about.

Thus, the liberalization of the electricity sector was considered as important when it became part and parcel of the Internal Market agenda. That agenda was not only rooted in the treaties, but also enjoyed a high degree of legitimacy in the decade following its adoption in the mid-1980's. Another historically significant factor consists of the development of the French-German tandem within the European Union. The agreement between France and Germany „not to isolate one another in the Council" indicates that even powerful member states with opposite positions may forego issue-specific opportunities in the search for a common solution. Both member states refrained from seeking to mobilize a blocking minority against the directive within the Council. As a result, they were willing to accept a compromise that did not really satisfy them completely. For France, the EU liberalization went beyond what the French Industry Ministry was really willing to concede. In Germany, it was felt that despite the modifications to the Single Buyer proposal, the directive would not really provide for an equivalent opening of the market in all of the member states. Both France and Germany subordinated their specific sectoral interests to the broader political logic of their roles and relationships within the European Union.

A second, less historically contingent characteristic of the EU institutional environment concerns the preferred mode of interaction between the Council representatives of the member states. The Council members' preference for collegial decision-making guarantees each member state a certain level of protection against the prospect of being outvoted in areas of qualified-majority voting. It also ensures the search for regulatory solutions that can be regarded as adequate and fair by all member states. The collective definition of „fair" criteria has important implications for the acceptance of EU legislation.

For example, the member states came to focus on the degree of the national market opening as the prime criterion to provide for an equitable liberalization of electricity supply across all the member states. This point of reference focused the member states' attention on specific dimensions of the Commission proposal and made the debate appear as more technical. The Council formulated specific criteria to guarantee the equivalence of market opening in each member state, eventually leading to the complicated national quotas. The agreement that was finally reached by France and Germany at the level of heads of government, was predominantly based on the directive proposal as it had been negotiated within the Council. Here again, the institutional embeddedness of the negotiation in an EU framework impelled both member states to tone down their preponderant sectoral economic interests.

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Our study of the liberalization of the EU electricity sector provides evidence that the EU member states do not conduct EU negotiations in a pure give-and-take spirit. In the case at stake, both France and Germany altered their positions, strategies, and to some extent their domestic preferences about the organization and regulation of their electricity supply industries. In both countries, the supply of electricity by public utilities had been marked by incremental change within stable economic structures and remained subject to relatively weak pressures arising from technological and market forces. One would expect these characteristic to render national interests particularly rigid. Nevertheless, their institutional embeddedness in EU negotiations led both France and Germany, over time, to change their preferences about their own national economic and regulatory structures. While the evolution of the EU debate resulted in a limited degree of French support for market opening, the momentum of a European negotiation became a radical spur for the liberalization of the German electricity

sector. On the whole, the effect of overdrawn EU negotiations on the electricity directive was to considerably soften the initial divergence between French and German national interests, eventually changing the very nature of these interests.

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