Does the European Union Matter?
The Effects of the Single Market on National Industrial Aid Policies

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Abstract

This paper will demonstrate that the increased strength of the European Commission and the pressure from a liberalized European market have had little effect on one aspect of national industrial policy, the level of national subsidies. This poses a paradox because national subsidies, also known as state aid, are a non-tariff form of market protection; and both liberalizing the European market and strengthening the Commission's role in Competition Policy are factors exerting pressure to reduce levels of national protection. When the Single European Act was passed in 1986, the European market expedited the liberalization process, and European Community member states committed themselves to removing tariff and non-tariff barriers to trade. However, aid levels have not been substantially reduced, and some measurements show the level rising after 1986. It appears that the pressure to protect national markets from increased competition is greater than European and international pressures to reduce national subsidy levels. This paper analyzes the level of aid during the period 1981-92, that is, before and after increased European trade liberalization and offers evidence showing the greater salience of national preferences of EU member states compared to the influence of supranational economic and legal pressures.

Does the European Union Matter?
The Effects of the Single Market on National Industrial Policy

At the end of 1992 most tariff barriers between countries of the European Union (EU)[1] had fallen, leaving national subsidies, or state aid, as the main form of non-tariff protection. European integration marked the strengthening of EU institutions and increased pressure on EU members to conform to free market standards of European Competition Policy, overseen by the European Commission. In addition, increased openness in the European market intensifies domestic pressure on national governments to intervene in the market and subsidize industries vulnerable to competition from fellow EU member states. Which influence, domestic or supranational, is stronger? This paper will examine how effective market pressures and Commission rules against national intervention have been in reducing the level of state subsidies. The conclusion from the data presented in this paper is that national preferences to support industry are more salient than the two international factors curbing market intervention.

EU state aid policy falls under the guidelines of EU Commercial Policy, and strict Commercial Policy is a primary goal amongst the extensive economic activities of the EU. Commercial policy, which is overseen by the Directorate-General for Competition (DG IV) of the European Commission, is an extremely important component of the Single Market because EU commercial activities essentially represent intra-EU trade, the basis of the customs union and Common Market. Since all tariff barriers have been eliminated after the launching of the Single Market at the end of 1992, non-tariff protectionism has become more important as a potential distortion to free trade between EU member states. State aid, assistance provided by national governments, is one type of non-tariff barrier to trade, and hence is considered as national protectionism. The rules restricting state aid allocation are overseen and implemented by the European Commission.

[1] In this paper I use "European Union" and "the Community" interchangeably for purposes of simplicity.

National assistance to industry is a controversial topic, in part, because of its financial significance. Annual amounts of state aid are considerable. According to a report published by the Commission's Directorate-General for Economic and Financial Affairs (1991:13), between 1988-90 an average of ECU 89 billion (US $ 90.2 billion in 1989 exchange rates) was spent on state aid per year.

The paper's presentation is as follows: First, I present the analytical questions about how European integration may have affected state aid levels. Following this, I derive two hypotheses from these questions and link the hypotheses to the theoretical literature. I then present longitudinal data of state aid amounts and offer interpretations of the findings.

I. Analytical Questions

This paper is motivated by the analytical questions which follow. The first addresses the effect of greater EU strength and increased openness in the market on the total EU amount of aid expenditure. The second proposes the effect of these same factors on cross-national variation of state aid expenditure.

1) Does the EU have any effect on the amount of state aid granted by national governments? The Treaties of the European Union (EU) were initially written to liberalize trade between its members. One might expect that the strengthening of the EU and its institutions, which espouse liberal trade practices, would have decreased the total sum of state aid. Concurrent with announcements of the Single Market Program, the EU called for moves towards stricter adherence to Competition Rules on state aid in an attempt to decrease aid expenditures and encourage freer competition. Because the EU uses economic criteria to judge the potential for aid expenditure to distort competition on a case by case basis, we would not expect "pork-barrel" cases to be approved. As an unelected institution, the Commission is relatively free from domestic political pressure; hence, "political" criteria previously used by national governments before they were obligated to consult the Commission would be replaced

by the Commission's stricter "economic" criteria.

By answering to a supranational body (the EU), national governments can also better resist domestic pressure to grant subsidies. In one scenario, governments may give the potential recipient the excuse that the European Commission would never approve the package if it were proposed, and consequently, refuse even to present the aid to the Commission. In another scenario, a weaker national government could submit weak cases, knowing that the Commission will reject the aid package. Based on the assumption that national governments also prefer to grant less aid, we would expect the amount of aid to fall considerably after the EU strengthened state aid policy and the Commission became a more credible scapegoat for miserly national governments.

On the other hand, one might also expect pressures for national subsidies to increase as industries became more sensitive to foreign competitors after trade was liberalized. The EU, which originally began as a trade "liberalizer", could have little effect on the level of non-tariff protection, or could even have metamorphosed into a trade "protector" if domestic political pressures are more effective. In short, if state aid acts as a substitute for tariffs, as tariffs began to fall (1986-1992), state aid should have increased in tandem. However, if EU pressure to limit state intervention was more salient, aid levels should have fallen as the Commission played a more active role in state aid policy.

2) With regard to the EU's greater role in the formation of European industrial policy, has the EU decreased the influence of national governments in developing national industrial policy? National governments must adhere to the strict rules of European Competition Policy; hence, we would assume that national industrial policy, and particularly decisions about state aid, would converge to a European norm after decades of substantial variation. As a result, we would expect to observe lessening cross-national variation, despite differences in political institutions and governing parties' partisanship. That is, the European process would leave no room for the influences found in national governments. Moreover, in order to be considered for

launching the European currency in 1999, member states' adherence to convergence criteria, which include reducing budget deficits, would imply a general reduction in national spending, including subsidies. This too would have the effect of decreasing national variation in the amount of aid provided. Hence, we would see a convergence of aid cross-nationally to a lower average after states adhere to the "free market" EU.

II. Two Supranational Factors Exerting Pressure to Reduce Aid

The previous questions can be examined more systematically by employing the following hypotheses:

Hypothesis 1: When the European Commission plays a more active role to implement tougher restrictions on state aid, European levels of state aid will fall and national expenditures will convergence to a lower amount.

Hypothesis 2: Because the creation of a Single Market in Europe increased trade and pressures to conform to a liberalized market, it consequently forced the reduction of market intervention, thus lowering European levels of state aid and converging national expenditures to a lower level.

A. Hypothesis 1: A Powerful European Commission

The European Commission is the institution which oversees state aid policy and must approve all aid before it is distributed by national governments. This section describes the legal competences of this institution and analyzes the increased involvement of the Commission in the enforcement of stricter aid policy.

Conventional wisdom holds that the European Union, as a supranational institution, imposes free market policies on its member states. In fact, if conventional wisdom is believed, EU member states are bending to this pressure and moving toward a liberal economic model where governments practice a "hands off" approach to economic policy. Highlighting state aid policy in particular, Dumez and Jeunemaître (1996:231) support this concept, stating, "Convergence toward the liberal model is currently being imposed on the member states by virtue of increasingly restrictive European attention to government subsidies." This view is bolstered by official statements from the EU. A recent communication from the Commission clearly states its commitment to the implementation of a more restrictive aid policy. It argues in favor of, "[continuing] to control state aids with the objective of reducing overall levels of state aid and reliance by firms on public support" (European Commission, 1996:20).

From the first foundations of the Single Market, European policy has always advocated free market principles and restrictions on state aid. Article 4 of the Treaty of Paris (1951) states that subsidies in the steel and coal sectors, in any form, are incompatible with the aims of the Treaty, which created a unified European Coal and Steel Community (ECSC). Six years later in 1957, the member states signed a treaty also advocating liberal economic policies. Article 92(1) of the Treaty of Rome (1957) creating the European Economic Community (EEC) states that state aid to industry is incompatible with the Common Market and argues that subsidies essentially distort competition between member states and with countries outside of the EU.

These Articles represent the starting point of the Commission's state aid policy. The Commission is committed to a strong belief in letting market forces filter out less competitive firms. "The common market makes little sense unless businesses tackle the market on the strength of their own resources without any aid to distort competition between them" (European Commission, 1978:123). The Commission also argues that an openly competitive system "provides for optimum distribution of production factors" and "the most rapid economic and social progress possible" (European Commission, 1978:123). Subsidies, in contrast, allow firms to compete from an advantageous position--a soft budget constraint. Such protectionism could produce reactionary measures, such as increasing state supports from other member countries, and thus crippling the Single Market (Cownie, 1986:248).

Despite such strong language in Article 92(1) of the EEC Treaty against the use of state assistance, the same Treaty also allows derogations to this rule. Article 92(2) gives the series of aid exempted from the ban, and Article 92(3) lists derogations which may be approved in certain circumstances. In general, the justification for these exceptions is that cases of aid whose outcome contributes to the Community's economic and social aims as a whole are needed (Commission, 1978:124). That is, the Commission must also balance social considerations with the assertion that aid must not affect trading conditions at the plight of European interests. For instance, the Commission will consider the potential for massive unemployment if the rejection of assistance forces a major firm to shut down. Obviously, such job losses would afflict the member state's economy and possibly have negative, European-wide repercussions, an incident the Commission prefers to avoid.

The Commission's general stance on aid approval can be summarized as the following: 1) aid restoring the *long-term* viability and reducing social costs of restructuring are acceptable, but aids maintaining the status quo of a firm are not; 2) aid should be granted selectively to decrease excess capacity and to redirect research spending into more profitable activities; 3) finally, sector-specific aid, which is viewed as especially distortionary, is looked upon unfavorably (Swann, 1983:51). As regards to the first point, the Commission has become increasingly strict on aid packages that appear to prop up ailing industries and unprofitable firms. Much of this aid falls under the "rescue and restructuring" category. "Rescue aid" involves loan assistance given to firms in difficulties for a short time period until they develop a remedy, usually involving the implementation of a restructuring plan to restore viability of the firm, for which they may receive "restructuring" aid (European Commission, 1978:158).

As the second point indicates, aid for investment projects that would increase production in industries experiencing over-capacity are not accepted but investment in newer, high-technology industries may be considered more favorably (Commission, 1978:124, 126). The European Commission (1996:5) states in one of its recent communications that "public investment supports competitiveness when it develops Europe's infrastructure, encourages intangible investment in skills and technology and assists the development of lagging regions." In sum, the Commission advocates directing aid towards new, high-technology industries as well as less developed regions.

Though the Treaties are forty years old, the Commission consistently advocated reducing subsidies and tightening rules on state aid. Even before the signing of the Single European Act in 1986, which expedited the move to the creation of a Single Market, the Commission warned against the dependence of firms on national aid protection. "...[G]ranting of State assistance could cause a permanent drift towards protectionism within the Community, both as between the Member States and in relations with the rest of the world. In both serious risks are involved, for protectionism would endanger Community solidarity and provoke retaliation by non-Community countries" (European Commission, 1978: 123).

Not only does the Rome Treaty state the principles of EU state aid policy, it also codifies in Article 93 the competences of the European Commission to supervise and restrict state aid. The process of granting state aid involves three main actors: the recipient, the national government, and the European Commission. The process can be described as follows: First, the potential recipient, usually a region or industry, requests subsidies from its national government. If the government wants to grant the aid, in adherence to EU Competition Rules, the governments must submit all cases of state aid over a significant monetary threshold to the European Commission. Finally, before the national government may distribute the aid, the case must receive the Commission's approval.

After the member state notifies the Commission of its aid package, the Commission can approve the case with "no objection." That is, the case clearly applies as a derogation and does not require "opening procedure" to hear outside arguments for and against the distribution of the aid package. This is the most typical outcome. In fact, current approval rates are rising: 86% of all proposed cases were accepted with "no objection" in 1992 as opposed to 69% in 1980. If the Commission has questions about the aid scheme's potential to distort competition with firms in other member states, the Commission "opens procedure." Opening procedure involves inviting all interested parties and all member states to submit comments on the case. This process is an attempt to keep the Commission's activities as "transparent" as possible. If after its investigation the Commission still believes that the aid is incompatible with Competition rules, it rejects the case. Another alternative is to approve the case only under specified amendments or conditions. Article 93(2) of EEC, specifically, establishes the Commission's legal authority to insist that national governments abrogate or alter incompatible aid. Such alterations include restricting the type, amount, intensity, or duration of the aid package. Finally, if the petitioning member state disagrees with the Commission's rejection, it has the right to appeal to the Court.

Though appeals are extremely rare, one case set the precedent for the Commission to restrict national governments from granting aid. In 1979 the Commission rejected state aid proposed by the Dutch government to the multinational company Phillip Morris because the Commission could find no legal grounds to approve the aid. The aid was planned in connection with the closure of one Dutch cigarette factory and the concentration of production in another factory in different region in Holland. Since increasing production in the new factory was not a "project of European importance", or a remedy to an economic disturbance in the Dutch economy, or an action to facilitate the economic activities of the cigarette industry, the Commission rejected the case (Swann, 1983:54). As a result, the firm took the case to the European Court of Justice. The Court ruled in favor of the Commission, and this ruling bolstered the Commission's guiding principle in judging aid cases. The Commission asserts that aid is only compatible with the common interest if it reduces unemployment, stimulates investment, or encourages restructuring operations at a Community level (European Commission, 1980:113).

Aid to industry has been a traditional part of the economic policy apparatus of European governments, but since 1980 the Commission has begun to enforce the rules restricting aid to industry. Before 1980 member states often notified the Commission of aid cases without sufficient time needed for the Commission to investigate the case, and others failed to notify the Commission at all (Cownie, 1986:247). However, in 1980 the Commission wrote a "reminder" to all the Member States of their obligations to Article 93(3) of the EEC Treaty to submit all aid cases for the Commission's approval. This step began the evolution of an increasing enforcement of aid rules and of and intensification of the Commission's activities in this policy area (Cownie, 1986:247).

If the Member State grants aid without the European Commission's approval, the Commission has the legal right to recover the aid. While in 1973 the European Court decided that the Commission held this power, the Commission did not begin to exploit this right until 1983 when it announced that it would withhold agricultural payments from the European Agricultural Guarantee and Guidance Funds (EAGGF) to countries granting illegal aid. In 1984 the Commission began implementing this policy by demanding repayments of aid (Cownie, 1986:247). Though the written reminder explaining the legal responsibility of member states to notify the Commission of state aid cases may have rattled member states' memory of the Commission's legal powers over state aid distribution, the enforcement of repayments appears to have been the real factor increasing the percentage of notified state aid cases.

Many (Lavdas & Mendrinou, 1995; McGowan & Wilks, 1995; and Smith, 1996) have asked why the Commission waited so long to enforce these rules and argue that in the late 1980s a sense of economic urgency pushed the Directorate-General for Competition Policy (DG IV), under the new "free market" leadership of Leon Brittan, towards a more restrictive policy. Indeed, Leon Brittan was appointed as the European Commissioner for Britain by the ultra-liberal Thatcher government in the hope that he would effectively reduce state aid across the Community (Smith, 1997:176). As the policy pursued by many European governments of aiding "national champions" during the 1970s emerged unsuccessful during the 1980s, DG IV adopted more free market policies in tandem with the drive towards a European Single Market (McGowan & Wilks, 1995).

European scholars presently debate the extent of powers of the EU as a supranational institution relative to the powers of national governments. There is a widespread belief that the EU, with its supranational institutions, has usurped many sovereign powers from national governments and has become the author of many policies previously determined at the national level, such as industrial policy. An analysis of competition policy, under which state aid policy falls, offers a good test case of the supranationalist argument because it is the policy area where the EU, specifically the Commission's Directorate-General for Competition Policy (DG IV), plays the most active role and also holds legal competences justifying its direct involvement in restricting member states' aid expenditures.

Though state aid policy offers strong evidence for proponents of the supranationalist argument, the institutional process of aid approval still allows national governments' interests some weight. First, national governments are essentially the distributors of the aid. Indeed, they could preempt any decision by the Commission by rejecting a firm's request for aid before the Commission is ever notified, i.e. national governments could simply refuse to submit the case. Alternatively, national governments could submit a weak case to the Commission, which would easily be rejected. In this scenario, states are perfect agents and understand the rules well enough to use the EU as a scapegoat so national governments can resist domestic pressure to grant protection.

Smith (1997) argues that when aid is not approved by the Commission, national governments can conveniently "blame Europe" and reinforce the widely-believed notion that a bureaucratic Commission has imposed its will against that of the national government, who the public believes has a preference to grant industrial assistance. However, the hidden preferences of national governments may, in fact, be to decrease aid expenditures.[2] By blaming the Commission, political costs are minimized and the national budget is not compromised. However, this portrayal of member states' strategic play when cases are rejected must be

[2] A Commission official is quoted in M. Smith (1996), stating, "Brussels is used willingly."

weighed against the fact that few cases are actually rejected by the Commission each year.

The assumption that national governments' preference is to reduce expenditure on state aid, however, is highly probable in light of the pressure on member states to launch the single European currency. Recent years have seen the drive to decrease national debts in order to meet the requirements established in the Maastricht Treaty (1991) to create a European Monetary Union (EMU). For countries to enter the last phase of monetary union, Phase III, planned to begin in January 1999, member states must meet the convergence criteria which would align the monetary policies of participating countries. Phase III will fix the exchange rates of the participating currencies and will introduce a single currency in these countries. The criteria for moving to Phase III include a low inflation rate, a low long-term interest rate, a low budget deficit, a low national debt, and a stable national currency. Because most member state currently have budget deficits over the Maastricht level, meeting these criteria requires austere monetary policy. Member states are under intense pressure to reduce government spending because of their highly inflated budget deficits and national debts. If the assumptions about national governments' preferences are true, we would expect levels of aid to fall precipitously after the enforcements of EU rules.

Data collected from interviews with European industrial lobby groups during fall 1995 support the notion that national governments still play an important role in state aid policy. The data show that the politics of state aid, that is the bargaining between the actors who demand aid and the actors who can deliver it, occurs at the *national* level and not behind the doors of the European Commission. Many (Greenwood, et al., 1992; Mazey and Richardson, 1990) have written on the growing influence in Brussels of European-level lobby groups on EU decision making, and others argue that the growing power of the supranational institutions has decreased national sovereignty (Marks et al., 1996). However, for the policy area of this paper--state aid--national level politics still appear significant.

Though European level groups are the Commission's main industrial contacts, they do not take official positions on state aid. In fact, the European-level lobbying groups in "sensitive" industrial sectors (specifically, iron and steel, and automobiles), which receive a large portion of state aid, remain neutral on these issues so as to avoid hostility between members receiving aid and members opposing aid. Rather, lobbying for state aid falls to their members, usually large firms or national industrial organizations, who lobby *national* governments, not the EU directly.

This finding corroborates the argument that the EU remains an intergovernmentalist arrangement, a compromise between the different national members, despite the increasing depth and range of competences that the EU holds (Moravcik, 1991). The rules governing state aid permit national influence because the national government initiates the process. The Commission's requirements for state aid cases to be accepted are transparent. Hence, if national governments are perfect agents of the Commission, then once aid is approved by national governments, the Commission will also approve the package. Given the interview data and the assumptions that national governments prefer to reduce aid and they use the Commission as a scapegoat against domestic demands for aid, we would still expect aid levels to fall.

The previous section underscores the extent of the Commission's power over national policy in this area. If theories about strength of Commission influence over national aid policy are correct, we expect to see EU aid totals decrease after the enforcement of these rules. Also, we should see, specifically, member states' with high expenditures begin to decrease their levels of aid as the result of Commission pressure. We would thus expect the null hypothesis, state aid levels have not fallen despite the Commission's stronger enforcement of strict policy, more difficult to obtain in the field of state aid policy in comparison to other areas where the EU also plays a policy role. However, if the analysis lends support to the null hypothesis, then EU influence in this policy realm is less salient than national pressures to grant aid.

B. Hypothesis 2: Market Globalization

Since the 1980s trade has expanded rapidly in Europe. According to a recent publication

(Eurostat, 1995:368) the European Union is the largest trading bloc in the world, in terms of the percentages of world imports and exports. However, this paper concerns itself with how increased trade within Europe has affected protectionism. As the Single European Act had hoped to achieve with the elimination of tariff barriers against trade between member states, intra-EU trade has experienced substantial increases as the result of this initiative.The importance of intra-EU trade is considerable. In 1992 the ratio of intra-EU imports to GDP was 13 percent (Eurostat, 1995:368).

How does opening up national markets to international, or European, trade affect national assistance policies? Some political scientists (Frieden, 1987) argue that growing internationalization of the market encourages convergence among states' economic policies. As markets become more open and trade volumes and capital flows increase, state intervention will have less effect on curbing market forces. The past decades have seen a large expansion of trade in Europe as markets have become less restricted by tariff barriers. Accordingly, countries attempting to intervene in the market with protectionist measures or market regulation will be penalized because these measures hinder competitiveness in the long-term. Government intervention to counter market fluctuations will prove ineffective as markets react to interventions by equilibrating against them. In contrast, those governments practicing non-interventionist policies will be rewarded with lower costs and increased competitiveness.

This poses a dilemma between capitalist efficiency and political expedience as constituents demand protection. Though addressing specifically monetary policy, Frieden (1991:450) argues that the broadening and deepening of the global market may result in gradually dampening some sectoral demands for protectionism. "[T]hose for whom overseas economic conditions are more relevant will favor more coordinated policies--and thus a surrender of more national policy autonomy--than will those for whom domestic conditions are determinant" (Frieden, 1991:450). Partisan differences, for instance, in levels of government spending will dissipate, and in the long run all governments will decrease their level of spending as they follow neo-liberal economic policies. According to this theory, we would see total EU state aid expenditures decrease as its member states converge spending pattern to a lower level.

Others (Boyer, 1996) argue that economic or policy convergence will not occur because a truly global economy is not, and will not be, a reality. The convergence theorists claim, according to Boyer (1996:30) that "each nation comes to resemble a small- or medium-size firm in an ocean of pure and perfect competition. Consequently, any Keynesian-style intervention is bound to fail, given that the competition is now international and foreign producers will capture the domestic market if local producers do not adjust to the costs and prices achieved by competitors." According to convergence theorists, globalized markets will result in the international equalizations of production costs and productivity levels (Boyer, 1996:31). However, we have yet to observe an economy exhibiting perfect competition and producing a general equilibrium. Given the unequal size and power of countries and firms, such an equilibrium seems unlikely in the near future (Boyer, 1996:31). Though we observe greater globalism, the market is not completely free of barriers to perfect competition.

Though convergence may not exist globally, others argue that countries of the EU are conforming their policies towards a more liberal model in a response to market pressure. Andrea Boltho (1996) argues that France, with its tradition of developing economic Plans, is moving towards a German model of less state intervention due to the constraints placed by the Common Market and, more recently, the European Monetary System convergence criteria . "European integration, more than emulation of Germany, seems to have been the driving force behind changes in policies" (Boltho, 1996:102). Other scholars (Scharpf, 1991; Schmidt, 1996) have argued in step with the convergence theorists and agree with Boltho's observations that differences in national institutional practices are diminishing. Cross-national differences in policymaking have faded as more and more the EU pushes national economies to rely more on the market and less on the state for financing and direction.

In contrast to the assumptions held by the convergence theories, other scholars maintain that increases in trade will exacerbate cross-national differences in economic policies. Because of the vagaries in the international market, governments may be under stronger domestic pressure to intervene after their economies open to international trade. Governments will thus compensate with public spending programs for dislocations in the international economy, such as a global recession, which would affect countries dependent on trade more greatly than countries not dependent on trade. Cameron (1978) has shown that countries more open to trade have higher public spending, and he argues that governments of trade-dependent economies respond to openness by increasing spending for income supplements. The welfare state thus acts to cushion the blow from changes in the international market. Rodrik (1996) has generalized this argument by showing that these results still hold when using data from the 1980s and when less industrialized countries are included in the sample. Specifically, he found that states increase *consumption* in the form of expanding public sector employment to compensate for increased openness.

More recently, Garrett and Mitchell (1996) and Garrett (1995) have found that increasing trade capital mobility has accentuated the effects of left partisanship on interventionist policies in countries with strong labor movements. As globalization increases, left governments with strong labor spend more on income transfer programs, specifically, pensions, family allowances, and unemployment benefits. With greater openness, variation on public spending across partisanships increases, rather than diminishes, as convergence theorists would expect.

For purposes of this paper, if convergence theories hold, we would expect European aid levels to fall after Europe began expediting its move to a Single Market with the passage of the Single European Act in 1986. Also, when comparing national aid levels, we would observe member states with originally high expenditures reducing state aid in response to market pressures penalizing intervention in the market. Moreover, we should observe member states attempting to imitate British levels of spending, since the UK is the member state practicing the most restrictive state expenditure policies. If the null hypothesis, aid levels will not change after liberalizing the European market, obtains, and convergence theories are not supported by the data, we can conclude that market pressures are less salient than pressures on national governments to grant aid.

III. The Data

What is a good test of the first hypothesis, which addresses the effects of the Commission's increasing competences in aid policy? Some would examine the rate at which the Commission rejects proposed aid cases. Indeed, the ratio of the number of rejections to the number of proposals is decreasing. Whereas in 1970 less than 5% of the cases were formally rejected, in 1980 2% were rejected and 69% were approved without opening the case for examination , i.e. with "no objection" (European Commission, 1980:112). The rejection ratio has stabilized, but the percentage of cases accepted without opening procedure is increasing: in 1992 1% were rejected and 86% were accepted with "no objection" (European Commission, 1994:638).

Though reports of the Commission's low rejection rate are usually cited to show the lack of Commission influence over national aid distribution, others (Smith, 1996) argue that the number of rejected cases is a poor estimator of Commission influence. The Commission has made increasingly stronger efforts to achieve a transparent competition policy. For instance, state aid rules are widely published. Hence, national governments clearly know before proposing aid cases those conditions accepted as derogations to the ban on aid and those conditions rejected. Accepted and rejected cases are also openly published. Since 1986 all cases, approved and rejected, are published in the *Official Journal of Commission Activities* (*OJ*); and when the Commission opens procedure for specific cases, it invites all interested parties--other member states or competing firms--for comments on the case through announcements in the *OJ*. Finally, national representatives are known to negotiate with Commission officials before submitting cases (Smith, 1996:577). Hence, with such transparency one would expect the number of rejected cases to decrease, and the number of cases approved with no objection to increase.

A better test of the influence of the Commission over aid policy, which also tests the second hypothesis regarding the effects of openness on state protectionism, involves analyzing the level of state aid by country over time. As trade increased in Europe, particularly after the introduction of the Single European Act in 1986 which coincided with the Commission's intensified involvement in national aid policy, did the amount of state aid across countries change? Moreover, did the types of aid change over time?

Table 1 gives the national totals of state aid expenditure, averaged over various time periods. All tables are found in the appendix of this paper. The Commission publishes state aid data in periodic averages with overlapping years in order to facilitate accurate comparability. The variation between annual levels is great because one large case can offset a country's total aid expenditure and EU totals for that year. Pooling the data in time periods compensates for any year of atypical high or low aid expenditure and offers a more representative description of the pattern of aid expenditure. The data in Table 1 show that average aid levels for the EU have not changed much from 1981-1992; in fact, total aid has increased from 1981-86 to 1990-92. Despite the addition of two, aid-needy member states, Portugal and Spain, in 1986 total EU aid expenditure dropped considerably from 1981-86 to 1986-88; yet, total aid has slowly increased since then. The drop in aid between 1981-86 to 86-88, no doubt, is an effect of the Commission's crackdown on aid to the steel industry, which suffered from severe over-capacities. Between 1981-86 aid expenditure for steel was high; however, these aids have been "virtually phased out" (European Commission, 1995:22). Only Portugal and Italy continue to grant aid to this sector, and for the latter, aid is provided only to assist the closure of mills.

When looking at the data from 1986-92, we see an interesting comparison between the large, core member states and the so-called peripheral states. The former are richer; the latter (Greece, Ireland, Portugal, and Spain) are poorer. In addition to state aid, the peripheral member states are targeted as recipients for grants under the Structural Funds, assistance financed by the EU to support the infrastructure programs of less developed member states. The high spending member states according to Table 1 are, surprisingly, not the poorer Europeans but the richer countries. Since 1986, France, Italy, and Germany have continuously increased their aid expenditure, while the Southern Tier countries have reduced their amounts. The exception, of course, is the United Kingdom. Compare the figures for the UK to those of the other large Europeans. The former dramatically decreased aid expenditure by almost 50%; this decrease, most likely, is explained by the elimination of aid to steel and operating coal mines. In comparison to the UK, Germany's expenditure is extremely high. Since reunification added five poorer and investment-starved, eastern Länder to the German state, Germany's increase in expenditure is more easily explained.

Table 2 shows a longitudinal comparison of aid to manufacturing described in terms of economic variables. We see that total aid to this sector has decreased from 1981-92. Measured as a percentage of value added, aid has decreased by one percentage point from 1981-86 to 1990-92. However, when we use figures which eliminate aid to steel and shipbuilding, two sectors which received huge amounts of aid in the early 1980s and have since 1986 been substantially decreased, we see that the reductions of aid to manufacturing is only slight. Steel and shipbuilding are sectors covered by strict disciplines overseen by the Commission to reduce aid expenditures and curtail overcapacity. In fact, when excluding these sectors, the fall in aid expenditure in manufacturing appears to have leveled off after 1988. Aid data as measured by ECU per person employed in manufacturing more convincing describes a reduction in aid, particularly in light of the increase in unemployment across Europe during the late 1980s and early 1990s.[3] A fall in employment would effectively increase the value of the figure describing aid per person employed and thus give a slightly biased description of aid expenditures.

Though the decrease is not considerable, levels of aid to manufacturing did fall. Yet,

[3] In EU12 unemployment rose from 8.9% in 1989 to 9.7% in 1992 (from Table found in Scott, 1996:110).

total aid appears on the increase. Thus, the question emerges: how relevant is manufacturing aid to total aid expenditure? Clearly, aid to manufacturing is a relevant form of protectionism. Manufacturing aid appears salient as a percentage of total aid expenditure, although these percentages are decreasing. In 1981-86 manufacturing aid represented 50.8% of total EU aid expenditure; whereas in 1990-92 that ratio fell to 40%. The other sectors for which the Commission approves aid are agriculture[4] & fisheries, transport (railways and inland waterways) and coal.

The data in Table 3 provide a more detailed breakdown of aid to manufacturing by country. Again, for aid to the manufacturing sector we note the same national patterns as for total aid expenditure observed in Table 1. The Southern Tier countries are reducing aid expenditure, whether measured in absolute figures, in percentage of gross value added, or in ECU per person employed in manufacturing. In contrast, the richer countries are intensifying aid spending. The divergent cross-national pattern is stronger when the traditional unemployment of the Southern Tier countries is taken into consideration. High unemployment would have the effect of biasing the ratio of aid per employee to show a larger aid expenditure than the absolute aid expenditure. Yet, the absolute figures showing the dramatic fall in aid expenditure for Southern Tier countries is cogent enough. The sum of aid to manufacturing for Greece, Ireland, Portugal, and Spain in 1986-88 was 7257 million ECU, whereas in 1990-92 the sum was only 3167 million ECU. The peripheral member states reduced their spending by more than half during this time period.

The larger countries show a trend of increasing expenditure to manufacturing. The high spender in this group is clearly Italy, whose aid when measured in terms of value added or per employee is exceedingly high. In fact, in 1990-92 only Germany's new Länder have a higher aid expenditure per employee than Italy.

[4] State aid to agriculture comprises only one part of the total level of support granted to agriculture under Community legislation; other programs include aid from the Community budget under European Agricultural Guarantee and Guidance Funds (EAGGF) as well as provisions under the Common Agriculture Policy (CAP) which include market supports and assistance to reduce farm production.

Even considering Germany's added aid burden associated with reunification, this country maintains high aid expenditure. Aid to the former West Germany did not decrease to the same degree relative to the concentration of aid to the former East Germany. While from 1988-90 to 1990-92 aid as a percentage of gross value added dropped noticeably in the former West Germany, aid per employee and absolute sums of aid did not fall as dramatically. The data show that Germany does not view aid to the new Länder as a trade off to aid to the Länder of the former West Germany. Moreover, the figures in Table 3 only represent manufacturing aid and exclude sectors for which Germany's expenditure is notoriously high. For instance, though aid to coal mining has fallen dramatically across the EU since 1981--particularly aid destined to current coal production--Germany has increased expenditure from 34,767 ECU per employee in 1988 to 36,883 ECU per employee in this industry in 1992 (European Commission, 1995:36). According to the Commission (1995:39) one third of total German state aid expenditure is directed to the mining sector. Compare these figures with the expenditure patterns of the United Kingdom, which has completely eliminated all aid to current mining production during 1990-92 (European Commission, 1997:36). Though recently Germany also announced cuts in aid expenditure to the mining sector, this drop is not nearly as sharp as observed in the UK during the late 1980s. From 1988-90 to 1990-92 aid to the coal sector as a percentage of overall aid expenditure dropped from 38% to 1% in the United Kingdom (European Commission, 1995:43).

The expectations of convergence theory would lead us to expect a mimicking of British spending patterns, since the UK is Europe's noted example of a liberal, non-interventionist, trading state. However, as the Tables of state aid spending show, the UK's dramatic decrease in aid expenditure to an extremely low level after 1981, in part because of phasing out of aid to mining and steel, is the aberrant case in the EU. The UK is clearly an outlier member state in terms of state aid expenditure. Only the Southern Tier countries appear to be reducing aid, though these levels do not yet approach British levels.

When analyzing the data for the EU as a whole, the data do not show a reduction of state aid expenditure or the convergence of member states expenditure to reduced aid levels.[5] Thus, we must conclude that our results do not support convergence theories. Rather, the richer EU member states are increasing aid levels, while the poorer member states are curbing aid expenditure. This could indicate a convergence of aid to a higher EU level rather than a lower EU level, the expected outcome produced by increased openness, according to convergence theorists. Moreover, the data do not support the hypothesis that increased involvement by the Commission in state aid policy effected a decrease in aid expenditure. This could indicate the continuing salience of national politics and national governments' preference in state aid expenditure.

IV. Interpreting the Results

A surprising finding was the divergent spending patterns across richer and poorer EU member states. These patterns are also noted in by a study of state aids with regional objectives. Though Martin and Steinen's (1997) study was conducted at a more micro, regional level, their results and conclusions lend insight to the findings presented in this paper. In Martin and Steinen's comparison of state aid expenditures to less favored regions as specified by Article 92 of EEC, they found that declining areas of core EU member states receive disproportionately more aid than less favored regions of peripheral member states. This result runs counter to the goals of EU regional policy, which establishes a hierarchy of first priority to economically lagging regions ("Objective 1"), found mainly in the peripheral states, Ireland, Greece, Portugal and Spain, and second priority to regions suffering industrial decline ("Objective 2") found in almost all EU countries (Martin and Steinen, 1997:19-20). The latter regions are comparatively richer than the former.

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[5] At the time of writing, the Commission published a Fifth Survey of State Aid, whose findings mirror the results of this paper. Between 1990-92 and 1992-94 the Commission found that state aid increased. Also, the richer countries' share of EU aid increased, while the poorer countries' share decreased during this time (Tucker, 1997:3).

The goal of regional aids is to establish structural convergence and "cohesion" across European regions. However, these researchers (Martin and Steinen, 1997) find that economic need did not determine regional aid expenditure. Rather, regions in countries that could afford high aid expenditure received more aid than those in countries faced with more severe budget constraints. In short, the Southern Tier countries are spending increasingly less on state aid because they cannot afford the strain on public finances. Though all EU countries are working to meet the convergence criteria to launch the new single European currency as defined by the Maastricht Treaty, the peripheral countries face a greater burden because they have the greatest reductions to make in the budget deficit, public debt, and inflation level (Martin and Steinen, 1997:28). The combination of overburdened public finances and convergence pressures appear to be the factors curbing state aid expenditure in the EU's peripheral countries.

Though levels of aid expenditure have not changed substantially during the period 1981-92, the objectives for which aid outlined has. Whereas previously governments targeted aid for specific enterprises, such as their national champions, aid is increasingly targeted for regions and "horizontal objectives", which are neither firm, region, nor sector specific. As previously indicated, the Commission looks unfavorably on sectoral aid because these more clearly distort competition to the advantage of this sector's firms in the recipient member state and to the disadvantage of this sector's firms in the rest of the Community. In contrast, the Commission looks favorably on regional aid because it believes that this support will bolster Community cohesion, one of the EU's central goals. As we would expect, the breakdown of aid reflects the Commission's preferences. We can consequently assume that the Commission, when scrutinizing aid packages, is affecting the changing composition of aid by rejecting more cases of sector specific aid than regional cases. Though considering the low number of rejected cases, member states also appear to be adapting their packages to take advantage of the Commission's preferences.

In 1986-88 regional aids to manufacturing in areas specified in Article 92(3) regions where living conditions are particularly low--comprised 39% of total EU manufacturing aid and was almost entirely concentrated in the Mezzogiorno and Berlin regions (European Commission: 1990:33). In 1990-92 the figure for regional aid to manufacturing rose to 50% of total manufacturing aid, and expenditures became more widely dispersed throughout the Community. Not surprisingly, sectoral aid to industry dropped from 20% in 1986-88 to about 12.5% in 1990-92 (respectively, European Commission, 1990:33 and European Commission, 1995:22). This pattern also reflects the phasing out of aid to steel, a sectoral aid, as well as member states' switch from sectoral aid to regional aid proposals (European Commission, 1995:21).

Also reflecting the Commission's preference ordering of aid objectives, horizontal aid is the second largest component of industrial aid. These include such schemes as assistance for research and development (R&D) and aid to small and medium enterprises (SMEs). The Commission looks rather favorably on these types of aid because they are "strategic" aid (Brander and Spencer, 1985), which assist the drive to increase Europe's competitiveness in new product markets and growth industries. Whereas sectoral aid is seen as propping up declining industries, horizontal aid in the form of E&D or SME schemes is viewed as assisting "winning" industries. In comparison to the U.S. or Japan, European countries' investments in research and development has lagged. EU institutions do not have enough resources do initiate investment; hence, the burden remains with national governments.

The Commission admits it has difficulties scrutinizing the impact of horizontal schemes that are proposed. "[A]ids for such horizontal objectives are in most cases in the Community interest,...nevertheless, the drawback [is] that their impact on competition is often difficult to assess because little or no information is available about their sectoral and regional repercussions" (European Commission, 1992:21). For instance, will granting research and development aid for Italian information technology unfairly advantage preestablished Italian firms to the dismay Dutch companies? Despite the Commission's drive towards a transparent aid policy, definitional criteria render some aid, such as horizontal aid, opaque. The Commission admits that though the horizontal schemes by definition may not be obviously industry or region specific, they may benefit certain industries or firms over others. Since the aids are not sectorally or regionally specific and are given on the basis of member states powers of intervention, the Commission cannot take a definite position (Cownie, 1986:254). Hence, general aid schemes pose problems for implementing a strict Commission review.

The European Commission acknowledges the clear shift in aid expenditure from regional objectives at the expense of sectoral objectives and also recognizes the possible strategic reasons for member states' attraction to applying for more opaque categories of aid. "Aid under both categories [horizontal and sectoral aid] can be employed for more or less hidden and unwanted purposes of industrial policy (support of single companies as national champions or protection of whole branches which are allegedly of vital national interest) and have, in such cases, particularly disastrous effects on competition" (European Commission, 1995: 27). Whereas the application of sectoral aid is more transparent and the Commission cannot easily determine distortionary effect of horizontal aid. Nonetheless, the Commission argues that horizontal aid is less harmful to competition than sectoral aid.

Firms also seem to be taking advantage of the Commission's preferences for regional aid. It appears that one way firms are circumventing aid rules is their attempt to relocate to zones that are cited to receive regional aid, one of the least restrictive aid categories. An example of this is the current Renault case. The French carmaker attempted to receive state aid to modernize its plant in Valladolid, Spain, after having announced that it would close its profitable plant in Vilvoorde, Belgium. (Buckley, 1997:1) Though the aid package was rejected, the event alerted Commission officials to the loopholes in the state aid rules.

Smith (1996) argues that the compositional change in aid expenditure represents the Commission's growing power over national governments in formulating aid policy. I would argue rather, that this shift reflects member states' adaptation to Commission rules in order to satisfy national governments' preferences for state aid expenditure. The Commission's primary target is the reduction in aid levels to a non-distortionary measure. Considering the longitudinal data presented here and the Commission's own comments on the status of this achievement[6], this has not been accomplished. On the whole, aid levels have not shown a strong downward tendency, as we would expect from both the convergence arguments and Commission strength arguments. Instead, we observe that national governments are learning to adapt to their new rules and take advantage of the Commission's "transparent" preferences for regional aid over sectoral aid and the opaqueness of horizontal aid. Hence, the data showing the replacement of sectoral aid with regional and horizontal aid do not support the argument that the increasing competences of the Commission in aid policy have affected overall national state aid expenditures. The Commission aid rules pose obstacles against maintaining high aid levels, but the richer member state have developed methods for circumventing them.

V. Conclusion

This paper's aim is to refute the arguments that the growing strength of the European Commission and the pressures exerted by an open European market are constraining national control over industrial policy and are forcing national governments to restrict spending on aid to industry. Instead, we see fluctuations since the 1980s, but certainly no distinctive downward trend. National aid policies are not moving toward UK-style, non-interventionist approach. Rather, market principles are taking a "back seat" to domestic interests.

Alternatives (Cameron, 1978; Garrett, 1995; Rodrik, 1996) to convergence theory suggest that domestic political pressures to compensate for cyclical and structural changes in the market explain the relative impotence of supranational factors on national policies of state assistance. They offer the hypothesis that aid is used as a market buffer. Theories concerning domestic pressure on national spending policy are only touched upon in the paper. However,

[6] According to the Commission, "State aids remain a significant problem in Europe" (European Commission, 1996:10)

this paper underscores the role of national governments in conducting aid policy. On this basis, one may proceed with examining how domestic pressures influence national governments' expenditure.

Based on the "alternative" theories' characterization of public spending as a social cushion, some member states' recent statements noting aid as an instrument promoting social harmony are anticipated. The desire for "social harmony" appears to be a significant factor influencing the spending patterns, particularly in Germany. Recently, Helmet Kohl's government opposed the economic advice of the President of the Bundesbank, Hans Tietmeyer, to reduce government spending in attempts to meet Maastricht criteria. In Kohl's explanation, he stressed the " 'social' aspect of Germany's 'social market economy'" and prided the distinction between his government and the radical approach of the liberal Thatcher government (Norman, 1997: 21). To be sure, Kohl has recently announced cuts to the mining sector in Nordrhein-Westphalen. However, this announcement was met with miner strikes throughout this Land; and though these cuts were not as sharp as in other EU member states, the government had to slow the speed at which these cuts could be made because to miner demands (Norman, 1997:21).

The data show the limits to EU influence on state aid policy and more broadly, industrial policy. National governments are not passively accepting the constraints placed on their development of industrial policy, specifically competition policy, by the supranational European Commission. Rather, they are adapting to the changes as players in the international market and as protectors of domestic interests.

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Table 1: Total State Aid, 1981-1992 (1)

	1981-86 (2)	1986-88	1988-90 (3)	1990-92 (4)
Belgium	4.4	3.9	3.8	3.6
Denmark	1	0.9	1.1	1.1
France	19.1	15.3	16	17.7
Germany	20.5	23.9	25.8	30.9
Greece	1.6	1.3	1.5	1.2
Ireland	1	0.7	0.6	0.6
Italy	24.2	20.6	22.7	25
Luxembourg	0.3	0.2	0.2	0.3
Netherlands	2.3	2.4	2.8	2.2
Portugal	*	0.7	0.9	0.8
Spain	*	5.9	6	5.4
UK	10.8	6.6	8.2	4.9
EEC 12	85.2 (5)	82.3 (6)	89.6	93.7

(1) Averages are in billions of ecu.
(2) 1981-86 and 1986-88 data, in 1989 prices, found in "Communication to the Commission" from Leon Brittan in European Commission (1990:4).
(3) 1988-90 data, in 1989 prices, from European Commission (1992:Annex IV, 3-14).
(4) 1990-92 data, in 1991 prices, from European Commission (1995:70-81).
(5) EEC 10 Total; excludes Portugal and Spain, which were not members at this time.
(6) EC 10 = 76.2

Table 2: State Aid to Manufacturing: EU Averages (1)

	% value added	ECU/person employed (2)	in mio ECU
1981-86	4.8 (4.0)	1761 (1474)	43309
1986-88	4.0 (3.8)	1515 (1439)	38835
1988-90	3.8	1372	40704
1990-92	3.7	1293	37822

(1) 1981-86 and 1986-88 figures from European Commission (1990:10, 44); 1986-88 data in 1989 prices from European Commission (1992:10); 1988-90 and 1990-92 data in 1991 prices from European Commission (1995:10).
(2) Employment data from the manufacturing sector only. The figures in brackets in 1981-86 and 1986-88 cells are ratios excluding aid to steel and shipbuilding.

Table 3: State Aid to Manufacturing, Country Averages(1)

	% gross value added, manufacturing				ECU/employee in manufacturing				in mio ECU			
	1981-86	1986-88	1988-90	1990-92	1981-86	1986-88	1988-90	1990-92	1981-86	1986-88	1988-90	1990-92
Belgium	6.4	4.3	5	4.3	2204	1606	1744	1527	1485	1175	1280	1119
Denmark	2.8	1.9	2.3	2	1135	593	6858 (2)	638	363	316	336	336
France	4.9	3.8	3.7	3	1886	1437	1449	1138	8097	6479	6424	5044
frmr FRG	3	2.7	2.6	2.1	1055	994	1099	979	7261	7869	8488	7134
frmr GDR	**	**	**	n.a.	**	**	**	4385	**	**	**	4848
Greece	12.9	24.3	16.9	12.3	n.a.	2983	2430	1579	1382	2074	1764	1032
Ireland	7.9	6.4	3.9	2.9	2738	2114	1821	1411	501	447	389	307
Italy	9.5	6.2	7.8	8.9	4360	2139	2425	2611	13407	10760	12162	12526
Luxembourg	7.3	2.3	3.4	4.1	2471	988	1369	1573	92	37	51	58
Netherlands	4.1	3.1	3.2	2.6	1461	1215	1266	978	1088	1101	1177	929
Portugal	**	2.2	7.3	5.2	**	302	911	625	**	245	736	479
Spain	**	6.8	3.7	1.7	**	1749	1080	493	**	4491	2902	1349
UK	3.8	2.6	1.9	1.5	1115	770	756	525	5374	4101	4067	2661
EEC 12	4.8	4	3.8	3.7	1761	1325	1372	1293	43309	38835	40704	37822

(1) 1981-86 data in 1988 prices from European Commission (1990:10, 44); 1986-88 data in 1989 prices from European Commission (1992:10); 1988-90 and 1990-92 data in 1991 prices from European Commission (1995:10).
(2) This figure must be an error. The figure in European Commision (1992:10) for this cell is "634" in 1989 prices.