

The Trap of Confederalism: Managing Developmental Gaps, Widening Divides

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Abstract

Europe's economic integration has had uneven distributional effects between its *core* (Western and Northern Europe) and *periphery* (Eastern and Southern Europe). Several market correction instruments and policies to further common developmental goals—including the Cohesion Policy, state aid measures, and investments by the European Investment Bank (EIB) and the European Fund for Strategic Investments (EFSI)—have been introduced by the EU in order to mitigate such divergence. We assess the distributive effects of those actions and find that these policies have not decreased developmental gaps among member states. Instead of serving longer-term common European interests, they are potential factors of widening divides in Europe. Mainstream integration theories explain such outcomes with the built-in bias of EU institutions, which in turn provide opportunities for core countries to generate an economic playing field tilted towards their stronger economies. These theories, however, cannot explain the preferences of EU-level political actors, e.g., why they create and uphold suboptimal policies, or why they repeatedly learn the wrong lessons from previous failures of managing developmental disparities in Europe. Drawing from research on comparative federalism, we argue that the trap of confederal political representation is the key factor behind the deficiencies of market correction policies in the EU.

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1. Introduction

The key governance problem of integrating markets of economies at different levels of development is that the deeper the integration, the stronger will be the need for mechanisms that could manage the developmental consequences of those integrated markets. Market integration requires the creation of a “level playing field” which is supposed to provide equal formal rights to the producers of goods and holders of the various factors of production in member states, which, however, are endowed with widely different capacities to live by and benefit from the extension of markets.¹ If left on their own, integrated markets will distribute wealth, opportunities, risks, and gains among participating countries not only unequally, but they might even produce developmental outcomes that could undermine integration.² Consequently, the key to successful market integration is to find the right institutional setup that can produce policies which correct the distributive outcomes of integrated markets in participating states’ common interests, sharing the risks and gains of integration.

Of all the transnational experiences of integrating national markets that have emerged in recent decades, the EU is unique in that it has created a complex set of political institutions with the responsibility to extend and correct markets. More specifically, the EU has introduced several policies with the objective to correct the market distribution of wealth and opportunities and promote common developmental goals among its member states.³ In this paper, we explore the four largest EU policies that, at the time of their launching, aimed either to reduce disparities generated by the integrated market or to promote mutually beneficial economic activity for the member states. We investigate the EU’s state aid regime, the Cohesion Policy, as well as funding from the European Investment Bank (EIB) and the European Fund for Strategic Investment (EFSI). We are interested in the distribution of resources and opportunities that these policies provided. Did they comply with their original objectives to reduce developmental disparities and promote the common interests of the core and the periphery? Or did they reproduce or even increase pre-existing inequalities among the member states? And, either way, what may explain the distributive consequences of these policies?

Among these four policies, state aid and the Cohesion Policy have been updated several times, with each round contributing either to increased inequalities among member states or failed attempts at bringing the outcomes closer to the Pareto frontier. The EIB and EFSI have always distributed resources and opportunities in highly uneven manners, reflecting the preferences of a small number of member states. Overall, we find that these four policies have reproduced disparities: they have failed to reduce developmental gaps among member states and did not promote longer-term common European interests. Among them, there is only one, the Cohesion Policy that directly targets the less developed parts of the EU, redistributing roughly 0.3 per cent of EU GDP. However, the Cohesion Policy does not include institutional

¹ Balassa 1961; Bruszt and McDermott 2014.

² Alcidi 2019; Bodewig and Ridao-Cano 2019; Bruszt and Langbein 2020; Celi et al. 2018; Offe 2015.

³ Bruszt and Palestini 2016.

guarantees that recipient states will use the transfers to reduce developmental disparities effectively and thereby decrease the need for transfers. As for other EU policies, a small group of countries are the primary beneficiaries with which they contribute to developmental disparities. We show that even during the period of crisis management in 2020—described by some as the EU’s Hamiltonian moment, a major step toward mutualizing the costs and gains of integration—member states have opted for policies that have further fragmented the single market and have increased inequalities among them.

These outcomes are puzzling because member states have considerably deepened market integration, which went hand in hand with increased economic and political interdependence. EU bodies were conscious of the potential negative economic and political consequences of integrating heterogeneous economies at different levels of development,⁴ and the introduction of the market correction policies we study here were interlinked with calls to manage the negative externalities of ever deeper market integration. The high social and economic costs of the 2008 crisis in several member states, the growth of populism, and, simultaneously, the turning of the EU into a de facto transfer union have all provided evidence for the validity of these calls. Why could member states not respond adequately to them? Why could they not depart from a pattern of policy making that imposes high costs on all members?

To answer this question, we explore the properties of the EU polity producing these policies. At least since the pathbreaking study of Fritz Scharpf on what he called the Joint Decision Trap, the structure of EU decision-making has been the starting point for most of the explorations of EU economic policy making.⁵ These studies explain why stronger and more developed member states *can* use the built-in bias of EU institutions and their power asymmetries for imposing their preferences on less developed member states *if they wish to do so*.⁶ However, they cannot explain why they would wish to do so, why they would prefer to implement market correction policies that, in the end, repeatedly produce suboptimal outcomes, impose costs even on them, and do not serve the common interests of social and economic cohesion, increased competitiveness, or the reduction of the risk of crises among member states.

To address the sources of these preferences, we introduce the notion of the trap of confederalism, which refers to the pathologies of governing a transnational market by a territorially fragmented polity in which political representation and accountability rest exclusively at the level of the member states. This structure of representation and accountability introduce a territorial bias into EU decision-making by generating strong incentives for elected politicians in the EU to externalize the developmental consequences of integration onto other member states and block EU policies from reaching the Pareto frontier if they endanger their domestic political position.

The EU’s intergovernmental decision-making system provides the opportunities to advance these preferences. The trap of confederalism means that this bias in the EU polity becomes institutionalized into its market correction policies so that they contribute to the reproduction of market-generated inequalities, and the sustaining of the core–periphery development gap. The distribution of resources and opportunities to economic actors via these policies furnish the fragmentation of the single market and contribute to the conservation of the economic and political problems that they were supposed to alleviate.

⁴ Werner Report 1970; Delors Report 1989; European Communities 1997.

⁵ Höpner and Schäfer 2012; Scharpf 1988, 1998; Tallberg 2008.

⁶ Höpner and Schäfer 2012; Scharpf 2010.

Our approach draws on the literature on comparative federalism studying the effects of various systems of political representation in multilevel polities. In this research stream, differences in the learning capacities of regimes where sovereignty is shared are explained by the way political representation and accountability are organized within them.⁷

Drawing on this literature we argue that because in the EU's confederal system all the elected policy makers have to fight for re-election in 27 separate political arenas, they have precious little room to commit to long-term policies that could serve the common interests of the member states. Policy makers from the more developed members have strong incentives to externalize the costs of the systemic problems of the EU while minimizing their commitment to the transfer of resources and opportunities to the periphery. They also have strong incentives to push for policies that would increase control over the use of transfers in the periphery. Elected politicians in peripheral states have the opposite incentives.

We make two contributions in this paper. First, drawing on the literature mentioned above, we bring together the effects of the two key pillars of political representation in multilevel polities. The first pillar leads from society to the state, representing territorial, functional, and ideological diversity. The second one rests within the state apparatus itself, balancing among these diverse representations with the help of a system of checks and balances in the process of decision-making. Written at a time when the politicization of European integration was still minimal, Scharpf's Joint Decision Trap model focused on the second pillar of political representation.⁸ Discussing the effects of the first pillar and highlighting the consequences of the nearly exclusive dominance of the territorial representation, which we undertake in this paper, has theoretical and practical relevance beyond the puzzle we present here. We also show how these two pillars of political representation create an imbalance in the representation of territorial interests, which is not solely about the domination of core countries over the periphery. The two pillars of political representation sustain an arrangement in which core and periphery work together in undermining the goal of the EU in leveling the playing field and prevent it from advancing the common interests of the member states.

Second, the exclusive focus on the second pillar has led some analysts to conclude that the growing heterogeneity among the member states is the source of the problems of market integration in Europe.⁹ By bringing the effects of the first pillar of political representation into the analysis, our study indicates that the problem is not with heterogeneity, but with how heterogeneity is represented in the EU, both toward and within the sphere of decision-making. Our paper thus contributes to the endogenous theorizing of integration: outcomes are shaped by the internal structure of political representation and decision-making in the EU. Altering the first pillar of political representation, and thus enlarging the room where the common interests of Europeans can be represented, might reduce the effects of the EU's territorially fragmented system of political representation, and it might increase support for altering the structure of decision-making.

The paper is organized as follows. In section two, we provide an analytical framework for the study of the distributive effects of four market correcting policies. In sections three and four, we discuss these policies in more detail. We explore both the justifications for their creation, the actual distributive outcomes they produce, and the factors that could account for these

⁷ Linz and Stepan 1996; Podvršič 2021; Stepan 1999, 2001; Bruszt 2002.

⁸ Scharpf 1988.

⁹ For example, see Höpner and Schäfer 2012, 431-432.

outcomes. Section five pulls together the different arguments, discusses their relevance for market governance, and makes some cautious suggestions for further research.

2. (Un)levelling the playing field

State aid control, the Cohesion Policy, and investments by the EIB and EFSI all aim at altering the market distribution of resources and opportunities either through direct redistribution of resources or by creating new opportunities that markets on their own would not provide. Each policy's declared objective is to reduce disparities among member states and promote common European developmental goals. The Cohesion Policy and certain aspects of the EU's state aid rules directly target the periphery while the others aim to assist developmental outcomes that are supposed to provide benefits to all member states.

How can we explain the four policies' inability to deliver on their initial objectives? Political economy approaches to European integration and mainstream integration theories offer conflicting answers to this question. Political economists, drawing on Fritz Scharpf's Joint Decision Trap, focus on the institutional setup of EU decision-making, on the built-in bias in the structure of EU decision-making, and on asymmetrical power relations among EU member states. They would expect no or just limited market correction policies primarily in the form of selective side-payments to allow for further market integration.¹⁰

However, based on neofunctionalist and liberal intergovernmentalist approaches, one could expect a larger commitment on the side of the stronger economies to move integration in the direction of the Pareto frontier. With growing interdependence, the pains and gains in the periphery can easily be transformed into pains and gains in the core member states, which, in turn, are supposed to induce change in the preferences of policy makers and powerful economic actors in these countries.¹¹

Although the first approach is somewhat closer to the reality, it cannot offer a convincing answer to the question of why policy makers in core countries keep sticking to the wrong preferences. Why do EU member states treat market correction, as a rule, a zero-sum game and not as a program serving the long-term common interests of all member states? Why have they not learned from failed attempts to manage crises which resulted from previous unsuccessful attempts at managing the developmental externalities of market integration,¹² and why is it rational for them to learn the wrong lessons over and over?¹³

For a better understanding of the link between the characteristics of the EU polity and the preferences of political actors, we turn to a stream of comparative federalism dealing with the properties of political representation in multilevel polities and its impact on market efficiency and distortion. Political representation and accountability can be structured in several different ways in multilevel polities, shaping the incentives of policy makers in substantially different directions.¹⁴ Researchers within comparative federalism investigate the incentives provided

¹⁰ Abdelal and Meunier 2010; Egan 2015; Höpner and Schäfer 2012; Jacoby and Meunier 2010; Scharpf 1988, 1998; Tallberg 2008.

¹¹ Haas 1964; Moravcsik 1998; Sandholtz and Stone Sweet 2012. For an excellent summary of this literature, see Genschel and Jachtenfuchs 2018.

¹² Bruszt and Vukov 2015; Jones et al. 2016.

¹³ Ban 2020; Matthijs and Blyth 2018.

¹⁴ Fossum and Jachtenfuchs 2017.

by different systems of political representation and their developmental and political effects. These studies typically focus on federal polities like India, Argentina, or the USA, as well as the former Soviet Union and the former Yugoslavia. They explore how federal and/or regional organization of political representation may tame or induce centripetal tendencies in multilevel polities¹⁵; facilitate cooperation among different levels of government and prevent defection across levels of government¹⁶; prevent the formation of national-level developmental alliances¹⁷; or help/hinder the state from serving encompassing social interests.¹⁸ Applied to the study of European integration, this approach helps to explore how a specific system of political representation could allow voters in Europe to choose from rival EU agendas and provide them guarantees that their preferences will be translated into EU-level policies.¹⁹

James Madison, one of the founders of comparative federalism, represents a key source of inspiration in this field. Madison was among the first to recognize that the properties of a system of political representation is critical for organizing diversity in multilevel polities. To put it differently, he argued that people's preferences are not exogenous to the structure of political representation. If organized in the right way, the system of representation can "refine and enlarge public views"²⁰. The Madisonian 'scheme of representation' foresaw the representation of the interests of the same groups of citizens in diverse ways and multiple associations, using the competition of self-interested representatives to create innovative combinations at the local, state, and (supra)national levels. These new combinations and new ways of accommodating *heterogeneous* interests were expected to serve as counterweights to powerful factions and combinations of *homogeneous* interests. Coalesced through carefully designed checks and balances, the second pillar of political representation, the system was expected to increase the probability of producing 'virtuous representations', that is, political programs and public policies that could represent common goods.²¹

Based on these ideas, we argue that the preferences of EU-level policymakers are shaped by the EU's confederal system of political representation. Unlike in a federal polity, all member state representatives which participate in decision-making at the EU level are elected from the 27 member states. There is no federal representation of the common interests of EU citizens to counterbalance the representation of the interests of the peoples of the member states.²² Europeans' ability to influence the policy orientation of European institutions through elections is limited. Voters are not able to choose between rival European agendas, and they only have indirect and limited opportunities to hold EU institutions accountable. EU-level policy makers have little incentive to commit themselves to longer term, mutually beneficial policies, especially if such policies would imply interstate distribution of resources and opportunities. If they want to retain their office, they have to convince domestic electorates that they represent national interests vis-à-vis other member states or 'Brussels' better than their domestic competitors.

The perspective we present here differs from postfunctionalist theorizing. According to postfunctionalists, primarily changes in public opinion alter the incentives of elected

¹⁵ Linz and Stepan 1996; Podvršič 2021; Stepan 1999.

¹⁶ Beramendi and León 2015.

¹⁷ Ardanaz et al. 2014.

¹⁸ Bruszt 2002.

¹⁹ Hix 1998.

²⁰ Hamilton 2008.

²¹ Manin 1994; Ordeshook 1992; Bruszt 1998.

²² Hix 1988.

representatives.²³ In our approach, changes in public opinion are not exogenous to the confederal system of political representation. Rational actors competing for the right to become or remain representatives have strong incentives to shape public opinion and go beyond mere re-presentation of the public preferences of the day. They compete with their opponents to make voters identify with their program. As such, in the confederal system, candidates have strong incentives to anticipate and discredit the strategies of their opponents, claiming that the latter misrepresent or do not represent national interests. They do not only represent high salience issues that have become politicized. If they want to be (re-)elected, they have strong incentives both to politicize previously low salience issues and, if they are incumbents, to prevent the politicization of other issues by co-opting or compensating in advance those domestic actors who have the capacity to politicize them. The politicization of EU transfers or the rules on spending EU money which appeared after 2008 are examples for the first; the continuous pressure by core countries to alter the rules of state aid policies or the principles guiding the investment decisions of the EIB or the EFSI are examples of the second.

Our approach draws on the work of Beramendi and Stegmueller who write about the “lopsided politico-economic geography” of the EU where “the influence of individual member states trumps the influence of citizens as members of a common polity”²⁴. We, however, take issue with their argument that heterogeneity “in the geography of income, production regimes, and institutional organization” is responsible for citizens' diverging preferences, and through it, the preferences of elected EU level policy makers. We do not question the relevance of these factors cited by Beramendi and Stegmueller but, following the Madisonian tradition, we stress the autonomous role played by the structure of representing heterogeneity. In the confederal regime of the EU, the room of representatives for departing from fragmented representation of the interests of citizens is limited by the dynamics of domestic political struggles in 27 diverse political arenas. Lacking the federal counterweights both in the structure of political representation and in the configuration of decision-making powers, representatives are confined to the narrow political spaces of the member states with limited incentives to politicize interdependence among and represent intertemporal trade-offs for the citizens of EU.

EU-level representatives and policymakers in this confederal system have strong incentives to internalize the gains and externalize the costs of market integration. If they come from core countries, they have strong incentives to expand opportunities for the domestic economic actors in their home countries, minimize transferring resources and opportunities to the periphery, and push for EU-level policies that could increase control over the use of those transfers. Elected politicians in the periphery, however, have the opposite incentives. The trap can best be understood as a collective action problem in which the motivation of each participant to commit herself to a common goal is hindered both by the contingent choices made by her electoral opponents at home and by the expectation that her negotiating partners from other member states have the same commitment problems.

Note that the problem is not *per se* that member state representatives represent primarily national interests. The source of the problem is that there is no federal counterweight in the EU polity to the representation of the separate interests of the member states. To grasp the specificity of the EU polity, one should imagine the USA being run by a council of fifty governors (with the elected leaders of Rhode Island or Arizona bargaining over federal

²³ Hooghe and Marks 2009.

²⁴ Beramendi and Stegmueller 2020, 641.

economic policies with the governors of New York and California) and a weak House of Representatives, with no elected executive and with no one in Washington accountable to the voters of the United States.

While the trap of confederalism shapes the preferences of EU-level representatives, the predominantly intergovernmental system of policymaking provides opportunities to advance those preferences. This institutional setup allows for, and in some cases even rewards the core's weak commitment to level the playing field. For the peripheral members, the same system of political representation allows for a weak commitment to investing in policies and institutions that could help reduce disparities. As a result, the market correction policies of the EU contribute to the reproduction of market-generated inequalities. Moreover, these policies furnish the fragmentation of the single market and contribute to the preservation of the economic and political problems that they were supposed to alleviate. In the following sections, we highlight how the distribution of resources and opportunities through the EU's market correction policies suffer from the trap of confederalism.

3. The EU's state aid regime and Cohesion Policy in the trap of confederalism

3.1. State aid

State aid is a 'licensed market distortion' in the EU's market governance. While the EU grants near constitutional status to defending market competition from distortion, the Treaties allow for certain exceptions to this rule. Articles 107 to 109 specify when the provision of state aid may be compatible with the internal market. Article 107(3) stipulates that aid may be compatible with the EU's internal market if it promotes the backward areas or facilitates a project of common European interest.

The evolution of the EU's state aid policy shares all the problems linked to the system of political representation, and it illustrates how the two pillars of political representation together reproduce the outcomes of the market distribution of wealth and opportunities. All elected policymakers in Brussels represent member state constituencies. Out of a desire to improve their chances for re-election, they might have incentives to fight for the removal of interstate barriers to free trade, but they might also have strong incentives to fight for rules that allow for the subsidizing of their own state's economic activity even at the expense of lost activity in another member state. Supporting an increase in state aid for their home country is a conspicuous way to signal their commitment to supply public goods to their voters.²⁵ Based on these considerations, we should expect the introduction of strict state aid policies being followed by repeated attempts at relaxing the restrictions of these policies and using them for redistributing opportunities to the stronger member states. The evolution of EU state aid policy reflects precisely this mechanism.

Although the member states granted the European Commission an exclusive mandate to define, monitor, and control state aid, the Commission's stricter rulemaking in the 1990s has gradually been watered down to the benefit of core member states. The recent decentralization of state aid rules and the loosening of the legal framework during the coronavirus crisis have further increased core country dominance. Consequently, instead of counterbalancing it, the EU's state aid regime reinforces the developmental gap between Europe's core and periphery.

²⁵ Dewatripont and Seabright 2006.

An institutionally embedded “cat-and-mouse dynamic” between the Commission and the member states has characterized the evolution the policy.²⁶ In the 1960s and 1970s, the Commission followed a non-confrontational approach and did not block state aid initiatives²⁷ particularly when France, Germany, the UK, and Italy generously supported their industrial restructuring. However, over the years, the ECJ provided support to the Commission through its state aid rulings and reinforced its competence in determining unlawful aid practices.²⁸ However, in the 1980s, even those member states that traditionally granted large amounts of aid to domestic industries initiated neoliberal reforms to enhance their competitiveness. The Commission jumped on the neoliberal bandwagon and became increasingly active in interpreting Treaty rules. It developed its own vision of what constitutes “good” aid policy.²⁹ The creation of the EU’s single market, and the fiscal discipline required by monetary integration, further assisted the Commission in becoming stricter and more active.³⁰

In the 1980, the debate shifted to budgetary discipline and cost-effectiveness. This implied that wealthier members with healthier budgets could continue providing more state aid than those facing liquidity problems. As the Commission took advantage of the window of opportunity presented by the Maastricht Treaty, and engaged in suspending sectoral aid, a growing number of reported cases exhausted its limited capacity. With approximately 400 officials, the “inadequate staff resources clearly weaken[ed] the [Directorate General’s] capacity for enforcement.”³¹ Despite its strong *de jure* mandate, the Commission’s federal oversight was *de facto* weak.

Facing capacity limitations, the Commission indicated to the member states that the high number of cases undermined its ability to focus on the most distortive aid measures.³² Subsequently, in the late 1990s, the Council of Ministers authorized the Commission to exempt certain categories of aid from the notification requirements.³³ Hence the Commission created so-called block exemptions, which ruled out the sectoral but allowed for horizontal aid such as subsidies to SMEs, training, research and development, innovation, regional development, green economy, and employment. The area covered by block exemptions kept expanding in the 2000s, and the policy’s gradual decentralization continued with the State Aid Action Plan (2005) and the State Aid Modernization Package (2012), which dispersed more responsibility to national administrations.³⁴ Block exemptions, which now constitute more than 90 per cent of new aid measures, provide a strong incentive for member states to spend on ‘good’, less distortive aid instead of sectoral support.³⁵ However, allowing horizontal aid with practically no restrictions also contributes to the fragmentation of the internal market because state aid follows national capabilities instead of promoting common European interests.

The regulation of regional development aid within block exemptions offers insight into the consequences of the trap of confederalism. Initially, the Commission wanted to limit state aid to the most backward regions of the EU. However, it backtracked on the original proposal

²⁶ Volberding 2021, 67.

²⁷ Doleys 2013; Volberding 2021.

²⁸ Doleys 2013; Micheau 2016.

²⁹ Blauburger 2009.

³⁰ Aydin 2014.

³¹ Cini and McGowan 1998, 47.

³² Doleys 2013.

³³ Aydin 2014.

³⁴ Colombo 2019; Finke 2021; Heimler 2018.

³⁵ Colombo 2019.

after confronting heavy resistance from old and strongest EU members. In the end, the Commission continued to allow state aid in the least developed regions of each member state, regardless of the countries' level of development.³⁶ It led to peculiar situations where two districts in Luxembourg, the wealthiest EU member state with a GDP per capita nearly three times greater than the EU average, qualified for regional development aid.³⁷

The decentralization of state aid is the institutional imprint of the trap of confederalism, with two important consequences. First, it allows for uneven national enforcement of state aid rules that could undermine the internal market.³⁸ State aid control suffers from structural problems related to “the fragmented nature of the architecture, as administrative responsibilities are dispersed across a multiplicity of loosely coupled actors displaying dissimilar mechanisms and capacities.”³⁹ Second, the distributive outcome of the policy favors larger and wealthier members because they have traditionally been more successful in influencing changes in state aid regulation and have also been more capable of taking advantage of them.⁴⁰ Consequently, the member states' budgetary power determines how much aid is granted.⁴¹

Core members, particularly France and Germany, have traditionally disbursed the highest amounts of state aid.⁴² In 2018, Germany and France were responsible for 51 per cent of all the state aid granted within the EU, while their share of the EU's GDP amounted to 34 per cent.⁴³ The budgetary power of economically strong member states seems to tilt the playing field towards core members' advantage, and, as Figure 1 shows, core countries' overspending of state aid relative to their share of total EU GDP has recently increased. Moreover, as Figure 2 reveals, since the Eastern enlargement in 2004, the core has spent twice as much state aid than the South and almost 40 per cent more than the East. Although most recently the Eastern member states' spending on state aid has been the highest in the EU relative to their GDP, this is not reflected in the per capita figures because of the superior budgetary capacity of the core members.⁴⁴

Figure 1: Share (%) of core EU members from total non-crisis state aid and total EU GDP (2004–2019)

³⁶ Cini 2021, 7.

³⁷ EC State Aid SA.38615 (2014/N) – Luxembourg Regional Aid Map 2014–2020, https://ec.europa.eu/competition/state_aid/cases/252478/252478_1564060_56_2.pdf.

³⁸ Colombo 2019; Nicolaidis 2003.

³⁹ Colombo 2019, 298.

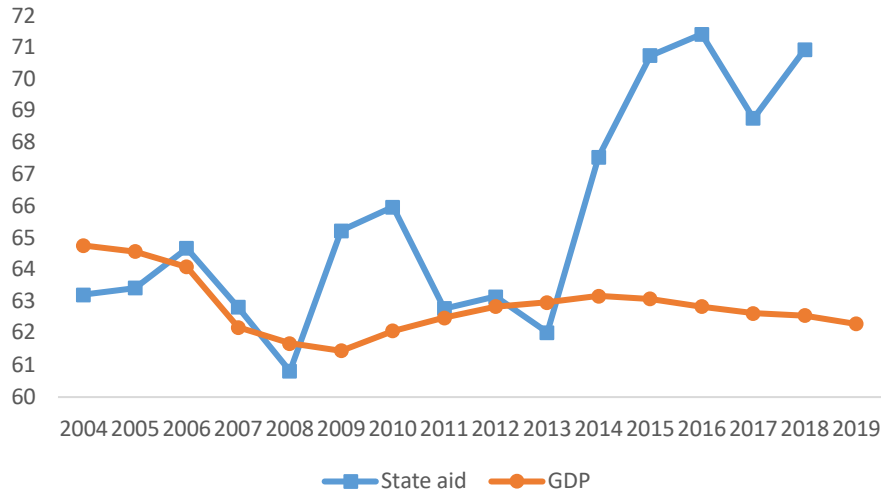
⁴⁰ Volberding 2021.

⁴¹ Sinnaeve 2001.

⁴² Heimler and Jenny 2012.

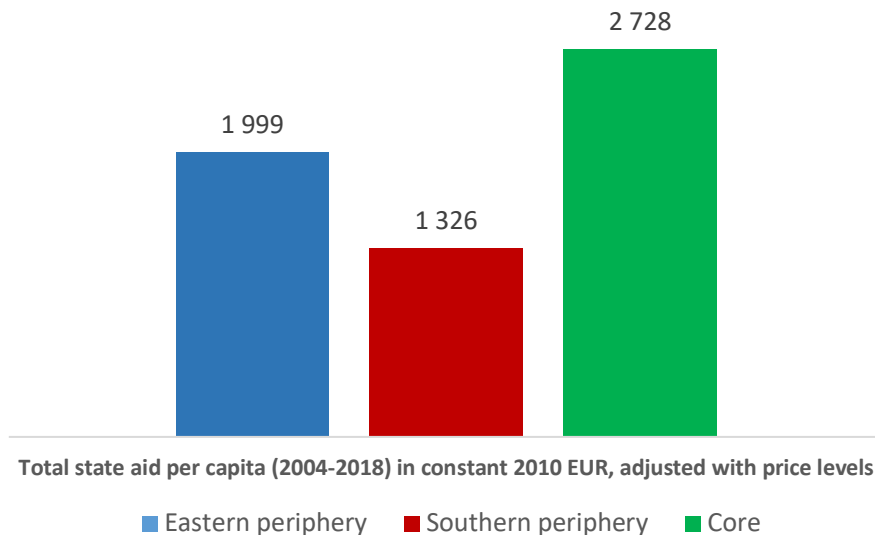
⁴³ EU State Aid Scoreboard 2020, https://ec.europa.eu/competition-policy/state-aid/scoreboard_en.

⁴⁴ Vukov 2020.



Source: Authors’ calculation based on Eurostat and EU State Aid Scoreboard.

Figure 2: Total disbursed state aid per capita (in EUR) in EU core and periphery (2004–2018)



Note: Calculated with population figures for 2019.

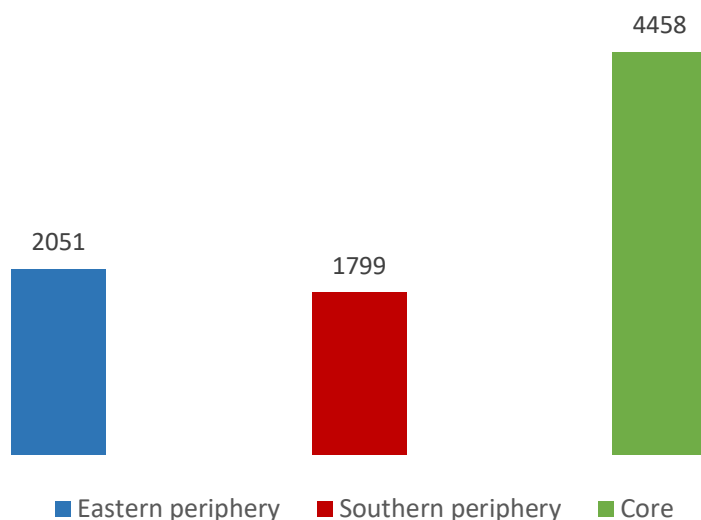
Source: Authors’ calculation based on Eurostat and EU State Aid Scoreboard.

The relaxation of state aid rules during the COVID-19 crisis has reinforced the core members’ advantage and exposed huge inequality in disbursing aid (see Figure 3). In March 2020, the European Commission established a temporary aid framework to facilitate crisis management. In this document, the Commission expressed that “given the limited size of the EU budget, the main response will come from Member States’ national budgets.”⁴⁵ By June 2020, the Commission had approved more than EUR 2 trillion in state aid, most of it initiated by the core members: Germany alone accounted for half of this sum, causing concerns among less

⁴⁵ EC, Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (2020/C 91 I/01), [https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52020XC0320\(03\)&from=HU](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52020XC0320(03)&from=HU)

affluent members.⁴⁶ Within a year, the core countries committed crisis-mitigating expenses equivalent to the total Cohesion Policy funding paid to the Eastern members since the 2004 enlargement (compare with Figure 4). The Spanish Minister of Economy expressed that to preserve the internal market, richer member states should not support their economies more generously.⁴⁷ As a spokesperson for the Commission admitted, the cross-country differences in state aid provision were “linked to the fiscal space they have as well as the respective size of their economies.”⁴⁸

Figure 3: Total COVID-19 state aid per capita (in EUR, adjusted with price levels) in the EU core and periphery (March 2020–April 2021)



Source: Authors’ calculation based on DG Competition and Eurostat.

However, neither the Commission nor the Court took any steps to contain core members’ excessive spending. For instance, the EU General Court rejected Ryanair’s legal appeals against aid packages supporting the French and Swedish aviation sectors, arguing that the aid schemes were appropriate to the damage suffered by the sector.⁴⁹ With this ruling, the Court indirectly suggested that during an economic crisis, the best preservation of the internal market is to further fragment it according to national economic interests.

The pandemic is not the only reason for the loosening of state aid control. The growing geopoliticization of competition has already pointed in this direction.⁵⁰ On the one hand, China’s extensive support to its firms competing in the global market and the increasingly protectionist stance of the US government may put European enterprises at a disadvantage. On the other hand, Brexit and the UK government’s anticipated lenient approach to state aid control also require an adequate EU response. Finally, the French and German governments have been lobbying the Commission to simplify the state aid framework to promote European

⁴⁶ Rios 2020.

⁴⁷ Dombey 2020.

⁴⁸ Fleming and Espinoza 2020.

⁴⁹ Lepièce and Brochier 2021.

⁵⁰ Meunier and Mickus 2020.

industry.⁵¹ Consistent with the trap of confederalism, a further dismantling of the “level playing field” in state aid control can be expected.

3.2. The Cohesion Policy

The EU’s Cohesion Policy initially aimed to offset market imperfections “in those economic sectors and geographical areas where the working of market forces needed to be reinforced or complemented.”⁵² Article 174 lays out the Policy’s main objectives, which stipulates that “the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favored regions.” Notwithstanding these objectives, the Policy shows similar symptoms of the trap of confederalism as state aid control. First, the territorial focus of the Policy has been considerably weakened over the last two decades. Second, the European Commission exerts only marginal control over how effectively the members spend the funds and whether spending serves any common European interests. These institutional characteristics may have contributed to the Policy’s mixed results in narrowing development gaps.

Although, as expected, the vast majority of Cohesion Policy funding does benefit peripheral member states (Figure 4), the literature is divided over its developmental effects. Many consider the Policy a pure side-payment without notably reducing disparities.⁵³ A more nuanced opinion argues that in countries with the right institutions and a supportive domestic developmental alliance, the EU transfers can have positive developmental effects.⁵⁴ Nevertheless, despite three decades of intensive transfers that have been several times greater than the Marshall Plan, Southern member states have failed to close the gap with the core members or withstand the detrimental consequences of the 2008 crisis.⁵⁵ This outcome can be partially attributed to the prioritization of spending on physical infrastructure, and a persistent downplaying of investing into R&D and human capital, which may involve more sustained growth effects than physical investments.⁵⁶

Figure 4: Total Cohesion Policy payments per capita (in EUR) in the EU core and periphery (2004–2019)

⁵¹ Bundesministerium für Wirtschaft und Energie, A Franco-German Manifesto for a European industrial policy fit for the 21st Century, 2019, <https://www.bmwi.de/Redaktion/DE/Downloads/F/franco-german-manifesto-for-a-european-industrial-policy.pdf>.

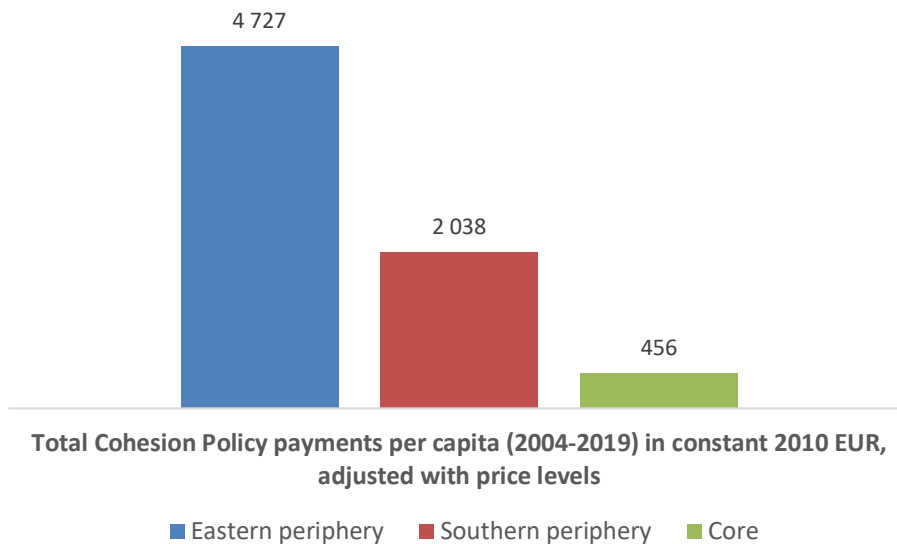
⁵² Delors Report 1989, 17.

⁵³ Boldrin and Canova 2003; Leonardi 2005.

⁵⁴ Rodríguez-Pose and Garcilazo 2015.

⁵⁵ European Commission 2014.

⁵⁶ Medve-Bálint 2018.



Note: Calculated with population figures for 2019.

Source: Authors' calculation based on Eurostat and European Commission data.

The above consequence arises from one of the key problems of the Cohesion Policy: member states treat it as an entitlement or a guaranteed benefit without being accountable to any national or European fora about the substantive results of their spending.⁵⁷ In other words, mechanisms ensuring that the transfers will reduce the need for them are lacking, such as guarantees that the funds would serve the longer-term common interests of core and peripheral countries. Once negotiations on the EU's budget are over, the recipients' main interest is to maximize flexibility in using funds without maximizing their effectiveness. This introduces a bias into the Policy's goals and governance "whereby the rules of the game and the goals are loosened, and the general EU interest fails to be pursued."⁵⁸

At the same time, the core members, which are the net contributors to the EU budget, are interested in minimizing the transfers and maximizing their effectiveness. The absorption problems of the poorest EU members strengthen their position: the funds yield greater returns where institutional capacity and quality of government is higher.⁵⁹ Spending would therefore be more efficient in countries and regions with better institutional performance. However, institutional quality, absorption capacity, and economic development are positively related to each other; hence the poorest countries face the largest developmental challenges and the greatest need for funding.⁶⁰

Aware of the above problems, net contributor countries ("Friends of Better Spending") urged for a considerable cut in the Cohesion Policy's budget during the negotiations prior to the 2014–20 programming cycle, while the net recipients ("Friends of Cohesion") firmly rejected this proposal.⁶¹ By capitalizing on the euro crisis, the net payers could enforce their position.⁶² Consequently, the Cohesion Policy's focus shifted towards stimulating growth,

⁵⁷ Medve-Bálint 2015.

⁵⁸ Barca 2009, 105.

⁵⁹ Rodríguez-Pose and Garcilazo 2015.

⁶⁰ Medve-Bálint 2018.

⁶¹ Mendez et al. 2012, 10. The "Friends of Cohesion" were exclusively peripheral member states: Bulgaria, Czech Republic, Cyprus, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia and Spain.

⁶² Becker 2019.

competitiveness, and efficiency and watered down the objective of territorial cohesion.⁶³ However, mechanisms that would guarantee the effective use of the funds were not introduced.

In theory, the conditionality mechanism adopted at the end of 2020 would provide greater mandate to the Commission to protect the EU's financial interests and suspend funding in those member states where breaches of the rule of law and mismanagement of transfers occur. However, because of the heavy resistance by the Polish and Hungarian governments, the European Council toned down the instrument "by reconfiguring the context in which it should be interpreted and applied," and also delayed its full entry into force.⁶⁴ The watering down of the original proposal, which is consistent with the trap of confederalism, produced an instrument that, contrary to its original intentions, cannot bite.

4. The EU's loan- and guarantee-based developmental policies: the European Investment Bank (EIB) and the European Fund for Strategic Investments (EFSI)

The European Investment Bank (EIB) was founded in 1958 as a development bank of the European Communities. According to Article 130 of the Treaty of Rome, the EIB shall contribute to the balanced and steady development of the common market through financing: "(a) projects for developing less developed regions; (b) projects for modernizing or converting undertakings or for developing fresh activities called for by the progressive establishment of the common market...; (c) projects of common interest to several Member States which are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States."⁶⁵ Thus, the EIB is a regional development bank, with an EU-specific focus on balancing and facilitating the common market. Contrary to its mandate, however, our findings indicate that the EIB caters to the dominance of a smaller number of countries from the Core and the Southern periphery and invest only a minimal amount into joint projects benefiting multiple member states. We demonstrate here that the EIB's and the Juncker Plan-attached European Fund for Strategic Investment's (EFSI) funding structure and procedural features are largely responsible for this outcome. We contend that the EIB's operational mechanism is victim to the trap of confederalism, i.e. it is the result of a polity which prioritizes member states' individual interests over the representation of a common European interest.

The EIB's lending figures in 2014-2019 reveal that out of the three EU geographical regions (Core, Southern Periphery, and Eastern Periphery), the Core countries received 45 per cent of total loans, the largest share of total EIB lending on nominal terms. The Southern periphery received 38 per cent of the financing, while the Eastern periphery received 17 per cent (Table 1). These patterns are slightly more skewed towards the Core in the case of EFSI, with 50 per cent of total loans, while the Eastern periphery received 20 per cent and the South 30 per cent (Table 2). Nominal lending figures show the distribution of EIB's and EFSI's total resources, thus they reflect their internal mechanisms for distributing available resources among various geographic regions.

Table 1. Aggregate data for EIB financing in different EU regions (2004–2019)

⁶³ Avdikos and Chardas 2016.

⁶⁴ Hillion 2021, 279.

⁶⁵ Treaty of Rome 1957, <https://netaffair.org/documents/1957-rome-treaty.pdf>. Accessed February 2, 2021.

	Eastern Periphery	Core	Southern Periphery
Total Loan (in million 2005 Euros)	126,635 (17%)	343,505 (45%)	290,709 (38%)
Total Loan per capita	75.7	80.8	144.1

Source: EIB, authors' own calculation.

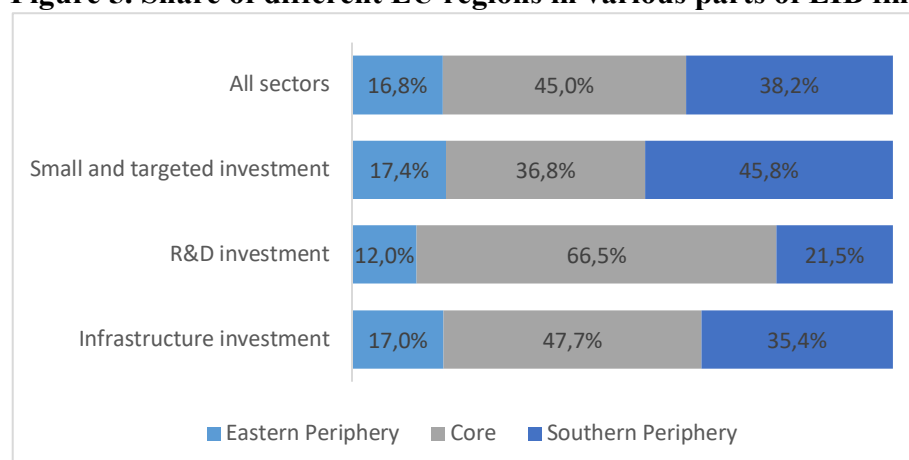
Table 2. Aggregate data for EFSI financing in different EU regions (2015–2019)

	Eastern Periphery	Core	Southern Periphery
Total Loan (in million 2005 Euros)	8,037 (20%)	19,505 (50%)	11,707 (30%)
Total Loan per capita	4.8	4.6	5.8

Source: EIB, authors' own calculation.

The EIB loans' sectoral distribution shows an additional skew in the EIB targets regarding their market upgrading impact. In the last 15 years, the EIB's lending targets differed significantly among the three regions. Core countries received much greater funding for R&D investment, while the East and the South received less than their share from all sectors combined (Figure 5)

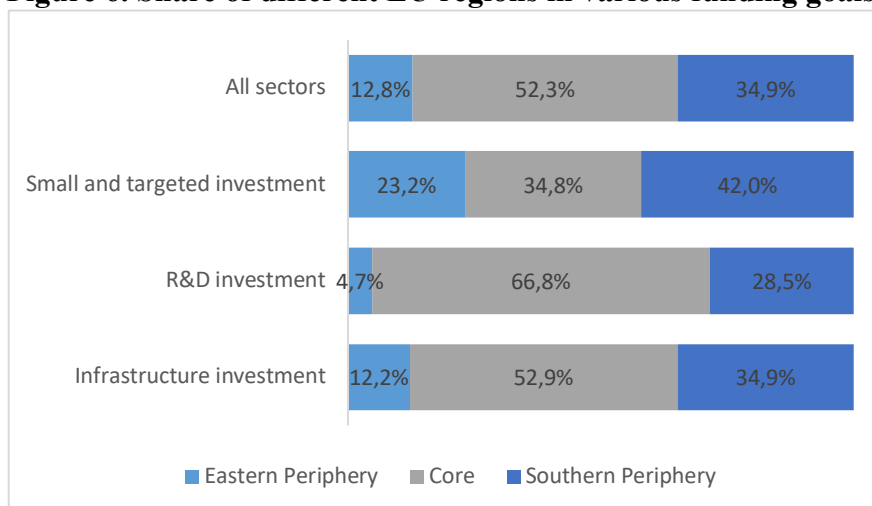
Figure 5. Share of different EU regions in various parts of EIB financing (2004–2019)



Source: EIB, authors' own calculation.

Considering the distribution of EFSI loans, we see a similar or even greater skewness towards the Core for R&D investments, while the East received more than the sectoral average in Small and Targeted Investment (Figure 6).

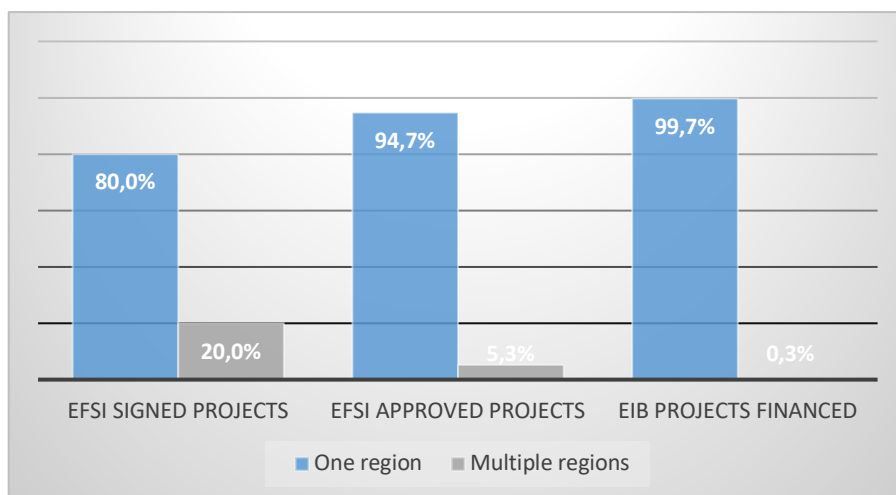
Figure 6. Share of different EU regions in various funding goals of EFSI (2015-2019)⁶⁶



Source: EIB, authors' own calculation.

The distribution of EIB resources leaves limited room for the 'reduction of territorial disparities'. We find at least as problematic that the EIB or the EFSI finances very few cross-country investments that would involve recipients from at least one core and one peripheral country (Figure 7).

Figure 7. Distribution of loan amounts by beneficiaries (2004–2019)



Source: EIB, authors' own calculation.

At the same time, the EIB's self-defined COVID crisis-related funding show a skew towards the Southern periphery, which receives 65 per cent, the Core 18 per cent and the Eastern Periphery 17 per cent of the funds.⁶⁷

⁶⁶ From EFSI data available on the EIB website (only EU members, <https://www.eib.org/en/efsi/efsi-projects/index.htm>). Infrastructure investment includes energy, transport, environment, and resource efficiency projects. R&D investment comprises bioeconomy, RDI, or digitalization loans. Small and targeted investment consists of smaller companies, social infrastructure, and regional development loans. In the case of multiple recipients, the project was assigned to the category or region which included the most sectors or countries. All amounts are in 2005 euro. Projects lacking a specified sector or country were excluded.

⁶⁷ European Investment Bank, EIB financing to support COVID-19 recovery, <https://www.eib.org/en/about/initiatives/covid-19-response/financing.htm>.

In sum, and against the EIB's mandate, we find it puzzling that (1) the EIB's and EFSI's loan and guarantee profiles are skewed among geographic targets within the EU, (2) the EIB's and EFSI's loan and guarantee profiles support industrial upgrading largely in core countries, and (3) the EIB and EFSI only minimally support cross-core and periphery projects or cross-country projects.

4.1. The trap of confederalism: EIB's organizational resources, lending, and decision-making bias

EIB's and EFSI's current lending patterns among the EU's three geographic regions reflect the long-lasting historical work of the trap of confederalism: representatives of the member states participating in the institutionalization of EIB had strong incentives to 'bring home the bacon', to create rules of decision-making and set principles of distributing resources that could maximize their share from the moneys. Although the EIB was founded with a purpose to compensate Italy for the negative distributional consequences of the common market, over time a drift in the EIB's lending target has occurred. Initially, the EIB lent the most to Italy on nominal terms (77 per cent) but from the mid-1960s both the number of recipient countries and lending volume were growing with an increasing share of EIB resources dedicated to core countries.⁶⁸

The changing distributional pattern of EIB lending targets from the South to the core over time can be explained by the institutionalization of the trap of confederalism in the EIB's organizational and procedural features. In particular, we emphasize the dominance of a small number of countries in the EIB's decision-making structure. First, core countries have an overwhelming voting majority in EIB's decision-making. The EIB's highest oversight body, the Board of Governors, consists of the Finance or Treasury Ministers from the 27 EU Member States. The EIB's most important decision-making body is, however, the Board of Directors, where larger member states have permanent members, smaller member states delegate members on a rotating basis, and the European Commission delegates one permanent representative.

Member states' voting shares depends on their share in the EIB's subscribed capital. Germany, France, and Italy control 19.21 per cent each. Spain 11.52 per cent, Belgium and the Netherlands 5.32 per cent each, Sweden 3.53 per cent, Denmark 2.7 per cent, Austria 2.64 per cent, Poland 2.46 per cent, and all other member states share the remaining voting rights.⁶⁹ Taking into consideration that a simple majority of the subscribed capital must support a decision taken by the EIB in most cases, we can see that Germany, France, and Italy together can veto decisions.⁷⁰ In other words, these three EU member states yield overwhelming decision-making power over the remaining 24 countries, including the countries from the periphery.

Moreover, representatives of core countries dominate the Management Committee, the chief agenda-setting body within the EIB where permanent EIB staff works. Similar to other large international organizations, such as the IMF or the World Bank, decision-making by Board

⁶⁸ Clifton et al. 2018, 737.

⁶⁹ European Investment Bank, Governance and Structure: Shareholders, <https://www.eib.org/en/about/governance-and-structure/shareholders/index.htm>. Accessed on February 2, 2021.

⁷⁰ European Investment Bank, Governance of the EIB, http://www.eib.org/attachments/general/governance_of_the_eib_en.pdf. Accessed on January 15, 2020.

members at the EIB is often influenced by permanent staff, with project-specific technical skills and expertise.⁷¹ Legally, there are obvious obstacles that keep member states from influencing EIB staff. However, the Management Committee has only nine members and larger member states delegate members more often than smaller member states. Further, Management Committee members are often responsible for projects coming from their home countries.⁷²

Finally, the EIB's regulatory set-up creates a bias for larger and safer projects that are more often found in core countries than in the periphery. The EIB must operate as a financial enterprise, thus it collects funding on capital markets and distributes investments according to an organizationally set risk-return profile. The EIB's risk-return profile favors core countries, because it is set—for a development bank—at a surprisingly prudent level.⁷³ As Moody's evaluated, "The EIB has a long track record of very low levels of nonperforming loans, which reflects its very prudent project selection as well as effective monitoring and risk management capabilities."⁷⁴ This implies that the selection criteria for projects is skewed towards projects that present very low risk and high probability of success at the outset. These kinds of projects are obviously more abundant in core countries than in the periphery. From a market correction institution, one would expect that it would be willing to take more risk than market actors, just as other multilateral development banks such as the World Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank do. All of these institutions have worse Non-Performing-Loan ratios than the EIB.⁷⁵

4.2. Post-GFC reforms: the trap of confederalism reloaded

Our analysis of the EIB's lending profile leads us to expect no change in the distributive logic of the EFSI, launched in 2014. The Juncker Plan, the accompanying decision by EIB's shareholders to increase its paid-in capital by 10 billion EUR, and the EFSI's design as a co-financing instrument where national development banks pledge their own resources for investment purposes did not change EIB's redistributive logic. The EFSI's preamble declared that it "should boost competitiveness and economic recovery and should be complementary to the objective of economic, social, and territorial cohesion across the Union."⁷⁶ However, the EFSI's decision-making process essentially mimicked that of the EIB. Therefore, we find core countries' dominance achieved through overt dominance in the decision-making structure, and through covert dominance via built-in institutional biases. The latter are manifested in the involvement criteria of differently positioned national development banks and in the lending criteria, which clearly favor projects in larger and more developed countries.

Differences between EFSI funds directed to the core and the periphery are especially puzzling since the EFSI contains a number of features that should have allowed for a more equitable distribution of resources: (1) a higher risk-return profile is allowed under EFSI projects than

⁷¹ Barnett and Finnemore 2012; Weaver 2008.

⁷² Transparency International EU 2016, 15, <http://transparency.eu/eib/>. Accessed on January 15, 2020.

⁷³ The very prudential lending profile is even less warranted due to the EIB's special access to liquidity in times of crisis. The EIB is among the few multilateral development banks with access to central bank liquidity, in this case to the European Central Bank's (ECB) main refinancing operations.

⁷⁴ https://www.moodys.com/research/Moodys-EIBs-credit-profile-reflects-sound-capital-and-liquidity-positions-PR_388900. Accessed on January 15, 2020.

⁷⁵ https://www.moodys.com/research/Moodys-EIBs-credit-profile-reflects-sound-capital-and-liquidity-positions-PR_388900. Accessed on January 15, 2020.

⁷⁶ Regulation (EU) 2015/1017 of the European Parliament and the Council of 25 June 2015, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R1017&from=ES>. Accessed on January 15, 2020.

under standard EIB financed constructions, (2) the pricing policy may also be different (cheaper) than under the EIB due to EFSI-provided guarantees, (3) the EFSI is granted higher operational and procedural flexibility, and (4) it has an explicit capability to mobilize funding from national development banks.⁷⁷ Nevertheless, there are a number of organizational characteristics of the EFSI that greatly counterbalance these advantageous features and cater for a skewed distribution of resources.

First, the EFSI framework hinges upon the participation of national development banks. In this scheme, NDBs not only channel member states' pledges to the EFSI, but also design and implement investments in relation to the EFSI.⁷⁸ A major disadvantage of this feature is that it effectively diverts European funds towards a member state's economic policy goals. This is because NDBs are mandated with the promotion of the national economy only, whereas EFSI funds should, in principle, be used to promote common European goals. In addition, in those countries where development banks manage smaller funds, there is less capability of attracting European funding designated to balance economic disparities, per EFSI design. Based on data collected by Mertens et al. (2021), for the total assets of NDBs in different member states, NDBs in the core controlled 59 per cent of total NDB assets, the Southern periphery 26 per cent, while NDBs in the Eastern periphery only controlled 14 per cent of total NDB assets. This is no coincidence. Core countries—and especially NDBs in core countries—pressured the Commission and the EIB into this direction.

Second, the EFSI Global Multiplier Effect (15x) also favors projects in core countries.⁷⁹ The Global Multiplier is the relation between EFSI-provided public funds and additional private investment, that is, EFSI funds comprise 1/15 of the total investment. Since this multiplier is set very high, it means that EFSI funding is only available for projects which can attract extra funding at this magnitude. A high multiplier directs EFSI investment to core countries for two reasons: (1) extra financing is more abundant in core countries than in the periphery, and (2) extra financing will prefer less risky investments, which are again to be found in higher numbers the core than in the periphery.

Third, a new financial instrument developed by the EFSI and NDBs, the Investment Platform, would in principle be suitable for financing smaller or riskier projects because of its capacity to combine financing from several sources and optimize the allocation of risk between various investors. But it did not live up to its potential.⁸⁰ According to the EFSI audit report, Investment Platforms developed slowly: only one existed in Italy by the end of 2016, and only 35 had been created by the end of 2017. Moreover, most of these Investment Platforms have been established in France, Italy, Germany, and Spain, by highly active and well-established NDBs. Further, these countries already account for the most significant volume of EFSI financing and the highest number of operations.⁸¹

⁷⁷ An additional advantage of EIB and EFSI is that their operations are largely exempt from state aid regulation in post-crisis investment promotion.

⁷⁸ Mertens and Thiemann 2017.

⁷⁹ EFSI Steering Board, EIB EFSI Multiplier Methodology Calculation (Update of July 2018), https://www.eib.org/attachments/strategies/efsi_steering_board_efsi_multiplier_methodology_calculation_en.pdf. Accessed on January 15, 2020.

⁸⁰ Mertens and Thiemann 2019.

⁸¹ European Court of Auditors, European Fund for Strategic Investments: Actions needed to make EFSI a full success, 2019, https://www.eca.europa.eu/Lists/ECADocuments/SR19_03/SR_EFSI_EN.pdf, 31. Accessed on January 15, 2020.

Fourth, although the EFSI was created to supplement existing EU transfers aimed at market correction and investment boosting, it is difficult to combine different sources of funding due to the EFSI's difference in set-up and rules compared to other EU instruments or national developmental funds.⁸² Because of the highly bureaucratic nature of EFSI financing, member states' capacities to prepare fundable projects also determines their capability to gain EFSI approval despite the availability of EFSI advisory services aimed at enhancing project preparation capacity.

Finally, the EFSI's design disregards the different public institutional and private financial market conditions among the three EU regions, which showcases the low degree of securitization and shallow capital markets in the Eastern periphery.⁸³ Considering that the EFSI had designed securitized co-financing with NDBs toward the financialization of development finance, we may see an increase in differences in the speed and scope of the development fund's financialization between Western and Eastern markets.⁸⁴ A difference which in itself may create differences in access to development finance.

5. Conclusions

Regulatory protectionism and its opposite, market integration by way of creating and implementing uniform rules are both intimately interlinked with the idea of accountability and representation.⁸⁵ Both integration and protectionism can create negative externalities which need to be handled within the multilevel polity in the common interests of states participating in the integration process. Restrictions on market freedoms via discriminatory national regulations might harm people from other member states who have no voice in the legislature of the country of the beneficiaries. Conversely, the extension of markets might negatively affect people in member states whose interests cannot gain adequate representation through intergovernmental decision-making that under-represents weaker member states and/or gives blocking powers to the beneficiaries of the extended markets.

Multilevel polities can manage such problems in different ways, and the literature on comparative federalism provides a rich terrain to compare diverse ways of organizing representation in the process of integrating markets among heterogeneous economies and societies. At one extreme, a multilevel polity can embed market-making in a federal system of political representation and accountability that combines territorially based representation with ideologically based one combining the political representation of member states' diverse interests with the representations of alternative formulations of the common interests of the peoples of the member states. Fortified with a system of checks and balances, such a federal political system may allow for larger regulatory autonomy (i.e., protectionism) of the member states and combine it with policies that provide compensation for the negative externalities of integration. The US, Canada, or Germany represent different variants on such a system.⁸⁶

The EU represents another extreme: it does not have built-in mechanisms that could force representatives at different levels to internalize the distributive consequences of market

⁸² Nyikos 2019, 109.

⁸³ Mérő and Bethlendi 2021.

⁸⁴ Mertens and Thiemann 2019.

⁸⁵ Sunstein 1988.

⁸⁶ For comparative studies on these federal regimes, see Börzel 2003, 2005; Parsons et al. 2021; Verdun 2016; von Beyme 2005.

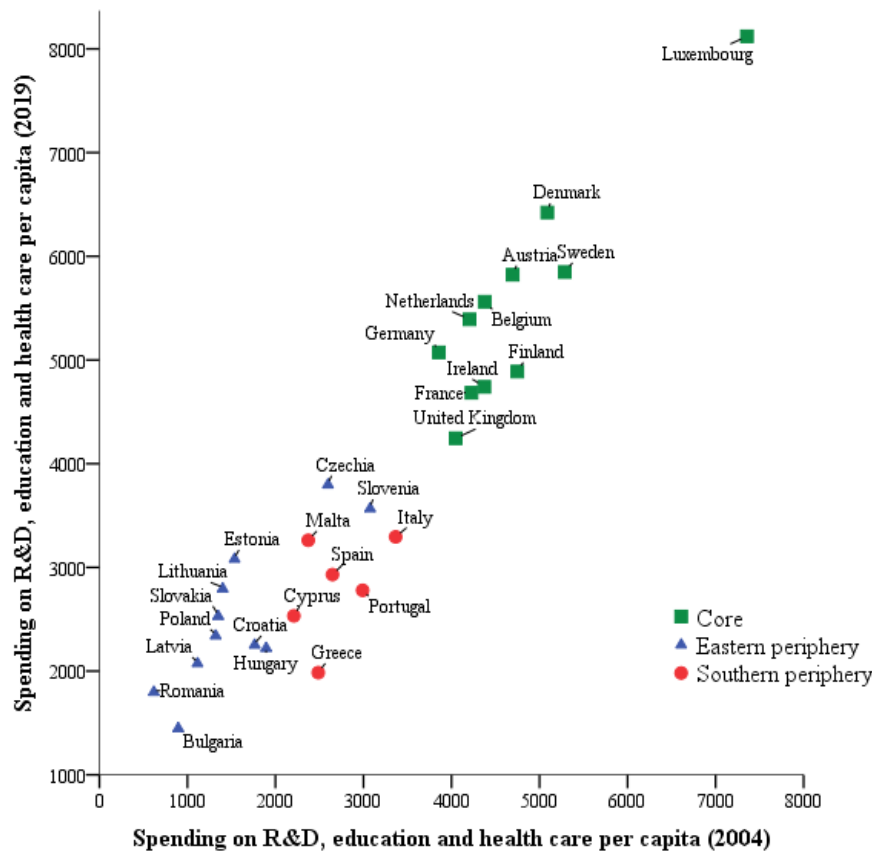
integration. The confederal system of representation drastically limits the representation of the common interests of the citizens of the member states, and it hinders making integration a positive sum game. As systemic frictions cannot be managed in the framework of the intergovernmental decision-making system, parties often shift their conflicts to the European Court of Justice, which, as a rule, takes the further extension of the market as the default interpretation of the EU Treaties and yields a configuration of freedoms and prohibitions that favors the core and disadvantages the periphery.⁸⁷

In this paper we argued that the confederal system of political representation combined with the EU's primarily intergovernmental decision-making structure constitute a permanent institutional bias that feeds short-term political interests, which are in turn tied to domestic political factors in the member states and hinder credible commitment to common European interests. The market correction policies of the EU that we have explored in this paper were all in one way or other substitutes for the politically unattainable common fiscal and economic policies. Neither of the policies we explored in this paper have considerably alleviated the problems that they were supposed to address. The EU system of political representation provided the member states with incentives and opportunities to keep softening these policies. The recipients of EU transfers could increase their autonomy in spending EU money, the core countries could increase their share from the pie, and meanwhile disparities between the core and the South have increased while they have declined unevenly between the Eastern and the core.

Decades of market-correcting policies should have improved the relative position of peripheral EU members to the core by narrowing the gap between them. However, as Figure 8 shows, there is a persistent gap between core and periphery in investment into fields that constitute key drivers of future economic growth and that market-correcting policies were supposed to promote, especially in the periphery. The lack of any notable convergence of the periphery to the core is an empirical illustration of market-correcting policies exposed to the trap of confederalism.

Figure 8: Investment in the future: total per capita spending on R&D, education and health care in 2004 and 2019 in the EU core and periphery

⁸⁷ Weiler 1999; Kukovec 2015.



Note: Spending on R&D, education and health care is the aggregate of total R&D expenditure, and general government expenditure on health care and education per capita in constant 2010 EUR, adjusted with price levels
 Source: own calculation based on Eurostat

The treatment of the COVID-19 crisis, celebrated by some as a step towards the mutualization of the risks and gains of market integration, did not depart from this pattern. The Next Generation EU plan, distributing EUR 806.9 billion across the 27 member states is, to be sure, a significant political achievement. But it has to be considered together with the near simultaneous redistribution of opportunities in the EU through the loosening of the spending rules and state aid regulations, which has allowed Germany, in 2020 alone, to commit around EUR 1 trillion in the form of state aid.

While the confederal organization of political representation contributes to the recurring crises of European integration, it also hinders the emergence of agency for managing these crises.⁸⁸ In the absence of a vertically integrated party system, the common interests of Europeans are underrepresented at the price of territorial interests. Finding a lasting solution to the mutualization of the risks and costs of market integration among diverse economies could in itself be an arduous and lengthy process of trial and error.⁸⁹ But in the framework of European political institutions, this process is burdened with a gigantic coordination problem among twenty-seven member states, all limited in their capacity to make lasting credible commitments.

⁸⁸ Offe 2015.

⁸⁹ Schelke 2017.

Transforming economic integration into a workable positive sum game would require a decrease in the territorial fragmentation of European solidarity, which would in turn require reforming the structure of political representation and decision-making in the EU.⁹⁰

Alternative scenarios for such reforms in the EU do not copy existing federal solutions. While most of them suggest direct elections for the head of the EU executive, they differ in their suggestions of institutionalizing checks and balances in the system so that the reformed polity could simultaneously accommodate the diverse interests of the peoples of the member states and the common interests of European voters and would force policymakers to form much broader coalitions to make EU-level policies.⁹¹

⁹⁰ Beramendi 2007.

⁹¹ See, e.g., Hix 1988; Börzel and Risse 2000.

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