The fog of integration:
Reassessing the role of economic interests in European integration*

Patrick Leblond
Assistant Professor
HEC Montreal
Department of International Business
3000 Cote-Ste-Catherine Road
Montreal, QC H3T 2A7
Canada
Tel: +1 514 340 5670
Fax: +1 514 340 6987
E-mail: patrick.leblond@hec.ca

Version: 26 February 2007

*For comments and advice with previous versions of this paper, I would like to thank Costanza Musu, Anthony Zito and the other participants at the conference on ‘Economic interests and European integration’ held at the University of Edinburgh on 8 April 2006 as well as two anonymous referees. Special thanks also go to Jonathan Beauchesne for his able research assistance.

Abstract

The main theories of European economic integration argue that private economic interests play an important role in the integration process. This role is a positive one, whereby economic interests provide the impetus and pressures for integration to move forward. Public policy analyses of the European Union's legislative process, however, show that intense lobbying by such interests can prevent legislative proposals from being adopted, even if these economic interests were initially in favour of supranational legislation in the given policy area. So how is it possible that economic interests may initially be favourable to integration in a given policy area but then end up rejecting legislative proposals made by the Commission, usually by intensely lobbying the European Parliament and/or the Council of Ministers? The answer is based on the idea that economic interests initially face great uncertainty as to the precise costs and benefits of integrating a particular policy area. Only once the 'fog of integration' lifts – as a result of concrete legislative proposals being tabled by the Commission – are economic interests able to calculate these costs and benefits and, consequently, decide whether to lobby for or against the proposal. To provide a first run at validating the argument, the paper examines two cases of integration failure in the EU: the directive on patenting computer-implemented inventions ('Software Patent Directive') and the directive on takeover bids ('Takeover Directive'). These cases not only indicate that the argument is valid but they also suggest that integration failure can take different forms depending on how economic interest polarize on a given policy issue. This leads us to conclude that regional integration scholars would benefit from integrating the lessons learned from the studies of EU politics and policy-making into their models of European integration.

KEYWORDS: economic interests; European integration; standards harmonisation; software patent directive; takeover directive; uncertainty.

INTRODUCTION

There appears to be a common belief amongst scholars of European economic integration that the latter proceeds as a result of private economic interests asking for the harmonisation of laws, regulations and standards in order to reduce the transaction costs associated with the movement of goods, services, capital and people across borders. When integration does not proceed forward, it is because member state governments prevent it from doing so, often as a result of domestic private economic interests preferring to maintain existing obstacles to cross-border economic exchanges. The reality is, however, different. There are many instances where private economic interests were initially in favour of integration but where the attempt to create supranational legislation that would harmonise rules and standards across the EU ended up failing as a result of fierce lobbying by economic interests. It should be noted that integration failure takes place when the *status quo* remains. As such, it can take two forms: a direct and an indirect one. Direct integration failure occurs with the elimination of the proposed legislation.[1] Indirect integration failure takes place when the adopted legislation contains so many loopholes, opt-outs or acceptable standards that it formally recognises the *status quo*.

An example of the first case of integration failure is that of the Software Patent Directive. On 6 July 2005, the European Parliament (EP) rejected the Commission's proposed directive on the patentability of computer-implemented inventions ('Software Patent Directive')[2] by an overwhelming majority. This vote effectively put an end to the proposed legislation. An example of the second case of integration failure is the Takeover

---

[1] Either it is withdrawn by the Commission or it rejected by the EP or the Council.
[2] See Commission of the European Communities (2002a).

Directive. On 16 December 2003, the EP adopted the Commission's proposed directive on takeover bids ('Takeover Directive')[3] but with a number of key amendments. The Council of Ministers finally approved the Takeover Directive along with the EP's amendments on 21 April 2004. The problem with this agreement, which was implemented into national law in May 2006, is that it contains many opt outs that greatly reduce its usefulness in fostering European economic integration. As such, it is generally considered a failure.

What do these examples of legislative failures mean for European integration and the theories that explain it? How can they be possible when, after all, business interests were originally supportive of the intent to harmonize standards and regulations in these fields as a way to promote further European economic integration? Such questions find no answers in existing theoretical approaches to regional integration. One reason for this situation may be because these approaches always assume that economic interests know clearly the benefits and costs of integration beforehand. But what happens if in fact they do not? How does it affect our understanding of European integration, both practically and theoretically? These are the questions that this paper seeks to answer.

It does so by examining the apparent paradoxical relationship between economic (especially business) interests and European integration, whereby supranational legislation in a given policy area can fail even though there is originally support from economic interests for integrating this policy area. If the EP and Council are responsive to the opinions of economic interests, this means that over time certain groups decide to oppose integration in the form of legislation proposed by the European Commission. What causes this change of heart? The answer, this paper will argue, is to be found in the

[3] See Commission of the European Communities (2002b).

initial fog (i.e. uncertainty) that surrounds EU integration proposals in terms of their costs and benefits for economic interests. But as the fog lifts and the terms of integration become more concrete, certain economic agents may realize that the proposed legislation that is on the table is not beneficial to their interests. Thus, they turn against it or lobby for amendments and exceptions, even if they initially supported integration in this particular policy area. If enough of these interests mobilize and lobby against the proposal, then it is likely to fail (directly or indirectly) at the EP and/or the Council.

This phenomenon may be more prevalent in reality than commonly presumed by scholars of European integration and lobbying, who usually assume that economic interests are fully cognisant of the net benefits or costs of integration in a given sector right from the start and, consequently, that they will readily share this information with uncertain policy-makers through lobbying activities. Although it is true that economic interests will share the information they possess in a given policy area, this does not mean that they know what the costs and benefits of integration are or will be. These depend on the form that integration will take, i.e. which rules, regulations and standards will be part of the new supranational legislation. As a result, economic interests may support greater integration in principle but not promote it actively. Consequently, the actual impetus for integration may come more from a policy entrepreneur like the European Commission (Nugent 1995).

This chapter is structured as follows. The next section discusses the weaknesses of the main theoretical approaches to the study of economic interests and regional integration. The subsequent section presents the argument regarding the relationship between economic interests and European integration under the assumption that there is initially a fair degree of uncertainty surrounding interests' cost-benefit calculations. The following two sections examine in detail the cases of the Software Patent and Takeover Directives, which are both integration failures but with different characteristics. The first one is an example of direct integration failure (i.e. no supranational legislation) whereas the second case is representative of cases of indirect integration failure (i.e. the formalisation of the *status quo*).[4] Moreover, the Software Directive case is representative of situations where economic interests are organised on a transnational basis while the case of the Takeover Directive is an example of instances where interests are organised nationally. As such, these two cases allow us to assess the merit of the argument as well as draw certain hypotheses for future research on EU integration. The final section concludes on the need of existing theories of European integration to revise their understanding of the role played by economic interests in European integration.

ECONOMIC INTERESTS AND REGIONAL ECONOMIC INTEGRATION

The main theories of European integration give a prominent place to the role that economic interests play in the process. For neofunctionalists, economic interests are pro-actively supportive of the successive integration of various sectors of the economy across borders (usually through the harmonisation of regulations and standards) as a way to overcome the increasing transaction costs that arise from the international exchange of goods, services, capital and people. For liberal intergovernmentalists, domestic economic interests determine the positions of the member states on a given policy issue, whose outcome is determined by states' bargaining amongst themselves.

[4] The integration concept of mutual recognition of standards generally falls into this category. The phenomenon of indirect integration failure has, curiously, received very little attention from EU scholars, even though many EU policy areas have experienced it.

In his study of regional economic integration, Mattli (1999) argues that the demand for integration comes from business interests that wish to reduce the transaction costs associated with cross-border trade. Transaction costs arise because of such obstacles as tariffs, quotas, different standards and regulations, different languages and cultures, etc. (see Mattli 1999: 47). Consequently, firms lobby for a new governance structure that fosters market integration (Mattli 1999: 49). This new 'governance structure' may include (over time) such things as 'common trade rules, common industrial standards, tax harmonisation, macroeconomic policy coordination and common social policies' (49).

Even if Mattli's 'transaction-cost' approach is based on new institutional economics (North 1990; Williamson 1985), it can easily be compared to neofunctionalism (Haas 1958; Lindberg 1963). One of the key building blocks of neofunctionalism is the concept of functional spillover, whereby the integration of particular economic sectors across countries creates pressures for integration in related sectors (so as to reduce transaction costs and, thereby, increase economic exchanges across borders). These pressures originate from economic interests that are adapting and benefiting from policy areas that are already integrated. This process is complemented by another parallel one: political spillover. In the latter, socio-economic interests transfer their loyalties and activities to the supranational level because they realise that this is where they can best achieve their objectives. In turn, this political spillover leads to greater functional spillover. In this ratcheting-up process, regional integration becomes almost irreversible, not to say teleological.

One important difference between Mattli's approach to regional integration and neofunctionalism's lies in the role given to supranational institutions. According to neofunctionalism, such institutions (or higher authorities) are key drivers (sponsors and guides) of integration, as long as they have some degree of autonomy. According to Mattli, supranational institutions are much weaker drivers of integration; the regional leader (or hegemon) is key to the supply of integration. The implicit recognition here is that states are the suppliers of integration. As such, they also have the ability to slowdown or stop integration (see also Hoffmann 1966). Moravcsik (1993, 1998) argues that states' position *vis-à-vis* integration is a function of the pressures they face from domestic societal (mainly economic) interests. The outcome of integration then depends on the intergovernmental bargaining that takes place between states, which is itself a question of state power. This is why Garrett (1992) argues that focusing solely on the functional aspects of international integration is insufficient. Instead, analysts need to take into account 'the distributional conflicts between states and the impact of power asymmetries on conflict resolution' (534). Drezner (2005) makes a similar point in his analysis of international policy convergence. For example, he indicates that coordination outcomes are dependent not only on the benefits of convergence but also on the adjustment costs that states would have to undertake if they were to switch to another country's standards.

> While governments may receive benefits from the development of a single global standard, this does not mean that states will prefer *any* [italic in original] global standard. For governments, any agreement to coordinate standards at a point that diverges from the domestic status quo comes with economic and political costs (Drezner 2005: 845).

So, contrary to neofunctionalism, Moravcsik's liberal intergovernmentalist approach argues (1) that economic interests exercise their influence at the domestic level, not at the supranational one, and (2) that economic interests may not always be in favour of integration. In any case, both approaches give economic interests a prominent role in the integration process. This role requires, however, that economic interests be clearly aware of the costs and benefits of integration, which may not always be the case. Just as war does for armies, regional economic integration gives rise to a fair amount of uncertainty for its participants.

Following Clausewitz (1984[1832]), we could indeed argue that there exists a 'fog of integration'. Governments as well as economic interests and supranational institutions are in fact most often unable to foresee all possible contingencies that can arise with respect to the integration of a given policy area. All sorts of unexpected 'frictions', to use Clausewitz's term, can arise to produce a less than optimal outcome. This uncertainty is readily recognised with regards to governments and supranational institutions but not in the case of economic interests. As the bearers of knowledge and information, the latter are generally seen as crucial elements in explaining regional economic integration. However, if economic interests are uncertain about their payoffs regarding a certain integration policy outcome, they are unlikely to lobby actively in favour or against it, either at the national and/or supranational level. Only once there is a legislative proposal on the table will interest groups mobilize one way or the other. As a result, their role in giving integration's initial impetus may be less prominent than proponents of neofunctionalism and liberal intergovernmentalism would have us believe.

The case of European Monetary Union (EMU) is illustrative. Although business interests and banks were generally in favour of a common currency, they did not lobby for it (Grossman 2002; Leblond 2004; McNamara 1998, 1999). They supported it but did not actively push for it. In fact, although they could anticipate benefits from EMU, they could not assess their level (Verdun 2000). The same applied to the costs of EMU. Only once concrete legislative proposals were on the table, could economic interests begin their calculations. Until then, the ambiguity caused them to act as mere 'cheerleaders' rather robustly active players. This is why there were keen to obtain the political and legislative details of EMU from the Commission and the Council (Leblond 2004). The uncertainty regarding the net benefits of monetary integration made it difficult to lobby for or against it (McNamara 1999). Support was positive but only with respect to the principle of a single currency. The fact that policy issues are often not well understood from the start makes it difficult for economic interests to devise specific strategies and lines of action (Grossman 2004). It is only when the fog (uncertainty) recedes that economic interests can decide on a specific course of action (e.g., lobby for or against a proposed legislation).

The absence of lobbying or pressures by economic interests does not mean that integration cannot take place. It just leaves a greater role for states and supranational institutions to play in the process, especially as initiators of integration. In the case of EMU, for example, France, Italy and Germany put EMU back on the European table (Gros and Thygesen 1992). However, the European Commission and a group of experts known as the Delors Committee also played a prominent role in moving European monetary integration forward towards the Maastricht Treaty (Jabko 1999; Verdun 1999). Then, the Commission and the European Monetary Institute ensured that EMU would indeed become a reality by completing the (incomplete) contract signed in Maastricht (Leblond 2004).

How does the fog or uncertainty that surrounds economic interests at the beginning of the integration process affect our understanding of the process of regional economic integration, especially if we continue to assume that economic interests have an important role in the process? For one, it highlights the importance that states and supranational institutions have in the process. This does not mean, however, that economic interests are not important players in the process. Without their support for integration (in principle) at the beginning of the process (in a given policy area), then it is doubtful that member states and/or the Commission would initiate it in the first place. Once they are able to calculate the costs and benefits of integration, economic interests will indeed play a determinant role in the outcome of the integration process (as defined by the existence of a body of supranational laws and regulations), as many analysts of the EU's policy-making process have now been arguing for over a decade (see *inter alia* Andersen and Eliassen 1991; Coen 1997; Greenwood *et al.* 1992; Mazey and Richardson 1993). In fact, the relationship between European integration and economic interests may be more dynamic than traditional theories of integration tend to argue. Such an approach would help rescue neofunctionalism in its inability to explain the absence or limited degree of integration in certain policy areas (Hass 1976). Economic interests may be rhetorically behind functional and political spillovers *in principle* – owing to the uncertainty of the costs and benefits of integration – but may end up backtracking *in practice* when an integrative piece of supranational legislation is tabled by the Commission if the net benefits of integration are negative.

THE ARGUMENT: UNCERTAINTY, LOBBYING AND THE ROLES THAT ECONOMIC INTERESTS PLAY IN THE EUROPEAN INTEGRATION PROCESS

So far, integration theories tell us that economic interests are often frustrated with the *status quo* of national rules, regulations and standards because they make international economic exchanges more costly than if borders did not exist. As a result, these interests are very supportive of any attempt to harmonize these rules, regulations and standards across-borders (i.e. integration). It does not necessarily mean, however, that they will be proactive in their support, in terms of lobbying governments or supranational institutions to integrate a given policy area. This is because these economic interests may not be clear about the costs and benefits of integration. It is possible that the harmonized rules or standards may require a lot of adaptation (i.e. be costly). The proposed rules may also give a competitor a clear competitive advantage. So spending a lot of money and energy on lobbying for integration may be very costly while providing little or no net benefits. Furthermore, integration as a principle or general concept can be considered a sort of public good for economic interests, whereby lobbying by one firm or group allows other firms and groups to do nothing and free ride. Consequently, no firm or group has any incentive to actively lobby in favour of integration. Claiming support for integration is sufficient. Public and private statements of support can be made, but little more. The burden of initiating the process of integration really lies with governments and/or supranational institutions.

Once the integration (harmonisation) process has been initiated and concrete proposals for legislation begin to emerge, then economic interests are in a better position to calculate the costs and benefits of harmonisation as the initial fog or uncertainty of integration is being lifted by states and/or supranational institutions. In the case of the EU, the Commission is responsible for proposing legislation on a given policy issue, which has been accepted for integration by the member states. This does not mean, however, that the Commission drafts legislation in a *vacuum*. As many students of the EU have observed, the Commission does not hesitate to consult various organised interests to gather information and expertise at the drafting stage (Bouwen 2002; Coen 1997; Greenwood *et al.* 1992; Mazey and Richardson 1993). But here economic interests are not lobbying in favour of a certain position but are rather providing information and expertise requested by the Commission. As Bouwen (2002) and Coen (1997) note, the Commission needs expert knowledge as a result of insufficient resources and expertise but it also requires that the advice it receives not be in the self-interest of those providing it; otherwise, it is likely to limit the access it grants to those information providers.

The Commission will not be successful in pushing through a given legislation at the EP and the Council if it does not have the support of economic interests. The challenge for the Commission is to maintain the original support from a large majority of economic interests as the uncertainty regarding the costs and benefits of integration disappears. Drezner (2005) indicates that the expected additional profit (i.e. the benefit) arising from integration (or harmonisation) is a function of the relative size of the market to which the firm (or economic interests) will now have an easier access. For its part, the adjustment cost is a function of the 'distance' between the pre-existing regulatory standards in various member states. This distance could be purely technical but it could also be more fundamental, i.e. based on different underlying philosophies. For example, accounting standards in the EU vary considerably: those of France and Germany are devised mainly for tax purposes while those in the United Kingdom and the Netherlands focus on the needs of investors. This reflects the different capitalist traditions in the various countries, with capital being traditionally provided by banks in France and Germany while it is mainly provided by securities markets in the Netherlands and the UK. One would expect that the adjustment cost would be higher when standards have different philosophies or underlying principles. A firm's adjustment cost could also be a function of some factor intrinsic to its business, such as its capacity to effect change within its organization or products/services (e.g., a large firm with a bureaucratic culture).

If there is a conflict between various economic interests – e.g., one firm accepts the legislative proposal while the other rejects it, then the EP and the Council have to decide the final outcome. They will do so based on the amount of lobbying performed by the respective firms (or, more generally, interest groups). The firm (or group) that lobbies the most widely and intensely should in principle win. This can mean the rejection of the Commission's proposal or its amendment. There is also the possibility that the Commission withdraws its proposal beforehand in order to submit a new, maybe more diluted version.

If the Commission is strategic, then it should choose an appropriate proposal right from the beginning, in order to maximize its chances of getting the EP and Council to vote for it. It is not always possible, however, for the Commission to harmonize standards in ways that reconcile pre-existing standards or regulations. For example, in the case of accounting standards it was impossible for the Commission to come up with a new set of European standards that would make the cost of adjustment the same for everyone. The different philosophies underlying existing standards across the EU were simply not compatible. In such cases, the Commission has to choose one standard over another. This is likely to lead to intense lobbying on sides of the debate: i.e. for and against the proposed supranational standard. If one group has too few resources to lobby effectively, then we can expect the other group to prevail (i.e. see the EP and the Council adopt its preferred position). However, as the case studies demonstrate in the next sections, such a situation is more likely when economic interests are organized on a transnational basis rather than on a national one, where it is cheaper to lobby. In the latter case, member state governments will oppose the legislation in the Council. If enough of them are against it, a sufficient minority will block the proposed legislation.

Although a blocking minority in the Council could mean the end of the proposal, it could also push the Commission to introduce a new proposal that more or less codifies the *status quo* by recognising both standards as acceptable. This is what mutual recognition is all about. In most cases, though, it can be considered to be a case of non-integration because it does not remove the existing transaction costs in place as a result of the various rules, regulations and standards. Such a situation, however, may be preferable to the Commission than outright legislative failure since it still affirms its jurisdiction in the given policy area and, as a result, allows it to build expertise, legitimacy and support for a renewed attempt at integration in the future.

This is the scenario that applies to the case of the harmonisation of accounting standards in the EU. From the late 1970s to the early 2000s, the were two accounting directives that harmonized only the rules for presenting financial accounts but not their measurement, which is the key issue in terms of being able to compare the accounts of companies located in different countries. This changed in January 2005 when the

International Accounting Standards Board's reporting standards became the new harmonized rules for all firms quoted on an EU stock exchange. This integration of accounting standards in the EU became possible only as a result of changes in the international political economy (Leblond 2006). As we will see below, the same thing happened in the case of the Takeover Directive.

In sum, it is possible for economic interest to support integration right from the beginning even though they do not know on what basis harmonisation would take place and there is a risk that the adopted standard strays too far from the standard under which they are currently operating, whereby they would face a net cost from integration. Firms can afford to take this risk because they know that they always have the possibility to lobby the EP and the Council down the road against a non-advantageous legislation being proposed by the Commission. For the Commission, it is important to consult firms (i.e. economic interests) early in the process in order to assess their support for integration in a given policy area and obtain information regarding their potential payoffs from standards harmonisation so that it may choose the most appropriate legislation to foster integration. If support is not forthcoming, then the Commission need not go any further with its intention to integrate a certain policy domain.

Even if economic interests are supportive of European integration, it does not necessarily mean that they will lobby in its favour. Some might not lobby at all. Others might lobby against integration. The present section has argued that there are situations where integration may fail as a result of lobbying by economic interests. This may seem paradoxical on the part of economic interests but as the fog of integration lifts, the calculus of economic interests changes. The ability to determine more precisely the benefits and costs of harmonising standards, rules or regulations will lead economic interests to decide whether to lobby (for or against) or not with respect to a proposed legislation by the Commission. The structure of this lobbying will likely determine the integration outcome. The next sections examine two cases of failed European integration to assess the validity of the argument presented so far.

TO PATENT OR NOT TO PATENT: THE CASE OF THE COMPUTER-IMPLEMENTED INVENTIONS DIRECTIVE

The case of the Computer Implemented Inventions Directive – better known as the so-called 'Software Patent Directive' – is indicative of the apparently paradoxical relationship between economic interests and European integration since it was rejected by the EP in early July 2006, following intense lobbying by developers and users of open-source software and small- and medium-sized enterprises (SMEs). According to the Commission, however, there was clearly an initial demand for harmonising standards in this area. The objective was to remove the existing legal ambiguity regarding software patents. The problem was that 'a computer-implemented invention may be protected in one Member State but not in another, which has direct and negative effect on the proper functioning of the internal market' (Commission of the European Communities 2002a: 2-3). It is only once the Commission's proposal was published that the uncertainty or fog of integration lifted, which allowed the various private economic interests to define their positions.

The Commission justified the need for harmonising national laws with respect to software patents on the grounds that the varying interpretations of patentability laws by national courts created nefarious legal uncertainty that limited innovation on Europe

(Commission of the European Communities 2002a). This was despite the fact there existed a supranational European Patent Office to grant European patents and a European Patent Convention to harmonise national laws regarding patentability. Divergence in court interpretations had for effect to render uncertain the scope of patent protection accorded to certain categories of software invention. The Commission argued that this situation had 'real and negative effect on investment decisions and free movement of goods within the internal market' (Commission of the European Communities 2002a: 9). This is because software companies would develop and sell their products only in jurisdictions where they found high patent protection from local courts.

At the time, the jurisprudence related to 'computer-implemented inventions' had been developed by courts in Germany and the United Kingdom only. In the UK, software (i.e. a computer programme) that corresponds to a method of doing business (e.g., e-commerce) or performing a mental act (e.g., some mathematical calculation) was considered unpatentable even if there was a 'technical contribution' (a term subject to interpretation and key to the Commission's proposed directive).[5] Instead, such programmes are protected by existing copyright laws, where the written code and instructions' manual cannot be copied without authorisation from the copyright holder. In Germany, however, the jurisprudence did not exclude the possibility that business methods could be patentable. This means that the scope of patent protection in Germany was much larger than in the UK. The result was that a piece of software could be protected in Germany but not in the UK. Clearly, this contravened the EU's principle of the free movement of goods.

[5] The patent exists to protect the fundamental technical background of the software or computer programme. Thus, the automation of a technique, task or method already known does not represent technical contribution worth patenting according to UK jurisprudence.

In October 2000, the Commission launched a wide (and final) consultation of the public on the issue. Two camps emerged (Commission of the European Communities 2002a: 4). On the one hand, there were developers and users of open-source software as well as SMEs, which argued against making software patentable. On the other hand, there were large software manufacturers, like Microsoft, and regional and sectoral organizations such as the Union of Industrial and Employers' Confederations (UNICE), the European Information and Communications Technology Industry Association,[6] and the European IT Service Association. Intellectual property professionals, such as lawyers, were also supportive of patents for software. Another important group that supported the idea of a software patent directive was the Business Software Alliance (BSA). It represents members such as Adobe, Apple, Autodesk, Compaq, Dell, IBM, Intel, Microsoft and Symantec.

In February 2002, the Commission issued its proposed directive on the patentability of computer-implemented inventions (Commission of the European Communities 2002a).[7] The core element of the Software Patent Directive was the notion of 'technical contribution', which is defined as 'a contribution to the state of the art in a technical field which is not obvious to a person skilled in the art' (13). This was the key concept in determining whether new software was patentable or not. The Commission saw it as a limit on the scope of patentability. Otherwise, the EU would have joined the United States, where the level of patent protection is very high since there is no

[6] The EICTA merged with the European Association of Consumer Electronics Manufacturers (EACEM) in 2001 to form the European Information, Communications and Consumer Electronics Technology Industry Associations (EICEA). It combines 32 national digital technology associations from 24 European countries. It represents more than 10,000 enterprises with more than two million employees.

[7] The Directive defines computer-implemented invention as 'any invention implemented on a computer or similar apparatus which is realised by a computer program' (Commission of the European Communities 2002a: 13).

requirement for a computer programme to provide a technical contribution in order to be patented. This means that patenting business methods is acceptable in the US. The fear with such an approach is that it stifles competition, innovation in information technology and, most especially, the development of new business methods like e-commerce. 'By codifying the requirement for a technical contribution, the Directive should ensure that patents for "pure" business methods or more generally social processes will not be granted because they do not meet the strict criteria, including the need for technical contribution' (Commission of the European Communities 2002a: 11).

In September 2003, the EP, under the co-decision procedure, proposed an amended Software Patent Directive that further limited patentability. This followed strong lobbying by groups such as the Foundation for a Free Information Infrastructure (FFII) – which created *Nosoftwarepatents.com* to promote freeware and open source software widely, the Free Software Foundation, the European Association of Craft, Small and Medium-sized Enterprises (UEAPME) as well as companies such as Red Hat, Novell and MySQL. These groups wished to seriously curtail the Commission's proposal regarding the patentability of software because they feared that it would prevent open-source software such as Linux – the alternative operating system to Windows – to emerge and compete against the products of larger software manufacturers, thereby stifling innovation and competition.

In the spring of 2004, the Council of Ministers made a counter proposal to that offered by the EP. The 'compromised' document basically removed all the EP's amendments. After a year of wrangling between the member states, the Council finally adopted its 'common position' (i.e. the second reading that ratified the spring 2004 decision).[8] In early July 2005, the EP rejected the amended directive proposed by the Council (and the Commission). As a result, the Software Patent Directive failed to become law and the status quo with all its associated legal uncertainties and ambiguities remained.

In terms of the argument presented in the previous section, the Software Patent Directive case is akin to the situation where only two opposite standards are available: patents vs. no patents. Both groups initially supported the idea of harmonising EU standards in this area; however, they differed as to how much harmonisation should take place. Large software firms and intellectual property professionals supported patents and the Europe-wide harmonisation of the rules applicable to them with respect to software. Small software developers and many individual users were in favour of harmonisation across the EU but saw an opportunity to limit the patentability of software programmes.

In the first case, large firms use patents defensively as bargaining chips when they collaborate in order to make their software programmes compatible with each other. Otherwise, they have to pay licensing fees to other manufacturers. So they argue that an absence of patent protection would reduce the incentive for innovation and new products. In the second case, SMEs claim that patents, which are costly to obtain, prevent them from competing against larger software manufacturers. Consequently, they are not in a position to negotiate with larger manufacturers. They lack bargaining chips. This is why they are fervent supporters of open-source software, which is made fully available to the public for interoperability at no cost. In such a world, there is no market protection. Any software developer is able to successfully enter the market simply by devising a programme that is compatible with other existing programmes and, therefore, that can be

[8] Poland, with some support from Hungary, Latvia and the Netherlands, opposed the directive.

marketed on its own merits. As such, copyright protection of the programme itself is sufficient.

The Commission proposed a directive favouring patents, which was accepted by large software manufacturers but rejected by small software developers and individual users. Because their competitive advantage was at stake one way or another, both groups lobbied forcefully for its position. Although financially less resourceful than the multinational firms, small software developers and users nevertheless managed to mount an effective lobbying campaign with the EP, framing the debate in terms of David against Goliath. Initially, the larger, multinational firms most probably thought that they could muster greater lobbying resources than the smaller firms, which is why they did not hesitate to lobby in favour of the Commission's proposal, especially with the member states to influence the Council's decision. As Bouwen (2002, 2004) argues, however, the EP has a greater demand for information about European encompassing interest than expert knowledge (which the Commission demands) or even domestic encompassing interest (which is more relevant to the Council).[9] As such, although the alliance of large software manufacturers was probably better at providing the Commission with expert knowledge and the Council with national encompassing interest (especially in countries where such firms have important operations), it found it much more difficult to provide the EP with high-quality information about European encompassing interest than small firms and the European association of consumers (BEUC) could.

In sum, the Software Patent Directive case is a good illustration of a situation where integration was clearly considered to be a good thing given the various national

[9] Coen (1997: 103-4) indicates that large firms have been slower in transferring resources to lobbying the EP than the transfer of power to the EP as a result of the Maastricht Treaty would suggest.

patent regulations in place across the EU, which represented an obstacle to the free movement of software programmes and the goods that use them. Not only did this limit competition, it also reduced innovation. Therefore, the Commission felt fully justified in proposing a directive that would harmonise the patentability of computer-implemented innovation across the entire EU. The reason why this attempt at integration failed is that private economic interests had different views as to what should be patentable or not. Large firms wanted more protection (i.e. wider applicability of patents) in order to maintain their existing competitive advantage, whereby patents were used as bargaining chips in making software programmes compatible across firms. For large multinational software manufacturers, it was important to also limit the gap between European patent rules for software and those of the United States, which had a permissible system of patenting software programmes. For their part, smaller firms and end users preferred a much more open system where the level of patent protection was very low. This would make it easier for them to compete with the large software manufacturers, especially in the key European market. In the end, the proponents of less protection won the day by gaining the EP's support, which caused the proposed directive to fail (i.e. be abandoned) and the *status quo* (i.e. national patent regulations) to remain.

EVERYTHING GOES: THE CASE OF THE TAKEOVER DIRECTIVE

At the end of 2003, the Council and the EP approved a Takeover Directive for the EU. This came after almost 15 years of wrangling on the issue, although all parties understood the need for harmonising company takeover rules across the Union.[10] Such harmonisation

[10] In fact, the issue dates back to the early 1970s. For a history of the Takeover Directive, see Callaghan and Höpner (2005).

was seen as crucial for facilitating the cross-border mergers and acquisitions, which in turn would facilitate the complete integration of EU economies. Many (including the Commission) complained, however, that the agreed (compromised) legislation did not improve economic integration in the EU but, instead, would increase protectionism. This is because the directive allows member states to opt out of key provisions limiting defensive measures that EU companies can adopt to fend off unwanted buyers: (1) multiple voting shares and (2) poison pill defences without shareholder approval.[11] The Commission had wanted to forbid such practices against takeovers unless they were approved by shareholders but it was forced by the EP and the Council to water down its proposal (Commission of the European Communities 2002b). As a result of these opt-outs, the Takeover Directive is now generally considered a failure because member states have taken full advantage of these opt-outs (*Financial Times*, 2 March 2006).

An earlier legislative proposal was rejected by the EP in July 2001,[12] following Germany's strong opposition as a result of intense lobbying by firms such as Volkswagen, Porsche and BASF, which felt vulnerable to foreign predators without protection from takeovers (*Financial Times*, 24 November 2003). Many family-controlled German firms argued against the Commission's earlier proposal because it called for management to remain neutral in case of a takeover and, therefore, not undertake any defence against a acquisition attempt. For example, the German state of Lower Saxony owns approximately 20 per cent of Volkswagen (VW), which allows it to

[11] Multiple voting shares (shares that provide more than one vote) allow a minority of shareholders to block takeovers even if a majority of stockholders (with shares worth only one vote) is in favour of selling its shares to a (hostile) acquirer. Poison pill defences work to dilute the shareholdings of stockholders who might be interested in selling their shares to the acquirer. Obviously, if such defensive measures required the approval of a majority of existing shareholders, then it is likely that it would vote against such value-destroying measures.
[12] The EP was split on the issue: 273 votes for and 273 votes against.

pressure the automaker to save local jobs rather than cut costs to maximise profits. As a result, it would want VW to fight any attempt by a foreign firm to take it over and force it to manage with the goal of maximising profits. VW was able to use its close links with the social democrats, which happened to be in power at the time, to influence the German government's position on the issue in its favour.[13] Many members of the EP (MEPs) agreed with the German position because they felt that the absence of a level playing field with the United States, which allows takeover defences such as poison pills, would open the door wide open to US firms acquiring European ones while the reverse would be more difficult. Furthermore, many MEPs thought that the proposed directive did not sufficiently protect the employees of the targeted companies.

Given the fact that a directive on takeover bids was a key component of the Financial Services Action Plan that would integrate Europe's financial markets by 2010, the Commission submitted a new version of the Takeover Directive to the EP and the Council for approval at the end of 2002 (Commission of the European Communities 2002b). This move was welcomed by UNICE, the European employers' federation, which strongly favoured a common framework for cross-border takeover bids. The problem was that Germany and German MEPs opposed the Commission's new draft directive because it did not prohibit shares with multiple voting rights (Callaghan and Höpner 2005: 310-311). The draft directive proposed the so-called 'breakthrough rule' (article 11) to prevent the use of poison pills by suspending restrictions on voting rights as well as transfers of securities during the period for acceptance of the bid but did not, however, limit the existence of shares with multiple voting rights.[14] The German position

[13] Chancellor Schröder was premier of Lower Saxony before becoming Germany's head of government.
[14] Multiple voting rights are illegal in Germany.

was clear: either the Takeover Directive rules out all takeover defence mechanisms or it rules out none.

Given the fact that German opposition to the earlier proposed legislation had been successful, it was impossible for the Commission to ignore the German government's request for including multiple voting rights in article 11. Amending the draft directive in such a way, however, faced strong opposition from France and the Nordic countries (Denmark, Finland and Sweden), which had supported the previous version of the directive (Callaghan and Höpner 2005: 311). The reason is that these countries allow the issuance of shares with multiple voting rights. For example, the Wallenberg family in Sweden has been able to keep a significant degree of control over many Swedish industrial multinational firms (e.g., ABB, AstraZeneca, Ericsson, Electrolux, Saab, SKF) via its holdings of shares with multiple voting rights, even if it effectively owned a small percentage of these firms' capital stock. In Sweden, three-quarters of the top firms are said to be deviating from the principle of 'one share, one vote' (*Financial Times*, 18 October 2005).[15] Faced with this imbroglio, the Commission tried to find a way to isolate the Nordic countries while keeping France's support for the draft directive by proposing that different classes of shares with multiple voting rights be prohibited but not France's double voting rights, which are allowed for certain shareholders if they meet certain conditions.[16] This strategy backfired when Germany maintained its position that all multiple voting rights be outlawed if other forms of takeover defences were to be restricted (Callaghan and Höpner 2005: 311).

[15] A study conducted for the Association of British Insurers in March 2005 found that one third of the companies included in the FTSE Eurofirst 300 index (i.e. Europe's 300 largest firms) deviated from the one share-one vote principle, with about one fifth having classes of shares with multiple voting rights (*Financial Times*, 18 October 2005).
[16] Double voting rights are often accompanied by caps on voting rights.

After many months of wrangling, the Takeover Directive was adopted by the Council and the EP in a highly watered-down compromise that allowed member states to opt out of the neutrality (of management) rule (article 9) and the breakthrough rule (article 11). Everybody thought a deal was better than no deal at all given the amount of time that had passed since the Commission's first proposal in the late 1980s (*Financial Times*, 24 November 2003).[17] But the end result is pretty much the same as if the EU had not adopted the Takeover Directive given the number of member states that have taken advantage of the opt-outs (Sagayam 2006).

The case of the Takeover Directive is a good example of how the fog of integration causes private economic interests to be initially supportive of harmonising national regulations and standards in order to improve cross-border commercial exchanges. However, once the Commission tables a proposition, then interests tend to polarize. Contrary to the Software Patent Directive, where the division was between large firms and smaller ones (along with consumers) on a transnational basis, the Takeover Directive saw business interests divide themselves on the basis of nationality. As a result, lobbying was most intense at the national level. Even MEPs tended to vote on the basis of nationality rather than party affiliation (Callaghan and Höpner 2005). In the end, the Commission was faced with the choice of seeing its proposition – which aimed at truly harmonising the regulation of takeovers in the EU by restricting the use of defence mechanisms – defeated by the EP and the Council in favour of a compromised solution that more or less recognised the *status quo* or withdrawing it in favour of the *status quo*.

[17] The only exception is Frits Bolkestein, the then Internal Market Commissioner, who threatened to either veto the agreement reached by the Council and the EP – such a move would have required a unanimous vote in the Council to pass the directive – or retract the Commission's proposal altogether. In any case, his colleagues in the Commission did not support him (Callaghan and Höpner 2005: 311).

After so many years, it was considered that the cost of starting from scratch again would be too costly. It was better to try to build on the existing directive, which had to be revised after five years.

CONCLUSION

Scholars of European integration in particular and regional economic integration in general have argued that private economic interests have an important role in the integration process. Usually, this role is a positive one. The argument is that such interests desire more cross-border economic exchanges but face important transaction costs as a result of differentiated national laws, regulations and standards; consequently, they ask their respective governments to get together and harmonise these rules for conducting business (i.e. integrate various policy areas). Depending on the theoretical approach, this integration process can take either a transnational/supranational form or a national/intergovernmental one.

In fact, private economic interests' initial support for integration does not always result in integration actually taking place, as the cases of the Software Patent and Takeover Directives presented herein demonstrate. On any process to integrate a given policy area, there may be interests that are bound to lose out in terms of facing greater costs to adjust to the new harmonised rules or standards. Consequently, they are likely to lobby for amending the proposed rules, if not abandoning them altogether. This lobbying is likely to take place at the EP and the Council since the fog of integration lifts only once the Commission has tabled a draft piece of legislation. Only then can interests groups assess where they stand with respect to integration and how they will respond to integration efforts. Hence, the ultimate outcome depends on the adjustment and lobbying costs of both sides relative to the benefits that they are likely to obtain from integration.

This means that the role of private economic interests in the integration process is not as straightforward as traditionally understood by scholars of regional economic and European integration. Private economic interests can, under certain circumstances, slow down or prevent integration from progressing forward. This is something that students of European politics and public policy have long understood and was made clear by Hix (1994) more than ten years ago. The time has now come to try to combine these different approaches and *foci* into a more coherent theoretical framework for understanding regional integration in general and European integration in particular. Maybe theories of public policy making in the EU can finally provide the missing link between neofunctionalism and liberal intergovernmentalism.

The two cases examined in this chapter show the way for fruitful research agenda for the future. For instance, they help us derive two hypotheses: (1) we are likely to see no integration take place at all (i.e. no supranational legislation) when private economic interests polarize transnationally on a given policy issue; (2) we are likely to see only the formalisation of the *status quo* in form of supranational legislation that allows opt-outs or the mutual recognition of existing national rules and standards when interests polarise on a national basis. Another example lies with the Takeover Directive, which does not really push integration forward even if it was adopted. This suggests that in many policy areas where there exists European legislation the degree of integration may be more formal than substantial. Therefore, analysing and explaining the varying depth of European integration across policy areas should also be an important part of this new research agenda on regional integration. After all, maybe the EU is not as integrated as we think. In the same vein, maybe North America is more integrated than we think. If so, we need to know why and existing theories of regional economic integration are currently unable to offer us the answer.

REFERENCES

Andersen, S. and Eliassen, K. (1991) 'European Community lobbying', *European journal of Political Research* 20: 173-87.

Bouwen, P. (2002) 'Corporate lobbying in the European Union: the logic of access', *Journal of European Public Policy* 9 (3): 365-390.

Bouwen, P. (2004) 'The Logic of Access to the European Parliament: Business Lobbying in the Committee on Economic and Monetary Affairs', *Journal of Common Market Studies* 42 (3): 473-95.

Callaghan, H. and Höpner, M. (2005) 'European Integration and the Clash of Capitalisms: Political Cleavages over Takeover Liberalization', *Comparative European Politics* 3 (3): 307-332.

Clausewitz, C. (1984 [1832]) *On War*, indexed edition, Princeton: Princeton University Press.

Coen, D. (1997) 'The evolution of the large firm as a political actor in the European Union', *Journal of European Public Policy* 4 (1): 91-108.

Commission of the European Communities (2002a) 'Proposal for a Directive of the European Parliament and of the Council on the patentability of computer-implemented inventions', COM (2002) 92 final, 2002/0047(COD), Brussels.

Commission of the European Communities (2002b) 'Proposal for a directive of the European Parliament and of the Council on takeover bids', COM (2002) 534 final, 20002/0240(COD), Brussels.

Drezner, D.W. (2005) 'Globalization, harmonization, and competition: the different pathways to policy convergence', *Journal of European Public Policy* 12 (5): 841-59.

Garrett, G. (1992) 'International cooperation and institutional choice: the European Community's internal market', *International Organization* 46 (2): 533-60.

Greenwood, J., Grote J. and Ronit K. (eds) (1992) *Organised Interests and the European Community*, London: Sage.

Gros, D. and Thygesen, N. (1992) *European Monetary Integration: From the European Monetary System to European Monetary Union*, New York: St. Martin's Press.

Grossman, E. (2002). 'Les groupes d'intérêts bancaires face à l'intégration européenne: une étude comparée de l'Allemagne, de la France et du Royaume-Uni', Ph.D. Dissertation, Paris: Institut d'études politiques.

Grossman, E. (2004) 'Bringing politics back in: rethinking the role of economic interest groups in European integration', *Journal of European Public Policy* 11 (4): 637-54.

Haas, E.B. (1958) *The Uniting of Europe: Political, Social, and Economic Forces, 1950-1957*, Stanford: Stanford University Press.

Haas, E.B. (1976) 'Turbulent fields and the theory of regional integration', *International Organization* 30 (2): 173-212.

Hix, S. (1994) 'The Study of European Community: The Challenge to Comparative Politics', *West European Politics* 17 (1): 1-30.

Hoffmann, S. (1966) 'Obstinate or Obsolete? The Fate of the Nation State and the Case of Western Europe', *Daedalus* 95: 892-908.

Jabko, N. (1999) 'In the name of the Market: how the European Commission paved the way for monetary union', *Journal of European Public Policy* 6 (3): 475-95.

Leblond, P. (2004) 'Completing the Maastricht Contract: Institutional Handicraft and the Transition to European Monetary Union', *Journal of Common Market Studies* 42 (3): 553-72.

Leblond, P. (2006) 'Making the EU count: institutional leadership and the global convergence of accounting standards', unpublished manuscript, HEC Montreal.

Lindberg, L.N. (1963) *The Political Dynamics of European Economic Integration*, Stanford: Stanford University Press.

Mattli, W. (1999) *The Logic of Regional Integration: Europe and Beyond*, New York, NY: Cambridge University Press.

Mazey, S. and Richardson, J. (eds) (1993) *Lobbying in the European Community*, Oxford: Oxford University Press.

McNamara, K.R. (1998) *The Currency of Ideas: Monetary Politics in the European Union*, Ithaca, NY: Cornell University Press.

McNamara, K.R. (1999) 'Consensus and Constraint: Ideas and Capital Mobility in European Monetary Integration', *Journal of Common Market Studies* 37 (3): 455-76.

Moravcsik, A. (1993) 'Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach', *Journal of Common Market Studies* 31 (4): 473-524.

Moravcsik, A. (1998) *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht*, Ithaca, NY: Cornell University Press.

North, D.C. (1990) *Institutions, Institutional Change, and Economic Performance*, New York: Cambridge University Press.

Nugent, N. (1995) 'The Leadership Capacity of the European Commission', *Journal of European Public Policy* 2 (4): 603-23.

Sagayam, S. (2006) 'Member states struggle to adopt Takeover Directive', *International Financial Law Review* 25 (April, Mergers & Acquisitions Supplement): http://www.iflr.com/?Page=17&ISS=21679&SID=624126.

Verdun, A. (1999) 'The role of the Delors Committee in the creation of EMU: an epistemic community?', *Journal of European Public Policy* 6 (2): 308-28.

Verdun, A. (2000) *European Responses to Globalization and Financial Market Integration: Perceptions of Economic and Monetary Union in Britain, France and Germany*, New York, NY: Palgrave Macmillan.

Williamson, O.E. (1985) *The Economic Institutions of Capitalism*, New York: The Free Press.