

**DRIVING A WEDGE BETWEEN EUROPE
AND THE REGIONS?
EC STATE AID CONTROL MEETS
GERMAN FEDERALISM**

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EC State Aid Control: Driving a Wedge Between Europe and the Regions?

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 EU has been very actor-centred, this paper takes a more sociological approach that views institutions as context rather than as agents. 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 look at broader incompatibilities between the institutional logics of Germany's co-operative federalism and centralised decision-making structures in the EC.

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1. INTRODUCTION¹

The literature on multi-level governance (Marks 1992; 1993; 1997; Hooghe and Marks 1997; Marks, Hooghe and Blank 1996; Peters 1997) suggests that one has been able to observe increasingly closer ties and co-operation between the Commission and the regional level in the European Union. Although there is now a broad consensus in the literature that such developments have not led to the marginalisation of national governments (Anderson 1990), as the largely normative ‘Europe of the Regions’ scenario might suggest, there is still a tendency to generalise from the close co-operation that exists in the Structural Fund, the policy area which has received most attention by multilevel governance scholars. Also, comparative politics studies (Kohler-Koch 1997; Conzelmann 1995) have regarded Germany’s federal system as constituting the ‘right’ institutional structure for such supranational – regional co-operation. The German *Länder* are among the strongest regions in Europe with regard to their competencies and resources. They are also experienced in working in a multi-level polity and are therefore regarded as possessing all the necessary requirements for close co-operation with the Commission.

This paper seeks to caution against both of 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 one gets, points to a more ambiguous relationship between the Commission and the regional level. It will be argued that in the field of the EC’s state aid control, which arguably has had more profound effects on the development of Europe’s regions than the Community’s own regional policy (Bentherbusch 1996), regions have come to see the activities of the Commission with increasing mistrust.² This holds particularly true for the German *Länder*.

The main objective of this paper is to highlight the role that institutions play in obstructing harmonious relations between national and supranational actors. In the traditional European studies literature institutions receive little explicit attention. Recent new institutionalist research has re-emphasised the relevance of such explicitly institutionalist analysis (Pierson 1996; Pollack 1996). However, most if not all of these studies either explicitly or implicitly perceive of institutions as agents—institutions *act* more or less independently from Member States and by doing so they affect policy outcomes. This paper is informed by a more sociological understanding, which perceives of institutions as the context in which actors are embedded in. It begins with a discussion of the literature of new institutionalism which suggests that institutional context can define rationality, create expectation about what is considered ‘appropriate’ behaviour and legitimise 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 EC state aid control in Germany operates against the background of two competing institutional logics: Germany’s co-operative federalism and the

¹ This paper is part of a larger research project on European regional initiatives and German federalism. The empirical evidence for this paper is based primarily on semi-structured interviews conducted when working for the Commission from March until September 1997, as well as interviews conducted in Brussels and in Germany in July and August of this year. The hospitality of the European Policies Research Centre where this paper was written is gratefully acknowledged.

² Despite its highly political nature, research on the EC’s role in state aid control has so far been dominated by the legal (Evans 1997; Wishlade 1993, Schina 1987), and to a lesser extent by the economic literature (Waniek 1996; Lammers 1996), while it has received little attention by political scientists. Notable exceptions are Lavdas/Menindrou (1995), Cini (1997); Hrbek (1997) and Smith (1998).

EC's state aid regime. It will be shown that even when national and European actors agree on the broad objective 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 national traditions.

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

2.1 Traditional accounts: inter-governmentalism and multilevel governance

Interactions between different levels of government in the EU are embedded in a dense institutional environment. The two principal approaches to European integration and policy making—inter-governmentalism and multilevel governance (MLG)—differ as to the role they ascribe to institutions. However, both approaches share fundamental assumptions about how institutions affect policy outcomes.

Inter-governmentalist accounts, like Moravcsik's 'liberal institutionalism' (1991; 1993), regard institutions as an arena for strategic interaction and bargaining. States create institutions in an instrumental fashion to overcome problems of international co-operation. Institutions help to create trust and commitment, facilitate side-payments and help to achieve efficient bargaining outcomes. However, inter-governmentalists claim that national governments retain control as principals (Pollack 1995) and few feedback effects of institutions on state behaviour are expected.

The multi-level governance (MLG) approach, by emphasising the role of supranational and subnational actors, adds a valuable institutional layer to the analysis. It identifies an emerging European polity, characterised by strong supranational institutions, which interact with both national and subnational actors. Decision-making and implementation is shared between actors of different levels of government rather than being monopolised by state executives. Supranational institutions can have an influence in policy-making which is *independent* from their role as agents of state executives (Marks, Hooghe and Blank, 1996: 346). If one assumes the existence of three principal actors in a particular policy area—say Commission, national government and region—such triadic relationships create opportunities for strategic interaction between these actors.³

Both inter-governmentalist and MLG accounts, share a conception of institutions which is based on rationalist foundations. Both tend to regard institutions as agents in their own right, actors capable of strategic interaction with other actors. Even when institutions are seen as providing the context in which decisions are taken, they are viewed as external opportunities and constraints, not as factors that shape the interests and expectations of participating actors. To substantiate this claim, the following section will look at recent work by neo-institutionalists.

³ See Ansell/Parsons/Darden (1997). For an analysis of the role that such triadic relationships played in the 'Europeanisation' of regional policy- processes and outcomes in Germany see Thielemann (1998).

2.2 New institutionalism: institutions as agents 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 and 1988) seminal article on the joint decision-trap, in which he lamented the fact that traditional approaches of European integration had largely ignored the role of decision-making rules. The basic premise 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 (Hall and Taylor 1996; Powell and Dimaggio 1991; Immergut 1997; Pollack 1996; Pierson 1996). However, the new institutionalist research agenda is characterised by a high degree of ambiguity, including a lack of agreement over what to consider an institution. In the following, Norgaard's encompassing definition 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). However, it will be seen that different institutionalist schools tend to focus on different kinds of institutions that Norgaard's broad definition entails.

Before we look at the various approaches of 'new institutionalism' in more detail, different understandings of the term 'institution' need to be distinguished. Institutions can represent formal rules or laws, as well as informal norms and customs. Scharpf (1988) emphasises formal institutions, such as the role of formal decision-making rules. Unlike formal institutions, informal institutions are not consciously designed but are part of habitual action (Lowndes, 1996: 182). Informal institutions have sometimes been regarded as being even more influential than formal ones.

'In our daily interaction with others, whether within the family, in external social relations, or in business activities, the governing structure is overwhelmingly defined by codes of conduct, norms of behaviour and conventions. Underlying these informal constraints are formal rules, but these are seldom the obvious and immediate source of choice in daily interactions' (North, 1990: 36).

Apart from this conception of institutions as processes—the way things are done—Norgaard's definition suggests that institutions can also be expressed in *organisational* forms. As indicated earlier, many writers either explicitly or implicitly perceive of institutions as *agents*. Supranational institutions, like the Commission or the European Court of Justice, are understood to *act* in the multi-level environment of European policy-making (Scharpf, 1988; Pierson, 1996; Pollack, 1996). This contrasts with strictly sociological institutionalist accounts, which perceive of institutions as the *context* that *constitutes* national and supranational actors. In the following the two major variants of new-institutionalism—rational choice and historical and sociological—will be scrutinised in more detail.⁴

Rational choice institutionalism

⁴ See Bulmer (1994); Shepsle (1989); Norgaard (1996). For a different categorisation see Hall/Taylor (1996) and Aspinwall/Schneider (1998) who treat historical and sociological institutionalism as two separate approaches.

Rational institutionalists work with an explicit model of the actor, one which is instrumental. Actors seek to maximise the attainment of goals and base their decisions on strategic and rational calculations. North (1990) regards institutions as incentive structures which influence an individual's utility-maximising behaviour. Rational choice institutionalism suggests that actors adapt their behaviour to institutions, in other words it views institutions as opportunities and constraints. Actors assess 'their goals, interests and desires independently of the institutions'. Institutions affect 'only the strategic opportunities for achieving these objectives' (Immergut, 1997: 231). Rational institutionalists view policy making and implementation as resulting from the strategic interaction of rational actors. Tensions during these processes are the consequence of power struggles among the participating actors, each of which tries to minimise its resource dependency on the other.⁵ Rational institutionalism is therefore based on a methodologically individualist and materialist understanding of political exchange, one that is based above all on rational strategic interaction. It is an understanding that has, at least implicitly, provided the key foundations of much of the existing EU literature.

However, there are limits to what an actor-centred institutionalism can explain as an actor's rationality itself is limited. More sociologically oriented approaches raise the question to what extent an actor's broader institutional environment can lead to rule-governed behaviour that may supplant instrumental calculation. In other words, sociological approaches ask questions about how traditions and rule structures form identities and shape expectations about what is considered 'appropriate' behaviour.

Historical and sociological institutionalism

Historical and sociological institutionalist approaches point to a number of factors that question rationalist assumptions. They constitute a necessary complement to the rational institutionalist approach.

Competing modes of rationality

Interest formation and decision-making can sometimes be better understood if one looks at it not in terms of rational utility maximisation but in view of the general institutional context—defined by the legal and political-administrative traditions of a political system or policy area—in which actors are embedded. The logic of a particular political system makes a particular sort of behaviour rational. According to Steinmo, institutions 'provide the context in which individuals interpret their self-interests and thereby define their policy preferences'. He continues: 'rationality itself 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' (Steinmo, 1993: 7).

Norms make behavioural claims on actors

⁵ For the concept of resource dependency see the extensive literature on policy networks; e.g. Rhodes (1997); Peterson (1993).

Institutions reflect norms of decision-making, providing a 'logic of appropriateness'. 'Seemingly neutral procedures and structures embody particular values, norms, interests, identities and beliefs' (Lowndes, 1996: 191). That institutions can provide an agent with a particular understanding of his/her interest regarding a particular policy-issue is hardly a new insight. In the early literature on bureaucratic politics, such phenomena have been ascribed the notion 'you stand where you sit'.⁶ A similar view of institutions also provides the basis for work on socialisation and social learning (Klotz, 1995; Finnemore, 1996). Interests are shaped against the background of existing rules and standard operating procedures which lead us to expect from 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'. March and Olsen claim that 'a calculus of identity and appropriateness' is sometimes more important to actors than a 'calculus of political costs and benefits' (March and Olsen, 1989).⁷

Recent work on *path dependence* helps us to understand the stability of institutions. New institutions and policies will often generate high fixed costs, learning effects, co-ordination effects, and adaptive expectations' and thus inhibit exit from a current policy path (Pierson, 1996: 145). It emphasises the ways prior institutional commitments condition future action and limit the scope of options perceived appropriate or possible. Put simply: prior decisions form the basis upon which new decisions are made.

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 mobilisation of interests, for example, by recognizing particular groups or by delegating functions to them, therefore recognizing the legitimacy of their particular claims. (Immergut, 1997: 340). By giving legitimacy to some groups while denying it to others, institutions affect not just the structure of the decision-making process, they also influence what interests are reflected in policy outcomes. The subsequent empirical part of this paper shows that:

- 1) institutional context plays an important role in European policy implementation as it influences the interests and actions of actors and shape expectations about what is considered 'appropriate' behaviour.
- 2) institutions give legitimacy to some actors and deny it to others which can have important effects on both policy process and outcomes.
- 3) the interaction of European and national is likely to lead to tensions between European and national actors when the internal logics of the different institutions diverge.

Ultimately, the aim is to test the following hypothesis:

⁶ See e.g. Allison's (1971) account of the Cuban missile crisis or more recently Peters (1992).

⁷ However, the above is not meant to suggest that the stances taken by the actors is institutionally pre-determined. Institutions only provide the context, which makes certain courses of action more likely than others. Institutions can restrict or enable actors but do not determine their actions.

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 national traditions.

3. EC STATE AID CONTROL IN GERMANY: THE VW DISPUTE

In its decision of 26 June 1996,⁸ 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.

On the surface, the dispute was about the applicability of Article 92(2)(c) of the Treaty of Rome which gives privileged state aid status to regions affected by German unification. By ignoring the Commission decision, the Saxon government strained its relationship with the Bonn government and threatened the solidarity among the five East German *Länder*. It also caused severe rifts in the Commission’s relationship with Saxony as well as with Germany more generally. The question that needs to be addressed is why the stakes were raised so high. Why did the Saxon government jeopardise its good relationship with the German government, the other *Länder* and above all the Commission for a relatively small amount of money? Can an actor-centred institutional analysis provide sufficient explanations? What role did the wider institutional context play?

Looking at the repercussions caused by the dispute, it becomes clear that it was about more than just a cut of a subsidy. The VW case raised fundamental questions about the legitimacy of the Commission’s involvement in Member States’ internal affairs. The following part of the paper will briefly outline the facts of the case and the positions taken by the parties. It will show the enormous tensions that were caused by this dispute before trying to give an actor-centred explanation of the events.

⁸ Commission Decision 96/6236; C-62/91.

3.1 Details of the case and the positions of the parties involved⁹

When VW decided in 1995 to revive two postponed investment projects in Mosel and Chemnitz, the German government notified a new multi-annual aid package by the Saxon authorities. In its decision of 26 June 1996,¹⁰ the Commission approved only DM 539.1 million of the total aid package of some DM 779.8 million, i.e. almost DM 241 million less than Saxony had intended to pay.¹¹ On 22 August 1996, having come under substantial pressure from Volkswagen to live up to its initial promise, the Saxon authorities filed an appeal before the Court of First Instance.¹² More controversially, the Saxon government also went ahead to pay VW the first tranche of the full sum (DM 141.9 million), some DM 90.1 million of which had not been approved by the Commission.

Without going into the legal details of the case three separate issues can be identified.¹³ *Prima facie*, the principal question was whether certain special provisions pertaining to state aid undertakings 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 of Rome 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’.

This Treaty article represents one of the exemptions to the general prohibition of state aids in Article 92 (1) which states:

‘Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market’.¹⁴

⁹ Evidence of the case is based on interviews undertaken, in July and December 1997, as well as in July 1998, with members of the Commission and the governments in Bonn and Dresden, including several officials who participated directly in the negotiations on the particular case. This evidence is supported by extensive press research. All quotes from German sources have been translated by the author.

¹⁰ Commission Decision 96/6236; C-62/91.

¹¹ Van Miert, blocked the full aid package, in spite of opposition from the German authorities and the two German European commissioners. Dempsey/Buckley, Saxony gives VW state aid in challenge to Brussels, *FT*, 30 July 1996.

¹² This appeal was followed by similar ones by the German government and the VW. After Saxony’s payment of the first tranche of the full amount in a *prima facie* contravention of the Commission decision, the Commission filed a suit with the European Court of Justice against the Federal Republic of Germany.

¹³ For a legal analysis see Perry (1997) and Nicolaysen (1996); for a discussion of Article 92(2)(c) Schütterle (1994).

¹⁴ One of the principal aims of European integration has been the creation of a common market (see Article 2 of the Treaty of Rome). In order to achieve this the Members States have agreed to protect the common market from distortions to competition (Article 3). From this pledge derives the necessity to run a common European competition policy.

The second issue was about Saxony's payment of the full aid package to VW, despite the Commission's decision. Article 93 puts member States under the obligation to notify any aid before aid is paid to any beneficiary. It also allows the Commission to sanction governments found guilty of breaching this Treaty obligation. Under European law a Commission decision on state aid has immediate legal effect in a Member State. These two issues soon gave way to a much broader third one, concerning the legitimacy of Commission involvement in the affairs of the Member State.

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. Article 92(2)(c) had been applied by the Commission on several occasions before unification, mostly for areas in the *Zonenrandgebiete* (areas in West Germany along the border to the East) and Berlin. However, the Commission felt that after unification this Treaty provision should no longer be applied.¹⁵ In only two cases—one in 1992 and one in 1994—did the Commission apply Article 92(2)(c) after unification.¹⁶ In these two cases, the Commission tried to establish its position that the provision should only be applied 'in individual cases and given special circumstances' (Schütterle, 1994: 716). In its Volkswagen decision, the Commission states that 'Article 92(2)(c) should be interpreted narrowly'.¹⁷ Without substantiating its reasoning, it goes on to argue that the VW case can be duly assessed by taking recourse to the others exceptions provided in Article 92(3)(a) and (c) of the Treaty.¹⁸

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 be a '*carte blanche*' for the German authorities in their giving of state aids in Eastern Germany.¹⁹ Van Miert stated: 'Almost seven years after the fall of the wall, we cannot treat the new German *Länder* more generously than economically disadvantaged regions in say Portugal or Spain'.²⁰ 'Germany is European champion when it comes to state aids'.²¹ [...]

¹⁵ See Rawlinson, in: Lenz, *Kommentar zum EG-Vertrag*, Art. 92 Rz. 25.

¹⁶ The former concerned aids in the context of the sale of a piece of land at the *Potsdamer Platz* in Berlin and the latter an aid for a rail-infrastructure project in the Tettau region in Bavaria.

¹⁷ Part X of Commission Decision 96/6236; C-62/91.

¹⁸ 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; (b) [...]; (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; [...].

¹⁹ DG IV's 1996 autumn in-tray included other delicate East German dossiers, with final decisions pending on illicit aid to Bremer Vulkan; in the petro-chemical sector, on money given for the re-structuring of the Leuna plant through ELF Aquitaine, and on subsidies to Buna when it was taken over by Dow Chemical; and also on aids to BASF-subsiary K+S during the merger of the East and West German potash industries. Another investigation was started into the issue of whether state guarantees for German regional banks and special rules on bank solvability amount to hidden state aid. In all of these cases even larger sums of monies were involved (*Die Welt*, 20 November 1997).

²⁰ Interview in the *Schweriner Volkszeitung*, Sachsens Beihilfen für VW sind weiter Zündstoff, 9 September 1996.

²¹ EU figures show that in the period 1992-1994, German subsidies were 2.6 percent of GDP and 5.4 percent of public spending, the highest in the EU. Subsidies to industry were ECU 2,012 per employee, only Italy gave

'I have sometimes been attacked by other Member States because they felt that we were too generous with regard to Germany, in particular the new German *Länder*'.²² Prior to its decision on VW, the Commission had received a letter by the French government in which it was informed that France takes a great interest in the Commission's treatment of the VW investment and other investments in the new German *Länder* which create additional capacities in the car-industry. The French government emphasised that the new German *Länder* should not be exempted from the Community's state aid discipline and that Article 92(2)(c) therefore should not be applied.²³

Questioned on Saxony's illegal payment, van Miert called Saxony's action the biggest challenge ever to state aid rules and made it clear that the Commission would seek an injunction, unless steps were taken to reverse this decision.

Saxony's positions

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 Article 93(3) (a) and (c) which require individual authorisation by the Commission. The Saxon government felt that the economic disadvantages that Article 92(2)(c) had aimed to address in the West German border regions had been rather small when compared to those which continue to exist in the new German *Länder*. In its legal appeal against the Commission's decision, the Saxon government stressed that the territory of Eastern Germany constituted one of the most economically developed areas in Europe before the division of Germany (Freistaat Sachsen, 1996: 37). Saxony also pointed to the fact that even Commissioner van Miert had acknowledged the continued need for assistance to the East in an interview in which he stated that the situation in East Germany was 'much more difficult than one could have foreseen. We were all too optimistic. State aids will be necessary for many years to come'.²⁴

In a letter to Commissioner van Miert, Saxony's prime minister Biedenkopf stressed that 'for the Free State of Saxony, keeping Article 92(2)(c) in the Maastricht Treaty, was an important precondition for its ratification'.²⁵

In a separate line of argument, the Saxon government criticised what it considered as arbitrariness on the part of DG IV's procedure regarding the analysis based on Article 93(3) (a) and (c). Under these provisions, when conducting its analysis whether a particular aid package is justified, DG IV compares the costs of the actual project with those of a hypothetical 'green-field project' in an area which does not qualify for exemption under Article 92(3)(a) or (c). The Commission decision to reduce the aid to VW was to a large

more with ECU 2,379. The Kiel Institute of World Economics estimates the total level of direct subsidies and tax breaks for the same period at around 8.6 percent of GDP.

²² Commissioner van Miert, Interview with the *Leipziger Volkszeitung*, 2 September 1996.

²³ Commission decision C 62/91, 26 June 1996, pp. 10-11.

²⁴ Focus 23, 1996.

²⁵ Biedenkopf (Prime Minister of Saxony), Letter 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.

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.²⁶

In its appeal to the Commission decision, Saxony attacked the decision on the grounds that the Commission had changed, without explanations, its assessment of the nature of the investment in the middle of ongoing procedures which started 14 January 1992. By referring to the planned investment in all contacts with the German side as a ‘green-field’ investment until two months before the announcement of the decision (Freistaat Sachsen 1996: 39), the Commission betrayed the legitimate expectations of both the German authorities and the investor. The Saxon government also complained that the Commission had not responded to letters written before the June decision in which Saxony had explained its position (Freistaat Sachsen, 1996).

Biedenkopf felt that that he could not wait for the decision by the European Court of Justice which could take several years. It was feared that by then VW would have decided against Saxony as the location for its investment with the consequence of endangering 20.000 jobs in the region. At the time, Saxony’s Minister of Economics was quoted saying: ‘We have to bribe these companies—otherwise they go elsewhere’.²⁷ This fear was reinforced as VW announced an immediate construction stop when the Commission’s decision became public. In a letter to the Saxon government by VW chairman Piëch, he stressed that his company’s investment in Saxony would not go ahead without the full payment. Therefore the Saxon government felt, it had no choice but to go ahead with the full payment while at the same time trying to prove the illegality of the Commission decision.

Bonn’s position

The Bonn government supported Saxony’s view on the applicability of Article 92(2)(c). However, it was very much concerned about Saxony’s payment to VW in breach of the Commission’s decision. A letter by the German government—regarding state aids for three separate VW investments in Eastern Germany—reads: ‘The German government emphasises that it regards Article 92(2)(c) as being applicable to [state aid] cases currently under investigation by the Commission of the European Communities’.²⁸ Similarly frank statements were made by Economics minister Rexrodt, who 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’.²⁹ During the Maastricht Treaty in Nordwijk, 4 November 1991, the German government insisted—against the original proposal of the Luxembourg presidency—on keeping the provision in the new Treaty, ‘in order to create an exemption clause for the new *Länder* that would give them more favourable

²⁶ The argument is that a ‘green-field’ investment faces additional costs in the form of lacking infrastructure, supply networks and skilled workforce, factors which are presumed to exist already when an already existing plant is expanded.

²⁷ Interview with *Die Zeit*, No.29, 12 July 1996.

²⁸ Quoted in a letter from Kurt Biedenkopf, Prime Minister of Saxony, to the members of the CSU/CSU parliamentary group in the German Bundestag, Dresden, 25 September 1996.

²⁹ Rexrodt, Günter (Minister of Economics), *Die Beihilfen- und Telekommunikationspolitik der Bundesregierung*, Speech at the DIHT conference: Im Blickfeld der EU: Beihilfen- und Telekommunikationspolitik in Deutschland, Bonn, 19. September 1996, 3.

conditions than would have been possible otherwise under the provisions of Article 92 (3) of the Treaty'.³⁰

Nonetheless, Bonn considered the payment to VW as an 'illegal act' and said that it expected a court challenge by Brussels. The German economics minister, Rexrodt, said that Saxony's action was a clear breach of EU rules.³¹ Similarly, Minister of State in the German Foreign Office, Werner Hoyer, called Saxony's actions a 'clear violation of law'.³² As Saxony's action had put Bonn in a very difficult position vis-à-vis the Commission and the other Member States, the German government decided not to use all legal remedies available to try to reverse the Commission decision. The Treaty allows for the government of a Member State to take a state aid decision of the Commission to the Council, if it disagrees with the decision. The Council then has the authority to overturn a Commission decision with unanimity.³³ As the German government did not pursue this avenue, one could come to the conclusion that the German authorities did not have much confidence that such a Council decision was on the cards (Hrbek, 1996: 507).

Steps taken towards a face-saving solution

In the aftermath of Saxony's payment to VW, talks were held at the highest political level, with Commission President Santer cutting short his holiday to meet Bonn officials. In September 1996, the Bonn government had its first success in its attempt to avert a direct clash with the Commission. Pursuing a strategy of conflict limitation it struck a deal with VW to freeze DM 91 million in federal subsidies destined for the company.³⁴ This neutralised the effect of the disputed aid paid to VW by the Saxon government. The Commission, in turn, dropped its plans for an injunction against the illegal payment of the aid. It did, however, file a suit before the European Court of Justice, with the aim of achieving a formal repayment.

A face saving solution for all sides was found on 18 November 1997 when the Commission authorised an aid package to VW's plant at Baunatal, in the state of Hesse.³⁵ VW repaid the DM 90 million into a special account (*Treuhandkonto*), and was granted a subsidy of the same size for one of its plants in Hesse. Although there was no formal link between the two subsidies, the bargain that had been struck was obvious. It took 16 months to diffuse one of the fiercest disputes between Brussels and the German authorities. 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.³⁶

³⁰ The then foreign minister H.D. Genscher in an interview with *Der Tagesspiegel*, No.15714, 14/08/1996.

³¹ Dempsey/Buckley, Saxony gives VW state aid in challenge to Brussels, *FT*, 30 July 1996.

³² Interview in the *Schweriner Volkszeitung*, Sachsens Beihilfen für VW sind weiter Zündstoff, 9 September 1996.

³³ Article 93(2), Treaty of Rome.

³⁴ The Bonn government was due to give VW about DM 120m in tax credits as part of an aid package already cleared by the Commission. It was part of this package that Bonn offered to freeze (Southey/Muenchau, Bonn and Brussels in deal on VW aid, *FT*, 5 September 1996).

³⁵ The 'Deggendorf procedure' stipulates that in the case of a breach of a state aid decision, the Commission will not approve any further aid to that particular investor until the original breach has been reversed.

³⁶ In addition to Saxony's legal action, the German federal government and VW put separate appeals to the European Court of Justice.

3.2 Repercussions caused

The dispute caused a serious backlash in Saxony's relationship with the Bund, the other German *Länder* and above all with the Commission.

Bundestreue

One of the sacred principles of German federalism is the pledge for *Bundestreue*. It requires that neither the Bund nor the *Länder* undertake actions that might compromise the position of the other, domestically or abroad. Reading the press release by the Saxon government announcing its decision to flout the Commission's decision on aid to VW, one notes that this decision was taken with little or no prior consultation—and certainly without the approval—of the German federal government. Its last paragraph reads: 'The president of the Commission of the European Union, the responsible member of the Commission, the German Chancellor and the Minister of Economics have been *informed* of the decision by the Saxon government'.³⁷ In his response to Saxony's action, the German economics minister, Rexrodt, said that 'it would have been more useful to continue the dialogue with the Commission instead of unilaterally and officially announcing the approval of the subsidies'.³⁸ The German Secretary of State for Economics, Lorenz Schomerus spoke of 'unnecessary confrontational procedural steps' with which Saxony burdened Germany's relationship with the European Commission.³⁹ Bonn was put in the awkward position of being attacked by the Commission for an action it had neither authorised nor approved. Saxony's actions, therefore, severely strained its relations with the Bund and arguably violated the principle of *Bundestreue*, as it undermined Bonn's position vis-à-vis the Commission.

Solidarity among the Länder

Saxony's actions found little open support from the other German *Länder*. The other East German *Länder* did not rally behind what Saxony regarded as the defence of East German interests, but instead tried to distance themselves from the actions taken by the Saxon government. Although many sympathised with Saxony's frustration about the Commission's decision, it was felt that Saxony's uncompromising stance jeopardised the Eastern *Länder's* interests in Europe. The West German *Länder* had become increasingly concerned about the levels of public aid to Eastern Germany even before the VW dispute. During times when economic problems increased across Germany, they had repeatedly expressed their concern to the Bund that generous state aid awards in the East made it difficult for them to attract investment.

The feeling in the other *Länder* was perhaps most candidly expressed in an open letter by several CDU Members of the European Parliament in North-Rhine Westphalia—i.e. party colleagues from Biedenkopf's previous political home-turf. In their letter they expressed their

³⁷ Press release No. 130/96, 29 July 1996 (my emphasis). This impression was confirmed in interviews with Bonn officials.

³⁸ Dempsey/Buckley, Saxony gives VW state aid in challenge to Brussels, *FT*, 30 July 1996.

³⁹ *Schweriner Volkszeitung*, 3 August 1996, Konflikt um VW-Beihilfen belasten den Aufbau Ost.

opinion that Biedenkopf's attitude on the issue was 'bad for Saxony, bad for Germany and dangerous for Europe'.⁴⁰

Relationship with the Commission

As the dispute widened, it led to an ill-tempered debate about undue Commission interference into *Länder* affairs. The Economics Minister of the Free State of Saxony, Schommer, put the blame for the dispute squarely on the Commission. 'It was unthinkable that Brussels could dictate to Saxony, on how to pursue the economic reconstruction of Eastern Germany'.⁴¹ Schommer went even further and spoke of the dangers of a lurking 'Euro-dictatorship', and one of his senior party colleagues stated that the European Commission betrays the European idea 'when it interferes à la Politbüro—naively, power-hungry and overpaid—in Saxon affairs'.⁴² The Saxon prime minister, Biedenkopf, questioned the democratic legitimacy of Commission decisions, such as the one in question. Whereas these kind of comments might not be unfamiliar to a British audience, they were virtually unheard of in the europhile German context.

On the other side of the dispute, the Commission considered Saxony's payment of the full sum to VW as serious breach of Community law.⁴³ Even before the dispute, van Miert had repeatedly criticised the lack of co-operation on the part of the German authorities. Now, he openly called the 'trustworthiness' of the German authorities into question. He said: 'There have been too many cases in which [the German authorities] did not play with their cards on the table'.⁴⁴

The stakes were raised to such an extent that the Saxon government felt it necessary to publish the following statement: 'We do not regard this as a conflict with Europe, but rather as a conflict with the European Commission'.⁴⁵ 'If the Free State now takes the European Commission to the highest European Court, this should not be seen as a court case against Europe'.⁴⁶ A number of reasons have been put forward to explain why the Saxon government was prepared to raise the stakes to the extent it did.

3.3 The search for actor-centred explanations

Certain special circumstances that applied in the VW case can be identified. First, special economic circumstances still prevail in eastern Germany. At the time, unemployment was at

⁴⁰ Open letter from the MEPs Brok, Konrad, Liese, Florenz, Mombaur, Lenz and Lehne to Biedenkopf, 28 August 1996.

⁴¹ Interview in the *Schweriner Volkszeitung*, VW-Beihilfestreit führt zum Subventionskrieg, 22 August 1996.

⁴² 'wenn sie à la Politbüro weltfremd, machtgeil und überbezahlt in sächsische Angelegenheiten hineinregiert'. Party chairman of the CDU in Saxony, Schimpff, who also holds one of his party's European briefs in an interview with the *Frankfurter Allgemeine Zeitung*, 19 September 1996, page 4 (quoted in Krämer (1997), 67, fn. 21).

⁴³ Van Miert, Interview with the *Leipziger Volkszeitung*, 2 September 1996.

⁴⁴ Van Miert in an interview with *Die Welt*, EU kritisiert deutsche Behörden, 9 February 1998.

⁴⁵ Press release No. 130/96, 29 July 1996.

⁴⁶ Press release No. 136/96, 12 August 1996.

about 15 percent, 50 percent above the national average. Manufacturing accounted for only about 18 percent of GDP, well below the 25 percent that would have been normal for a modern industrial region.⁴⁷ Second, despite the relatively small amount of money in dispute, VW drove a hard bargain by ordering a construction stop after the Commission decision. The company's less than conciliatory attitude can partly be better explained by its particularly burdened relationship with the Commission's competition directorate. At the time of the Saxon dispute, there was another Commission investigation into VW's practices in Italy, where VW prohibited its dealers to sell cars to non-Italians.⁴⁸ Also, during a Commission inspection of one of VW's Mosel factories, Commission officials found that VW exceeded production limits set by the Commission's decision.⁴⁹ Finally, it has been argued that Biedenkopf, who has been one of the most colourful figures of German politics over the last two decades, might have tried to instrumentalise the issue for party political reasons, in a similar fashion to his position on monetary union a few months later.

However, it can be argued that the above arguments do not provide for sufficient explanations and that one needs to look for institutional factors to account fully for the difficult relationship between DG IV and the German authorities. The VW case was hardly a singular one and appears to be only the tip of the iceberg, given that disputes between the German authorities and DG IV over state aids have become quite notorious. First, more than one third of all EC state aid decisions involve Germany. In 1995, the Commission initiated 27 formal investigative state aid procedures in Germany, compared to four in France and none in the UK (Wishlade and Olsen, 1997: 32).⁵⁰ Second, there have been heated disputes over the issue of 'maximum area coverage' which led to a belated start of European regional funding for Eastern Germany in the 1994-99 programming period. At the time, the German authorities openly accused DG IV of blackmail (Bentherbusch 1996). Finally, Germany is the only country which has so far refused to accept the Commission's most recent proposal for a multi-sector framework on state-aids.

Moreover, there is a considerable degree of agreement between the Commission and the German authorities over the necessity, objectives and content of a European-wide state aid policy.⁵¹ Even after the disputed Commission decision, the German minister of economics Rexrodt emphasised the extent of agreement over objectives. In September 1996 he restated the German government's view, a position that is broadly shared by *Länder* officials in East and West:

⁴⁷ Norman, Peter (1996), Saxony enters aid minefield, *FT*, 2 September 1996.

⁴⁸ In January 1998, the Commission ruled that this practice constituted an infringement of the common market and European competition rules, and imposed record fines of DM 200m on VW.

⁴⁹ *European Report*, 9 September, No. 348, 2. A Commission framework for the motor industry stipulates that in sectors of the EU motor industry which are characterised by over-capacity, subsidies to car makers are to be tied to capacity constraints.

⁵⁰ One should note that notification figures for Spain—a country where the subnational level also plays an important part in economic development—also tend to be higher than in more centralised states. Nonetheless, Germany's figures are very high.

⁵¹ In the early days after unification, Commission officials recall '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'. (Senior competition official of the Commission quoted in: Tucker/Norman, The EU's bad boy, *FT*, 7 October 1997). In 1994, when van Miert took over the competition directorate from Sir Leon Brittan, it was Germany which expressed its concern that the socialist van Miert might be too lax in applying state aid and merger control procedures (Middel, Firmen fürchten "Karl den Großen", *Die Welt*, 31 January 1998).

‘the Brussels Commission and the German government agree on the necessity for a European wide control of state aids through the Commission. We [the German government] also know that this discipline continues to be in the interest of our own economic policy. Nobody here wants a subsidy race or the weakening of the common market. In this, the German government and the Commission pursue the same objective’.⁵²

Therefore, it will be argued that where an actor-centred analysis has its limits, looking at the wider institutional context in which German and European actors are embedded can advance our understanding of the sources of tensions in the relationship between the German authorities and the Commission.

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

Comparing Germany’s federal institutional set-up with the institutional logic governing decision-making on state aids within the Commission, helps to identify several institutional cleavages.

4.1 Germany’s co-operative federalism

Joint decision-making

Germany’s federal constitution (Basic Law) divides sovereign powers between the federation and the *Länder*. In contrast to the American model of federalism and normative fiscal federalist theories (Oates, 1972; Buchanan, 1974; Musgrave, 1959), functional responsibilities in many policy fields are not neatly separated between the federal and the state level of government. German federalism is a highly co-operative form of government. Decisions on regional state aids are taken in the framework of the ‘joint task’, a structure which can be regarded as the prime example of Germany’s co-operative federalism and exemplary for what Scharpf, Reissert and Schnabel (1976) have termed *Politikverflechtung* (a system of interlocking competencies).

The constitutional reforms of 1969, introduced the system of ‘joint-tasks’ (*Gemeinschaftsaufgaben*),⁵³ one of them being the ‘joint task’ for the improvement of regional economic structures (*Gemeinschaftsaufgabe zur Verbesserung der regionalen Wirtschaftsstruktur*, hereafter GA).⁵⁴ Decision-making in the ‘joint tasks’ is characterised by complex, multilateral negotiations between state and federal representatives. In these

⁵² Rexrodt, Günter (Minister of Economics), *Die Beihilfen- und Telekommunikationspolitik der Bundesregierung*, Speech at the DIHT conference: Im Blickfeld der EU: Beihilfen- und Telekommunikationspolitik in Deutschland, Bonn, 19. September 1996, 2.

⁵³ Three ‘joint tasks’ were created. Apart from the one governing regional policy. There is one regarding the joint responsibility for university construction and another one for the improvement of agricultural Structures and coastal protection.

⁵⁴ The GA is Germany’s main policy instrument. Its assistance represents variable additional assistance to other permanent regional investment aids (*Investitionszulagen*) (Institut Finanzen und Steuern 1981: 119).

negotiations, annual frameworks plans are drawn up which establish policy parameters like the overall territorial coverage of regional policy, the criteria for area designation, overall funding levels and award structures, and each *Land*'s quota of assisted areas and funding.

For proposals to become legally binding decisions, agreement between the Bonn government and the majority of the *Länder* is necessary, i.e. a very high degree of consent. In practice, decisions are usually taken unanimously. In order to address regional problems and to fulfil their duty to advance the public interest, both the federal and the *Land* governments, therefore, have to co-operate. Germany's policy-making process is therefore characterised by mutual trust, a consensual policy style and the search for compromise (Richardson, 1982).

Legalistic tradition and institutional stability

If political compromises cannot be found, conflicts are expected to be resolved by the use of legal instruments. Much has been written about the legal culture of German politics (Greiffenhagen and Greiffenhagen, 1993). However, this legalistic tradition does not just play a role when there is a clash of interest but it accompanies the whole policy-making process. 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). Decision-making in the framework of the joint tasks involves clearly defined procedural rules and a high degree of transparency. Great emphasis is laid on the use of sophisticated statistical indicators, for example for the designation of assisted areas, in order to give decisions the necessary scientific grounding.

As a reform of the system of joint decision-making would necessitate a change of the Constitution (requiring a two third majority in both *Bundestag* and *Bundesrat*), the joint decision-making structures reigning in the German regional policy system (GA), have proven very resistant to change.

'Ressort-Prinzip'

The German system of co-operative federalism is also characterised by a high degree of administrative fragmentation, not just vertically between Bund and *Länder* but also horizontally between different government departments. Horizontal co-ordination problems are not uncommon in other government systems. However, the logic of interlocking politics (*Politikverflechtung*) that characterises policy making in the 'joint tasks' increases such problems. More 'generalist' departments at both the Bund and the *Land* level (such as the finance ministries and the cabinets), which are more interested in horizontal co-operation, are frequently at odds with vertically co-operating specialised departments. Federal ministries come to arrangements with their *Land* equivalents, and present the finalised agreement to other ministries. Horizontal co-ordination is therefore characterised by what has been termed *vertikale Ressortkumpanei*.

4.2 The EC's state aid regime

A very different institutional logic informs the Community's state aid regime.

Centralised and hierarchical order

DG IV, the Competition Directorate, is very special amongst the 24 directorates that make up the European Commission. It is the Commission directorate with perhaps the clearest supranational brief, with its decision-taking being highly centralised and insulated.

‘Indeed here is a part of the Commission whose competence must remain untouched by the decentralising impetus of subsidiarity. In fact, as a centralising as well as a decentralising force, the subsidiarity principle only serves to strengthen the Commission’s authority in this policy area’ (Cini, 1997: 5).

DG IV’s relationship with the other European institutions is very different from those in other EU policy areas as it can operate relatively unrestricted from both Council and the European Parliament. Usually, decisions about the legality of an aid payment are taken by the majority of votes in the College of Commissioners. However, an increasing number (currently around 45%) of decisions are taken ‘by way of delegation of powers, by the Member of the Commission responsible for state aid’ (Mederer, 1997), excluding other Commissioners from the decision-making process. It has been argued that DG IV acts as prosecutor, judge and jury in individual cases. At the same time it is responsible for the evolution and substance of policy. In state aid matters, the Commission is therefore in the unusual position that allows it to act relatively freely from formal Member State constraints.

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 (Cini, 1997: 11). The prohibitive treaty provisions are rather open-ended in character⁵⁵ and the procedural aspects of the exercise of the Commission’s authority have never been codified. ‘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).

Once the Commission has been informed of a government’s aid, it has to decide whether the measure is a state aid according to the Treaty. Only when assistance is granted where a private investor would not invest, is the assistance regarded as state aid. This introduces a grey area where the Commission’s discretion becomes first obvious. In the second stage of the process, DG IV has to decide whether it wants to initiate proceedings under Article 93(2), which leads the Commission to decide ‘that the state concerned shall abolish or alter’ a particular aid. It has been said that ‘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’ (Evans and Martin, 1991: 83-6). The EC state aid decision-making process can be compared with a black-box as it is characterised by a lack of transparency (Wishlade 1998). The opaqueness of this process has frequently led to criticism that DG IV takes decisions on an *ad hoc* basis and that it uses them to strategically advance policy.

⁵⁵ Already in the Treaty provision it is stated that the exemptions listed in Article 92(3) *may* be compatible with the common market.

Cini points out that in the field of state aids the Commission does not just act as a ‘quasi-legislator’ in its executive decision-taking function, but also has a key role as policy-maker. ‘Commission policy-making is a highly political function which can be a great deal more controversial than policy initiation. Policy-making on state aid measures clearly has discretion at its core’ (Cini 1997: 26).

Enforcing horizontal co-operation

In the Treaty of Rome, an obvious tension exists between the EC’s Competition and Regional Policy. In its preamble, it states the aim to strengthen the ‘economic and social cohesion’ of the Community and ‘to promote its overall harmonious development’ [...] ‘by reducing the differences existing between the various regions and by mitigating the backwardness of the less favoured regions’. All Member States assist their backward regions and one of the means doing so is by giving aids to companies. The rationale is to reduce regional disparities by deliberately interfering with the market. However, as these companies are in competition with other companies which do not receive such aid, such regional policy measures distort competition and interfere with trade in the common market.

In the case of a dispute between the two objectives—of 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 usually overrule those of the Commission’s regional policy directorate. Using its power of having to approve national regional development schemes, DG IV also exerts considerable influence on regional policy making at the Member State level (Bentherbusch, 1996).

4.3 Agreement over content—Clash over process

The above analysis has shown that decision-making on state aids at the national and the European level is governed by very different institutional logics.

Behavioural claims

New institutionalist writing suggests that 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 often 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 been playing by the rules, just different rules to the ones that oneself is embedded in. In the case of state aid control in Germany, several such institutional cleavages can be identified.

Joint- vs. hierarchical decision-making

The horizontal, consensus-based approach of Germany's co-operative federalism clearly clashes with the very centralised 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. No central authority has the power to decide alone on policies, as it is done by DG IV in the state aid arena.

Rules vs. discretion

Actors who have been trained in Germany's legalistic tradition find it difficult to accept the discretionary policy style of DG IV. Accusations from the German side—as expressed 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 legitimate expectation of national actors.

Vertical vs. horizontal co-ordination

Moreover, DG IV's involvement in wider aspects of regional policy causes consternation with German policy makers steeped in the tradition of vertical departmental independence (Ressortprinzip). Complaints about undue interference by DG IV in regional policy making are examples of this.

Structural bias

Sociological institutionalists have also stressed that different sets of institutions legitimise and empower different categories of social actors. In Germany, draft notifications for state aids are developed by the granting bodies which are usually located at the *Land* level. The Federal Ministry of Economics then forwards them to the Commission for approval (Wishlade and Olsen, 1997). During this process, the role of the federal ministry is limited to a formal one. Nonetheless, it is the federal government, which is held responsible by the European authorities for any illegal state aid payments. It has been seen that the Commission's 'blindness' regarding the subnational level of government in the context of state aid control, fuels tensions with between the Commission and the German *Länder* as well as between federal and state level within Germany. On the one hand, this is because 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 earlier described 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.

5. CONCLUSIONS

This paper casts doubt on the idea that the relationship between the EU and Europe's regions is characterised by ever closer co-operation and that the German *Länder* should be viewed as a prime example of this co-operation. In the area of EC state aid control, tensions between the Commission and subnational actors cannot be explained satisfactorily by just looking at actor-centred explanations, or differences in 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 supranational level can help to explain tensions in the relationship between the EU and the Member State.

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 centralised decision-making structure in the EU. More empirical work is needed to assess the importance of the Commission's informal contacts with national and subnational authorities as policy networks might well play an important role in overcoming differences that result from diverging institutional logics.

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