

**Supranational Administrative Acts and Judicial Review in
the EU's State Aid Regime**

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4. Explaining Patterns of Annulment Litigation in State Aid Policy

This chapter presents a theoretical model of governmental annulment litigation. This model tries to synthesize the relevant concepts discussed by existing scholarship into a coherent relationship to provide an appropriate representation of a government's decision regarding whether or not to initiate judicial compliance conflict against supranational administrative acts. The thorough formalization of the government's decision-making process in this context helps me to maximize the degree of transparency and consistency in the theoretical expectations.

I proceed in four steps: The starting point is a formal representation of governments' utility associated with different available reactions to individual supranational administrative acts. Second, I derive the conditions under which the initiation of an action for annulment represents a government's optimal reaction to such an administrative act. In a third step, I discuss economic, political, administrative, and other structural factors likely to systematically influence whether or not these conditions are met. Finally, I derive hypotheses accordingly.

The only study to have specifically sought to explain governmental annulment litigation is provided by Hartlapp and Bauer (Hartlapp and Bauer 2011: 13). These researchers argue that governments are most likely to engage in annulment litigation when the political, economic, and structural costs associated with complying with supranational administrative acts are high. While the framework of Hartlapp and Bauer is a valuable starting point, it essentially reduces a government's available responses to supranational requirements to a binary choice between compliance and litigation; in fact, governments also have the option to simply disregard the acts. Furthermore, the authors' framework does not take into account how different responses on the part of a government might enable it to avoid high structural, political, or economic costs. By assessing the government's utility associated with each available response in terms of costs and benefits, the model I describe below refines the framework provided by Hartlapp and Bauer in two respects. First, it can determine the conditions under which governments would rather ignore supranational administrative acts than litigate against them. Second, by taking aspects of the judicial arena seriously, the model is able to show that litigation is not only a method of potentially avoiding the costs of compliance but also an instrument that can offer substantial benefits to governments.

Figure 18 helps to illustrate the structure of the theoretical argument. I first focus on micro-level variables that systematically affect how governments react to individual supranational administrative acts. This corresponds to relationship 1 (see Figure 18), which defines when governments are expected to litigate.

In a second step, I discuss factors that systematically influence whether the micro-level conditions will be met more or less frequently (relationship 2). In this sense, these macro-level factors determine a government’s general propensity to litigate. They do not determine whether or not governments will litigate in specific cases, but generally enhance or reduce the probability that any individual case will be answered with litigation. Consequently, these macro-level factors should systematically influence the frequency of litigation (relationship 3).

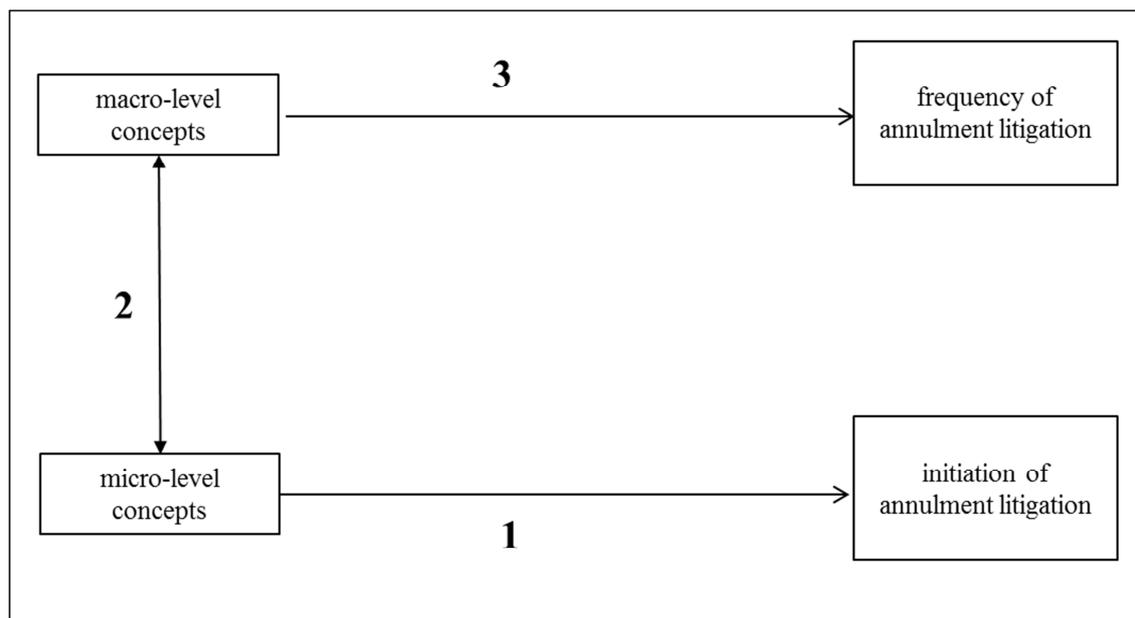


Figure 18: Structure of the Theoretical Argument

4.1 General Theoretical Framework

I conceptualize a government’s decision regarding how to respond to a supranational administrative act as the result of a cost-benefit analysis that takes all available options into account. Governments are therefore seen as rational utility-maximizers. Generally, actors are defined as acting rationally when their preferences are complete, reflexive, and transitive. Preferences are considered complete when all available options can be compared; they are reflexive when any option is at least as good as itself; and they are transitive as long as it is true that when option A is preferred over option B and option B is preferred over option C, then option A is also preferred over option C (Varian 2006: 35). Essentially, these assumptions ensure that rational actors can rank available options and identify the optimal choice among them.

Transferring these assumptions to the specific context of this study, I assume that when governments are confronted with a supranational administrative act, they base their response on an evaluation of the utility associated with all available options. Litigation is never the only inevitable action; the decision “always involves a choice” (Chalmers and Chaves 2011: 25); this is also the case for national governments dealing with supranational administrative acts. Available responses include (i) complying with the act, (ii) simply ignoring the act, and (iii) subjecting the act to judicial review in the form of annulment litigation, i.e., engaging in judicial compliance conflict. Supranational administrative acts requiring adjustments to domestic policy arrangements carry conflict potential. Whether this conflict potential will translate into compliance, ignorance, or litigation depends on the government’s utility associated with each of these options.

But what determines this utility? The literature review has provided several potential answers. Specifically, government reactions to EU requirements are argued to depend on (a) the level of adaptation costs they impose, (b) the government’s capacity to fulfill requirements, (c) the legitimacy of the requirements, and (d) the legal certainty associated with different reactions. Furthermore, the review suggested that whether or not governments litigate depends on (e) their expectations of legal success and (f) the value legal success has for them.

I integrate all of these aspects into one coherent decision-theoretic model in the following manner: When governments form expectations regarding the probability of legal success, they also evaluate the other available options in terms of how likely they are to offer certain benefits or impose specific costs.

The first source of benefits associated with each option reflects governments’ *benefits from being able to maintain the domestic status quo* and avoiding any supranationally required adjustment. Arguments emphasizing adaptation costs (Downs et al. 1996; Duina 1997; Knill and Lenschow 1998) and governmental capacity to adjust (Chayes and Chayes 1993) both essentially speak to this category. If supranational administrative acts impose high adaptation costs on governments, the benefits of not having to adjust would be high. Similarly, if governments can only adjust to supranational requirements with great difficulty, then not having to adjust would entail higher benefits than having to adjust, despite the lack of sufficient capacity to effectively comply. This, of course, assumes that noncompliance carries (at least some) costs, no matter whether it is voluntary or involuntary.

The costs associated with each available option are construed as the *costs of yielding to a supranational institution*. When governments yield to Commission requirements, they de-facto comply with supranational administrative acts. Existing scholarship emphasizing the

importance of concerns related to legitimacy argues that yielding domestic policy arrangements to supranational requirements can be costly when such actions are viewed as inappropriate. Costs thus essentially depend on whether supranational requirements are perceived to be legitimate interferences in domestic arrangements or not (Bergmann 2000; Börzel et al. 2010; Dworkin 1986; Frank 1988; Lampinen and Uusikylä 1998; Mbaye 2001). When requirements are perceived as illegitimate, then being forced to comply with them will be difficult for governments to accept. Thus, having to adjust to illegitimate requirements yields a lower utility than adjusting to legitimate requirements.

The situation is slightly different when governments must yield to rulings by the ECJ. Here, the costs of yielding domestic arrangements to a supranational institution represent the costs of legal defeat. In this context, I assume legitimacy concerns to be less important, based on two arguments. First of all, this relative lack of importance is due to the generally higher level of trust (and, perhaps more importantly, the lower level of distrust) and legitimacy attributed to the ECJ in comparison to the Commission (Commission 1999: 51). Second, adversarial rulings by the ECJ are explicit public indications of member state defection. Receiving such a negative ruling can thus result in additional costs, namely reputational costs at the European level. Gaining a reputation as defector can have consequences for a government's ability to negotiate new rules, as other governments that have lost trust in the defector will ask for costly side-payments. This argument corresponds to rationalist accounts (such as the Enforcement-Approach) that emphasize the role of costs of defection (e.g., Downs et al. 1996). These costs are thought to depend on how vulnerable states are to reputational costs (Börzel et al. 2011: 5; Keohane and Nye 1977).

Of course, costs and benefits are logically connected through the notion of opportunity costs. In my conceptualization, the costs of adjusting domestic arrangements do not simply reflect the opportunity costs of not being able to maintain domestic arrangements. Instead, they are conceptualized as distinct concepts with distinct conceptualizations within the empirical analysis. Opportunity costs nevertheless play a part in government equations, since governments are assumed to assess the costs and benefits of any one option in light of the costs and benefits provided by all the other available options. The benefits of choosing one option are thus always evaluated in terms of the forgone benefits of the other options.

In addition, the literature suggests that national reactions to EU requirements depend on the degree of legal certainty offered by the available options (Schmidt et al. 2008). Particularly in the context of state aid policy, governments draw *benefits from enhanced legal certainty* that are independent of the ability to maintain or the obligation to adjust arrangements (Blauberger

2009b, 2009c). For example, reduced benefits resulting from a government diverging from its preferred policy position can be compensated by additional benefits obtained from the legal certainty of policy positions. This factor is thus treated separately in the government's utility function.

Finally, I integrate *time* as a factor into the government's assessment. Due to the long duration of typical annulment proceedings, this seems to be an important aspect. Furthermore, with this explicit inclusion of considerations of time and timing, this study can incorporate the arguments presented by Goetz and Meyer-Sahling (Goetz and Meyer-Sahling 2009: 181), who hold that a more thorough analytical focus on questions of political time is required in order to develop an understanding of how the EU "distributes opportunities". Moreover, as outlined in the literature review, actors' temporal reference-frames are important for understanding the relationship between governments and courts (Alter 1998).

Overall, these considerations result in the following function reflecting a government's expected utility for any available option:

$$E(u) = p * b * \delta^t - (1 - p) * \delta^t * c + L$$

Specifically, the expected utility $E(u)$ of any option is determined by the expected benefits of continuing as originally intended, $p * b$, which is the product of the probability of being able to continue as intended, p , and the benefits associated with doing so, b . These expected benefits are discounted if they are not realized immediately but rather in the future. From these expected benefits, the expected costs of (potentially) having to yield to a supranational institution are subtracted. These expected costs of adjusting domestic arrangements are the product of the probability of not being able to continue as intended, i.e., $(1 - p)$, and the costs of doing so, c . These expected costs are discounted by the factor δ^t , where t reflects the time required for payoffs to be realized if they materialize in future periods. The factor L represents the benefits resulting from legal certainty. I differentiate between options that provide governments with low, medium, and high potential for enhancing the degree of legal certainty. Based on this function, I assess the government's utility associated with all three available responses to supranational administrative acts: compliance, disregard, and litigation. The formal model approach enables me to analytically derive consistent expectations regarding the conditions under which litigation is an optimal response to EU requirements.

Compliance

Let us first consider the government utility associated with compliance. Where supranational administrative acts simply approve and authorize national governments to proceed as initially intended, a government's decision regarding how to react is trivial. Therefore, I will focus the discussion on cases in which supranational administrative acts demand at least some adjustment of domestic policy arrangements. In such a situation, choosing compliance implies that the government's probability of not having to adjust – by definition of the scenario – reduces to zero ($p_{comply} = \mathbf{0}$). Furthermore, all benefits of not having to adjust are forfeited ($b = \mathbf{0}$).

The costs resulting from adjusting domestic policy in response to supranational interference refer to the costs associated with allowing the Commission to interfere in national policy-making, c_{COM} . These costs should be greater than or equal to zero ($c_{COM} \geq \mathbf{0}$). Based on the argument proposed in the literature that the legitimacy of supranational interference can be determined by the legitimacy attributed to the interfering institution (Dworkin 1986; Frank 1988), I differentiate between the costs of yielding to the Commission and the costs of yielding to the ECJ. These costs do not necessarily have to be different, but allowing for differences will make the model more flexible.

In addition, since the decision to comply implies that governments yield to supranational requirements right away ($t = \mathbf{0}$), discounting the resulting costs (c_{COM}) is irrelevant (because $\delta^0 = \mathbf{1}$).

Finally, I argue that complying with Commission requirements yields a medium level of legal certainty. On the one hand, complying yields a high level of legal certainty in the specific case in question. If governments comply with a specific decision by, for example, giving up a certain state aid measure, then they do not have to fear that the Commission will interfere at a later point to demand the re-introduction of the aid measure. On the other hand, governments will remain uncertain regarding the Commission's application of EU state aid law in future cases. Might a very similar state aid measure be approved in the future? This becomes particularly relevant when the Commission bases its decisions on indeterminate legal concepts.

The same holds true for Commission regulations. Generally, state aid measures that are constructed in compliance with Commission regulations enjoy greater legal certainty than state aid measures that ignore such regulations. However, wherever supranational administrative regulations involve indeterminate legal concepts, the legal certainty of national state aid measures designed according to such regulations depends on the consistent

interpretation of the Commission. The large amount of discretion that indeterminate legal concepts offer the Commission makes the Commission's future interpretation of these legal concepts uncertain. Whether or not a future state aid measure might be similarly problematic is difficult to assess when problems are determined by a relatively vague legal concept. Will the Commission uphold its past interpretation? Of course, the Commission does try to guarantee consistent application and enforcement practices, but in the absence of a general administrative law at the supranational level that would constrain and direct Commission behavior, much of the Commission's enforcement practice rests on soft-law and the Commission's intention to exercise its discretion consistently. Consequently, I argue that complying with supranational administrative acts provides governments with a medium level of legal certainty, $L = 0$.²⁷ Of course, compliance can help to establish common practice that will constrain the Commission in the future. However, by refraining from asking the ECJ to interpret and clarify supranational administrative acts, member states avoid further constraints on the Commission's discretion and consequently enhance legal certainty for future state aid measures. Thus, compliance with supranational administrative acts demanding behavioral adjustments yields a utility of:

$$u_{comply} = p_{comply} * b * \delta^t - (1 - p_{comply}) * \delta^t * c_{COM} + L$$

Integrating the parameter values specified above yields:

$$u_{comply} = 0 * b * \delta^0 - (1 - 0) * \delta^0 * c_{COM} + 0$$

which reduces to:

$$u_{comply} = -c_{COM}$$

Annulment litigation

The second option governments have is to initiate annulment litigation against the supranational administrative act. In this case, the probability of being able to proceed as initially intended becomes the probability of winning court proceedings (p_{win}). Only if the annulment proceedings are successful can the member state continue as it originally intended. Furthermore, these expected benefits are only realized after the court proceedings are concluded. Since “[a]ctions brought before the Court of Justice of the European Union shall

²⁷ A low level would be $-L$ and a high level $+L$.

not have suspensory effect” (article 278 TFEU), the implementation of a contested state aid measure must wait until the ECJ annuls any negative Commission decision prohibiting the measure. This is also true for aid that has been found to be illegal after it was paid out. Should the Commission order the recovery of such illegal aid, an action for annulment cannot be used to postpone the recovery (article 14(3) of Regulation No. 559/1999). On average (i.e., taking the average of all annulment proceedings across all policy sectors from 1999 to 2006), annulment proceedings in this study’s data set lasted for 30 months (2.5 years). For any democratically elected government, a 2.5-year wait for expected benefits is not trivial. Hence, discounting seems appropriate ($\delta^t < 1$).

In this case, domestic policy arrangements must be adjusted if legal proceedings are lost ($1 - p_{win}$). Instead of yielding to the Commission, however, governments must now yield to the ECJ’s ruling. The expected costs associated with having to yield to a supranational institution are consequently the costs of having to accede to a ruling by the ECJ in case of a loss in the annulment proceedings (c_{ECJ}). These costs can be understood as the costs of being exposed as a defector by the ECJ. Since these costs are not realized until (and unless) the case result in a negative ruling by the ECJ, these costs are also discounted. Finally, I assume that the factor L (representing the level of legal certainty resulting from litigation) is at its highest level: Since actions for annulment have no suspensory effect, governments must comply with the supranational administrative acts until (and unless) they are declared void by the ECJ. As a result, governments immediately enjoy a degree of legal certainty similar to the degree when they comply. However, with the initiation of annulment litigation, governments extract additional legal certainty because the initiation of an action for annulment can provoke the ECJ to engage in judicial law-making to specify the indeterminate legal concepts used by the Commission. Governments can direct the ECJ’s attention to such concepts through the pleas they present during proceedings. The resulting case-law can restrict the Commission’s discretion and thereby enhances legal certainty.

The resulting function reflects government utility associated with engaging in annulment litigation:

$$E(u)_{annulment} = p_{win} * b * \delta^t - (1 - p_{win}) * \delta^t * c_{ECJ} + L$$

Disregard

Finally, governments have the option to simply ignore or disregard supranational administrative acts, going ahead (or continuing) as planned in spite of the required

adjustments. This could be considered noncompliance with the supranational legal act. If the Commission detects such noncompliance, it is free to refer the matter directly to the ECJ (article 108(2) TFEU). In such a case, the ECJ would not bother to rule on the legality of the Commission's legal act and would not address the Commission's assessment of the national state aid measure. Instead, it would only consider whether the specific act has been complied with or not. Thus, when a government ignores a supranational administrative act and the Commission refers the matter to the ECJ, the ECJ will – by definition of the scenario – rule against the member state. As a result, the relevant probability of being able to proceed as intended (p) in this scenario is equal to the probability of the Commission *not* referring the matter to the ECJ ($0 \leq p_{com} \leq 1$). Once it does so, the probability of success in the legal proceedings is zero.

Since the member state in this scenario does not yield to the Commission but rather (again) seeks an ECJ ruling, the costs associated with having a supranational institution interfere in domestic policy again correspond to the costs of yielding to the ECJ ($c_{ECJ} \geq 0$). Finally, in cases of disregard of supranational administrative acts, legal certainty is lower than in cases of compliance and litigation, as governments cannot be sure at any point in time that the Commission will not detect noncompliance and refer the matter to the ECJ. Furthermore, in such a case, the ECJ will not focus its proceedings on the supranational administrative act but instead on national compliance. Therefore, court rulings will not offer any valuable specifications of indeterminate legal concepts that might yield additional benefits (for example, by constraining the Commission's discretion with respect to the future adoption of supranational administrative acts). Thus, I specify the degree of legal certainty regarding policy application to be smaller than zero ($L < 0$).

$$E(u)_{ignore} = p_{com} * b * \delta^t - (1 - p_{com}) * \delta^t * c_{ECJ} - L$$

Furthermore, since the benefits of not adjusting behavior are realized instantly ($t = 0$) while the potential costs associated with legal defeat in court proceedings are not, the relevant utility function is:

$$E(u)_{ignore} = p_{com} * b * \delta^0 - (1 - p_{com}) * \delta^t * c_{ECJ} - L$$

which reduces to:

$$E(u)_{ignore} = p_{com} * b - (1 - p_{com}) * \delta^t * c_{ECJ} - L$$

4.1.1 Analyzing Governments' Optimal Response

Having specified the utilities associated with each possible response, I now analyze the conditions under which litigation is a government's optimal response to supranational administrative acts.

First, however, it seems important to emphasize that there is no unique optimal response that will provide governments with the highest utility in all circumstances. If such a unique optimal solution existed, governments would always respond to supranational administrative acts in the same way, i.e., with compliance, disregard, or judicial review. Empirically, however, all three alternatives can be observed. Thus, if the theoretical model is indeed an appropriate representation of reality, it should be able to predict which alternative is the optimal response under certain conditions.

Against this background, the next few paragraphs are dedicated to deriving the conditions under which litigation is a government's optimal response to supranational administrative acts.

Governments will litigate if the expected utility of doing so (1) exceeds the utility of complying with the Commission's requirements and (2) exceeds the expected utility of ignoring the Commission's requirements. To begin with, I derive the first of these two conditions, starting with the formal representation of this condition:

$$E(u)_{Annulment} > u_{comply}$$

Specifying both utilities as determined above yields:

$$p_{win} * b * \delta^t - (1 - p_{win}) * \delta^t * c_{ECJ} + L > -c_{COM}$$

This can be simplified in several steps:

$$p_{win} * b * \delta^t - c_{ECJ} * \delta^t + c_{ECJ} * p_{win} * \delta^t + L > -c_{COM}$$

$$p_{win}(\delta^t b + \delta^t c_{ECJ}) > \delta^t c_{ECJ} - c_{COM} - L$$

to produce **condition 1**:

$$p_{win} > \frac{\delta^t c_{ECJ} - c_{COM} - L}{\delta^t (b + c_{ECJ})}$$

This condition (1) holds that governments will initiate annulment litigation instead of complying with supranational administrative acts when the difference between the costs of losing in court and the costs of capitulation to the Commission ($\delta^t c_{ECJ} - c_{COM} - L$) divided by the sum of the benefits of avoiding adjustments and the costs of losing in court ($\delta^t (b + c_{ECJ})$) is smaller than the probability of winning the annulment proceedings.

However, only when the government's utility of litigating also exceeds its utility of simply ignoring the administrative act is initiating an action for annulment indeed the government's optimal response. The conditions under which this is the case are derived below.

$$E(u)_{Annulment} > E(u)_{ignore}$$

Again, specifying the expected utilities as derived above yields:

$$p_{win} * b * \delta^t - (1 - p_{win}) * \delta^t * c_{ECJ} + L > p_{Com} * b - (1 - p_{Com}) * \delta^t * c_{ECJ} - L$$

This can be simplified in several steps:

$$p_{win} * b * \delta^t - \delta^t c_{ECJ} + p_{win} * c_{ECJ} * \delta^t + L > p_{Com} * b - \delta^t c_{ECJ} + p_{COM} * c_{ECJ} * \delta^t - L$$

$$p_{win}(\delta^t b + \delta^t c_{ECJ}) > p_{Com}(b + \delta^t c_{ECJ}) - 2L$$

to produce **condition 2**:

$$p_{win} > \frac{p_{Com}(b + \delta^t c_{ECJ}) - 2L}{\delta^t (b + c_{ECJ})}$$

Both of these conditions are inequalities expressed in terms of the probability of winning the judicial proceedings, p_{win} . Only when both conditions are fulfilled is litigation the government's optimal response. Should condition (1) hold but condition (2) not, the government's utility when litigating is greater than its utility when complying. At the same time, however, its utility when litigating is smaller than its utility when simply ignoring the Commission's administrative act. In this case, the optimal response would be to ignore the supranational administrative act. This scenario corresponds to the realization of outcome scenario II (ignore) in Figure 19. Here, condition (2) is designed to be more restrictive than condition (1), requiring higher values of p_{win} for fulfillment. Whether the initiation of an action for annulment will be the optimal response depends only on whether condition (2) is fulfilled. In other words, in this scenario, condition (2) is the crucial condition determining the initiation of judicial compliance conflict. To determine the effect of individual variables on the probability of judicial compliance conflict, one must analyze whether these variables shift condition (2) to the left or the right, i.e., whether they make condition (2) less or more restrictive.

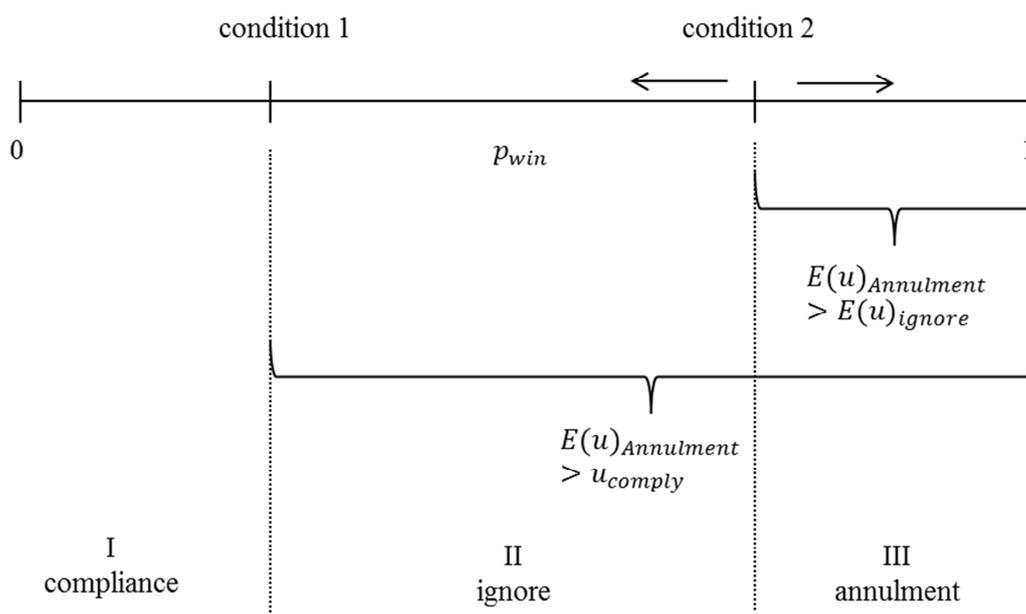


Figure 19: Optimal Response Option 1

Governments' optimal response to supranational administrative acts when condition (2) is more restrictive than condition (1). Author's own illustration.

Figure 20 illustrates the opposite scenario. Here, condition (1) is more restrictive than condition (2). Consequently, if condition (2) is fulfilled but condition (1) is not, a

government's utility when litigating is greater than its utility when ignoring supranational administrative acts. At the same time, however, its utility when litigating is *not* greater than its utility from compliance. Thus, the government's optimal response is to comply with the Commission's administrative act (sector II: compliance).

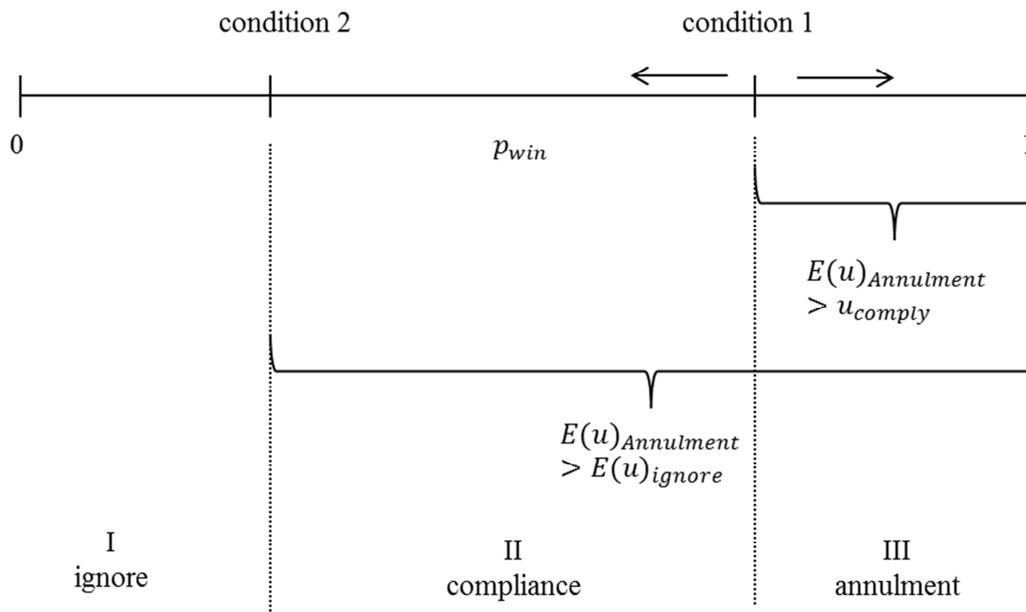


Figure 20: Optimal Response Option 2

Governments' optimal response to supranational administrative acts when condition (1) is more restrictive than condition (2). Author's own illustration.

Consequently, the probability that governments will find litigation to be their optimal response to supranational administrative acts is effectively determined by condition (1) in this scenario. To evaluate how individual factors influence governments' willingness to engage in litigation, one must analyze whether condition (1) becomes more or less restrictive with respect to marginal increases in the specific factor of interest.

Analyzing whether condition (1) or condition (2) is more restrictive would be irrelevant if they were defined by the same variables and if these variables had identical effects. In this scenario, the two conditions would effectively be just one condition. This is not the case, however. The effect of the costs associated with yielding to Commission requirements c_{COM} can help to illustrate this point. Increasing the costs of yielding to the Commission makes condition (1) less restrictive and thus litigation becomes more likely. This would suggest a positive relationship between these costs and a government's willingness to litigate. Condition (2), however, is unaffected by these costs. As a result, whether or not increasing costs of

yielding to the Commission can indeed be expected to have a positive effect on governments' willingness to engage in litigation effectively depends on whether condition (1) is more restrictive than condition (2). Otherwise, the model would suggest no relationship between the costs of yielding to Commission requirements and the probability of litigation against such requirements.

This example illustrates why it is relevant to determine when condition (1) is more restrictive than condition (2) and when it is not. Against this background, in the following analysis I will show that condition (1) is more restrictive than condition (2) in most circumstances, and that the opposite should apply only in rare cases. The reasoning is as follows:

Condition (1) is more restrictive than condition (2) if:

$$\textit{condition 1} > \textit{condition 2}$$

which corresponds to:

$$\frac{\delta^t c_{ECJ} - c_{COM} - L}{\delta^t (b + c_{ECJ})} > \frac{p_{COM}(b + \delta^t c_{ECJ}) - 2L}{\delta^t (b + c_{ECJ})}$$

After getting rid of the equal denominators, this yields:

$$\delta^t c_{ECJ} - c_{COM} - L > p_{COM}(b + \delta^t c_{ECJ}) - 2L$$

To show that this condition will hold most of the time, I introduce an assumption that affects the probability (p_{COM}) that the Commission will ignore passive disregard by governments and abstain from referring such instances to the ECJ. Specifically, I assume that this probability tends towards zero.

This assumption would seem to be plausible for three reasons. First, it is much less difficult to monitor compliance with decisions than with general provisions of EU secondary legislation, as decisions have fewer (and explicitly specified) addressees and because supranational administrative acts are generally much more focused in their content, defining very specific requirements (such as the recovery of state aid or abstention from granting state aid). Consequently, monitoring compliance with supranational administrative acts should be more transparent and require fewer resources than monitoring compliance with, for example, EU

directives. As a result, it is likely that the Commission will detect noncompliance. Second, allowing member states to ignore supranational administrative acts risks high reputational costs for the Commission, potentially fostering the perception of political bias that the Commission tries to avoid. Thus, it is unlikely that the Commission will be unwilling to enforce compliance. Finally, I argue that neither the Commission's ability to observe nor its willingness to enforce noncompliance changed substantially over the period analyzed in this study (1998–2006). Although the Commission's strictness regarding the enforcement of state aid rules has definitely increased over the decades, this change is most visible when we compare the Commission's efforts to enforce state aid rules during the 1970s and 1980s with efforts in later periods. At least since the 1990s, when state aid became a priority of the Commission (Cini and McGowan 2009: 176), the Commission has been able and willing to strictly enforce the EU's state aid rules. It thus seems plausible to assume that the probability that the Commission will ignore member state noncompliance with supranational administrative acts is close to zero for the period under study. For $p_{Com} \approx \mathbf{0}$, the right-hand side of the inequality tends towards $(-2L)$, and the overall inequality effectively reduces to:

$$\delta^t c_{ECJ} - c_{COM} - L > -2L$$

This can be restated as:

$$\delta^t c_{ECJ} + L > c_{COM}$$

This means that condition (1) is more restrictive than condition (2) as long as $\delta^t c_{ECJ} + L > c_{COM}$. Thus, condition (1) effectively determines the probability that governments will perceive litigation to be an optimal response *if* the sum of the discounted costs of legal defeat and the benefits received from legal certainty ($\delta^t c_{ECJ} + L$) are greater than the costs associated with adjusting domestic policy in response to Commission requirements, c_{COM} . In other words, this condition always holds if the costs associated with yielding domestic policy to Commission requirements are smaller than the discounted costs associated with legal defeat in court. Should the discounted costs of legal defeat actually exceed the costs of yielding domestic policy to Commission requirements, the benefits received from legal certainty L will determine whether the condition holds. Since legal certainty is thought to be highly valued in the context of state aid policy (Blauberger 2009a, 2009b, 2009c), I argue that this condition will hold most of the time.

This implies that the option of litigating is primarily weighed against the option of complying with supranational administrative acts and not against passively ignoring them. This does not mean that condition (2) is never more restrictive than condition (1). In fact, it would be implausible to assume that governments would never weigh the utility of litigation against the utility of passive disregard of supranational requirements. However, such cases seem to represent fringe solutions rather than common practice.

Consequently, we are most likely confronted with a situation in which condition (1) effectively determines the probability that governments will perceive litigation to be an optimal response to supranational interference in national state aid policy. This means that the effects of

- the probability of winning legal proceedings (p_{win}),
- the costs associated with legal defeat in court (c_{ECJ}),
- the costs of yielding to the Commission (c_{COM}),
- the benefits associated with proceeding as initially intended (b),
- the factor by which governments discount future benefits (δ), and
- the potential to enhance the level of legal certainty (L)

on the restrictiveness of condition (1) effectively determine the probability of litigation.

I have omitted the factor of the time (t) that governments must wait before costs and benefits are realized, as t is more likely to be a constant than a variable across the country sample and during the period studied. In the case of compliance, governments do not have to wait for payoffs at all. This means that t is always zero. Furthermore, the time governments must wait for payoffs to be realized depends on the duration of judicial proceedings. I have calculated the average duration of annulment proceedings across all sectors between 1998 and 2006 (i.e., the period covered by the regression analysis). During this period, the average duration of annulment proceedings in any given year was 30 months, varying between a minimum of 29.5 months and a maximum of 30.9 months. The maximum range of 1.4 months seems to be a negligible variation in the context of an average length of annulment proceedings of 2.5 years. Furthermore, there is no reason to believe that the duration of annulment proceedings varied significantly between countries. Thus, I treat the factor as a constant for the purposes of this study, excluding it from the empirical analysis. This is not to say that this factor does not matter. However, I argue that it is appropriate to assume that its impact on government decision-making has been the same for all governments during the entire period under

investigation. It can thus be excluded as potential source of the non-constant frequency of judicial compliance conflict observed.

4.1.1 Micro-Level Determinants of Litigation

The following section analyzes condition (1) in greater detail. Specifically, the analysis assesses how the different variables that specify this condition influence the probability of litigation.

Benefits of not having to adjust domestic policy

To begin with, I examine the benefits of not having to adjust domestic policy, i.e., the benefits of being able to continue as initially intended (b). With marginal increases in these benefits, a government's optimal response to supranational administrative acts is increasingly likely to be litigation. This can be shown by taking the derivative of utilities when litigating and when complying with respect to the benefits, b :

$$\frac{\partial E(u)_{Annulment}}{\partial b} > \frac{\partial E(u)_{comply}}{\partial b}$$

$$\frac{\partial p_{win} * b * \delta^t - (1 - p_{win}) * \delta^t * c_{ECJ} + L}{\partial b} > \frac{\partial(-c_{com})}{\partial b}$$

A government's utility when complying with supranational administrative acts is unaffected by these benefits: $\frac{\partial(-c_{com})}{\partial b} = 0$. This is not the case when litigating. Overall, taking the derivative of both sides of the inequality yields:

$$p_{win}\delta^t > 0$$

This condition should hold as long as the probability of winning in court is greater than zero ($p_{win} > 0$). Thus, increasing the benefits of not having to adjust domestic policy arrangements – ceteris paribus – will increase the probability that governments will perceive litigation to be their optimal response to supranational administrative acts, as long as there is some chance of winning the legal proceedings ($p_{win} > 0$). Therefore, I expect a positive relationship between the benefits of being able to continue as initially intended and governments' willingness to litigate.

Costs of yielding to Commission requirements

Second, let us consider the costs of yielding to Commission's requirements, c_{COM} . This factor only appears in the numerator of the right-hand side (*rhs*) of condition (1): $\frac{\delta^t c_{ECJ} - c_{COM} - L}{\delta^t (b + c_{ECJ})}$.

Specifically, an increase in these costs reduces the numerator and thereby decreases the value of the *rhs* of the inequality representing condition (1). More formally, it can be shown that the derivative of the *rhs* of condition (1) with respect to the costs of yielding to Commission requests (c_{COM}) is negative:

$$\frac{\partial \left(\frac{\delta^t c_{ECJ} - c_{COM} - L}{\delta^t (b + c_{ECJ})} \right)}{\partial c_{COM}} = - \frac{1}{\delta^t (b + c_{ECJ})}$$

Condition (1) is thus more likely to hold as the costs associated with adjusting domestic policy in response to Commission interference increase. In other words, higher values of c_{COM} make governments more likely to litigate. Thus, I expect a positive relationship between these costs and governments' willingness to litigate.

Potential to enhance legal certainty

To determine the effect of the benefits associated with enhanced legal certainty on the probability of litigation, I take the derivative of the *rhs* of the inequality representing condition (1) with respect to legal certainty (L):

$$\frac{\partial \left(\frac{\delta^t c_{ECJ} - c_{COM} - L}{\delta^t (b + c_{ECJ})} \right)}{\partial L} = -1$$

This derivative is strictly negative. Hence, condition (1) is more likely to hold as the benefits of legal certainty (i.e., the benefits of reducing legal uncertainty) increase. The probability that litigation will be a government's optimal response to a supranational administrative act is thus expected to increase with the benefits governments associate with legal certainty.

Probability of winning the legal dispute

Next, I turn to the simplest case: p_{win} , the probability of success in the legal proceedings. Since condition (1) is specified in terms of this probability, it is evident that as p_{win} increases, condition (1) is more likely to hold, and litigation is – ceteris paribus – more likely to be a government’s optimal response. I thus expect a positive relationship between the probability of legal victory in court and a government’s willingness to go to court. In more intuitive terms, governments are expected to be more willing to go to court if the probability that they will win court proceedings increases.

Costs of legal defeat

Next, I turn to the costs associated with legal defeat in court. I show that marginal changes in the costs of legal defeat make condition (1) less likely to hold. This reflects the intuitive effect that that compliance becomes more attractive than the relevant alternative of litigation as the costs of losing judicial proceedings increase. This can be shown by taking the derivative of the *rhs* of the inequality with respect to the costs of legal defeat, c_{ECJ} :

$$\frac{\partial \left(\frac{\delta^t c_{ECJ} - c_{COM} - L}{\delta^t (b + c_{ECJ})} \right)}{\partial c_{ECJ}} = \frac{\delta^t (\delta^t b + \delta^t c_{ECJ}) - \delta^t (\delta^t c_{ECJ} - c_{COM})}{(\delta^t b + \delta^t c_{ECJ})^2}$$

This derivative is greater than zero if

$$\delta^t (\delta^t b + \delta^t c_{ECJ}) > \delta^t (\delta^t c_{ECJ} - c_{COM})$$

This can be shown to always be the case by simplifying the inequality to

$$\delta^{2t} b + \delta^{2t} c_{ECJ} > \delta^{2t} c_{ECJ} - \delta^t c_{COM}$$

and

$$\delta^{2t} b > -\delta^t c_{COM}$$

As the *rhs* of this final inequality ($-\delta^t c_{COM}$) is always negative, while the left-hand side (*lhs*) is always positive ($\delta^{2t} b$), this condition always holds. Thus, the derivative of the *rhs* of condition (1) is always greater than zero, making condition (1) is less likely to hold as c_{ECJ} increases.

In effect, this means that governments will be more likely to choose to comply than to engage in litigation as the costs associated with losing legal disputes increase. Therefore, I expect a negative relationship between the costs associated with legal defeat and governments' willingness to litigate.

Timing: How governments discount future payoffs

To avoid a more complicated presentation of derivatives, I approach the analysis of the impact of the extent to which governments discount costs and benefits realized in the future in a different way. Rather than analyzing how marginal changes in the discount factor (δ) affect the probability that condition (1) will hold, I turn to the raw form of condition (1). Condition (1) is simply a reformulation of the situation in which the expected utility of litigation exceeds the utility associated with complying with supranational administrative acts. Hence, an alternative method of investigating the effect of a government's discount factor on its perception of judicial compliance as the optimal response is to take the derivative of both utilities with respect to this factor and compare the strengths of the effects:

$$\frac{\partial E(u)_{Annulment}}{\partial \delta} > \frac{\partial E(u)_{comply}}{\partial \delta}$$

This yields:

$$\frac{\partial p_{win} * b * \delta^t - (1 - p_{win}) * \delta^t * c_{ECJ} + L}{\partial \delta} > \frac{\partial (-c_{com})}{\partial \delta}$$

The *rhs* of the inequality is unaffected by changes in δ : $\left(\frac{\partial (-c_{com})}{\partial \delta} = 0\right)$. However, the utility associated with litigation does react to changes in δ . Overall, taking derivatives yields:

$$t\delta^{(t-1)}p_{win}b - t\delta^{(t-1)}c_{ECJ} + t\delta^{(t-1)}p_{win}c_{ECJ} > 0$$

Consequently, the effect of the magnitude of a government's discount factor for future payoffs (δ) on the probability that litigation will be the optimal response depends on whether the left-hand side of the inequality is greater or less than zero. It can be shown that there is no unique effect of δ on the probability of litigation: Discounting affects both benefits and costs. Thus, the effect of government discounting crucially depends on the level of these costs and

benefits, as well as on the probability that either will be realized. Formally, this can be shown as follows:

$$t\delta^{(t-1)}(p_{win}b - c_{ECJ} + p_{win}c_{ECJ}) > 0$$

Only if this condition holds will higher values of δ be associated with a higher probability of judicial compliance conflict. Dividing both sides of the inequality by $t\delta^{(t-1)}$ yields:²⁸

$$p_{win}b - c_{ECJ} + p_{win}c_{ECJ} > 0$$

$$p_{win}b > (1 - p_{win})c_{ECJ}$$

This inequality will hold if the probability of winning in court is high ($p_{win} \approx 1$), in which case the inequality will approach

$$b > 0$$

This always holds as long as there are benefits associated with not having to adjust domestic policy. However, as the probability of winning in court sinks very low – i.e., if it approaches zero ($p_{win} \approx 0$) – the inequality approaches

$$0 > c_{ECJ}$$

This never holds as long as legal defeat incurs costs and does not provide benefits (negative costs) to national governments. This suggests that government discounting does not have a unique effect on the probability of litigation. Rather, this effect crucially depends on the probability of success in legal proceedings.²⁹

Consequently, I expect that the effect resulting from a government's discounting of future payoffs on the probability of initiating litigation significantly depends on the probability of winning in the court proceedings. When this probability is high, then high values of δ (i.e., a

²⁸ For any $t > 0$.

²⁹ The same result can also be shown by taking the derivative of $p_{win}b > (1 - p_{win})c_{ECJ}$ with respect to p_{win} , which yields $\frac{\partial p_{win}b}{\partial p_{win}} > \frac{\partial (1 - p_{win})c_{ECJ}}{\partial p_{win}} = b > -c_{ECJ}$. This demonstrates that for increasing probabilities of winning legal proceedings, the condition (under which high values of δ make judicial compliance conflict more likely) is more likely to be fulfilled.

high valuation of the future, or limited discounting) will increase the probability of litigation, since waiting for expected benefits incurs few costs. In contrast, when the probability of winning in court is low, then high values of δ are expected to reduce the probability of litigation because postponing the expected costs reduces these costs (due to the high value of δ) only marginally. Thus, the effect of governments' valuation of time on their willingness to go to court should increase with the probability of winning legal disputes.

The theoretical discussion above proposes that if supranational administrative acts carry some degree of conflict potential, the probability that governments will respond by initiating judicial review is influenced by six factors. Litigation becomes more likely with increasing costs of yielding to Commission requirements, increasing benefits of avoiding domestic policy adjustments, and increasing benefits from legal certainty. In contrast, higher expected costs of legal defeat make litigation less likely. These expected costs of legal defeat depend on the actual costs of legal defeat and the probability that they will have to be paid (in other words, the probability of legal success). Finally, the effect of a government's valuation of time is expected to depend on its expectations of legal success. Should a government expect to win legal proceedings, a high valuation of time is expected to increase the probability of the initiation of an action for annulment. Should it expect to lose such proceedings, a high valuation of time is expected to reduce this probability. These expected relationships are summarized in Table 1.

Table 1: Summary of Expected Influences on Annulment Litigation

	Expected effect on initiation of actions for annulment
Benefits of maintaining policy arrangements	+
Costs of yielding to Commission requirements	+
Potential to enhance legal certainty	+
Expected costs of legal defeat	-
<i>Costs of legal defeat in court</i>	-
<i>Probability of legal success</i>	+
Timing (valuation of time)	+/-

4.2 Governments' General Propensity to Litigate

As described above, this section presents macro-level variables that will determine governments' general propensity to litigate. To this end, I build on insights from the relevant research summarized in the literature review wherever possible.

4.2.1 Benefits of Not Having to Adjust Behavior

When supranational administrative acts carry conflict potential, one of the factors affecting the probability of litigation was argued to be the benefits associated with not having to adjust domestic state aid policy. Specifically, the higher the benefits of being able to carry on as initially intended, the more likely it is that litigation will be a government's optimal response. These benefits were constructed as the result of the level of adaptation costs imposed by supranational requirements and the government's ability to carry out such adjustments.

On the basis of rationalist approaches such as the Enforcement-Approach (e.g., Downs et al. 1996), one might be inclined to conceptualize these benefits of not having to adjust based on the expected material benefits associated with these measures. This seems to be particularly relevant in the case of state aid policy measures, which explicitly pursue economic goals. Adherents of the Misfit-Approach would emphasize that the benefits of not having to adjust policy depend on how far-reaching the required adjustments are. If these adjustments affect core policy beliefs and deeply embedded institutional structures, implementing the adjustments will be very costly (Börzel 2000; Duina 1997; Knill 1998). Consequently, avoiding such far-reaching structural adjustments would be more valuable than avoiding rather marginal adjustments. Finally, supporters of the Management-Approach (e.g., Chayes and Chayes 1993) would argue that the benefits of not having to adjust behavior crucially depend on one's capacity to carry out such changes. When governments lack the capacity to readily create and implement policy changes and can only do so with great difficulty and investment of resources, avoiding such changes will be more valuable than in cases in which policies can be changed without much effort.

Against this background, I approach the benefits a government enjoys from not having to adjust state aid policy according to Commission requirements in terms of three factors: the economic benefits associated with state aid measures, the degree of adjustment required, and the government's capacity to implement these adjustments.

Economic benefits of implementing state aid

To begin with, it seems evident that the expectation of economic benefits is one of the primary motivations behind any state aid policy measure. National governments adopt state aid measures in order to support certain industries and sectors in hopes of positive effects in terms of economic growth, employment, and enhanced competitiveness. The Commission tries to minimize governments' activities in this regard so as to minimize distortions of competition within the Internal Market and prevent any form of protectionism.

In this light, changing domestic state aid policy according to Commission requirements carries the risk of minimizing the expected economic benefits of the measure. If companies identified as being in particular need of financial support from the state cannot be supported (either because the company cannot be directly targeted but must qualify for aid provided through a horizontal aid scheme, or because the aid has been declared illegal), achievement of the intended economic benefits becomes uncertain. When supranational administrative acts are perceived to reduce the economic benefits of state aid measures, there are benefits to not having to adjust state aid measures in accordance with these acts.

On the micro-level, it seems plausible to assume that governments attribute higher priority to some state aid measures than to others, depending on the scale and scope of these measures. The key question in this regard is: What are the effects on employment, competitiveness, and growth?

While these micro-level differences with respect to the expected economic benefits of individual state aid measures remain, I argue that expected economic benefits are systematically affected by the macro-economic environment. In times of strong economic growth, the need for additional support through state aid is likely to be less acute than in times of economic downturn. In times of prosperity, companies are able to compete on their own merits and increase rather than decrease their number of employees. During such periods, support from the government is not required in order to reduce existing (and prevent future) unemployment. As a result, governments that find themselves in economic trouble rank state aid policy higher on their list of priorities than governments acting within a prosperous economic environment. The expected economic benefit of any domestic state aid measure is valued more highly in a 'bad' economic climate than in a 'good' one. Thus, macro-economic changes are likely to affect a government's willingness to actively fight for its right to subsidize domestic companies. Consequently, the frequency of litigation is expected to vary systematically with the macro-economic conditions under which governments experience

Commission interference with state aid policy. Specifically, the frequency of litigation can be expected to decrease with the quality of the economic climate:

H1: The better the economic climate, the lower is the frequency of litigation over state aid policy.

To test this hypothesis, I use data on gross domestic product (GDP) provided by the OECD (OECD 2011) as a measure of the economic climate. Specifically, I calculate the yearly change in GDP as a percentage. The higher the yearly change in GDP, the less likely governments will perceive themselves as facing an economic downturn. Consequently, I expect to find a negative relationship between the yearly change in GDP and the frequency of litigation.

Evading adaptation pressure

Second, the benefits of not having to adjust state aid policy are determined by how far-reaching these required adjustments are. When supranational administrative acts require only marginal changes to existing arrangements, different results are expected than when they touch upon core elements of domestic state aid policy. This argument is at the heart of one of the most prominent theoretical approaches to questions of (non)compliance and implementation, i.e., the Misfit-Approach. Essentially, this argument maintains that member states react differently to supranational requirements because these requirements exert different levels of adaptation pressure on them. There are two different versions of this argument. Some scholars have focused on the misfit in terms of domestic administrative traditions (Knill 1998; Knill and Lenschow 1998); others have placed emphasis on misfit with respect to national policy arrangements (Börzel 2000). The rationale behind this argument is the insight that “institutions do not automatically adapt to exogenous pressure” (Knill and Lenschow 1998: 596) but are generally rather stable (March and Olsen 1989; Powell and DiMaggio 1991). In this sense, all change requires effort and resources, with greater levels of effort and resources required to implement more far-reaching changes.

Against this background, Commission interference can be expected to result in litigation when it requires far-reaching structural adjustments in domestic state aid policy arrangements: Avoiding far-reaching adjustments is more valuable to governments than avoiding marginal adjustments. On the micro-level, the different levels of adaptation pressure exerted by various supranational administrative acts should thus explain why some of these acts result in judicial

compliance conflict while others do not. The question is whether there are systematic differences in adaptation pressure on the macro-level.

Although the concept of misfit is one of the most prominent theoretical approaches to explaining patterns of compliance, its integration into macro-level quantitative research is a generally difficult endeavor. Some researchers have tried to account for potential misfit indirectly by arguing that more powerful member states have more power to upload their national policies to the European level than weaker member states. As a result, more powerful member states are expected to experience lower levels of misfit and adaptation pressure. Since this study focuses on supranational administrative acts, which by definition are adopted without the input of member states, state power would not seem to be a suitable approximation of adaptation pressure.

Instead, I propose a more policy-specific approach to adaptation pressure. In general, the Commission's preferences for national state aid design involve low levels of national state aid. Where state aid cannot be avoided and seems justified in order to promote competitiveness, state aid should be horizontal rather than sectoral (Blauberger 2009b). The supranational administrative acts adopted by the Commission should reflect these preferences. When supranational administrative acts address sectoral state aid measures, such as the rescue of individual companies in financial distress, the misfit between the requirements defined in the supranational administrative act and the national status quo can be rather large. Greater misfit between these two factors is expected to reflect greater levels of adaptation pressure.

This conceptualization of adaptation pressure can be transferred directly to the macro-level. Specifically, systematic differences with respect to the adaptation pressure exerted by supranational administrative acts should be reflected by differences in how much money is spent on sectoral aid. High degrees of such macro-level misfit are expected to result in the frequent initiation of judicial compliance conflict, due to the generally higher level of adaptation pressure of the supranational administrative acts involved:

H2: The greater the degree of misfit between supranational requirements and domestic state aid practices, the higher is the frequency of litigation over state aid policy.

To test this hypothesis, I construct a state aid policy misfit indicator. Specifically, I combine the national level of state aid and the share of horizontal aid measures to form one index. I accomplish this by multiplying the overall state aid level as a share of GDP with the share of sectoral aid measures. In this way, high levels of state aid and high shares of sectoral aid

reflect a higher degree of misfit than high state aid levels combined with low shares of sectoral aid. Similarly, low levels of aid and a low share of sectoral aid reflect a lower degree of misfit than low levels of aid that is spent primarily on sectoral aid measures. By creating this policy-specific misfit indicator, this study provides a much more thorough quantitative assessment of policy misfit than other quantitative studies in this field have been able to provide. Some quantitative studies have attempted to account for misfit by differentiating between new and amended legislation (e.g., Kaeding 2006; Mastebroek 2003) (assuming that amended legislation will produce a lower level of misfit than new legislation), by referring to the number of national implementing measures required (König and Luetgert 2008), or by relying on the level of state power (Börzel et al. 2010) (assuming that powerful states that are more capable of uploading their preferences to the European level than weak member states also face lower levels of adaptation pressure when European requirements return to the national level). The state aid policy-specific misfit indicator I present does more justice to the actual concept of misfit, which has dominated the qualitative debate on Europeanization and compliance, than these previous approaches.

Ability to change domestic policy

Third, the benefits associated with not having to adjust domestic policy arrangements are determined by the government's ability to implement the required changes. When governments find it difficult to change domestic arrangements, they will enjoy high benefits when they do not have to do so. Consequently, governments with a low capacity to enact adjustments in domestic state aid policy will litigate more frequently to avoid making these adjustments. This argument, which emphasizes governments' capacity to bring domestic policy in line with supranational requirements, is based on theories presented by the Management-Approach (e.g., Chayes and Chayes 1993).

H3: The lower a government's capacity to adjust its domestic state aid policy, the higher is the frequency of litigation over state aid policy.

However, to test this hypothesis, the concept of capacity requires further specification. The existing scholarship suggests that three aspects of government capacity are most relevant in this context: a government's need to coordinate policy changes at the national level (Guiliani 2003; Haverland 2000; Kaeding 2006, 2008; Steunenberg 2007), its need to coordinate changes vertically with regional actors Levy, 1995 #565}(Haverland and Romeijn 2007;

König and Luetgert 2008), and the quality of the bureaucracy that prepares and implements such policy changes (e.g., Berglund et al. 2006; Börzel et al. 2010; Knill and Hille 2006; Lampinen and Uusikylä 1998). This focus accounts for two relevant characteristics of state aid policy. First, the competences to adopt and implement state aid policy can be concentrated or shared between actors and state levels. Second, state aid policy, in particular with regard to the important role of case-law, is a dynamic and complex regulatory body that requires a substantial level of legal expertise to effectively navigate.

Governments can be constrained in adjusting their domestic state aid policy by their level of bureaucratic effectiveness for two reasons. First, adjusting domestic state aid policy according to supranational requirements can entail not only adjustments to policy content but also changes in administrative structures and processes. Second, adjusting the content of state aid policy might not be as straightforward as one might assume. Since state aid affects many other policy fields, such as industrial policy, environmental policy, employment policy, social policy, and regional policy, state aid policy changes must often be coordinated with regulation in other affected fields to avoid inconsistencies, contradictions, and the resulting legal uncertainty. When such changes can be brought about only with great effort due to an ineffective national bureaucracy, avoiding such changes will be valuable to the government.

On the micro-level, this suggests that whether governments respond to supranational administrative acts by initiating judicial compliance conflict depends on the administrative demands of the act as well as on the government's ability to meet these demands. As a result, systematic differences in governments' bureaucratic abilities to meet the administrative demands of supranational administrative acts should influence the macro-level patterns of litigation. More specifically, low levels of bureaucratic effectiveness should result in greater willingness on the parts of governments to try to contest policy adjustments and should consequently lead to more frequent instances of litigation.

To test this hypothesis, I rely on the concept of "government effectiveness" (Kaufman et al. 2007a). This concept captures "perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies" (Kaufman et al. 2007a).

H3.1: The lower the level of government effectiveness, the higher is the frequency of litigation over state aid policy.

Dimensions two and three of a government's capacity to adjust its state aid policy are related to its need to coordinate policy changes with other actors. I split this argument into two parts. First, I focus on the government's need to coordinate policy changes at the national level. Second, I will discuss its need to coordinate policy change with regional actors. Both perspectives relate directly to the idea that the access of veto players to the policy process creates an obstacle to policy change by increasing the need for compromise and bargaining (Tsebelis 1995, 2002). Who the effective veto players in the design and adjustment of national state aid policy are is largely determined by member states' institutional architecture and the preferences of the relevant actors. Specifically, with greater bargaining requirements for the implementation of changes in state aid policy in response to individual supranational administrative acts, litigation becomes more likely. At the macro-level, this need for bargaining and coordination should be systematically affected by the institutional and political characteristics of the political arena. Consequently, I expect national governments that operate under significant political constraints to litigate more frequently:

H3.2: The greater the political constraints of national governments, higher is the frequency of litigation over state aid policy.

To test this hypothesis, I rely on the political constraints index compiled by Henisz (2000)³⁰, which captures the number of branches of government with effective veto power, taking the heterogeneity of preferences into account. However, this measure does not assess the vertical dimension of political constraints on governments. Specifically, the POLCON III index does not account for the existence of sub-national entities and their influence on national policy. Although it does take the existence of second legislative chambers into account, they are only considered to be effective when (among other things) they are formed by means of a distinct electoral process.³¹

However, vertical constraints on adjusting state aid policy might also be highly relevant constraints on governments' capacity to adjust domestic state aid practices. Specifically, where regional actors have effective veto power or even independent authority over state aid policy, they can make it difficult for national governments to adjust domestic state aid policy. The effects of regional actors and federalist institutions are regularly discussed as influences

³⁰ POLCON III

³¹ As a result, Henisz does not count the German second legislative chamber (the *Bundesrat*) as an effective second legislative chamber, since it is not directly elected but instead composed of representatives from regional (*Länder*) governments.

on member states' implementation performance (König and Luetgert 2008; Mbaye 2001; Thomson 2007).

This implies that national governments will be more willing to avoid adjusting domestic state aid policy when they cannot order these adjustments hierarchically but must instead coordinate such changes through bargaining with regional actors. On the macro-level, this situation is expected to occur more frequently in political systems in which regional actors enjoy a high degree of authority. National governments operating in contexts characterized by high levels of regional authority can thus be expected to litigate more frequently than governments operating in a centralized context that are able to adjust their state aid policy autonomously. To test this hypothesis, I rely on data on regional authority provided by Hooghe et al. (2010).

H3.3: The higher the political authority of regional actors, the higher is the frequency of litigation over state aid policy.

4.2.2 Costs of Yielding to Commission Requirements

In addition, the probability of litigation depends on the costs associated with yielding domestic policy arrangements to requirements formulated by the Commission. The European Union is no longer an exclusive or elite project. Questions of EU politics have entered national political discourses (Hooghe and Marks 2009), and parties have begun to adjust their programs to address the cleavages between the winners and losers in European integration (Kriesi and Grande 2008). These developments imply that supranational interference in domestic policy arrangements carries a potential for political costs.

Of course, yielding to Commission requirements will not always impose costs. As a good and compliant member of the EU, it is important for a member state to follow the body of EU law over which the Commission watches. Furthermore, in situations in which national governments favor domestic adjustments, they can use outside requirements (such as Commission interference or other supranational requirements) to effectively shift the blame for domestic reform to the supranational level, while actually pursuing a policy that they favor (Featherstone 2001; Grande 1995; Moravcsik 1994). In the context of state aid policy, one might imagine that ending preferential tax treatment could be an interesting prospect for national governments in times of budgetary distress. However, since raising taxes is likely to be a controversial and politically costly strategy, representing such a measure as the result of an international commitment articulated and specified in the form of a supranational

administrative act might significantly reduce political costs, as this strategy would enable the government to shift the blame to the Commission. The theoretical framework employed in this study is flexible enough to allow for such cases.³² However, I assume that such instances are the exception rather than the rule in state aid policy. I also assume that bowing to Commission interference in domestic policy is commonly perceived by the general public as a sign of the government's weakness and inability to act and is therefore associated with political costs.

If these costs are indeed a relevant influence on governments' decisions of whether or not to litigate, then I expect governments to be more likely to litigate against administrative acts adopted by the Commission when these acts are perceived as *illegitimate* interference, for two primary reasons.

First, in cases of inaction on the part of the government, opposition parties, relevant interest groups, and the media (if these actors find the interference to be illegitimate) can use this inaction as an opportunity to publicly attack the government by claiming that the inaction is a reflection of the government's weakness, incompetence, or general inability to attain policy goals of national importance. This renders the option of compliance with a supranational administrative act that seems to be an illegitimate interference in domestic policy arrangements potentially costly.

Second, if the government decides to litigate, it can use this decision to publicly promote its willingness to stand up to the bureaucrats in Brussels and actively fight for national interests. Taking the Commission to court can in this sense actually provide political benefits at the national level, as long as the Commission's interference is perceived as illegitimate. Bragging about an inappropriate defection is unlikely to be politically beneficial.

In sum, when supranational administrative acts are seen as illegitimate interference in domestic policy arrangements, reactions can be exploited by national governments to avoid political costs and by political opponents to extract political gain.

However, whether or not interference by the Commission is perceived to be legitimate does not exclusively depend on the specifics of the respective administrative act. Rather, the public's general perception of EU integration and the government's ideological orientation systematically influence this perception.

Governments must justify their responses to supranational requirements. Responses perceived to be inappropriate are likely to be exploited by political opponents and receive widespread media and public attention. Whether or not supranational interference carries a potential for

³² Assume $c_{com} < 0$ rather than $c_{com} \geq 0$.

political costs should therefore be influenced by the perceived legitimacy of the project of EU economic integration. Is this a process that works to the country's benefit, or are there negative side-effects that call for national remedies? In political systems in which a *critical perception of EU integration* prevails, the potential for political costs of passively allowing supranational interference should thus be greater than in systems in which the benefits of the Internal Market are rarely questioned. At the same time, actively fighting Commission interference by taking the Commission to court should hold a greater potential for political gain in systems with a critical rather than a positive view of EU integration.

As a result, in such hostile or critical systems, I expect governments to communicate the initiation of litigation openly and aggressively. At the same time, compliance with inappropriate Commission interference in such critical systems would be expected to be met with open criticism from opposition parties and affected interest groups. In political systems with a positive view of EU integration, I do not expect this kind of 'politicization' of reactions to supranational requirements. In such systems, since the decision to simply comply with such requirements is much less likely to be criticized by opposition parties and any criticism will likely receive only minimal public attention, governments will be under less pressure to fend off interference through litigation. Consequently, I expect to find litigation less frequently in systems with a positive perception of and attitude towards EU integration than in systems with a critical view of this process.

To test this argument, I rely on data from the Comparative Manifesto Project (Volkens et al. 2011) on hostile mentions of the EU and expressed opposition to specific European policies that are preferred by European authorities. However, to avoid bias resulting from extreme fringe parties, I weight parties' criticism towards the EU using the share of votes they received. In this way, I hope to obtain an appropriate measure for the level of criticism that domestic political landscapes express towards the EU. I expect the frequency of litigation to increase with the degree of criticism towards the process of EU integration:

H4: The more critical the domestic political landscape is towards EU integration, the higher is the frequency of litigation over state aid policy.

Since this study focuses on supranational administrative acts in the context of state aid policy, there is another potential influence on the perceived legitimacy of Commission interference that could be significant. Specifically, a government's *ideological position* on the left-right spectrum might influence the legitimacy it associates with Commission interference. State aid

in whatever form is always a type of subsidy and a measure of redistribution. As a result, from an ideological perspective, conservative governments are characterized by a weaker preference for such active governmental involvement in economic affairs than are left-wing governments. While this difference likely influences a government's inclination to adopt measures of domestic state aid in the first place, it should also affect the government's willingness to openly defend these measures before the ECJ. In other words, governments across the political spectrum will – at times – find it necessary to intervene to support domestic companies or industries by means of subsidies (in whatever form). From an ideological perspective, conservative governments would be expected to do so less often than left-wing governments. But what happens when the Commission demands the adjustment of such domestic state aid measures? Are the costs associated with adhering to Commission requirements the same for left-wing and conservative governments? Applying an argument similar to the one presented above, I propose that the costs associated with complying with Commission requests principally depend on whether or not the demand is perceived to be legitimate by the government and its supporters. Left-wing governments and their supporters (characterized by a greater preference for active governmental involvement in economic affairs) are more likely to perceive such interference as an illegitimate attempt to enforce a 'neo-liberal' agenda than conservative governments and their adherents would. Consequently, it is expected to be more costly for left-wing governments to simply accept and comply with supranational administrative acts demanding the adjustment or termination of specific national state aid measures:

H5: The higher the share of left-wing party cabinet members, the higher is the frequency of litigation over state aid policy.

To test this hypothesis, I use data on the proportion of cabinet members belonging to left-wing parties (Armingeon et al. 2012). A higher share of leftist cabinet members should reflect a greater governmental preference for active economic support by the government and thus a higher propensity to fight against attempts to limit such support.

4.2.3 Potential to Enhance Legal Certainty

The various possible responses to supranational administrative acts were argued to provide governments with different potentials to enhance the level of legal certainty in state aid policy. It was asserted that litigation would provide a higher level of legal certainty than other

available alternatives because it offers all the legal certainty of complying (due to the non-suspensory effect of judicial proceedings in the EU) plus the legal certainty resulting from the specification of indeterminate rules through judicial law-making. In this sense, litigation can provide additional legal certainty when supranational administrative acts are based on indeterminate legal concepts or ambiguous rules. Such rules grant the Commission a high level of discretion regarding their future application. A court ruling that clarifies these legal provisions can restrict the Commission's discretion in this regard. As a result, the probability that national governments will litigate increases with the benefits associated with legal certainty and therefore with the potential for judicial law-making provided by supranational administrative acts.

However, not all governments are equally willing to realize existing potentials to enhance legal certainty through judicial law-making. Because governments have come to realize that the ECJ is an important influence on the course of EU integration, several governments have adopted a strategy of *legal activism* characterized by an active approach to judicial processes at the European level. Granger (2004) argues that this strategy of legal activism is reflected by governments' participation in preliminary references initiated by 'foreign' courts. Governments have the right to file observations, providing the court with their perspective on the legal issue at hand, and they regularly submit such observations when preliminary references are referred to the ECJ by 'their' domestic courts. (After all, it is 'their' national laws that are being interpreted from the perspective of European law in such cases.) However, what Granger observes is a growing tendency for governments to file observations also when preliminary references are being sought by courts from other countries. She argues that this reflects an explicit strategy to make more active use of the judicial arena in order to join the legal discourse and influence the development of EU (case-)law. Specifically, Granger argues:

“Governmental agents submit that observations do not only serve defensive purposes but are also used to influence EU law and practices (e.g. in France and Sweden) or to promote a particular vision of EU law (e.g. in the United Kingdom, France, Denmark, and Portugal). Such motivations suggest more Repeat Players-like behavior. This appears to be confirmed by the fact that, in case of conflict between the occasional defense of domestic interests and long-term influence on legal developments, these governments tend to favor the latter.” (Granger 2004: 12)

Overall, this suggests that governments differ with respect to their willingness to realize the potential of judicial law-making. While some try to actively shape and influence the legal discourse at the European level, others take on more passive and defensive roles. Although Granger restricts the discussion of the degree of legal activism to the context of preliminary reference proceedings, actions for annulment are another instrument with which national governments can effectively set the judicial agenda. Specifically, by strategically selecting supranational administrative acts and bringing forward specific pleas before the court, annulment litigation enables governments to directly provoke judicial law-making. Against this background, the question of whether or not a supranational administrative act's potential for judicial law-making will be realized by a national government should depend on the government's degree of legal activism. In this sense, the initiation of an annulment action is just another expression of a generally pro-active approach to judicial proceedings in the EU. As a result, I expect the frequency of litigation to increase with the government's level of legal activism:

H6: The greater a government's level of legal activism, the higher is the frequency of litigation over state aid policy.

While it remains unclear why certain governments are more eager to have an active influence over the future development of EU law than others, the effects of such preferences can be observed – according to Granger – by examining their readiness to submit legal observations to preliminary references initiated by ‘foreign’ courts (i.e., from courts other than ‘their’ domestic courts). With this theory in mind, I have compiled yearly data on the share of ‘foreign’ preliminary references concerning state aid policy for which national governments have submitted legal observations. A government that submitted legal observations to many preliminary references originating from ‘foreign’ courts would display a higher level of legal activism than a government that did not submit legal observations to any foreign preliminary reference. I use this data to test Hypothesis 6.

4.2.4 Expected Costs of Legal Defeat

Moreover, I expect governments to consider the expected costs of legal defeat as they consider whether or not to litigate. Clearly, the expected costs of legal defeat depend on two separate analytical concepts: the size of the costs and the probability that they will have to be

paid. Overall, I expect governments to litigate less frequently when the expected costs of legal defeat are high:

H7: The lower the expected costs of legal defeat for governments, the higher is the frequency of litigation over state aid policy.

The ECJ is often characterized as a rather dangerous and unfriendly environment for national governments. Neo-functionalism accounts in particular argue that the ECJ has repeatedly acted against the preferences of the member states. Supporters of this claim cite ECJ preliminary rulings such as *van Gend en Loos*³³ and *Costa v. ENEL*,³⁴ which enabled the ECJ to establish the doctrines of direct effect and the supremacy of EU law and thereby substantially constrained member states' sovereignty (Alter 1998; Burley and Mattli 1993; Stone Sweet 2004). The potential of the ECJ to hurt member states is also evident in the context of enforcement (i.e., infringement proceedings). When member states are unwilling or unable to comply with EU legislation and fail to respond to reasoned opinions by the Commission, the Commission can refer matters to the ECJ. Such cases are rarely won by member states. Specifically, Börzel et al. (2011: 3) report legal victory for the member state in only 5% of such cases between 1978 and 1999. These court cases are not without consequences for member states but they have been an effective method of enforcing compliance (Panke 2007). Although there seems to be almost no chance for member states to win court proceedings in the context of infringement proceedings, the situation is somewhat different with respect to annulment proceedings. Specifically, out of 508 actions for annulment initiated between 1962 and 2009, 54 resulted in partial annulment and 81 in the complete annulment of the Commission act under review. This means that in 26.5% of cases, the member states were actually (completely or partially) successful. Of the 115 annulment cases recorded in the context of state aid policy for the same time period, member states were partially successful in 15 and completely successful in 19 cases (29.5%). In the context of actions for annulment over state aid policy, it seems justifiable to assume a non-zero probability of legal success for member states. Nevertheless, the question of how one can measure governments' expectations regarding legal success in such proceedings remains salient.

On the micro-level, national governments most likely assess their probability of winning legal proceedings on the basis of relevant precedents and the power of legal arguments specific to

³³ NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration: C-62/26. European Court Reports: English Special edition: p. 1.

³⁴ Flaminio Costa v E.N.E.L.: C-6/64. European Court Reports: English Special edition: p. 585.

the particular legal dispute. If the ECJ has adopted negative rulings in a number of very similar legal disputes, governments will assume that they have a low probability of winning such a case, as it would require the ECJ to diverge from its previous rulings. However, if the ECJ has adopted relevant case-law against the Commission, governments are likely to be more optimistic about their chances for legal success.

Of course, it is difficult to find a relevant macro-level concept for such case-specific expectations regarding legal success. I approach this challenge by relying on governments' *experience* with similar legal disputes. Not only Galanter's classical account (Galanter 1974) but also research on governmental litigation in the WTO-context (Davis and Bermeo 2009) suggests that "repeat players" can be more optimistic about their legal success and will consequently litigate more frequently. Their experience becomes a valuable resource that enhances their expectations of being able to convince judges of the validity of their legal arguments. In this sense, it is irrelevant whether governments have had positive or negative experiences; learning from both outcomes is possible and can be valuable. Consequently, governments that have accumulated more experience with actions for annulment in the past can be more optimistic about winning their future legal disputes and should thus have a higher propensity to litigate in the present. In addition, they can be expected to litigate more frequently. This hypothesis is tested by determining the cumulated number of actions for annulment that governments initiated within the context of state aid in the past.

H7.1: The more litigant experience governments have accumulated in the past, the higher is the frequency of litigation over state aid policy in the present.

Thus, a government's level of experience is argued to affect its probability of legal success, but not the level of the costs associated with legal defeat. Making this analytic distinction is not as straightforward with respect to the second factor expected to influence governments' expected costs of legal defeat: *state power*.

On the one hand, the existing scholarship suggests that political and economic power will make states less vulnerable to the reputational costs associated with exposed defection (Börzel et al. 2011; Börzel et al. 2010). Thus, losing a legal dispute should not be as costly for powerful states.

But how does losing annulment litigation relate to exposed defection? Governments lose annulment proceedings when the ECJ refuses to completely or partially annul the administrative act under review. Technically, the ECJ does not evaluate member state

compliance, but rather compliance by the Commission: It evaluates whether the Commission acted despite a lack of competence, infringed any procedural requirements, treaty provisions or other rules, or generally misused its powers (article 263 TFEU). In other words, the ECJ evaluates whether the Commission was legally ‘right’ in adopting the administrative act. However, by upholding Commission decisions that declared that certain national arrangements must be adjusted or abolished, negative ECJ rulings (‘negative’ from the member state’s point of view) highlight a country’s need to bring its domestic practices in line with European requirements. This can damage the level of trust in this member state at the European level. Since policy application is a sensitive issue that remains in the hands of the member states, a general level of trust regarding correct application is required among partners negotiating common rules. In this sense, whenever the ECJ rules that Commission acts defining certain provisions for domestic policy application are legitimate, this exposes the respective member state as being out of line with EU rules. At the European level, this could result in reputational costs for the member state. If bargaining partners become less certain that a state will follow jointly agreed-upon rules, it might be asked for stronger commitments in order to generate trust, or it may be subjected to other forms of compensation in negotiations for package deals. This argument that relates exposed cases of noncompliance to reputational costs is often found in the literature on compliance and implementation (e.g., Börzel et al. 2010: 1368) and is generally derived from the work of Keohane and Nye on interdependence (Keohane and Nye 1977). According to these researchers, *reputational costs weigh less heavily on more powerful states*, because weaker states cannot afford to reject cooperation with such states due to their (economic or political) influence. This idea seems to be equally relevant in the EU context (Thomson et al. 2006). Against this background, Börzel et al. argue that a “less powerful member state is less able to bear the costs of the judicial procedure before the ECJ” (Börzel et al. 2011: 5). I integrate this argument into my analysis by expecting more powerful states to litigate more frequently than less powerful states, due to their lower susceptibility to potential reputational costs resulting from legal defeat.

At the same time, studies from the field of Law and Politics suggest that *state power influences the probability of legal success*, as the ECJ might be more inclined to respect legal requests from powerful member states for fear of noncompliance with or legislative overrule of ECJ rulings (Carrubba et al. 2008; Carrubba et al. 2012). Specifically, these arguments assume that the ECJ’s institutional authority rests largely on its ability to adopt rulings that are complied with and not overruled by the Council. Due to the lower vulnerability of powerful

states to reputational costs and their high degree of influence in the Council, powerful member states are particularly dangerous in both regards. The ECJ should thus be particularly worried about their preferences when adopting rulings. Assuming that powerful member states are aware of this, they should be more optimistic about legal success when initiating litigation.

These two approaches do not lead to contradictory expectations regarding the relationship between state power and states' propensity to litigate; however, their explanations of the relevance of this factor are different. Consequently, finding the expected relationship formulated in Hypothesis 7.2 will not allow me to determine why power plays a role. Is it due to its negative effect on the costs of legal defeat, its positive effect on governments' expectations regarding legal success, or for both reasons? While this uncertainty is unfortunate, testing the hypothesis nevertheless allows me to assess the argument that the expected costs of legal defeat influence governments' propensity to litigate.

H7.2: The greater a member state government's power at the European level, the higher is the frequency of litigation over state aid policy.

I test this hypothesis by examination of member states' relative voting power in the Council, as specified by the Shapley-Shubik Power Index (Shapley and Shubik 1954).

4.2.5 Timing: Governments' Valuation of Time

Finally, the long duration of annulment proceedings was argued to be a relevant characteristic of the judicial process that can affect governments' decisions of whether or not to litigate. Underlying this argument is the intuition that governments worry not only about the expected costs and benefits of litigation, but also about when these costs or benefits will be realized.

For the period under study, the average duration of annulment proceedings remained rather constant, at about 2.5 years. This is not a trivial time period for governments that are generally elected for terms of four or five years. Depending on the temporal position in its election cycle, a government can thus form expectations about whether a potentially costly ruling will be likely to fall within their term in office or in the next legislative period (when the party in power might well have changed). How governments evaluate the expected costs and benefits of rulings depends on the current temporal position within the legislative term. This was demonstrated formally above.

When a government has little hope of legal success (due to limited power or limited experience; see above), worries regarding costs should be less important for a government approaching the end of its legislative term, as the potential costs could be realized during the term of a successor government. In contrast, when a newly elected party in government is confronted with the decision of whether or not to litigate, it can be almost sure (in view of the average duration of annulment proceedings of 2.5 years) that any costs resulting from a negative ruling will be realized within its own term in government. Consequently, worries over expected costs will be taken more seriously. Thus, while pessimistic expectations regarding legal success should generally be associated with a lower number of actions for annulment, the relationship could vary over the course of a government's legislative term.

To translate this argument into a testable hypothesis, I need to find a way to conceptualize governments' valuation of time. To this end, I utilize the time that has passed since the last election. This approach is based on the assumption that parties in government are more concerned with what happens during their own time in office than afterwards. As a result, governments' valuation of time (i.e., their discount factor) is not fixed, but rather varies over the legislative period. Specifically, I assume that when governments assess the relevance of having to wait for several years until payoffs are realized, they will do so in consideration of their remaining time in office. The national election calendar therefore reflects the relevant reference-frame for governments' valuation of time.

Specifically, it seems plausible to assume that one year before an election, payoffs that are expected to be realized after 2.5 years will be discounted more strongly (smaller discount factor δ) than if the election were three years away. In the latter situation, parties in government can be more certain that payoffs will be realized during their term in office. As a result, they will have to deal with any resulting costs but also with potential benefits. In the situation of upcoming elections, parties in government are less certain that this will be the case, and they will worry less about potential costs and benefits.

At the same time, governments are aware that their term might very well end prior to the officially set date of the next elections. Consequently, the officially defined end of the legislative term might not be the ideal method of conceptualizing a government's reference period. Instead, the beginning of the legislative term might be a better point of reference: Governments are always uncertain about when exactly their term in power will end, but are always certain when this time began. As a government's time in power is finite, the probability of it reaching its end increases with every additional year that passes following the last election. Thus, governments' valuation of time increases (lower values of δ) as the last

election lies farther in the past. In other words, as the time passed since the last election increases, governments' valuation of time increases, and governments will discount payoffs realized in future periods more strongly as the time passed since the last election increases.

In this context, I expect that the temporal position in the election cycle will affect governments' propensity to litigate. The direction of this effect will depend on the expected chance of legal success. If these chances are high (and expected costs of legal defeat are consequently low), I expect a negative relationship between the time passed since the last election and the propensity of governments to initiate judicial compliance conflict. If chances of legal success are low, I expect a positive relationship between the time passed since the last election and the propensity to go to court. This propensity should be reflected by the number of annulments initiated:

H8: When governments expect to lose in court, the relationship between the time passed since the last election and the frequency of litigation is positive. When they expect to win in court, the relationship between the time passed since the last election and the frequency of litigation is negative.

To test this hypothesis, I construct an interaction term representing the product of the time passed since the last election for each government (reflecting their valuation of time) and the expected costs of legal defeat, as captured by the variables of 'state power' and 'experience' with legal dispute.

4.2.6 Control Variables

In order to rigorously test these hypotheses regarding the factors that are thought to determine governments' general propensity to litigate, it seems advisable to control for two further concepts: the level of conflict potential that governments face and their cultural predispositions towards EU requirements.

Conflict potential

As discussed above, governments' decisions of how to react to supranational administrative acts are trivial when these acts simply authorize all aspects of domestic policy arrangements and allow governments to continue their domestic policy without requiring any changes. In this case, supranational administrative acts carry no conflict potential, as they require no adjustments in the domestic status quo. Consequently, the theoretical discussion above has

focused on government reactions when supranational administrative acts do indeed carry conflict potential.

This has direct implications for any attempt to explain the frequency with which governments engage in litigation. It is important to assess the frequency of litigation in the context of the frequency with which governments encounter supranational administrative acts with conflict potential. Since litigation can only be a reaction to supranational administrative acts, its frequency necessarily relies on the existing number of supranational administrative acts. Without the adoption of supranational administrative acts, no judicial compliance conflict can result.

With this in mind, I rely on the number of negative state aid decisions adopted by the Commission (i.e., decisions that declare specific domestic state aid practices to be illegal) as a control variable for the level of conflict potential.

This is not meant to suggest that negative Commission decisions are the only kind of supranational administrative act to carry conflict potential. Even positive state aid decisions by the Commission that declare national state aid practices to be compatible with EU law have been litigated against.³⁵ In addition, actions for annulment have also been initiated against supranational administrative acts in the form of Commission regulations³⁶ and against decisions to open the formal investigation procedure.³⁷ In fact, this is the main reason why I chose to focus on the number of actions for annulment and not on the share of supranational administrative acts litigated against as the dependent variable in this study. It is difficult to justify an exclusive focus on negative decisions to determine this share, as conditional and positive Commission decisions as well as Commission regulations and directives have also been litigated against. At the same time, using the sum of all supranational administrative acts – including positive decisions – as the denominator of this share would reflect different state aid traditions rather than different approaches to the instrument of judicial compliance conflict. Consequently, I choose to focus on the number of actions for annulment initiated while taking different levels of conflict potential into account.

Negative Commission decisions seem to be an appropriate approximation of conflict potential and its dynamic and spatial variance, as they reflect how often the Commission interferes in domestic state aid arrangements in the most drastic way available, i.e., by declaring them to be illegal. At the same time, this specification has the benefit of allowing a distinct assessment

³⁵ This primarily occurs when governments are not willing to accept the classification of domestic policy measures as state aid measures, which implies stricter Commission oversight (e.g., *Netherlands v Commission*: T-233/04. Official Journal C 128, 24.5.2008; p. 30–30).

³⁶ E.g., *Kingdom of Belgium v Commission*: C-110/03. European Court Reports 2005: p. I-02801.

³⁷ E.g., *Germany v Commission*: C-376/07. Official Journal C 11; 16.1.2010: p. 24–24.

of conflict potential and adaptation pressure. While the level of conflict potential measures how frequently governments are confronted with relevant and effective interference in domestic state aid policy, the extent of adaptation pressure resulting from this interference corresponds to the question of how far-reaching the adjustments required by Commission acts are.

Cultural predispositions

The model derived in the previous sections assumes that all governments make essentially the same cost-benefit analysis. However, different countries might have different cultural and procedural predispositions towards dealing with European requirements.

Short reaction times requiring governments to initiate actions for annulment within two months of the adoption of a supranational administrative act might make the formation of expectations regarding the likely outcome of a legal dispute, the need for coordination, and economic effects difficult. When decisions are made under time constraints, decision-makers with limited knowledge and ability tend to simplify their options and use heuristic shortcuts (Kahneman and Tversky 1974; Simon 1955, 1959).

To allow for this possibility of boundedly rational governments returning to typical procedures and reactions when faced with supranational requirements, I rely on the work of Falkner et al. (2007b; 2008; 2005), which identifies different ‘worlds of compliance’. In their analysis of compliance in the context of EU social policy legislation, Falkner et al. find that countries can be characterized by a “typical pattern of how the implementation of a piece of EU legislation is tackled procedurally” (Falkner et al. 2005: 26). According to this typical pattern, as mentioned in Chapter 2, countries can be classified into different worlds of compliance: the worlds of law observance, domestic politics, neglect, and dead letters. It is difficult to formulate specific hypotheses regarding the probabilities that countries from these different worlds of compliance will use litigation when confronted with supranational administrative acts.

One might assume that countries from the world of law observance will typically comply with supranational administrative acts unless they are clearly illegal. In such a case, they will resolve the conflict within the institutional boundaries of the system through annulment litigation. In the world of transposition neglect, one could expect that neglect for EU legislation could carry over to supranational administrative acts. This would suggest that these countries will litigate less – not because they typically comply, but rather because they usually ignore supranational administrative acts. It is much more complicated to formulate

expectations about typical responses from countries in the world of domestic politics. Here, responses to EU requirements that must be transposed depend on whatever is politically valuable. Whether this is typically compliance, noncompliance, or litigation cannot be determined.

Overall, it is difficult to formulate distinct and specific hypotheses regarding how these cultural predispositions will affect governments' propensity to litigate; litigation as a legal activity that allows governments to try to contest EU requirements does not easily fit into the binary distinction between compliance and neglect that characterizes the worlds of compliance model. Nevertheless, I integrate the concept into the analysis as a control in order to explore whether typical frequencies of litigation cluster across the different worlds of compliance.

4.3 Chapter Summary

This chapter derives the determinants of governments' general propensity to litigate against supranational administrative acts in the context of state aid policy. Testable hypotheses were formulated accordingly, proceeding in several steps. First of all, I presented a formal decision-theoretic model that specified governments' utilities associated with the available responses to supranational administrative acts. Based on these utilities, I derived the conditions under which litigation would be a government's optimal response. Consequently, the relationship between the micro-level variables that specify these conditions and the probability to litigate against any specific supranational administrative act was determined.

Having clarified the micro-level conditions that determine when litigation is optimal, I turned to a discussion of the macro-level characteristics of governments that could influence this condition to make it less restrictive (meaning that litigation would be more likely). These macro-level characteristics determine governments' general propensity to litigate.

Generally, litigation against any individual act is more likely when the benefits of not having to adjust behavior are high. These benefits systematically depend on the general economic climate within which governments operate, the degree of misfit between their own and the Commission's preferences regarding state aid policy, and governments' capacity to adjust domestic state aid arrangements. Furthermore, litigation should be more likely when the costs of yielding to Commission requirements are high. These costs were argued to depend on public opinion regarding EU integration and on governments' ideological orientations. In addition, litigation is thought to be more likely when the benefits of legal certainty through judicial law-making are high. However, whether such potential benefits are realized by

governments depends on their general level of legal activism. Moreover, the expected costs of legal defeat will determine the probability of litigation. Governments with high levels of state power and high levels of litigant experience should thus have a higher propensity to litigate. Finally, questions of timing should be relevant. Specifically, I argued that a government's valuation of time affected the probability of litigation. On a macro-level, a government's valuation of time was assumed to be determined by the national election cycle. The direction of this relationship between the valuation of time and the probability of litigation depends on whether governments expect legal success or defeat.

All of the hypotheses derived on the basis of these arguments are summarized in Table 2 below.

Table 2: Summary of Hypotheses

			expected effect on frequency of litigation
<i>Benefits from not having to adjust behavior</i>			
H1	Economic climate	GDP growth	–
H2	Policy misfit	State aid policy misfit indicator	+
H3	Capacity to adjust policy		+
H3.1	Bureaucratic effectiveness	Government effectiveness (Kaufman et al. 2007a)	–
H3.2	Political constraints	POLCON III (Henisz 2000)	+
H3.3	Regional authority	Regional Authority Index (Hooghe et al. 2010)	+
<i>Costs of yielding to Commission requirements</i>			
H4	Skepticism of EU integration	Skepticism expressed in party programs weighted by electoral success of parties based on CMP data (Volkens et al. 2011)	+
H5	Ideological orientation	Share of left-wing cabinet members (Armingeon et al. 2012)	+
<i>Potential to enhance the level of legal certainty</i>			
H6	Degree of legal activism	Share of ‘foreign’ preliminary references to which governments submit legal observations	+
<i>Expected costs of legal defeat</i>			
H7	Expected costs of legal defeat		+
H7.1	Expected probability of legal success	Experience measured as the number of annulments concluded in the past	+
H7.2	Costs of legal defeat	State power as measures by the Shapely-Shubik Power Index (Shapley and Shubik 1954)	+
<i>Timing</i>			
H8	Governments’ valuation of time	Time passed since last election	+/-