

**Robert Schuman Centre for Advanced Studies**

Bounded Rationality and Policy Learning in EU Negotiations:  
the Liberalization of the Electricity Supply Industry

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## **Robert Schuman Centre for Advanced Studies**

### European Forum

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This Working Paper has been written in the context of the 1999-2000 European Forum programme on “Between Europe and the Nation State: the Reshaping of Interests, Identities and Political Representation” directed by Professors Stefano Bartolini (EUI, SPS Department), Thomas Risse (EUI, RSC/SPS Joint Chair) and Bo Stråth (EUI, RSC/HEC Joint Chair).

The Forum reflects on the domestic impact of European integration, studying the extent to which *Europeanisation* shapes the adaptation patterns, power redistribution, and shifting loyalties at the national level. The categories of ‘interest’ and ‘identity’ are at the core of the programme and a particular emphasis is given to the formation of new social identities, the redefinition of corporate interests, and the domestic changes in the forms of political representation.



## **Abstract**

Taking the example of the liberalization of the electricity supply industry, the article analyzes the impact of EU institutions on the interest definitions of its large member states. Confronting central tenets of the intergovernmental approach, I suggest that member state executives act within the limits of bounded rationality and do not always represent clear and fixed preferences in EU negotiations. Based on the examples of France and Germany, I show that national interest definitions may change greatly during the course of the decision-making process. In the EU, institutional principles, policy-concepts and fairness criteria guide member state orientations and hinder the pursuit of unilateral advantages. Incremental negotiation techniques within the Council of Ministers can induce learning processes and a reassessment of domestic situations. Furthermore, even if as a result of these techniques EU legal acts contain several flexibilization elements, they can trigger behavioral changes that clearly surpass their regulatory content.



## Introduction

In 1996, after eight long years of controversial negotiations, the European Union (EU)/European Community (EC)<sup>1</sup> agreed to liberalize the EU electricity markets. This reform was a watershed in the evolution of a sector that had until then been exempted from competition. The outcome is puzzling, however, because member states' positions on this issue differed markedly. As many member states defended their established sectoral structures in the EU negotiations, several well-informed commentators doubted that they would ever be able to agree on a directive.<sup>2</sup> And after the passing of the act the EU reform was qualified as the least common denominator of negotiations between the large member states France, Germany, and Britain.<sup>3</sup>

In contrast to this line of reasoning this article demonstrates that the regulatory reform cannot be satisfactorily explained by approaches which assume that the member states form their interest definitions solely on the basis of their domestic situations and defend them rigidly in the Council negotiations. The intergovernmental approach is most outspoken on this issue: member state actors form their preferences on the basis of domestic economic situations or due to the pressure of domestic economic interest groups.<sup>4</sup> However, this reasoning is not exclusive to intergovernmentalism but is also prevalent in many policy analyses of the European Union. For example, in their analysis of EU environmental policy making, Adrienne Héritier and her collaborators assume that the large member states attempt to transfer their regulations, their regulatory culture, and their regulatory practices to the European level to limit adaptation costs and to strengthen the competitiveness of their national industries.<sup>5</sup> Thus, even if these approaches assess the autonomy of the supranational actors differently influential strands of the literature on EU decision making assume that the member states form their preferences independently from EU-level interactions.

In line with the central assumptions of these approaches, the overwhelming majority of member states and sectoral utilities opposed EU

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<sup>1</sup> I use these terms interchangeably even if the article refers solely to the first pillar of the European Union, namely the European Community.

<sup>2</sup> Padgett 1992; Ortwein 1996.

<sup>3</sup> In her study on the evolution of EU energy policy, Janne Haaland Matlár clearly subscribes to an intergovernmental explanation of electricity liberalization. In her view, the final compromise reflects „national differences in market structures, energy policies and market philosophies“ in Great Britain, France and Germany (Matlár 1997: 159-160).

<sup>4</sup> Moravcsik 1998.

<sup>5</sup> Héritier et al. 1994: 2.

liberalization for a long time and tried to limit its scope. Therefore, these approaches explain the resistance towards the sectoral reform quite well but do not account for the unanimous agreement of the member states on the need for a fundamental reform. They have only a limited importance for explaining the outcome because they conceptualize the preference formation of the member states too statically. To provide for a more adequate explanation of the regulatory reform, I treat the question of whether the member states have fixed or variable preferences as a matter for empirical investigation and endogenize into the analysis their processes of preference formation at the EU level.

The theoretical framework therefore departs in three crucial aspects from the intergovernmental approach. It rests on the *concept of bounded rationality*, on *neo-institutional premises*, and on *theories of policy learning*. The intergovernmental conception of actors' *rationality* is inconclusive. On the one hand, it asserts that the member states do not have a complete rationality.<sup>6</sup> But on the other, all the actors have very little difficulty obtaining relevant information, processing it, and developing consistent preferences. Transaction costs for obtaining relevant information are low and the actors therefore enjoy "complete information".<sup>7</sup> As a result, intergovernmentalism ascribes a very high degree of rationality to all actors enabling them to define clearly the situational logic at work. I depart from this assumption and start from the premise that human beings, organizations and nation states face substantial "informational and computational limits on rationality" so that even all "intendedly rational behavior is behavior within constraints".<sup>8</sup> Two dimensions of the boundedness of rationality are of particular relevance and give rise to two different modes of interaction. First, the member states cannot fully assess the responses of other actors to their own moves which, combined with a lack of control over the evolution of the EU policy agenda,<sup>9</sup> may lead them to step back from their initial positions, re-order their preferences, and *newly position themselves*. Second, as a result of issue complexity and as a consequence of their multidimensional domestic structures, member states are often unsure whether their initial preferences are based on 'correct' assessments of the adequacy of the EU policies at hand.<sup>10</sup>

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<sup>6</sup> Moravcsik 1998: 23.

<sup>7</sup> Moravcsik 1998: 66.

<sup>8</sup> March 1978: 590.

<sup>9</sup> Much of the literature on EU policymaking centers on one aspect of this argument, namely the relative autonomy of the EU institutions. For a recent collection of articles that stress the autonomous role of the European Commission and the European Court of Justice, see Sandholtz/Stone Sweet 1998.

<sup>10</sup> In his historical institutional analysis of EU social policymaking, Paul Pierson also points to the change of member state preferences. However, as he traces such changes mainly to factors

This second dimension of the boundedness of rationality can give rise to *learning processes* that may change interest definitions<sup>11</sup> even when these are deeply rooted in domestic structures and practices. As a result of new information embodied in a Commission proposal and due to the growing information on the situation in the other member states, member states subject their domestic arrangements to detailed scrutiny which may lead them to re-evaluate their domestic settings. Their voluntary attempts to change the goals or the instruments of EU or domestic political programs as a response to new information revealed in EU level interactions may be considered to be good indicators of such instances of policy learning.<sup>12</sup> In sum, the course of negotiations in the EU is not just marked by “the relative bargaining power of important governments”<sup>13</sup> even if such power is part and parcel of the process. Given uncertainty over their preferred outcome, processes of policy deliberation and policy learning also shape the interaction among member states.

The intergovernmental approach largely discards *institutional factors* in its explanatory framework. This holds both for the autonomous role of supranational organizations (the European Commission, the European Parliament, and the European Court of Justice) and for the ways in which the EU institutions structure the behavior of the different actors. Apart from assuming an almost complete rationality on part of the actors which decreases the need for institutions that reduce uncertainty, shape expectations and guide behavior, this conception results largely from a claim about the absence of institutions in EU ‘constitutional’ policymaking: “Unlike the EC’s everyday legislative process...treaty amendments are subject to essentially no procedural constraints”.<sup>14</sup> Assuming a bounded rationality and focusing on ‘daily’ decision-making, I argue that EU institutions have a much larger role to play. The EU institutional setting forms an important arena for member state negotiations, which greatly aided the liberalization of the electricity supply industry.<sup>15</sup> Certainly, the EU institutions do not determine actors’ behavior or decisions but

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exogenous to the EU (1996: 139-142), his argument does not seriously question the intergovernmental account of the member states’ preference formation.

<sup>11</sup> I use the terms *interest definitions* and *preferences* interchangeably even if the term preferences implies, in its generic connotation, a rank ordering of interests.

<sup>12</sup> On the topic of policy deliberation and policy learning, see Hall 1993; Majone 1993; Sabatier 1993.

<sup>13</sup> Moravcsik 1998: 3.

<sup>14</sup> Moravcsik 1998: 61.

<sup>15</sup> There are several strands of neo-institutional approaches. For useful overviews, see Hall/Taylor 1996; March/Olsen 1998. For some applications to the European Union, see Pierson 1996; Scharpf 1985; Pollack 1996.

they do form important normative and cognitive frameworks.<sup>16</sup> They provide both standards for appropriate behavior and standards for the assessing the consequentiality of EU legal acts. As a result, they have a twofold impact on the formation and pursuit of preferences by member states. By structuring the decision-making process, they allow for the selection of eligible preferences and appropriate solutions whilst hindering the pursuit of unilateral advantages. They thus *remove certain options from the set of feasible outcomes*. Furthermore, EU decision-making practices can stimulate genuine learning processes and preference changes that are based on the re-evaluation of domestic settings both in the light of Commission proposals and in the light of the situation in other member states. This can *enlarge the 'bargaining space' or shift its position*.

Moreover, *informal institutional factors* can often have a greater impact on the pursuit and formation of preferences than the formal decision making powers of the supranational organizations and the formal EU decision procedures.<sup>17</sup> Institutional principles, policy concepts and fairness criteria shape the orientations and behavior of the member states and also the space for negotiation outcomes. Incremental negotiation techniques in the Council generate negotiation dynamics and processes of policy learning.<sup>18</sup> They change the set of feasible outcomes and result in policy solutions typical of the EU. The legal acts of the European Union contain pronounced flexibilization mechanisms which allow for the resolution of conflicts and for an appropriate implementation in different national contexts. Nevertheless, EU regulations and directives are not a *menu à la carte*. They contain a core set of rules that have to be implemented in all member states and that trigger behavioral changes beyond their regulatory content.

The analysis focuses on the large member states Great Britain, France and Germany. The focus on the large member states does not mean that these always dominate EU decision-making. But if those member states that play the central role in the intergovernmental account of the integration process change their preferences as a result of policy learning at the EU level, less powerful member states are likely to be at least equally receptive to such processes.

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<sup>16</sup> See March/Olsen 1989.

<sup>17</sup> In their analyses of the EU electricity liberalization, Susanne K. Schmidt (1996) and Lisa Conant (1999) emphasize the competition policy mandate of the European Commission and the supporting role of the ECJ in this policy area.

<sup>18</sup> Thomas Risse and Harald Müller argue more generally that „[a]rguing can be conceptualized as a micro-mechanism for learning in a social interaction environment“ (1999: 17).

The article is set up as follows. First, the decision-making process in the liberalization of the EU electricity markets is flashed out. Second, this process is analyzed by means of an intergovernmental approach to illustrate which elements cannot be covered by this theoretical perspective. Thirdly, the main part of the article demonstrates the importance of informal mechanisms of conflict resolution in the EU and illustrates that they generate specific negotiation dynamics and processes of regulatory learning. The conclusion summarizes the key points of the article and provides evidence that the impact of EU directives can greatly surpass their regulatory content.

## **1 The Decision Making Process to Liberalize the Electricity Supply Industry**

Until the mid-1980s, the EU institutions played no role in the regulation of the electricity supply industry even though they had some legal bases in the three treaties of the EC: EURATOM, ECSC and EEC. Thus far, there is no legal provision for a Community energy policy in the EC treaty. Due to the emphasis placed by the member states on their national autonomy in this sector, the role of the Commission's Energy Directorate General (DG XVII) was mostly restricted to the formulation of studies and forecasts.

It was only with the Internal Market Programme that the liberalization rationale was extended to those economic sectors which had previously been exempted from competition, such as transport, telecommunications and electricity. When the Commission drew up an inventory of obstacles to an Internal Energy Market in 1988, it identified most of them in the fields of electricity and gas. The Commission therefore envisaged the application of Community law to these sectors, and set as its goal free trade between member states.<sup>19</sup> Its inventory contained some vaguely defined plans for a comprehensive liberalization of the two network bound energy sectors. Just one year later, DG XVII presented some draft proposals that would introduce a few competitive elements into these sectors, namely, directives on the transit of electricity and gas, on price transparency throughout the Community, and on the notification of investments. Of these proposals, the member states objected only to the latter, their reason being the interference with private investment decisions.<sup>20</sup>

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<sup>19</sup> Commission 1988: 20.

<sup>20</sup> Agence Europe 19.5.1990: 12.

After further internal preparations and controversial discussions with the member states, the European Parliament and sectoral firms and associations, the Commission put forward an ambitious proposal for the liberalization of the EU electricity and gas markets.<sup>21</sup> Following an extended debate covering both the procedures and the content, it presented a far-reaching proposal for a directive to create an Internal Energy Market on the basis of Article 100a (EEC).<sup>22</sup> Earlier, the Commission had dropped plans to liberalize the sector unilaterally on the basis of Art. 90 (3) EEC which would neither have involved the European Parliament nor the Council of the EU. Taking as a precedent its opening up of the telecommunications market, DG IV (Competition) had suggested such a strategy even though the other institutions and also parts of the Commission regarded this approach as illegitimate. In contrast to this approach, with its directive proposal for the IEM the Commission emphasized a step-by-step approach and the use of the co-decision procedure signalling that it wanted to consult both the European Parliament and the Council.

The proposal aimed at a fundamental reform of the established sectoral practices. Its core elements were intended to introduce competition mainly into the generation of electricity, which has a 50-70 percent share in the total cost of supply. First, distributors and large industrial firms would no longer be bound to their 'area supplier' but be able to contract deliveries from other generators by giving them statutory access to the network, in other words, third party access (TPA). Second, all exclusive rights for the construction of power stations and power lines would be abolished and replaced by a non-discriminatory authorization procedure. Finally, to prevent cross-subsidies between different activities (which might undermine competition) the management and accounting procedures of vertically integrated utilities would be separated, a process known as 'unbundling'.

The directive proposals provoked widespread opposition from the utilities and the member states. Until then, the member states' orientations were shaped by the long stability of their sectors which had excluded competition. In their opinion, the radical EC proposals were incompatible with their domestic arrangements and long standing sectoral orientations. Various member states also feared negative economic repercussions on their sectors arising from an opening of the markets. Only the United Kingdom and Ireland were clearly supportive of the controversial TPA-proposal because the UK had already liberalized its domestic sector and Ireland was considering a reform. All of the

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<sup>21</sup> Commission 1991.

<sup>22</sup> Commission 1991.

other member states were opposed or at least very skeptical.<sup>23</sup> The utilities even founded an EU trade association to defend their domestic positions. In general, EURELECTRIC formulated a defensive posture in favor of the status quo.<sup>24</sup> However, unlike most of the EURELECTRIC members, the British utilities supported the Commission plans from the outset and some continental utilities also expected advantages from liberalization, with the Dutch and several French and Spanish distributors anxious to loosen their dependence on their suppliers. Finally, the large industrial consumers and their associations supported the liberalization plans.

In its first reading of the proposal, the European Parliament stressed the traditional sectoral orientations – the maintenance of the security of supply, the environmental implications of this sector, the need to maintain equal prices for similar customers as well as other public service obligations of the utilities. However, it was evident from the voting behavior of the parliamentary parties that, in its second reading, the EP was unlikely to reach the absolute majority required to amend or reject the Council's common position. Thus, the Commission included in its own amended proposal only those elements of the EP's position, which would not run against the spirit of market integration.<sup>25</sup> Following the production of the amended Commission proposals, the highly controversial discussion was continued in the Council of the European Union. In general, the major cleavage was between those member states with highly centralized sectors in state ownership and a preference for state planning on the one hand, and those with more decentralized sectors who emphasized the introduction of competition more strongly. The first group consisted mainly of France, Greece, Italy, Spain and Belgium. In the beginning, the second group consisted only of the United Kingdom, but they were later joined by Germany, the Netherlands, and after their accession to the EU, Sweden and Finland. Under French leadership, the first group of countries argued for limits to be placed on liberalization and for some consideration to be given to the utilities' role as service providers in the general economic interest.

During the negotiations, France and Germany were the main antagonists. While France feared the repercussions of liberalization on its nationalized regime, Germany dwelt on the economic consequences arising from a market opening in the context of heterogeneous national regimes. On the one hand, the German utilities feared an inflow of French electricity because of the high excess capacity and price advantages of the French state monopoly Electricité

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<sup>23</sup> Handelsblatt 09.04.1992.

<sup>24</sup> See EURELECTRIC 1992.

<sup>25</sup> Commission 1993.

de France (EDF).<sup>26</sup> On the other hand, they worried about the closure of the French market because of the high degree of vertical integration within EDF. While, in the second half of the 1980s, EDF and the French government had even supported plans for a limited opening of the EU market to turn the excess capacity into revenues, they took a much more defensive posture when they learned about the comprehensive reform plans of the European Commission. At the end of the 1980s, they perceived liberalization as a threat to the fundamental principles of the French monopolistic sectoral regime.<sup>27</sup>

To defend its sector, France even suggested its own competition model to the Council of the EU and was able to win the support of other countries with similar supply structures. Earlier, in late 1993, the French industry ministry had published the results of a study on the French sectoral set-up that had largely been triggered by the EU negotiations. The so-called *Rapport Mandil* concluded that the major principles of the French sectoral regime should be preserved and that a thorough liberalization should be rejected. However, it also recommended that the generation and the foreign trade monopolies of EDF be abolished and the market access of some types of independent generators be improved. On the basis of these results, the French government proposed an alternative to the Commission model, calling it the *Single Buyer* (Acheteur Unique) model.<sup>28</sup>

Thereafter, the Council asked to Commission to assess whether the French proposal could be considered as equivalent to the Commission's own proposal. Accordingly, the Commission ordered a study to be undertaken by the Energy Economics Institute of the University of Cologne. According to this study, the French model led to far less competition than the Commission's own proposal,<sup>29</sup> so that the Commission demanded major modifications to the French Single Buyer proposal.<sup>30</sup> Nevertheless, in principle the Council of the EU accepted the Single Buyer model as an alternative to the model the Commission itself had suggested. After the French proposal, the equivalence of the market opening was at the core of the Council debate. Both competition models, it was claimed, should guarantee a similar degree of market access, market results and consumer choice. The intense and continuous negotiations as well as the successive solutions to a broad variety of issues led to several changes in the amended Commission proposal and progressively enhanced the willingness of the member states to agree to a settlement. Due to the problem-solving and

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<sup>26</sup> See Harms 1987.

<sup>27</sup> Agence Europe, 24 March 1995.

<sup>28</sup> See Mathis 1995.

<sup>29</sup> EWI 1995.

<sup>30</sup> Commission 1995.

mediating strategies in the Council debate, at the end of 1995 some member states, namely the United Kingdom, Sweden, Finland and Denmark, were willing to compromise.<sup>31</sup> However, Franco-German disagreements over the compromise position still threatened to forestall agreement, which was only achieved after bilateral consultations between the French and German heads of state in mid 1996.

The European Parliament passed the directive without further changes in late 1996. The directive provides for a progressive market opening. Between 1999 and 2003, the member states have to liberalize about 25 percent to 33 percent of their national markets. The extent of the liberalization is certainly not as great as in the telecommunications sector.<sup>32</sup> Nevertheless, the directive does introduce fundamental changes to established sectoral practices.<sup>33</sup> Even if it allows the member states to choose between several alternatives – for instance, the regulation of network access and the eligibility of different consumer groups – it introduces competition into the sector and thereby fundamentally alters established sectoral regimes. Strong modifications made to the original French Single Buyer proposal indicate that the member states opting for this concept will not be able to evade the aim of market integration that the directive implies.

## **2 The Change of Member State Preferences**

### **2.1 National Structures and National Preferences**

The intergovernmental approach rests on a few fundamental assumptions about the preference formation of the EU member states. First, it implies that the member states form their preferences independent of the effects of the EU institutions. „Preferences, unlike strategies and policies, are exogenous to a specific international environment“.<sup>34</sup> Secondly, the issue specific preferences the member states hold “within each negotiation” are clearly defined,<sup>35</sup> well ordered and stable as they are based on domestic structures or on domestic interest coalitions.<sup>36</sup> These assumptions will now be applied to the liberalization

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<sup>31</sup> Agence Europe 21 December 1995.

<sup>32</sup> See S. Schmidt 1997.

<sup>33</sup> European Parliament and Council of the European Union 1996.

<sup>34</sup> Moravcsik 1998: 24.

<sup>35</sup> Moravcsik 1998: 23.

<sup>36</sup> Apart from the economic rationality criteria, Andrew Moravcsik also names geo-political calculations (1998: 27-34). These criteria need not be addressed here because they did not play a role during the liberalization of the electricity supply industry. The intergovernmental

of the electricity supply industry to illustrate that the member states' interest definitions do not exclusively rest on domestic economic structures or domestic interest coalitions. Their preferences can substantially change during the course of EU negotiations – which is the reason for the successful outcome of these negotiations.

*Prima facie*, the liberalization of the electricity supply industry seems to be a perfect case for reasoning on the basis of structural national interests. The domestic sectoral arrangements were at the core of twentieth century industrialization in all of the member states. The sector was marked by a very long period of stability in all the member states. Since electricity supply is 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. Changes caused by the globalization of markets as in telecommunications were basically absent and neither did the slow evolution of generation technologies trigger re-assessments of the established sectoral regimes.<sup>37</sup> Therefore, the member states were very likely to base their preferences on their domestic sectoral structures. The government of France remained wedded to the infrastructure built by the state-owned utility EDF in the postwar period – the supply of electricity by a state owned utility in accordance with national priorities such as the development of nuclear power. Likewise, the German government defended an institutional structure of energy supply that had profound historical roots – sectoral arrangements were characterized by the presence of a small number of large firms, several regional utilities, multiple local producers, both public and private ownership, and continued reliance on coal and nuclear energy. Of the three large member states, only the United Kingdom was likely to opt for EU liberalization because it had already liberalized and privatized its domestic sector.

In this situation, the member states ought to have developed clearly defined and stable preferences about their domestic settings and EU liberalization. However, only the United Kingdom lives up to these expectations. In France and Germany, we can note clear changes in the national positions and preferences.

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approach is clear that the relationship between domestic structures, domestic interest coalitions, and national preferences is variable and not fixed. On the one hand, economic interest groups have an influence on the formulation of governmental policies. But on the other, governments have to weigh these against “broad constraints set by general demands for regulatory protection, economic efficiency, and fiscal responsibility” (Moravcsik 1998: 37).

<sup>37</sup> Author's interviews with various government officials, trade associations, and firms.

## 2.2 Bounded Rationality and Preference Changes of the Large Member States

Between 1987 and 1990, the *United Kingdom* radically reformed its sectoral arrangements.<sup>38</sup> The Conservative government included the electricity supply industry, which had been nationalized after the Second World War, in its comprehensive privatization program. Modeled on the earlier reforms of telecommunications and gas, a regulatory agency, the Office for Electricity Regulation, was set up. Also in line with the preceding reforms, the sector was privatized, liberalized, re-organized and highly regulated. To organize large-scale electricity trading, the government even designed a complicated trading mechanism, the Electricity Pool. After this national reform, the British utilities and the Department of Trade and Industry (DTI) tried to transfer this model to the EU-level and consistently supported the EU reform.<sup>39</sup> Thus, the intergovernmental assumptions apply to the UK without reservation.

In contrast to the British position, the French and the German interest definitions were neither clear nor stable, they changed during the course of the negotiations. In the context of EU negotiations, such preference changes can – beyond attributing them to changes of exogenous technical and economic factors<sup>40</sup> – be traced to two sets of factors: to shifts in influence positions or interest coalitions on the one hand and to learning processes of the actors on the other. In the first case, which is well explained by the intergovernmental approach, the changing influence of individual actors or shifts in the actors' alignments lead to changes in the national preferences. In the second case, the intergovernmental explanation is not satisfactory. If the embeddedness in EU negotiations triggers learning processes and preference changes, both structural and interest based theories of preference formation are insufficient.

The following analysis demonstrates that the French and the German preference changes were not related to changes in influence positions or interest coalitions on the domestic level but to positional changes and learning processes induced by the European Union. In both countries, important state actors could not foresee the implications of their initial positions and actions on the liberalization issue. They displayed a bounded rationality that was manifest

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<sup>38</sup> See Henney 1994.

<sup>39</sup> Author's interviews with DTI; Electricity Association, PowerGen, National Power.

<sup>40</sup> Since the mid-1980s, international oil and gas prices dropped and combined-cycle gas turbines have become increasingly popular in electricity generation. These technical and economic developments could have served as partial justifications for the liberalization of the EU electricity market. However, none of the 51 interview partners considered them as relevant developments in the EU negotiations.

in two types of uncertainty. The main French actors (EDF and the Ministry of Industry) could not foresee the reactions of other member states and the European Commission to their initial support for a limited opening of the EU electricity market, which later forced them to reposition themselves and to oppose a comprehensive reform. The German Federal Economics Ministry could not initially identify its own ‘correct’ preferences because the Commission plans were a radically new proposal and the issues involved were highly complex. Learning processes in the course of the Council negotiations led to a re-assessment of the German sectoral setting and a preference change in favor of liberalization.

In *France*, the Ministry of Industry (Ministère de l’Industrie) and the national utility Electricité de France dominated the domestic decision making process. During the liberalization process, both actors broadly agreed on their positions. The Ministry of Industry acted mainly as a ‘sponsoring department’ for the national monopoly utility. Those actors who favored a comprehensive liberalization of the French sector – like the competition directorate in the Ministry of Economics and Finance, several large industrial conglomerates and some local distributors – did not play a major role.<sup>41</sup> Initially, the two protagonists emphasized their economic interests in exporting electricity to other member states because of the high overcapacities that EDF had built up since the oil crisis in the 1970s. As a result of its ambitious nuclear program, the firm had now large over-capacities that could not be absorbed by the French market. Because the cross-border electricity exchange in the EU was not based on competition, but on the voluntary co-operation of European suppliers, EDF faced important internal barriers to trade within the EU. For example, in the second half of the 1980s, Spanish utilities blocked EDF’s attempts to deliver electricity supplies to a Portuguese utility for more than two years.<sup>42</sup> EDF’s negotiations with large German industrial firms also ended without a success. To give substance to its demands for a strengthening of cross-border electricity trading, in 1988 the Ministry of Industry even called upon the Commission to open state aid proceedings against the German government because of subsidies granted to the hard coal sector.

However, only shortly thereafter EDF as well as the Ministry of Industry started to oppose fervently the Commission’s initiative to liberalize electricity when its potential repercussions on the French sectoral organization became clearer. Facing the potential loss of its monopoly status, EDF now propagated a co-operative increase of cross-border electricity trading in the EU as a fall back

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<sup>41</sup> Author’s interview Ministry of Economics and Finance.

<sup>42</sup> McGowan 1993: 48.

position which would leave the market situation of the incumbent utilities virtually unaffected.<sup>43</sup> As a consequence, the position of the Ministry of Industry also changed: “The realization that EDF was no longer on board dampened the French government’s enthusiasm for the IEM at around 1989”.<sup>44</sup> Now, fundamental principles of the French electricity supply industry’s organization came to the center of its attention.<sup>45</sup> According to the French actors, the Commission plans would endanger their national autonomy in energy supply, the long term security supply based on nuclear energy, the equal treatment of customers across the country as well as the tradition of *service public* that EDF symbolized more than any other state enterprise.

With its emphasis on interest politics, intergovernmentalism can in part explain the involuntary, instrumental adaptations of the French actors because the Ministry of Industry’s position largely followed EDF’s turnaround. However, even then it remains unclear why EDF changed its position. To explicate the firm’s positional adaptation, an intergovernmentalist account would need to take the bounded rationality of actors more into account than it actually does. It would also need to pay more attention to the impact of the EU agenda and the EU institutions on the national actors’ positions. Even the largest European utility and the French Ministry of Industry could not forecast the consequences of their initial position to demand an increase of EU cross-border electricity trading. Both of them expected that such an increase would be possible without major repercussions on their domestic sectoral regime. In particular, they did not expect that the European Commission would put forward a comprehensive scheme to liberalize the EU electricity markets in such a radical way. In short: they could not calculate the responses of other actors to their initial move and overrated their ability to control the political agenda of the EU institutions. Consequently, they adapted to the dynamic evolution of a political agenda they could no longer control and tried to limit the damage to the French sector.

In *Germany*, we can note preference and positional changes of several actors. Initially, the German actors were very hesitant with regard to European proposals for an Internal Energy Market. The German coalition government, the opposition parties, and the different Ministries at the federal and regional level all took a rather negative stance. They welcomed the Commission’s decision to opt for the co-decision procedure, which let the member states have an effective say in the liberalization debate. But with regard to the core elements of the

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<sup>43</sup> See also EURELECTRIC 1992.

<sup>44</sup> Eising and Jabko 1999: 16.

<sup>45</sup> Agence Europe 24.03.95.

Commission proposal, they emphasized the heterogeneity of the member states' sectoral structures and the need to maintain the long standing principles of network-bound energies – the security of supply, the economic provision of services, and environmental protection.<sup>46</sup> Due to the new character of the Commission proposals and their unpredictable consequences, established domestic structures and rules initially guided the actors' orientations. The sedimentation of the sectoral institutions let the EU-plans appear as a 'new idea' that had to face important obstacles.<sup>47</sup>

Two developments at the beginning of the 1990s are indicative of the *status quo* orientations among state actors. First, the most important institutional arrangements of the sector – for instance, its contractual arrangements, the sectoral exemption from competition law, and the three-tiered set-up of local, regional and large interconnected utilities – were by and large transferred to the new German Länder during the reunification process.<sup>48</sup> 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 neither intended to change regulatory standards of environmental protection nor to introduce more competition into the electricity sector. As late as 1991, Economics Ministry officials considered that there was no need to change dramatically German competition rules in the electricity sector.<sup>49</sup> State actors were satisfied with a process of incremental reform and had no plans to overhaul the whole electricity supply industry.

Only two years later the Federal Economics Ministry would not only fervently support EU liberalization but would also put forward its own reform proposals.<sup>50</sup> The close interaction of national bureaucrats and politicians within the EU negotiations had shifted the attitude of ministry officials towards a more positive evaluation of competition in the energy sector. The long, intense, and detailed debate on the advantages and disadvantages of divergent sectoral models triggered a fundamental re-assessment of the principles that had

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<sup>46</sup> For example, see Bundesministerium für Wirtschaft 1991: 97.

<sup>47</sup> Giandomenico Majone highlights that „...new ideas face powerful intellectual and institutional obstacles. Economic, bureaucratic, and political interests combine to restrict the range of options that are submitted to public deliberation or given serious consideration by the experts. Because of intellectual and institutional inertia, ideas in agreement with current practices and accepted doctrine usually enjoy a considerable comparative advantage over unconventional proposals“ (Majone 1989: 35-36).

<sup>48</sup> Ortwein 1996.

<sup>49</sup> Cronenberg 1991: 45.

<sup>50</sup> Bundesministerium für Wirtschaft 1994a, b.

informed the organization of the German electricity supply industry.<sup>51</sup> This learning process led to a re-evaluation of the conventional wisdom that competition could not really work in electricity sector due its 'special' technical and economic features. As a consequence, the introduction of competition was now considered as economically more rational than the prior sectoral regime. Thus, the leading ideas that had informed the sectoral organization and regulation of electricity in Germany for more than 100 years changed radically. Electricity came to be seen as a rather conventional commodity and the Ministry developed its own reform plans for the sector.

Within the German sector, the interlocked reform debates at both the European and the domestic level triggered positional adaptations. The German sector consists of three different groups of firms: very large utilities, about sixty regional utilities linked to them, and a multitude of local utilities.<sup>52</sup> Early in the debate, all of the three groupings and their sectoral trade association opposed the EU reform.<sup>53</sup> But gradually, the combined pressure for reform at two political levels led to the erosion of consensus among the sectoral actors.<sup>54</sup> While the local utilities 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 municipal firms would be granted major exemptions from liberalization due to their linkages with political actors in the major political parties and at the local level.<sup>55</sup> They also came to regard the EU liberalization as an opportunity to undermine the municipalities' control over local supply areas given that such an opening up of municipal areas of supply was unlikely to come about in a national reform. The turnaround of the large and the regional utilities formed an involuntary positional adaptation to the changed preferences of the state actors, which improved the likelihood that both the European and the domestic reform plans would succeed.

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<sup>51</sup> Authors interviews Bundesministerium für Wirtschaft, Bundesministerium für Umwelt, Naturschutz und Reaktorsicherheit.

<sup>52</sup> In 1993, the large interconnected utilities *generated* about 80 percent of electricity, the regional suppliers generated about nine percent, and the municipal firms generated about ten percent. The large utilities *distributed* about 34 percent of the electricity produced, the regional firms distributed around 39 percent and the municipal firms distributed about 27 percent (Schiffer 1995: 166).

<sup>53</sup> See Grawe 1991.

<sup>54</sup> Author's interviews Bundesministerium für Wirtschaft; Deutsche Verbundgesellschaft; Verband kommunaler Unternehmen; Vereinigung Deutscher Elektrizitätswerke; RWE Energie AG. See also ARE/DVG 1994.

<sup>55</sup> See ARE/DVG 1994.

The intergovernmental approach can only very partially account for the changes that took place in Germany. It can partly explain the positional adaptations of the large and the regional utilities that saw the EU reform in part as a ‘window of opportunity’ to open up the municipal firms’ supply areas given that they could no longer defend their own monopoly status.<sup>56</sup> However, the Federal Economics Ministry’s preferences evolved not exogeneously to the EU negotiations but must be regarded as a result of a learning process initiated by these negotiations. This makes an intergovernmental explanation unsatisfactory.

In sum, with its emphasis on domestic structures and interest alliances, the intergovernmental approach is able to account for important elements of the member states’ preference formation. Nevertheless, even in the French case it would need to consider more than it does so far the effects of bounded rationality and of a lack of member state control over the EU political agenda. Moreover, in Germany, EU reform opened up options to state actors that led to a fundamental re-assessment of the domestic sectoral structure. Intergovernmentalism cannot satisfactorily account for this learning process. Therefore, the following section analyzes the effects the EU institutional setting has on the member states’ preferences.

### **3 Negotiation Dynamics and Regulatory Learning in the EU**

#### **3.1 The Institutional Setting of the EU**

European integration has entailed fundamental changes in the institutional set-up the member state actors and the sectoral utilities are embedded in. For the electricity sector this transformation was particularly profound. The frequency of the energy group meetings within the Council of the EU increased from three or four times a year at the end of the 1980s to once or even twice a week during the liberalization debate. The high density of interactions in the context of specific negotiation techniques and institutional principles contributed to the emergence of social norms and impinged upon the member states’ definitions of interests. This section shows that the interaction of the member states within the

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<sup>56</sup> For the main argument of this article it does not matter that the interest differentiation of the firms *followed* rather than *preceded* the state actors’ preference changes, which contradicts the intergovernmental conception of pluralist political processes in the member states. Lisa Conant also overlooks this point when she suggests that the Federal Economics Ministry acted in line with the position of the large utilities (Conant 1999: 18). For a concise criticism of intergovernmentalism on this issue, see Wolf 1999.

European Union generates informal mechanisms of consensus formation that further the resolution of conflicts, trigger learning processes and generate problem solutions typical for the European Union.

The EU's institutional set-up differs markedly from that of the member state polities.<sup>57</sup> It is characterized by a multi-level structure, the combination of supranational and intergovernmental elements, and a strong role for the judiciary. During the policy cycle, the EU's actors are largely restricted to agenda setting and policy formulation, whereas implementation is organized by the member states. Additional factors enhance the complexity of actor relations. The territorial and functional representatives come from fifteen widely differing systems. Therefore, actor constellations are remarkable for their heterogeneity and fluidity. Furthermore, the competencies of the political actors vary according to different procedures and they also change in different phases of the policy cycle. Neither the Council or individual member states nor the European Commission or the European Parliament enjoy complete control over the process or the substance of decision making. Throughout these processes, multi-layered negotiations and consultations with shifting centres overshadow formal powers.

Owing to these institutional characteristics, the EU is open to and, indeed, in need of points of reference that guide actors' behavior and further their co-operation. Precisely because of its heterogeneous composition and complex institutional set-up, regimes<sup>58</sup> that reduce the complexity of decision situations and form a more or less fixed set of reference points are crucial.<sup>59</sup> Within the formal treaty framework, processes of co-operation and informal principles and norms have evolved that contribute to the convergence of expectations and behavior. First, a fundamental set of principles and norms revolves around the whole range of the EU institutional set up and all of its policy areas. These institutional and distributive principles and norms give orientation to the actors when it comes to questions related to the allocation and use of powers, to appropriate procedures and to the fairness of outcomes. They provide for the actors' fair and efficient participation in decision making and for fair results of these processes. Second, there are more specific principles, norms and concepts that are important guiding posts within and across specific policy areas. These substantial concepts relate primarily to the content of a policy, the goals to be attained and the instruments to be employed. They concern the appropriateness

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<sup>57</sup> See Eising/Kohler-Koch 1999.

<sup>58</sup> For the classic statement on the regime approach in international relations, see Krasner 1983.

<sup>59</sup> See Grande 1994: 219.

of the EU rules. Considering the heterogeneity of the actors involved in EU decision-making they serve as persistent “focal points” and guide political action in specific issue areas. Thereby, they ensure some coherence and continuity in EU policies. Policy concepts, institutional principles and distributive criteria greatly shaped the negotiations leading to the liberalization of the EU electricity markets and helped to overcome the fervent initial resistance towards the regulatory reform. On the one hand, they rendered certain preferences and outcomes illegitimate and hindered the member states’ pursuit of such preferences. On the other hand, they furthered the learning processes and preference changes of the member states.

### **3.2 Policy Concepts and the Commission’s Right to Initiate EU Policies**

As a result of the heterogeneous background conditions in the member states policy concepts have a special relevance for guiding actors’ orientations. The actors need not necessarily agree on “all the definitions of the central problems”, rather what is needed is “sufficient overlap” for any policy concept to become a “successful dominant approach”.<sup>60</sup> Even if these concepts are multidimensional they guide orientations with regard to the content of a policy, the goals to be attained and the instruments to be employed. In environmental policy, the concept of *sustainable development* provided a focal point for the convergence of expectations guiding political action.<sup>61</sup> In social policy, the *social dimension of the internal market* fulfilled a similar function and galvanized agreement on the Social Protocol of the Maastricht Treaty.<sup>62</sup> In EU technology policy, the *network concept* has contributed to the spread of cooperative research projects in the European Union. Among these substantial concepts, *EU market integration* is of primordial importance. It is not confined to one policy area but travels across issue areas and economic sectors. The liberalization of the electricity supply industry was part and parcel of the EU Internal Market Programme whose beneficial economic impact is almost taken for granted and which has enjoyed broad support across the member states since the mid-1980s because it is embedded in a neoliberal policy agenda and rooted in the founding treaties. Therefore, measures aimed at market integration are considered to be highly legitimate in the EU context. They form the backbone of European integration and the dominant economic policy doctrine since the early 1980s. They guide the actors orientations and behavior in such a way that they are unable to refuse such measures even if the scope of negative integration is extended to economic sectors that have developed their own

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<sup>60</sup> Gottweis 1999: 75.

<sup>61</sup> Lenschow 1999.

<sup>62</sup> Falkner 1999.

principles and rationality criteria - such as the electricity supply industry. The central position of market integration among EU policies acted as a catalyst for the initiative to liberalize the network bound energies, which was also justified by the precedents other sectors, such as telecommunications, had set.

Among the EU institutions, the European Commission is the ‘traffic center’ for the adoption and diffusion of policy concepts. Its right of initiative grants the Commission a central position in the phases of agenda setting and policy formulation: „Within the broad framework of the treaties it will decide whether, when, and in which direction European rules and regulations ought to be generated“.<sup>63</sup> As a consequence of its competition policy responsibilities, the Commission acquired an excellent knowledge of the British reform. However, due to the intensity and the scope of this reform, which had included a change of ownership, a restructuring of the industry, the setting up of a new regulatory agency and of a specific trading mechanism, the British model could not be transferred directly to the EU level. Nevertheless, informed about the initial French interest in increasing electricity exports, the interest of large industrial consumers in lowering their electricity costs and the British reform, the Commission developed a liberalization agenda for the EU electricity supply industry. The Commission’s main point of reference was a development specific to the EU. It mainly transferred the Internal Market Programme to the electricity sector. The Commission justified the creation of an Internal Energy Market with the opportunity costs of a “Non-Europe” in this sector as well as with positive effects for the EU industry and consumers.<sup>64</sup>

Due to the central role of market integration, the member states were unable to oppose the initiative entirely and had at the very least to discuss it. However, the great resistance of the state actors and the utilities towards the Commission initiative indicates that even the high legitimacy of the liberalization doctrine would not necessarily guarantee the success of the endeavour. Therefore, the impact of other factors, namely the institutional principles and fairness criteria, needs to be considered in more detail.

### **3.3 Institutional Principles: the Consensus Principle**

Institutional principles shape actors’ orientations and beliefs about what constitutes legitimacy in the EU political system and what supports its claim to make binding decisions.<sup>65</sup> The principles refer mainly to the *participation* of the

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<sup>63</sup> Kohler-Koch 1994: 172.

<sup>64</sup> Commission 1988: 6-9.

<sup>65</sup> Kohler-Koch 1999.

actors and to the *decision rules* in the negotiation processes. The participation of the different EU bodies, the inclusion of societal actors and the consensus principle within the Council of the EU shall bridge the actors' heterogeneity and their cleavage lines. Even if majority decisions are increasingly common in the Council since the Single European Act, and the Maastricht and the Amsterdam treaties, its decision-making practices are still characterized by a search for consensus to find solutions that are acceptable for all member states.<sup>66</sup> The possibility of taking a decision by qualified majority certainly enhances the Council's propensity to reach an agreement because the „possibility of breaking deadlocks by voting drives the negotiators to break the deadlocks without actually resorting to the vote“.<sup>67</sup> Nevertheless, with heterogeneous situations in the member states, multi dimensional cleavage lines, manifold issues to be negotiated, a dynamic political agenda and unclear and unstable preferences of the member states, the consensus principle warrants not only 'comprehensive protection' against being outvoted in important issues or even continuously.<sup>68</sup> It also allows for a search for problem solutions that *all* member states consider as *appropriate and fair*, and which ensures compliance with such rules. Therefore, the EU institutions and the member states alike consider the consensus principle to be both appropriate and rational.

The choice of the decision procedure in this case confirms that the participation and the consensus principles have informed the EU actors' behavior. The Commission could choose among four different procedures. First, it could have applied the EU competition rules of Art. 85, 86 EEC-treaty against the utilities. Secondly, it was entitled to initiate infringement procedures according to Art. 169 EEC against the member states. Thirdly, it had the formal power to unilaterally formulate a Commission directive based on Art. 90 (3) EEC. Finally, it was able to propose a directive on the basis of Art. 100a EEC-Treaty that would allow for the participation of the other EU bodies in the liberalization process. Why then had the Commission mainly recourse to the fourth of these procedures to open up the EU electricity markets?

The member states and the utilities as well as the European Parliament and the largest part of the Commission preferred a procedure that would involve all of the EU bodies. The large majority of the actors perceived the application of EU competition law as both procedurally and substantially inadequate for opening up electricity markets. The application of EU competition law is the domain of the Competition Directorate-General (DG IV). In contrast to most of

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<sup>66</sup> Hayes-Renshaw/Wallace 1995.

<sup>67</sup> Weiler 1991: 2461-62.

<sup>68</sup> Gehring 1995: 209.

the other Commission services, DG IV's bureaucratic culture is highly legalistic.<sup>69</sup> Within the Commission, DG IV is the most visible exception to the participation and consensus oriented approach. The Competition Directorate-General suggested applying EU competition law and Art. 90 (3) EEC to the electricity market while DG XVII, which is responsible for energy policy, opted for market opening on the basis of Art. 100a EEC. The planned unilateral action of DG IV that followed its own precedent in the telecommunications sector faced fierce resistance from the European Parliament and the member states. Due to the economic relevance of the sector and to its quasi-public status in many member states, these signaled to block the use of Art. 90 (3) EEC.<sup>70</sup> The only member state wholeheartedly supporting the EU reform – the United Kingdom – was also unwilling to tolerate unilateral action by the Commission.<sup>71</sup> This indicates that the preferences for consensus do not depend on situational calculations but on fundamental institutional considerations. Both the Council of the EU and the European Parliament emphasized the need to proceed consensually, to involve all of the EU bodies in the negotiations, and to consult the sectoral actors extensively. Therefore, and based on a large majority in a collegiate meeting, the Commission refused DG IV's envisaged approach and proposed instead a stepwise procedure in co-operation with the Council and with the European Parliament.<sup>72</sup>

After this decision had been taken, DG IV initiated infringement proceedings against some of the member states so as to maintain a high degree of pressure on them and on the European Parliament whose socialist majority fraction was hesitant with regard to the liberalization of the sector.<sup>73</sup> These proceedings should support the directive negotiations but could in themselves not provide for an appropriate problem solution because their functionality for the market opening was rather limited. On the one hand, DG IV referred only five member states (France, Ireland, Italy, Netherlands, and Spain) for the infringement of treaty obligations to the ECJ and these referrals were limited to

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<sup>69</sup> See Laudati 1996.

<sup>70</sup> See Financial Times 23.01.92. Unlike in the electricity sector, in telecommunications there was a broad agreement among all actors that the sector should be liberalized. Moreover, DG IV's use of the Art. 90 (3) EEC procedure was limited to the opening of partial sectoral markets (services and equipment). Therefore, the cases had a more limited relevance for the whole sector than the plans for the electricity sector. The higher legitimacy of procedures that warrant the participation of all the EU bodies lets the Commission more and more refrain from using the Art. 90 III EEC-treaty procedure. And if it does so, it consults the Council and the European Parliaments whose participation is not required (Lecheler/Gundel 1998: 95)

<sup>71</sup> Author's interview European Commission.

<sup>72</sup> Author's interviews European Commission.

<sup>73</sup> Financial Times Energy Monthly 53/15 (May 1993).

but one isolated aspect of the liberalization – *legal import and export monopolies*. On the other hand, this strategy depended on the support of the European Court of Justice (ECJ) whose opinion could not be predicted. In two related cases (Almelo and Corbeau), the ECJ had rather unsurprisingly decided that the Community rules on the four market freedoms also applied to utilities. But in its judgements, the Court had maintained that these firms could be exempted from competition in order to maintain “sufficient financial equilibrium to guarantee the provision of public services”.<sup>74</sup> In these judgements, the ECJ did not specify the criteria for exemption and left the final decision to the discretion of the national courts. Therefore, the interpretation of these judgements differed across the economic actors, the member states and the Commission.<sup>75</sup> Among EU bodies, the member states, and the firms there was some uncertainty about the ECJ judgements in the infringement cases. Nevertheless, according to the member state officials, the legal strategy to open up the market did not appear entirely credible,<sup>76</sup> so that DG IV’s strategy could increase the pressure on the negotiations only to a limited degree.

Unlike in the Art. 177 EEC procedures related to the Almelo and Corbeau cases, in the infringement procedures the ECJ itself had to formulate the case specific rulings. That the ECJ did not rule against any of these import and export monopolies in its 1997 rulings confirms the limited credibility of the competition policy route. In fact, even after the member states had already agreed on a directive to liberalize the sector, the ECJ still held that the member states could maintain the most essential aspects of their national export and import monopolies. The European Court of Justice regarded these trade monopolies as violations of the EU rules on market integration but it accepted their maintenance if they were necessary to enable the utilities to perform tasks of general economic interest assigned to them by the member states.<sup>77</sup>

In sum, the decision procedure, which involved agreement on a directive by both the European Parliament and the Council of the EU and in which the utilities were to be consulted guaranteed not only that the claims of all EU bodies to participate in the process were taken into account. For all of the actors, political negotiations among the EU institutions also promised a higher degree of control over the outcome and a more adequate regulatory solution than a legal strategy would allow.

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<sup>74</sup> Hancher 1994: 4.

<sup>75</sup> LeNestour/Zinow 1995.

<sup>76</sup> Author’s interviews Ministère d’Economie et des Finances; Bundesministerium für Wirtschaft.

<sup>77</sup> See judgements C-157/94 (Commission – Netherlands), C-158/94 (Commission – Italy), C-159/94 (Commission – France), C-160/94 (Commission – Spain), all dated 23 October 1997.

The consensus principle was not confined to the choice of the decision procedure, it also informed the decision-making processes within the Council of the EU. As a result of the implementation of the Maastricht treaty, in our case the co-operation procedure had been turned into the co-decision procedure that allows qualified majority voting in the Council. But due to the heterogeneity of national structures and the economic relevance of the industry the member states were not prepared to outvote each other on such a salient issue. Even the main antagonists in the debate, Germany and France, agreed “not to isolate one another” during the Council negotiations but to search for a consensual solution of all member states.<sup>78</sup> They refrained from attempts to mobilize a qualified majority in favor of the directive and from the option of constructing a blocking minority against it which existed until the very end of the negotiations. In the end, the member states agreed on the directive in a consensual manner. Thus, the informal consensus principle had a greater relevance for the negotiations than the formal procedures that were open to the Commission and to the member states and which would have allowed them to pursue their issue specific interests.

However, the participation of the different EU bodies in decision making and the consensus principle in the Council of the EU need not necessarily lead to agreements and to effective problem solutions. In contrast: the consensus principle may even support the veto-orientations of individual actors. As it is almost impossible for the member states to exit from EU negotiations, a persistent blockade of decisions is possible, as Fritz W. Scharpf has convincingly argued in his analysis of the EU ‘joint decision trap’.<sup>79</sup> Therefore, an analysis of negotiation techniques in the Council will supplement that of the institutional principles since these techniques restrain the unilateral pursuit of member state interests and even change their preferences.

### **3.4 Incremental Negotiation Techniques and Regulatory Learning in the Council of the EU**

Let us first once again recall the basic tenets of the intergovernmental approach and of approaches devoted to the analysis of policy making in the EU. In the intergovernmental approach, member states’ preferences are essentially taken as given. Agreements are reached on the basis of differential power positions and mutual concessions in a given bargaining space.<sup>80</sup> Policy analyses that pay more attention to institutional factors in EU policymaking paint a strikingly similar

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<sup>78</sup> Author’s interviews European Commission; Department of Trade and Industry.

<sup>79</sup> Scharpf 1985.

<sup>80</sup> Moravcsik 1998: 50-66.

picture of the Council negotiations. ‘Opposing national interests and goals often only allow for solutions based on a least common denominator basis, on mutual exchanges and on comprehensive package deals’.<sup>81</sup> Even analyses that ascribe a relatively great action capacity to the European Union do not relate this to the Council negotiations, but to the autonomous role of the Commission, the influence of scientific experts, and even to member state hopes that they need not really implement EU legal acts.<sup>82</sup>

These perspectives contain several elements that explain why member states may arrive at joint decisions. Nevertheless, recalling the initial preferences of the member states, only the United Kingdom and Ireland opted for a comprehensive liberalization of the electricity market. Thus, the initial negotiation space would not have allowed the adoption of a joint decision in favor of liberalization. Therefore, the following section provides evidence that the embeddedness of the member states in the EU negotiation setting systematically hinders a unilateral pursuit of interests and changes their preferences. In the Council and its administrative sub-structure a special mode of interaction evolved, which allows for the resolution of complicated negotiation problems and massive conflicts of interest. So far neglected, but of special interest are the (1) *incremental negotiation techniques* of the Council.<sup>83</sup> These generate a particular negotiation dynamic, trigger regulatory learning effects of the member states, and result in regulatory solutions typical for the European Union. Compared to them, (2) the *member states’ role changes during their term of the Council presidency* and the (3) *moderation of the Council debate by the European Commission* are quite well known. These three components of the Council negotiations are closely related but they must be disentangled because they have divergent implications.

(1) The Council proceedings are structured by *incremental negotiation techniques*. 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, and as a result of the multilateral character of the EU, the multiplicity of national positions are grouped into small bundles of

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<sup>81</sup> Héritier et al. 1994: 181.

<sup>82</sup> Eichener 1996: 271-276.

<sup>83</sup> The *incremental negotiation* technique differs from the *decision* technique of „disjointed incrementalism“ (see Dahl/Lindblom 1976: 82-85). Unlike the latter, the former does not limit the scope of policy changes to the margin, but allows for radical reversals. However, incrementalism as a negotiation technique also has a function that Dahl and Lindblom ascribe to continuous and incremental policy changes: „Incrementalism is a process of constantly testing one’s preferences...“ (Dahl/Lindblom 1976: 83).

controversial issues for which compromise proposals are debated. This procedural structuration has important implications for the resolution of member state conflicts. First, it decouples the controversial problems from the underlying national structures and from individual member state interests. It provides for the formulation of *types and categories* of problems as well as solutions rather than for a debate of highly idiosyncratic situations. Thereby, it leads to a rather abstract and analytical debate about these categories and, in part, delegitimizes modes of argumentation that rest on specific 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, embeddedness in the Council debates limits the range of legitimate arguments available to the member states. 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 needed to bring up a proposal that was conceived as a general alternative to the Commission's proposal. The French proposal was detached from the French domestic structure and its general elements were subsequently analyzed and compared to the Commission's own proposal. Based on a study commissioned by an independent energy policy think tank, the Commission was then in a position to demand important changes to the French Single Buyer proposal. Finally, the Council accepted the Single Buyer in principle, though in a substantially modified form.

The second consequence of isolating problem bundles is the Council's sequential approach to dealing with disagreements. The debate starts with those proposals that are immediately solvable and tractable and gradually proceeds to the more controversial issues. The least contested 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 renegotiation. Backtracking behind interim agreements is generally not possible and the negotiations stay focused on open problems. The Council negotiations generate their own momentum because they build up several specific solutions and point out remaining problem areas. The iterative negotiation technique makes for regular interim negotiation successes, which forestall a break-up of the negotiations since several issues have already been cleared and since the remaining problems have been concretized. For example, during the negotiations of the liberalization directive, the incremental negotiation technique led to the deletion of the initial 185 member state reservations to the amended Commission proposal.

Thirdly, the iterative debate and the successive solution of a variety of problems increase the member states' knowledge of the dossier and of the problems involved. The successive negotiation rounds generally lead the main actors to re-evaluate gradually both the Commission's proposals and their own domestic regulatory regime so that their assessments of the envisaged regulation and of the domestic setting may change during the course of the negotiations. The continuous debate about the pros and cons of every single detail of each member state's sector systematically induces learning processes and preference changes. The incremental debate increases the knowledge about the individual elements of the often highly complex regulatory proposals. It also reduces uncertainty about the effects on multidimensional domestic structures. Therefore, the incremental techniques of isolating problem bundles place the initial member state preferences and their domestic settings more and more into a test stand. New information about the situation in the other member states and the pressure to analyze the domestic situation in the light of the Commission proposals often result in re-assessments of the efficiency of national arrangements. This can help the resolution of initially intractable conflicts. This can, but does not necessarily lead to greater acceptance of the EU framework.

In the case of France, the Ministry of Industry turned away from an initial short-term economic rationality that emphasized the gains from electricity exports, towards a more fundamental set of institutional considerations. It emphasized the principles of the French nationalized system of electricity supply but was also prepared to provide for a limited opening of the French electricity market as its Single Buyer proposal indicates. Similarly, Ireland moved from an initial support of the liberalization to a more defensive posture and tried to seek exemptions as a 'small electricity system'.

By contrast, learning processes that started within the Council debates explain the fundamental preference change of the German Federal Economics Ministry. Initially, the Ministry's orientation was shaped by the long stability of the German sectoral regime that had excluded competition. The sedimentation of the sectoral institutions outweighed the fact that the Commission's liberalization plans fit very well with the liberal tenets of the German economic policy doctrine of a Social Market Economy and with the debate on the strengthening of the German industry in an era of economic globalization. As a result of the EU initiative the Ministry no longer rigidly defended the domestic institutions but argued for a comprehensive sectoral reform.<sup>84</sup> The Ministry's involvement in the EU negotiations formed an important mechanism for the transmission of the liberalization doctrine to the national level. It led to a

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<sup>84</sup> Bundesministerium für Wirtschaft 1993: 52.

changing assessment of the economic rationality of competition within the network bound energy sectors.<sup>85</sup> As a result of this debate, the assumption of technical and economic peculiarities that had been taken for granted and had justified the sector's exclusion from competition appeared less and less convincing.<sup>86</sup>

Further ideational factors complemented this re-evaluation: First, British privatization from 1990 onwards had an important demonstration effect: it showed that competition could be introduced into the electricity sector without endangering the security of supply and was greatly valued by the BMW officials. The British reform completely undermined the general argument that competition could not really work in the sector due to its economic and technical features. Secondly, at the domestic level electricity liberalization became linked to the broader debate about the competitiveness of German industry and 'production site Germany' (*Standort Deutschland*) which had been launched by the national producers' association, Bundesverband Deutscher Industrie, in the late 1980s. This debate had gained momentum in the 1990s due both to the economic structural crisis in the new German Länder and the perception of growing pressure from economic globalization. In the context of the European debate and of the debate on globalization, reform proposals by national expert commissions gained in importance. Reports by the Deregulation Commission and by the Monopoly Commission also recommended the liberalization of these sectors.<sup>87</sup> Their input provided additional legitimacy for a sectoral reform. Considering the radical nature of the sectoral reform, the reports of these well-renowned commissions confirmed the overhaul of the 'conventional wisdom'. Neither similar proposals made by practically the same set of experts in the 1960s and 1970s<sup>88</sup> nor political pressure from the large industrial consumers in the 1980s had resulted in political reform.<sup>89</sup> The German Federal Economics Ministry was also more open to the Commission proposals than the French Ministry of Industry because these plans were largely compatible with the idea of a Social Market Economy, while in France, the *Service Public* tradition forestalled their acceptance. On the basis of the EU negotiations and of the national reform proposals, the Economics Ministry proposed a national reform whose scope went even beyond the Commission plans. Therefore, one may safely conclude that the Ministry did not just bend to

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<sup>85</sup> Author's interviews Bundesministerium für Umwelt, Naturschutz und Reaktorsicherheit; Bundesministerium für Wirtschaft.

<sup>86</sup> Bundesministerium für Wirtschaft 1994a: 39.

<sup>87</sup> Deregulierungskommission 1991; Monopolkommission 1994.

<sup>88</sup> Gröner 1965, 1975; Emmerich 1978.

<sup>89</sup> Padgett 1990.

negotiation pressures in the Council of the EU but planned the reform voluntarily as a result of a learning process.

(2) Moreover, the *role changes of the member states* during their term of the Council presidency lead them to sort out potential areas of compromise and to work towards reconciliation.<sup>90</sup> It is largely the Council presidencies who structure the negotiations, isolate the problem bundles and search for the solution of open problems in the iterative negotiations. Incumbent member states that hold the Council presidency are expected to suppress the pursuit of their own interests and search for areas of agreement. Co-ordination within the 'troika' is supposed to ensure the continuity of the process. As the holders of successive Council presidencies, even France and Germany had to abstain from pursuing their own preferences and to put forward compromise proposals. In the final phase of the negotiations, the Spanish and the Italian presidencies concretized important elements of the liberalization proposals and devised some compromise proposals. It is not only during the phase of the Council presidency that these role changes support the evolution of compromise positions. They let the understanding for the other member states' positions grow even if the member states' differences in the underlying interests persist.<sup>91</sup> Thus, they give rise to empathy – the member states develop a capacity for participating in one another's perceptions and definitions of the situation.<sup>92</sup>

(3) The *Commission* is also present throughout these negotiations and, by mediating during the debate, attempts to facilitate the formulation of a negotiation solution. Even if it keeps its own perceptions and interests in mind while doing so, as a guardian of the treaties the Commission, from the point of view of the member states, enjoys a neutral status which gives a high degree of legitimacy to its arguments. To support its own position in favor of the sectoral liberalization, it based its reasoning on the expertise of a well respected Energy Economics Institute that compared the French Single Buyer model to the Commission model.<sup>93</sup> Based on earlier studies by this institute which had argued for the introduction of competition into the sector,<sup>94</sup> the Commission could be reasonably assured that the Institute would support its own model. Subsequently, on the basis of the Institute's study, the Commission demanded far reaching changes to the original French proposal which were largely accepted by the member states. As a result, the French Single Buyer model was

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<sup>90</sup> For studies that emphasize socialization effects within Council working groups and COREPER, see Beyer 1998; Lewis 1998.

<sup>91</sup> Author's interview Department of Trade and Industry.

<sup>92</sup> On empathy, see Finnemore/Sikkink 1998: 896.

<sup>93</sup> EWI 1995.

<sup>94</sup> See Klopfer and Schulz 1993.

greatly modified. Even Electricité de France no longer considered it as a real alternative to the Commission model of negotiated third party access,<sup>95</sup> and most of the member states are going to implement the Commission model.<sup>96</sup>

Finally, as a consequence of the incremental negotiation technique at work within the Council system the most important and most conflictual issues are gradually isolated. For these issues, not only package deals within the dossier but also issue linkages across policy areas become virtually impossible because the open questions are so central to the negotiation partners. Cross-issue or cross-area package deals presuppose not only that the actors accept the linkage of unrelated issues but require also “complementary asymmetries” in other dossiers or policy areas which are difficult to find. Furthermore, the member state actors in different Councils of the EU would need to accept compromises on issues whose benefits are accruing “outside of their own field”.<sup>97</sup> Therefore, issue linkages and package deals are only of limited use in the daily business of the European institutions and are restricted to rather special cases.

Much more important are concessions in the form of *flexibilization elements* to moor the ‘loose ends’ of the negotiations. Such flexibilization mechanisms – the inclusion of open textured or general legal clauses and of alternative regulatory options as well as the granting of administrative discretion, transition periods, and exemptions - have two main functions. Apart from aiding conflict resolution in the Council debate they are intended to allow for a flexible implementation in heterogeneous national contexts. To resolve member state conflicts, these mechanisms matter most when not all but only *a single or a few member states* are involved. They privilege these states and need to be justified in terms of uneven abilities or for technical reasons.<sup>98</sup>

### **3.5 Fairness Criteria: the Equity of the Market Opening**

As a result of the consensus principle, fairness criteria have special relevance for the resolution of distributive conflicts among the member states. The

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<sup>95</sup> Author’s interview EDF.

<sup>96</sup> Commission. DG XVII 1997.

<sup>97</sup> Scharpf 1997: 130.

<sup>98</sup> Exemption rights can lead to a ‘variable geometry’ of EU law in the member states because some directive rules are not applicable in all of the member states. Exemptions and selection rights are also problematic with regard to the functional equivalence of the EU rules and with respect to the equal treatment of citizens and corporate actors across different member states. Therefore, they may give rise to legal review procedures when it comes to the implementation of the directives.

perception of the fairness or the unfairness of a planned regulation impinges greatly upon its acceptance.<sup>99</sup> Not only in international regimes, but also in EU negotiations reciprocity criteria form an important yardstick for measuring the fairness of a regulatory outcome. As a consequence of reciprocity criteria, the member states consider a unilateral maximization of utility as illegitimate and accept normative standards that hold for all of them. Only equivalent exchange values are accepted as a result of the Council negotiations. In his seminal article on this topic, Robert Keohane distinguished among two types of reciprocity: specific reciprocity and diffuse reciprocity.<sup>100</sup> In cases of specific reciprocity, the partners exchange goods with equivalent values in a fixed sequence. In cases of diffuse reciprocity, the equivalence of the exchange need not be symmetric and the sequence is open.

In bilateral and single-issue negotiations specific reciprocity can easily be realized and verified. However, in a multilateral setting with a multitude of negotiation issues the equivalence of contributions can often not be resolved. Therefore, in the Council of the EU specific reciprocity cannot be related cost-benefit-equilibrium of the member states across all issue areas. To reduce their uncertainty about the fairness of the envisaged regulation and to arrive at a joint decision, it is therefore important for the member states to agree on the reference point and on the normative basis of the reciprocity criterion. I suggest that the *reference point of reciprocity* is either the contribution of the negotiation partners to the aspired problem solution or their portion of the costs. So far, only the equality of states has been regarded as *normative basis of reciprocity*. This neglects the fact that many international organizations also consider differential capacities of their members, which must therefore be regarded as a second important normative basis of reciprocity. Combining the equality and the capacity dimensions with the cost sharing portion and the contribution to the problem solution results in a four-fold-matrix (see table 1). On the one hand, the sovereignty principle and the equality of states is the normative starting point for many forms of international co-operation. For example, in EU environmental regulation, the member states have to contribute equally to a certain level of environmental protection by implementing the EU clean air or clean water standards (table 1, upper left field). On the other hand, several international organizations also consider the differential capacities of their members when formulating such standards. Thus, in several areas of the world trade regime, developing countries need to reduce their tariffs to a lesser

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<sup>99</sup> Wilson 1980: 366.

<sup>100</sup> Keohane 1986.

degree than industrialized nations (table 1, lower left field).<sup>101</sup> The financing mechanism of the EU is a good example for considering differential capacities when reciprocity is related to the sharing of costs. A large part of the EU's own financial means rest on contributions of the member states that are proportionately related to their value-added taxes or to their gross domestic product (table 1, lower right field). In this way, all the member states bear the same relative costs.

Specific reciprocity does not necessarily encourage co-operation. In contrast, given the prevalence of the consensus principle in the EU, it may result in decision blockages. Diffuse reciprocity, by contrast does not fix the equivalence and the sequence of the exchange as precisely as specific reciprocity.<sup>102</sup> It therefore improves the likelihood of co-operation even if the values to be exchanged are not equivalent. In this context, Niklas Luhman's argument about trust also holds for diffuse reciprocity: both allow for forms of co-operation that may not prove immediately useful for the actors.<sup>103</sup>

**Table 1: Specific Reciprocity in the European Union**

		Reference point of reciprocity	
		<i>Contribution to problem solution</i>	<i>portion of cost sharing</i>
<b>Normative basis of reciprocity</b>	<i>equality</i>	Equal contribution or equal standards	same absolute costs
	<i>capacity</i>	Contribution or standard according to capacity	same relative costs

As already suggested, both forms of reciprocity are interrelated in a specific way. As diffuse reciprocity cannot be realized in a multilateral and multi-issue environment, all the member states initially emphasize criteria of specific

<sup>101</sup> Differential capacities can also be considered if every member state contributes equally to the problem solution or to the costs of the regulation. In such instances, *compensatory payments and flexibilization mechanisms* can be put into effect to take regard to differing capacities. However, in general, such measures do not hold for all but *only for an individual or a few member states*. Therefore, they were not integrated into the table. On the flexibilization elements, see section 4.4.

<sup>102</sup> Keohane 1986: 4.

<sup>103</sup> Luhmann 1989: 24.

reciprocity to ensure the fairness of each individual EU regulation. Therefore, the Council of the European Union formulated several conditions to ensure specific reciprocity in the opening of the national electricity markets. It demanded (1) the equivalence of economic results, (2) the equivalence of the national market opening and of the access to these markets, as well as (3) conformity with the treaty rules of the parallel existence of the Single Buyer model and the Commission's model.<sup>104</sup> In other words, the Council interpreted specific reciprocity in the context of market integration, which ought to limit deviant behavior and the ability of individual member states to formulate alternative decisions. Even if these criteria did not exactly prescribe the degree and the content of market opening, they formed an institutionalized focal point during the negotiations. More and more, specific reciprocity was related to a similar degree of market opening, and finally a quota for the degree of liberalization in all of the member states was formulated. Thereby, all the member states were supposed to *contribute equally to the problem of opening the Internal Energy Market*. This focal point directed the attention of the member states to certain dimensions of the directive proposal. The reciprocity criterion weakened the generic discussion about the appropriateness of the liberalization as such and focused the member states' attention upon the fairness dimension of the proposal. Due to this re-orientation the member states could gradually formulate quantitative criteria for the sectoral liberalization which had not been included in the earlier Commission proposal. That the criterion of specific reciprocity justified several fundamental changes to the French Single Buyer proposal illustrates the high degree of legitimacy that it enjoys among the member states. The neutrality of the Commission and the scientific evidence from the Energy Economics Institute in Cologne further supported the detailed amendments to the French concept.

Despite successive agreements on several aspects of market opening, the Franco-German conflict forestalled agreement amongst the member states for a long time. After they proved unable to resolve their differences in a series of bilateral negotiations at the working level and at the ministerial level, the German Bundeskanzler and the French president finally agreed on the liberalization. This change in the decision making level had largely a symbolic function and signaled to the sectoral firms and trade associations that the pursuit of sectoral interests would not justify a blockade of the overall integration process. The techniques of consensus formation in the Council and the embeddedness in EU institutional principles and fairness criteria had increasingly led these actors to perceive that it was no longer appropriate to maximize national-sectoral interests. The French president and the German

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<sup>104</sup> Council of the EU 1994.

Bundeskanzler stepped back from a sector-orientation and sanctioned the outcome of the Council negotiations without adding substantial changes to the directive proposal. Such modifications would have been considered as inadequate and illegitimate by the other member states. The Franco-German agreement sub-ordinated their domestic sectoral costs and the specific reciprocity criterion to a more *diffuse political reciprocity in the integration process*. Their long-term co-operation and their reputation as ‘motors of integration’ let them consider any unilateral pursuit of sectoral interests as inappropriate. Thus, the differentiation of the EU institutional set-up into different layers of decision-making can modify the relevant rationality and fairness criteria. In this way, the institutional differentiation can sometimes lower decision barriers and blockages.

## Conclusion

The intergovernmental approach claims that the analysis of EU negotiations can be reduced to studying the pursuit of relatively stable member state preferences that are formed on the basis of domestic structures or domestic interest coalitions. Since it conceives of the member states’ interest definitions in this rather static way it seems ill-equipped to cope with preference changes endogenous to EU negotiations. The article has demonstrated that even in issues not suitable to policy learning because they involve entrenched interests and stable domestic arrangements, the positions and preferences of indeed those member states that occupy a central position in the bargaining processes can change substantially, as happened in the case of both France and Germany. In many respects, such changes are not related to the evolution of technical or economic factors or to shifting interest alliances. They are either positional adaptations to the dynamic evolution of the EU political agenda or are learning processes by actors whose rationality is bounded. Learning processes are particularly likely to occur if the planned EU regulations or directives promote rather new ideas, are quite complex or if the domestic situations are multi-dimensional so that neither the EU rules nor their impact on the domestic structures can be easily assessed. These learning processes are likely to cause member state preferences to change if they reveal a limited efficiency of or inconsistencies amongst domestic arrangements. Often, more context specific and complementary expertise on the domestic level will be necessary to stabilize such preference changes.

A neo-institutional approach is appropriate for conceptualizing such learning processes because it is able to take into account the impact of the EU institutional set-up on the preference formation of the member states. This article has highlighted informal institutional characteristics that further co-

operation and aid the evolution of joint behavioral standards: policy-concepts such as market integration; institutional principles such as the consensus principle; fairness criteria such as reciprocity. Furthermore, the incremental negotiation techniques in the Council of the EU hinder the unilateral pursuit of national interests and lead to learning processes and preference changes on part of the member states.

As a result of incremental negotiations, the EU legal acts contain several flexibilization mechanisms, without merely being a *menu à la carte*. They contain several provisions, which all member states have to implement and which must be considered as a regulatory core. These core rules limit the directives' degree of flexibilization and guarantee their uniform validity across all member states. In this way, it is the quotas for market opening which ensure that the member states must gradually liberalize their markets.

Consensual agreement on the directive, its flexibilization elements and the sanction potential of the EU legal system largely guarantee formal and effective implementation. In several member states, market opening clearly surpasses the minimum requirements of the directive.<sup>105</sup> Moreover, liberalization triggers far-reaching behavioral changes on part of the sectoral firms that are beyond the scope of the directive's content. To name just a few developments: In some member states, electricity spot markets were set up; cross-border investments and also domestic mergers and acquisitions increased substantially; many utilities restructured their organizations and reduced overhead costs; prices for industrial consumers have been substantially reduced; and long term contractual relations between the machinery sector and the utilities have broken down. However, in areas outside of market integration the competition mechanism does not apply so that behavioral changes as a consequence of EU directives are bound to be more limited.

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<sup>105</sup> Belgium, Germany, Finland, the Netherlands, Sweden, Spain and the United Kingdom liberalize their markets entirely. Denmark opens 90 percent of its market, Austria opens it to 50%, Luxembourg liberalizes 45%, and Italy liberalizes 40%. Only France, Greece, Ireland, and Portugal do not substantially open their markets substantially beyond the minimum provisions of the directive (Commission. GD XVII 1999).

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