



Institutional limits of a 'Europe with the Regions': EC state-aid control meets German federalism

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ABSTRACT Recent research on European integration has taken a fresh interest in the role of institutions in the policy process. Whereas much of the new institutionalist writing on the European Union (EU) has been very actor-centred, this article takes a more sociological approach that views institutions as the context in which actors are embedded. By shaping actors' expectations and giving legitimacy to certain groups, institutional context affects both policy process and outcomes. A case study of state-aid payments by Saxony to Volkswagen supports the hypothesis that, in order to explain tensions between the Commission and the German authorities in the state-aid field, one needs to complement actor-centred analysis by looking at broader incompatibilities between the institutional logics of Germany's co-operative federalism and centralized decision-making structures in the EU.

KEY WORDS European Union; German federalism; multi-level governance; new institutionalism; regions; state-aid control.

1. INTRODUCTION¹

The literature on multi-level governance (Marks 1992, 1993; Marks *et al.* 1996) suggests that one has been able to observe increasingly closer ties and co-operation between the Commission and subnational authorities in the European Union (EU). Although there is now a broad consensus in the literature that such developments have not led to the marginalization of national governments (Anderson 1990; Bache 1998), as the largely normative 'Europe of the Regions' scenario might suggest,² there is still a tendency to generalize about the close co-operation that exists in the Structural Funds, the policy area which has received most attention from multi-level governance scholars. Also, comparative politics studies (Conzelmann 1995; Kohler-Koch *et al.* 1997) have regarded Germany's federal system as constituting a relatively conducive institutional structure for such supranational-regional co-operation. As the German *Länder* are among the strongest regions in Europe with regard to their competencies and resources and are experienced in working in a multi-level polity, they have been regarded as possessing the necessary requirements for close co-operation with the Commission.

This article seeks to caution against both these presumptions. If one looks beyond the narrow bounds of the Structural Funds and analyses other Commission

policies *vis-à-vis* the regions, the picture points to a more ambiguous relationship between the Commission and the regional level. It will be argued that in the field of EC state-aid control,³ which arguably has had more profound effects on the development of Europe's regions than the Community's own regional policy (Bentherbusch 1996; Wishlade 1998), regions have come to see the activities of the Commission with increasing suspicion.⁴ This holds particularly true for the German *Länder*.

The main objective of this article is to highlight the role that deeply entrenched institutional rules and norms play in obstructing relations between domestic and supranational actors. In the traditional European studies literature, institutions receive little explicit attention. Recent new institutionalist research has emphasized the relevance of such explicitly institutionalist analysis (Shepsle 1989; Bulmer 1994, 1998; Pierson 1996; Pollack 1996). However, many of these studies either explicitly or implicitly perceive of institutions as agents – claiming that supranational institutions can *act* more or less independently from member states and affect policy outcomes. While there is a necessity for more disaggregated actor-based analysis as propagated by, among others, Marks (1997), this article seeks to complement such analysis by highlighting a more sociological understanding, which perceives institutions as the *context* in which actors are embedded.⁵ It begins with a discussion of a part of the literature on new institutionalism which suggests that institutional context can define rationality, create expectation about what is considered 'appropriate' behaviour and legitimize particular categories of social actors. A high-profile dispute over subsidies to the car company Volkswagen (VW) in Saxony provides empirical evidence which confirms that European Community (EC) state-aid control in Germany operates against the background of two competing institutional logics: Germany's co-operative federalism and the EC's state-aid regime. It will be shown that even when domestic and European actors agree on the broad objectives and content of EC state-aid policy, decisions from Brussels are likely to be resisted when the decision-making process, from which such decisions emerge, challenges institutionally entrenched domestic traditions.

2. ANALYTICAL FRAMEWORK: THE ROLE OF INSTITUTIONS IN EUROPEAN POLICY-MAKING

2.1 Traditional accounts

Interactions between different levels of government in the EU are embedded in a dense institutional environment. The principal approaches to European integration and policy-making – intergovernmentalism, neo-functionalism and multi-level governance – differ as to the role they ascribe to institutions.⁶ However, all three approaches share fundamental assumptions about how institutions affect policy outcomes, assumptions which are based on rationalist foundations. All three tend to regard institutions as agents in their own right, actors capable of strategic interaction with other actors. Even when they view institutions as providing the context in which decisions are taken, they view them solely as external opportunities and constraints, not as factors that shape the interests and expectations of participating

actors. The following section will contrast this traditional view of institutions with one based on recent work by 'new institutionalists'.

2.2 'Institutions': actors or context?

In the European studies literature one has been able to observe an increased interest in the explicit analysis of institutions in European integration and policy-making from the mid-1980s onwards. March and Olsen's (1984) pioneering institutionalist work coincided with Scharpf's (1985, 1988) seminal article on the joint decision trap, in which he lamented the fact that traditional approaches to European integration had largely ignored the role of decision-making rules. The basic premiss of what has come to be known as 'new institutionalist' analysis is that institutions structure political actions and outcomes, rather than simply mirroring social activity (Powell and Dimaggio 1991; Hall and Taylor 1996; Pollack 1996; Pierson 1996; Immergut 1997). However, the new institutionalist research agenda is characterized by a high degree of ambiguity, including lack of agreement over what to consider an institution.⁷ In the following, Norgaard's definition which encompasses both formal institutions (e.g. decision-making rules) and informal ones (e.g. habitual action) is used as a starting point. He defines institutions as 'legal arrangements, routines, procedures, conventions, norms, and organizational forms that shape and inform human interaction' (1996: 39). The two major variants of new institutionalism – rational choice and sociological institutionalism – will be contrasted below.⁸

Rational choice institutionalism

Rational institutionalists work with an explicit model of the actor, one which is instrumental. Actors seek to maximize the attainment of goals and base their decisions upon strategic and rational calculations. North (1990), for example, regards institutions as incentive structures which influence an individual's utility-maximizing behaviour. Actors assess their goals, interests and desires independently of institutions; in other words, it is assumed that actors' preference formation is external to the institutional context in which actors find themselves. Institutions affect 'only the strategic opportunities for achieving these objectives' (Immergut 1997: 231). It is an understanding that has, at least implicitly, provided the key foundations of much of the existing EU literature.

Norgaard's definition above suggests that institutions can express themselves in *organizational* forms. Most 'rational institutionalist' writers (Scharpf 1988; Pollack 1996) pursue an actor-centred analysis. Supranational institutions, like the Commission or the European Court of Justice, are understood to *act* in the multi-level environment of European policy-making. In contrast, more sociological institutionalist accounts perceive of institutions as the *context* that *constitutes* national and supranational actors by shaping their interest and identities (March and Olsen 1989; Powell and Dimaggio 1991).

Sociological institutionalism

There are limits to what an actor-centred institutionalism can explain as actors' rationality itself is limited. Steinmo emphasizes that rationality is embedded in context: 'In politics, political institutions provide the basic context in which groups make their strategic choices. And any rational actor will behave differently in different institutional contexts' (1993: 7). Sociological-oriented approaches raise the question as to what extent an actor's broader institutional context – defined by the legal and political-administrative traditions of a political system or policy area in which actors are embedded – can lead to rule-governed behaviour that may supplant instrumental calculation. In other words, sociological approaches ask questions about how traditions and rule structures shape expectations about what is considered 'appropriate' behaviour and how they influence policy outcomes. Hence, sociological institutionalism complements other approaches by making the following two principal propositions.

(i) Institutions make behavioural claims on actors

Institutions provide actors with a particular understanding of their interests regarding a particular policy issue. In the early literature on bureaucratic politics, such phenomena have been summed up by the phrase 'you stand where you sit' (Allison 1971). Interests are shaped against the background of existing rules and standard-operating procedures which lead us to expect others to act in a certain way. Decisions are often taken according to what is considered 'appropriate' behaviour, with institutional norms being the main shapers of such notions of 'appropriateness' (Knill and Lenschow 1998). A calculus of identity and appropriateness is sometimes more important to actors than a calculus of political costs and benefits (March and Olsen 1989).

(ii) Institutions entail a structural bias in favour of particular groups

Institutions should not be regarded as neutral structures for another reason. They often represent an important structural bias, as they privilege certain types of policy and certain actors over others (Hall and Taylor 1996; Armstrong and Bulmer 1997: 52). Political institutions can facilitate the mobilization of interests, for example, by recognizing particular groups or by delegating functions to them, thereby recognizing the legitimacy of their particular claims (Immergut 1997: 340). By giving legitimacy to some groups, while denying it to others, institutions affect not only the structure of the decision-making process, they also influence what interests are reflected in policy outcomes.⁹

This article seeks to test the following hypothesis: even if there is broad agreement about the objectives and the general content of certain policies, tensions between the Commission and national actors are likely to arise when relevant actors are embedded in competing institutions which differ in their view about what constitutes 'appropriate' behaviour by other actors. Or, phrased differently, decisions from Brussels are likely to be resisted when the institutional logic of a

particular EU policy clashes with key institutionally entrenched domestic traditions.

3. INSTITUTIONS IN COMPETITION: GERMAN FEDERALISM MEETS EC STATE-AID CONTROL

Comparing Germany's federal institutional set-up with the institutional logic governing decision-making on state aids within the European Commission helps to identify a number of institutional cleavages. Three important characteristics of the German institutional context are its joint decision-making, its legalistic tradition and the principle of ministerial autonomy (linked to its emphasis on vertical administrative co-ordination). These characteristics are to be contrasted with decision-making in EC state-aid control which is centralized, characterized by discretionary powers and which has the power to interfere horizontally with other policy areas.

3.1 Germany's co-operative federalism

Joint decision-making: the importance of co-operation and consensus

Germany's federal system is by its very nature a decentralized one. Germany's federal constitution (Basic Law) assigns policy responsibility to the federation (*Bund*) and the states (*Länder*), depending on the policy issue concerned. It is important to note the important role that the *Länder* play in Germany's legislative and administrative set-up.¹⁰ The *Länder* not only participate in the formulation of two-thirds of federal legislation via the Bundesrat, they are also responsible for the implementation of most legislation, i.e. they act as Germany's principal administrators. In this role the *Länder* carry out about two-thirds of total public expenditure. In contrast to the American model of federalism and assumptions of fiscal federalist theories (Oates 1972), functional responsibilities in many policy fields are not neatly separated but are shared between the federal and the state level of government.

German federalism, notwithstanding certain differences between policy areas, is a highly co-operative form of government (Benz 1994). Regional policy decisions, which set the framework for the vast majority of state-aid grants, are taken in the context of the 'joint tasks' (*Gemeinschaftsaufgaben*), a structure which has become the trademark of Germany's co-operative federalism. It is a structure exemplary of what Scharpf *et al.* (1976) have termed *Politikverflechtung* (a system of interlocking competencies).¹¹

In order to reach legally binding decisions within the 'joint tasks', agreement between the Bonn government and the majority of the *Länder* is necessary. In practice, decisions are usually taken unanimously. Even in areas where such formal co-operative arrangements between the *Bund* and the *Länder* remained absent, a high degree of co-operation and co-ordination between the two levels of government is still the order of the day. Aid packages to industry, like the one to Volkswagen, often have a federal and a *Land* component.¹²

This is not to imply the absence of political conflict within German policy. Over the last decade, mainly as a result of unification, co-operation and the search for compromise have become particularly difficult. None the less, overall, the characterization of Germany's policy process as one essentially driven by the search for compromise, mutual trust and a common interest to avoid the politicization of conflicts (Richardson 1982) still holds, in particular when viewed from a comparative perspective.¹³

The legalistic tradition in German policy-making

Much has been written about the legal culture of German politics (Beyme 1985; Greiffenhagen and Greiffenhagen 1993) and the habit of regulating even minor details by laws. There is a tendency 'to aim at comprehensive regulation by legal norms, to assert constitutional-legal justification for political actions and demands, and to seek authoritative, definitive and hence legally binding resolution of conflict' (Blair 1991: 64). The extensive powers of the German Constitutional Court support this.

However, this legalistic tradition does not just play a role when there is a clash of interests but it accompanies the whole policy-making process in Germany.

The law is unambiguously in politics both as a structuring instrument defining institutions and the rights and duties of citizens, and equally in the guise of a statement of political and social values to which the society as a whole is committed and to the promotion of which those active in politics are held to be especially bound.

(Johnson 1978: 178)

Civil servants in the various government ministries (most of them lawyers) are very much guided in their policy-making by what they believe is legally possible and what they believe can survive a test in the courts (Sturm 1996: 120). Policy-making in Germany's federal system is complex but highly transparent, involving clearly defined procedural rules.¹⁴ Great emphasis is laid on the use of sophisticated statistical indicators, for example, in the designation of assisted areas, in order to give decisions the desired scientific grounding.

Ministerial and departmental autonomy

Finally, the German system of co-operative federalism is also characterized by a high degree of administrative horizontal fragmentation between different government departments. This is mainly due to Article 65 of the Basic Law which sets out the principle of ministerial autonomy. Although it is the Chancellor who sets the government's overall policy guidelines, ministers lead their departments with a considerable degree of autonomy.

Strong bureaucratic links between government departments at federal and *Land* level further contribute to this sectoralization of the policy process. Members of specialist departments at federal and *Land* level often have to co-operate closely in

policy-making and by doing so they seek to restrict the input of other ministries. This is particularly true for the Federal and *Länder* ministries of economics, which operate at the interface of domestic and European policy-making and which are the key departments regarding state-aid issues. In its extreme form, this phenomenon of vertical co-operation, at the expense of horizontal co-ordination, has been termed 'departmental buddyism' (*Ressortkumpaneit*).

3.2 The EC's state-aid regime

A very different institutional logic informs the Community's state-aid regime, one characterized by centralization, discretion and Directorate-General IV's. (DG IV's) horizontal interference in other policy areas.

Centralized decision-making

The EC state-aid regime, governed by Articles 92–4 of the Treaty of Rome, is very centralized in its decision-making structure. DG IV, the Competition Directorate, is special among the twenty-four directorates that make up the European Commission as it has an unparalleled degree of independence from non-state actors, member state governments and other EU institutions. DG IV's state-aid regime is relatively shielded from the influence of business interests. Although competing firms regularly provide the Commission with information for its investigations, there has been little evidence to suggest that industry has been successful in shaping policy-making in the state-aid arena. DG IV is the Commission directorate with perhaps the clearest supranational brief. The particular character of the EC's state-aid regime goes back to the Treaty of Rome and the wish of the member states to empower the European Commission into a role of neutral arbiter that would enhance the credibility of the regime. Unlike other DGs, DG IV can operate relatively unrestricted from other EU institutions. For a DG IV decision to come into effect, a simple majority of the College of Commissioners is usually sufficient, with the Council not being involved at all. Furthermore, an increasing number of decisions (currently around 45 per cent) are taken 'by way of delegation of powers, by the Member of the Commission responsible for state-aid' (Mederer 1996), excluding other Commissioners (and the national pressure they can bring to bear) from the decision-making process. Although the European Court of Justice has the power to check decisions taken by the Commission, the Court has tended to support the reasoning of the Commission (Evans and Martin 1991: 89). Given, therefore, that there are few constraints on DG IV and that its decision-making process is centralized, it has been claimed that the Competition Directorate can often act simultaneously as prosecutor, judge and jury (Cini 1997).

Discretion and opaqueness

The discretion that the Commission can exercise at the various stages of the state-aid decision-making process is substantial, if not unique when compared to other

policy areas (Cini 1997). The Treaty provisions with regard to state aids are rather open-ended in character and procedural aspects of the Commission's authority have never been codified in any detail. According to Evans and Martin (1991: 83–6), 'the decision to approve an aid, or to open the full investigative procedure under Article 93(2), has more to do with the gut-feelings of the *rapporteur* than with any specific and detailed economic or legal analysis'. DG IV tends to use broad statistical indicators and is prepared to sacrifice some rigour in the choice of what it measures in order to be able to compare data across the EU. The opaqueness of the DG IV decision-making process has frequently led to criticism that state-aid decisions are taken on an *ad hoc* basis and used to advance policy strategically. 'The result has been inconsistent decisions, each one based on the political needs of the moment, which together do not amount to a coherent body of principle' (Burnside 1998).

Enforcing horizontal co-ordination

The Competition Directorate is also special as it has been able to assert its influence on other EU policy areas, in particular on regional policy. The majority of public aids in the EU are regional aids and such assistance has become the main source of general investment aid to large firms. In the case of a dispute between the two objectives – competition and cohesion – it is usually the cohesion objective which has to give. As all national and European regional policy schemes need to be approved by DG IV before coming into effect, DG IV's priorities overrule those of the Commission's regional policy directorate. The most controversial aspect of Commission control of regional aids has been its role in restricting assisted area coverage. Recent initiatives by DG IV regarding area coverage seek to reduce significantly the percentage of population across the Union eligible for aid interfering substantially with the regional policies of member states.¹⁵ The main objective of DG IV's approach to area coverage is to shape regional assistance schemes to its liking (Wishlade 1998: 356–7). DG IV no longer appears to limit its action to the supervision and prohibition of illegal state aids, but enlarges its range of activities using quasi-regulatory tools for which the legal basis is highly contested (Della Cananea 1993: 68).

4. EC STATE-AID CONTROL IN GERMANY: THE VW DISPUTE

In its decision of 26 June 1996,¹⁶ the Commission scaled down an aid package put together by the *Land* of Saxony to support VW investments in Mosel and Chemnitz. The Saxon government launched an appeal to the European Court of Justice to get this decision overturned. Without waiting for the outcome of this legal challenge, the Saxon authorities decided to pay the full amount to VW, in contravention of the Commission decision. By ignoring the Commission decision, the Saxon government strained its relationship with the Bonn government. This action also caused severe rifts in the Commission's relationship with Saxony as well as with Germany more generally.

On the surface, the dispute was a legal one about the applicability of Article 92(2)(c) of the Treaty of Rome which gives privileged state-aid status to regions affected by the division of Germany. However, despite its particularities, the VW controversy should not be seen as a singular case but against the background of a whole series of disputes between DG IV and the German authorities. Thus, it becomes clear that the VW conflict was about more than just the cut of a subsidy as the case raised more fundamental questions about the wider relationship between DG IV and the German authorities and the legitimacy of the Commission's involvement in member state internal affairs.

4.1 Details of the case and positions of the parties involved¹⁷

When VW decided in 1995 to revive two postponed investment projects in Mosel and Chemnitz, the German government announced a new multi-annual aid package from the Saxon authorities. In its decision of 26 June 1996,¹⁸ the Commission approved only DM 539.1m of the total aid package of some DM 779.8m, i.e. almost DM 241m less than Saxony had intended to pay.¹⁹ On 22 August 1996, having come under substantial pressure from VW to live up to its initial promise, the Saxon authorities filed an appeal before the European Court of First Instance.²⁰ More controversially, the Saxon government also went ahead to pay VW the first part of the full sum (DM 141.9m), some DM 90.1m of which had not been approved by the Commission.

Without going into the legal details of the case, the following issues can be identified.²¹ *Prima facie*, the question was whether certain provisions pertaining to state-aid undertakings, contained in the Treaty on European Union (TEU) which aim at overcoming the economic effects of the division of Germany, should have been applied in this particular case. Article 92(2)(c) of the Treaty, which represents one of the exemptions to the general prohibition of state-aids in Article 92 (1), reads:

The following shall be compatible with the common market: . . . aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, insofar as such aid is required in order to compensate for the economic disadvantages caused by that division.

The second issue was about Saxony's payment of the full aid package to VW, in contradiction of the Commission's decision which, under European law, has immediate legal effect in a member state. These two issues soon gave way to a broader third one, concerning the legitimacy of Commission involvement in the domestic affairs of member states.

The Commission's position

In its decision on the Saxon aid package, the Commission made it clear that it regarded Article 92(2)(c) as not applicable in this case. Without substantiating its

reasoning, it went on to argue that the VW case could be duly assessed by recourse to the other exceptions provided for in Article 92(3)(a) and (c) of the Treaty.²²

The real concern of the Commission becomes clearer when reading statements by Commissioner van Miert at the time. He was worried that the application of this Treaty provision would give the German authorities *carte blanche* in the granting of state aids to Eastern Germany.²³ Van Miert stated 'Germany is European champion when it comes to state-aids' and he continued: 'I have sometimes been attacked by other member states because they felt that we [DG IV] were too generous with regard to Germany, in particular the new German *Länder*.'²⁴

Prior to its decision on VW, the Commission had indeed received a letter from the French government in which it demanded that the new German *Länder* should not be exempted from the Community's state-aid discipline.²⁵ Clearly concerned that Saxony's illegal payment might set a dangerous precedent, van Miert called Saxony's action the biggest challenge ever to state-aid rules.

Saxony's position

Saxony took the view that Article 92(2)(c) renders aid to Eastern Germany automatically compatible with the Common Market and does not leave the Commission with the option to apply other Treaty articles which require individual authorization by the Commission. In a letter to Commissioner van Miert, Saxony's prime minister Biedenkopf stressed that 'for the Free State of Saxony, retaining Article 92(2)(c) in the Maastricht Treaty was an important precondition for its ratification'.²⁶

In a separate line of argument, the Saxon government criticized the arbitrary nature of DG IV's analysis. The Commission's decision to reduce the aid to VW was to a large extent based on the argument that the projects in question represented an extension of earlier investments, for which less aid could be granted than for 'green-field' investments. In its appeal, Saxony attacked DG IV's decision on the grounds that the Commission had changed, without explanation, its assessment of the nature of the investment in the middle of ongoing procedures which started on 14 January 1992. By referring to the planned investment in all contact with the German side as a 'green-field' investment until two months before the announcement of the decision (Freistaat Sachsen 1996: 39), the Commission had, the Saxon government argued, betrayed the legitimate expectations of both the German authorities and the investor. This arbitrariness in the Commission's treatment of the case was particularly resented as DG IV had not responded to letters written before the June decision in which Saxony had already put forward its position (Freistaat Sachsen 1996).

Biedenkopf felt that he could not wait for the decision by the European Court of Justice which, he feared, would take several years. He was concerned that by then VW would have decided against Saxony as the location for its investment, thereby endangering 20,000 jobs in the region. This fear was expressed by Saxony's Minister of Economics, who was quoted at the time as saying: 'We have to bribe these companies – otherwise they go elsewhere.'²⁷ The Saxon government's concerns

were reinforced as VW announced an immediate halt in construction when the Commission's decision became public. In a letter to the Saxon government, VW chairman Piëch stressed that his company's investment in Saxony would not go ahead without the full aid payment of the original aid package.²⁸

Bonn's position

The Bonn government supported Saxony's view on the applicability of Article 92(2)(c). Economics minister Rexrodt said that the German government 'regards Article 92(2)(c) as the basis for the economic reconstruction of those territories which have suffered disadvantages as a result of the division of Germany' (Rexrodt 1996: 3). During the Maastricht Treaty negotiations in Noordwijk, 4 November 1991, the German government insisted – against the original proposal of the Luxembourg presidency – on keeping Article 92(3)(c) in the revised Treaty. According to the then Foreign Minister Genscher, this was done 'in order to create an exemption clause for the new *Länder* that would give them more favourable conditions than would otherwise have been possible under the provisions of Article 92(3) of the Treaty.'²⁹

Repercussions

In the aftermath of Saxony's payment to VW, talks were held at the highest political level between Commission President Santer and Bonn officials. None the less, the dispute caused a serious backlash in Saxony's relationship with the *Bund*, the other German *Länder* and, above all, the Commission. Bonn was put in the awkward position of being attacked by the Commission for an action it had neither authorized nor approved of. Although the other German *Länder* generally sympathized with Saxony's frustration about DG IV, they felt that Saxony's uncompromising stance jeopardized the *Länder's* interests in Europe. When the dispute widened, it led to an ill-tempered conflict about undue Commission interference in *Länder* affairs. The Economics Minister of the Free State of Saxony, Schommer, put the blame for the dispute squarely on the Commission. 'It is unthinkable that Brussels can dictate to Saxony, on how to pursue the economic reconstruction of Eastern Germany.'³⁰ Schommer went even further when he spoke of the dangers of a lurking 'Euro-dictatorship', and one of his senior party colleagues was quoted as saying that the European Commission betrays the European idea 'when it interferes à la Politburo – naively, power-hungry and overpaid – in Saxon affairs'.³¹ Whereas these kinds of comment might not be unfamiliar to a British audience, they were virtually unheard of in the generally europhile German context.

A face-saving solution for all sides was agreed on in November 1997 when VW repaid the DM 90m in question, and was granted a subsidy of the same size for another investment. The Commission withdrew its court case against Germany regarding the illicit payments of state aids. Proceedings before the European Court of Justice concerning the applicability of Article 92(2)(c) continue.

4.2 Searching for actor-centred explanations

A number of reasons can be put forward to explain why the VW dispute raised the stakes to the extent it did. These include the special political and economic circumstances in East Germany that provided the background to this case, but also the personal influence of the key protagonists involved in the dispute. Saxony's prime minister Biedenkopf is one of Germany's most colourful post-war politicians who, despite being an influential figure in the Christian Democratic Party (CDU), had a number of disputes with the then CDU-led Kohl government. His policy of 'Saxony first' was guided primarily by attempts to combat unemployment which stood at levels of more than 25 per cent in certain parts of Saxony at the time.³² Biedenkopf's principal opponent, Commissioner van Miert, had a reputation for his confrontational style. At the time of the VW dispute, he made public his determination to take a tough line on aids to the former German Democratic Republic (GDR) in the wake of the fraudulent use of EU subsidies to the East German shipbuilding industry (Bremer Vulkan). Finally, the chief executive of VW, Piëch, a highly controversial figure not just since the 'Lopez dispute' with General Motors, also played a prominent role. His letter to Biedenkopf and his public announcements in the aftermath of the Commission's decision, indicating his intention to move the planned investment to Eastern Europe, could be interpreted as barely concealed attempts at blackmail.

While the VW dispute thus reflected a fairly exceptional actor constellation which clearly left its mark on the controversy, events cannot be fully understood without reference to the wider tensions that had existed between DG IV and the German authorities for some time. Actor-centred explanations, like the ones outlined above, do not provide sufficient explanations of the events, as the VW dispute constituted only the tip of an iceberg, given that the tensions between the German authorities and DG IV had become notorious. More than one-third of all EC state-aid decisions involve Germany. In 1995, the Commission initiated twenty-seven formal investigative state-aid procedures in Germany, compared to four in France and none in the UK (Wishlade and Olsen 1997: 32). Moreover, there have also been heated disputes between DG IV and the German authorities over issues of 'maximum assisted area coverage' (Bentherbusch 1996) and government guarantees to the Landesbanken (Smith 1998: 74). Germany is also the only country which has so far refused to accept the Commission's recent proposal for a multi-sector framework on state aids and has substantially criticized the recently adopted revised 'Guidelines on National Regional Aid'.³³ These tensions have developed despite the considerable degree of agreement between the Commission and the German authorities over the necessity, objectives and content of a European-wide state-aid policy. In the early days after unification, a senior Commission official recalls that 'there was even an excessive German attitude of not asking for special treatment from Brussels. . . . When we offered them [German officials] a special limited exemption from the rules governing aid to shipyards they rejected it.' In 1994, when van Miert took over the Competition Directorate from Sir Leon Brittan, it was Germany which expressed the concern that the socialist van Miert might be too lax in applying state aid and merger control procedures.³⁴

In the following, it will therefore be argued that, whereas an actor-centred analysis has its limits, examining the competing institutional logics identified, in which German and European actors are embedded, can advance our understanding of the underlying source of tensions in the relationship between the German authorities and the Commission.

5. INSTITUTIONAL LIMITS TO A 'EUROPE WITH THE REGIONS'

The analysis in section 3 has shown that decision-making on state aids at the national and the European level is governed by different institutional logics. Referring to the VW case, this final section will show how the two principal claims put forward by the sociological institutionalist framework discussed earlier in section 2 can help to explain more fully the complex relationship between the German authorities and DG IV.

Behavioural claims

The first claim holds that actors choose their preferences according to established institutional principles. A particular institutional logic can lead to certain expectations about what actions to expect from other actors. If actors are embedded in different institutional logics, these expectations of what is considered appropriate behaviour are likely to be disappointed. As a result, accusations by some actors about others not 'playing by the rules' are common. However, it is probably often the case that the other has just been playing by different rules. In the case of state-aid control in Germany, three such institutional cleavages have been identified.

(i) *Joint vs. centralized decision-making*

The EC's competence to control member state state-aid policies is one of the most political of European competencies. Commission intervention is often regarded in the member states and regions as a major constraint on their freedom to make policy, and matters are made worse by the way DG IV takes its decisions. The consensus-based approach of Germany's co-operative federalism clearly clashes with the very centralized and hierarchical decision-making logic of DG IV's state-aid control procedures. In Germany's joint decision-making system, policy-making is the result of negotiations and no central authority usually takes decisions unilaterally, as DG IV does in the state-aid arena.

In the VW case, there was a great degree of frustration among federal and *Länder* policy-makers who felt that DG IV ignored their offers of co-operation and compromise. This was particularly the case when Biedenkopf's letters to Van Miert remained unanswered. The German authorities resent what Wishlade (1998) calls DG IV's 'draconian style' when imposing its policies.³⁵ They have repeatedly accused the Commission of ignoring its Treaty obligation to 'keep under constant review all systems of aid . . . *in co-operation* with the Member States' (Article 93(1); my emphasis).

(ii) Rules vs. discretion

Policy-makers who are steeped in Germany's legalistic tradition, which is based on firm rules and procedures, find it particularly difficult to accept the discretionary policy style of DG IV. Accusations from the German side – as voiced by Saxony and VW in the above case – that the Commission changes its position in the middle of ongoing procedures according to political expediency are an expression of the widespread frustration of many German civil servants and companies that DG IV can ignore the legitimate expectations of domestic actors.³⁶ Germany's administrative culture is characterized by the so-called '*Prinzip der Selbstbindung der Verwaltung*' which stipulates that public administrations must act in conformity with past decisions and administrative directives (Evans 1997: 70). It is part and parcel of a more general principle of law, which guarantees the protection of legitimate expectations (*Vertrauensschutz*). The VW case shows that DG IV does not always seem to follow its own guidelines, and in this particular case it was accused of having violated the legitimate expectations of the Saxon government and VW, who claimed that they had relied on the exception provided for Germany in the Treaty.

Moreover, the German authorities have repeatedly argued that the enforcement of measures, motivated by industrial policy objectives (such as fighting over-capacities in the European car sector) through Articles 92 and 93, represents an abuse of these Treaty provisions and of DG IV's policy discretion.³⁷

(iii) Vertical vs. horizontal co-ordination

DG IV's involvement in the wider aspects of regional policy causes further consternation with German policy-makers steeped in the tradition of ministerial autonomy and vertical departmental independence (*Ressortprinzip*). Frequent complaints by German policy-makers about undue interference by DG IV in domestic regional policy-making are a poignant example of this. Domestic regional policy strategies, such as the GA framework plans (*Rahmenpläne*), have to be approved by the Commission according to Article 93 of the Treaty. Until this approval has been given, such initiatives cannot come into effect. By withholding its approval, DG IV can impose its policy priorities on German policy-makers. In the view of German officials, DG IV has repeatedly abused this power in order to force a reduction of designated area coverage in Germany (Bentherbusch 1996). German policy-makers object to DG IV's horizontal interference in regional policy-making and argue that such actions cannot be justified on competition grounds.

Structural bias

The second sociological institutionalist claim identified earlier stresses that different sets of institutions legitimize and empower different categories of social actors. The German federal system emphasizes the important role that the German *Länder* play in both the legislative and the administrative process, regarding domestic and European policy-making.

In order to safeguard their domestic role, the German Constitutional Court has

acted as the guardian of the delicate balance of power between *Bund* and *Länder* in Germany. More than once, it has stopped what it regarded as the encroachment of the federal government on the competencies of the *Länder*. In a 1975 judgment on the German system of grants-in-aid, the German Constitutional Court stressed that federal subsidies must not be used as an instrument of manipulation of investment in order to promote the general objectives of the Federation in the *Länder* and held that the *Bund* must have due regard to the investment plans of the *Länder* (Blair 1991: 79).

In 1992 a new Article 23 was introduced to the Basic Law, which significantly enhanced the participatory rights of the *Länder* in the European policy process. Among other provisions, it establishes the right of *Länder* representatives to take the lead role in negotiations at EU level. By doing so, it recognizes the *Länder's* right for a substantial and autonomous role in European policy-making. This development has to be seen against the background of long-standing efforts by the *Länder* to redress some of the far-reaching effects of European integration on the distribution of power in a federal state. The nature of European integration implies the transfer of sovereign competencies. Sovereignty is given up in exchange for participation in decision-making at the European level. However, while this logic applies to unitary states, problems arise in the case of a federal state. When regions relinquish authority, they are often not adequately compensated with increased participation in the European decision-making process, since EU policies have traditionally been the prerogative of national governments.

When it comes to specific encroachments at the European level into domestic politics, the European Court of Justice has neither the authority, nor it seems the will, to act as the guardian of subsidiarity. On the contrary, the European Court has consistently backed DG IV in its state-aid decisions, even when such decisions have gone beyond competition concerns or undermined national or subnational competencies in policy areas such as regional policy.

It has been seen in the VW dispute that the Commission's 'blindness', regarding the subnational level of government in the context of state-aid control, fuels tensions between the Commission and the German *Länder*, as well as between the federal and the state level within Germany. On the one hand, this 'blindness' leads the Commission to ignore the autonomy of the German *Länder* and their specific interests. On the other hand, it can lead to awkward situations, as described earlier in the VW case, when the German federal government was taken to Court by the European Commission over an illegal payment which it had neither made nor approved of.

6. CONCLUSIONS

This article casts doubt on the idea that the relationship between the EU and Europe's regions is characterized by ever closer co-operation and that the relationship between the Commission and the German *Länder* should be viewed as a prime example of this co-operation. The case study on Saxony's aid to VW has shown that tensions between the Commission and the German authorities over the

EC's state-aid regime are a reflection of broader incompatibilities between the institutional logics of Germany's co-operative federalism and more centralized decision-making structures of the EU. In the area of EC state-aid control, tensions between the Commission and subnational actors therefore cannot be explained satisfactorily by looking at actor-centred explanations, or differences in policy objectives between the participating actors. In order to arrive at satisfactory explanations, reference to the institutional context in which interactions take place must be made. By shaping expectations and giving legitimacy to certain groups of actors, institutions affect both policy process and outcomes. Therefore, identifying diverging formal and informal decision-making rules at the national and the supra-national level can help to explain tensions in the relationship between the European, national and subnational actors.

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NOTES

- 1 The hospitality of the European Policies Research Centre in Glasgow, where this article was written, is gratefully acknowledged.
- 2 Hooghe (1996) has instead coined the expression 'Europe with the Regions'.
- 3 European state-aid control is charged with safeguarding competition in the Single Market and is therefore part of the European Community pillar of the EU.
- 4 Despite its highly political nature, research on the EC's role in state-aid control has so far been dominated by the legal literature (Evans 1997; Schina 1987), while it has received relatively little attention from political scientists. Notable exceptions are Cini (1997) and Smith (1998).
- 5 Marks's call for an actor-centred analysis of multi-level governance is based on a view that perceives of states as 'institutional contexts in which human beings pursue their goals'. This approach is to avoid 'reifying the state as an actor with interests or preferences' (Marks 1997: 34).
- 6 For an intergovernmentalist account see, for example, Moravcsik (1993), for neo-functionalism (Haas 1964).
- 7 A confusion not limited to the new institutionalist literature (see Marks 1997).
- 8 Some writers (Hall and Taylor 1996) add historical institutionalism as a third distinct 'new institutional' approach.
- 9 However, one should be cautious to view the influence that institutional context has on actors in an overly deterministic fashion. Actors have choices and, given the right circumstances, can change institutional structures.
- 10 Article 70(1) of the Basic Law stipulates that 'the *Länder* shall have the right to legislate in so far as this Basic Law does not confer legislative power on the Federation.'
- 11 The most important 'joint task' with regard to state aids is the 'joint task for the improvement of regional economic structures' (*Gemeinschaftsaufgabe zur Verbesserung der regionalen Wirtschaftsstruktur*, hereafter GA). The GA is Germany's main regional policy instrument.
- 12 In order to discourage the poaching of investment from one *Land* to another through aid incentives, Germany's regional policy framework (*Rahmenplan*) even stipulates that a transfer of investment from one *Land* to another needs the consent of both *Länder* involved (Yuill *et al.* 1997).
- 13 The rebuilding of federal structures in Eastern Germany after unification was modelled

along the lines of those West German ‘partner *Länder*’ which helped in this process (Goetz 1999). While there are differences in policy style between the German *Länder* (Knodt 1998), there is no distinct East German policy style.

- 14 A good example of such transparency is Germany’s unique system of horizontal fiscal equalization.
- 15 See the Commission’s new guidelines on national regional aid (OJ C74, 10 March 1998) and Agenda 2000 (Com (97) 2000 final, 15 July 1997).
- 16 Commission Decision 96/6236; C-62/91.
- 17 Evidence for the case is based to a large extent on interviews undertaken, in July and December 1997, as well as in July 1998. Quotes from German sources have been translated by the author.
- 18 Commission Decision 96/6236; C-62/91.
- 19 Van Miert blocked the full aid package, in spite of opposition from the two German European Commissioners (*FT*, 30 July 1996).
- 20 In addition to Saxony’s legal action, the German federal government and VW put separate appeals to the European Court of Justice.
- 21 For a legal analysis, see Perry (1997); for a wider discussion of Article 92(2)(c), see Schütterle (1994).
- 22 These provisions of Article 92 read: ‘3. The following shall be compatible with the common market: (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; . . . (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.’
- 23 DG IV’s 1996 autumn in-tray included other controversial East German dossiers, with final decisions pending on illicit aid to Bremer Vulkan, in the petro-chemical sector, on money given for the restructuring of the Leuna plant through ELF Aquitaine, on subsidies to Buna when it was taken over by Dow Chemical, and on aid to BASF-subsidary K+S during the merger of the East and West German potash industries.
- 24 Commissioner van Miert in an interview with the *Leipziger Volkszeitung*, 2 September 1996. EU figures show that in the period 1992–4, German subsidies were 2.6 per cent of GDP and 5.4 per cent of public spending, the highest in the EU.
- 25 Letter referred to in the original Commission decision (C 62/91, 26 June 1996, pp. 10–11).
- 26 Letter from Biedenkopf to van Miert, Dresden, 25 July 1996. See also statements made by Biedenkopf in an interview with the German magazine *Der Spiegel*, No. 32, 1996, p. 34.
- 27 Interview with *Die Zeit*, No. 29, 12 July 1996.
- 28 Interview with *Der Spiegel*, No. 32, 1996.
- 29 Interview with *Der Tagesspiegel*, 14 August 1996.
- 30 Interview with *Schweriner Volkszeitung*, 22 August 1996.
- 31 ‘wenn sie à la Politbüro weltfremd, machtgeil und überbezahlt in sächsische Angelegenheiten hineinregiert’. Party chairman of the CDU in Saxony, Schimpff, in an interview with *Frankfurter Allgemeine Zeitung*, 19 September 1996.
- 32 Saxony had constituted one of the former GDR’s industrial heartlands and therefore had suffered particularly from the breaking away of its Eastern European markets after unification.
- 33 For the multi-sector agreement, see OJ C107 (7 April), 1998; for the new Regional Aid Guidelines, see OJ C74 (10 March), 1998.
- 34 See *FT*, 7 October 1997 and *Die Welt*, 31 January 1998.
- 35 In the recent case of the new Guidelines on National Regional Aid (OJ C74, 10 March 1998), member states were given two months to agree to the new guidelines. If they failed to do so, the Commission indicated that it would consider initiating procedures under Article 93(2) (Wishlade 1998: 344).

- 36 It could be argued that this frustration played a large part in driving the Saxon government to breaking the law itself, when it decided to ignore the Commission's decision in the VW case.
- 37 See Decision 90/381 (OJ L188/55, 1990), which amends the German aid scheme for the motor vehicle industry. The German government argues that efforts 'to enforce measures which are motivated by industrial policy pursuant to Articles 92 and 93 . . . would represent an abuse of these Treaty provisions'.

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