

**The Firm and European Integration:  
The Long History of the European Company Statute**

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August 2005

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(Please do not distribute.)

Memo prepared for *The State of the European Union, Volume 8*, first conference, Princeton, NJ, 15 September 2005.

## **ABSTRACT**

Starting in the late 1950s, numerous proposals were put forth for the establishment of a European-wide code of company law for multinational firms. Such a code was deemed essential by numerous constituencies in promoting deepened market integration, increasing foreign direct investment, and in creating globally competitive European companies. Yet, despite relatively broad-based support, attempts to establish a European Company Statute (ECS) were unsuccessful for more than four decades, giving the ECS the distinction of having had the longest dossier period of any EU legislative proposal.

This paper explains why early ECS proposals failed and why an agreement was finally reached in 2000. It pays explicit attention to the form that ECS took in the end and why the coalitions supporting and opposing the ECS shifted over time. The paper argues that nuanced explanations for the development of the code for multinationals requires an expanded historical institutionalist research agenda. Specifically, the paper makes two theoretical arguments. It stresses the value of historical institutionalism in explaining why states' willingness to support the ECS remained relatively constant over time and why they shifted only slowly and only in some countries. However, it also argues that historical institutionalism must be supplemented with theories that account for why the institutional preferences of core actors (especially firms) varied across countries and time. In addressing this final dimension, the paper turns to the literature on varieties of capitalism to account for cross-national variations in large firms' preferences over transnational European law. A short conclusion reflects on the value of studying the EU through a comparative political economy lens and also comments on the promise of using single case-studies to widen the intellectual exchange within EU studies and between this field and others.

## INTRODUCTION

The institutional landscape of Europe has undergone a profound transformation since the 1957 Treaty of Rome, with a particularly large number of new legislative acts emerging after the agreement to form the single market in the 1980s (see Fligstein and Stone Sweet 2001). By 2005, several thousand legislative acts had been adopted by member-states, creating a dense institutional environment that affects, to lesser and greater degrees, all aspects of economic life in Europe. Most legislative instruments concern economic matters and were adopted relatively quickly after the European Commission presented its proposals. Even many contentious and ambitious projects were agreed upon in comparatively short time spans. In many cases, only a few months were needed to collect member-state signatures -- rarely did it take more than a few years from an original proposal to its adoption.

There are, however, some notable exceptions to the relative swiftness with which the EU has agreed on legislative instruments. Among these exceptions, the European Company Statute (ECS) stands out amid EU portfolios for having experienced the longest dossier period. At around 40 years from the first formal proposal to its adoption, the ECS represents a particularly valuable empirical resource on which to examine rival explanations of institutional development within the EU.<sup>1</sup>

The European Company Statute is a novel legal instrument that gives companies the opportunity to eschew national law in favor of transnational legislation governing major areas of the modern firm, including its terms of incorporation, board structure, and reporting system. As such, the ECS represents the very first instance in the history of capitalism where corporations can chose to be legally transnational.<sup>2</sup> Beginning in the mid-1960s, numerous governments and economic interest groups argued that the opportunity to form a genuinely European company that was not governed by diverse national legal traditions represented a critical tool in ensuring

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<sup>1</sup> I am counting 1965 as the beginning of the ECS process. That was the year the French government first presented a formal proposal. However, the very first suggestion for a European statute appeared already in 1959 during a conference of French notaries, and was followed by a speech by Pieter Sanders a year later that developed the idea further (Sanders 1960). Sanders would later be asked by the Commission to formulate a more complete document in 1966, a year after the French government had submitted its proposal.

<sup>2</sup> Recall that descriptions of multinational companies as “stateless” or “transnational” are erroneous in the sense that all MNCs have one national domicile for each of its subsidiaries. As many management scholars argue, MNC are therefore more appropriately termed “multidomestic” companies. In contrast, companies incorporating under ECS provisions would be genuinely transnational in their legal status.

more competitive European enterprises and helping states attract more foreign investments. The ECS, it was argued, would significantly reduce business transaction costs by allowing companies that cooperate closely across national boundaries to rationalize their administrative structures and operate under a single transnational statute. According to one high-level working group, the ECS would potentially deliver *annual* savings of €30 billion (CAG 1995).

Despite this very substantial sum, and despite the perceived lack of competitiveness in Europe's entrepreneurial sector, agreement on the ECS eluded member states for a longer period than any other initiative. Why does the ECS have this unusual and singular distinction?

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This paper uses the ECS case to examine the value of employing general theories of institutional development in the study of European integration. In Section II, I propose to analyze the merits of sociological and historical institutionalist theories in explaining the ECS case. I will argue that the latter tradition presents a valuable foundation on which to develop a finer understanding of the evolution of company law in general, and the ECS in the specific. However, I will also suggest that by itself, historical institutionalism is insufficient, because it has difficulties accounting for variations in states' institutional preferences. Any explanation of institutional development in the EU must include a theory of when and why states' vary in their preferences over common designs. A substantial literature already addresses this issue, but rarely do existing contributions account for all relevant variations in state preferences, namely variations across countries and in their intensity, and across time and issue-area. Section II will argue that a theory of institutional development in the EU ought to account for all these variations in state preferences. My suggestion is that such an enterprise is usefully rooted in the historical institutionalist tradition, but that it must be supplemented with microlevel theories from the varieties of capitalism literature.

To increase the number of observations on the dependent variable (institutional development), Section III will break down the history of the ECS into three distinct phases and bring it up to date. In each period, I will focus on the three dominant issues in the protracted ECS negotiations: employee representation in firms, the universe of companies that could avail of the ECS, and matters of taxation. My preliminary research (reported in part below) illustrates the value of employing central elements from the historical institutionalist and varieties of capitalism traditions.

In the concluding section, I wish to address two issues with broad significance in EU studies. First, what lessons does the ECS case teach us about the relationship between member-states and EU regulatory innovation? Here the central message will be that significant variations continue to exist in the economic designs of EU member-

states. Since these are unlikely to disappear, common solutions in the future ought to accommodate this diversity. New modes of governance (like the open method of coordination) point to one solution based in informal, peer-oriented, soft law solutions. The ECS offers a more formal solution to institutional diversity, and potentially points the way towards a more general type of solution to intractable differences in the economic domain.

The second issue that the conclusion will address is methodological in nature: what is the value (and limits) of using single case studies to advance EU studies? The field of political science (especially the political economy sub-field) has increasingly come to champion the detailed, microlevel studies of critical institutions as a means to understanding broader social developments (Greif, Levi, etc.). A detailed study of the evolution of the firm, which represents the critical institution in advanced capitalism, promises to significantly enhance our understanding of how the interaction between national and transnational regulatory structures affect broader trajectories in EU's development.

A shift towards this type of case-study would represent a departure from the traditional emphasis in EU studies on the politics of major constitutional designs in the union's history. This paper suggests that if done with due attention to methodological rigor and substantive importance, such a move would open up opportunities to make EU-studies a more interdisciplinary enterprise, and more importantly, make findings in EU studies material to debates outside its traditional boundaries.

The following pages give a brief sense of the four sections. Your comments on all aspects are most welcome.

## **EXPLAINING INSTITUTIONAL DEVELOPMENT IN THE EU**

The high density of the institutional environment in which EU members operate has led to a scholarly debate about its general effects. For example, the sociological institutionalist tradition stresses the conditioning function of institutional environments on the preferences and actions of political actors. In strong versions of this tradition, the design of subsidiary institutional domains are expected to converge with the institutional logic of the system as a whole (Meyer). In the European context, this would lead us to predict that as the density of the legislative environment grew, the likelihood of an agreement on the ECS would increase. The central mechanism posited in these accounts is the opportunity costs of not reforming national designs in ways that approximate the institutional logic of the larger system (cf. Green, Caporaso, and Risse 2001).

Yet, even during the most intense period of institutional innovation within the EU – in the 1980s when the single market was formed – the preferences of core constituencies did not change in ways that brought about an agreement. In fact, as the case-studies below illustrate, in several instances the intensity of already existing preferences increased. This is apparent also in the final design of the ECS; rather than representing an “optimal” solution in terms of the structural congruity between national and European rules, the outcome was a compromise that accommodated the diverse view of member-states. In short, there was agreement without convergence in national institutional preferences.

A different interpretation of the effects of greater institutional density is offered by historical institutionalists. To scholars in this tradition, a more dense environment is thought in many cases to engender responses that lead to greater demands for continuity in existing subsidiary designs (Schickler 2001; Thelen 1999, 2004; also Pierson 2004). They suggest that as an institutional environment expands by adding new layers of governance, actors with stakes in existing designs are often in a better position to protect their interests in those designs. In other words, unlike the strong versions of sociological institutionalism, historical institutionalists hypothesize that a dense institutional environment fosters path dependence. They also suggest that the process of layering affords groups opportunities to engage in incremental reforms that over time may alter the path of development in ways different than had layering not taken place.

The final agreement on the ECS lends a great deal of support to the historical institutionalist interpretation of the effects of institutional density and layering. As such, historical institutionalism offers a potentially valuable tool to explain how the expansion of supranational legislation impacted upon domestic groups’ willingness to preserve or jettison national designs. However, historical institutionalism lacks a microlevel theory of what informs the preferences of societal actors. Without a clearer theory of why these preferences vary, the nature of inter-state bargaining over the ECS cannot be adequately explained. In this paper, I suggest that we turn to the varieties of capitalism research tradition to develop a stronger theory of what informs the institutional preferences of core domestic groups.

A basic hypothesis in the varieties of capitalism literature is that firms and governments will evaluate the effects of institutional change with reference to the consequences for domestic groups’ ability to make use of the existing (and potential future) institutional advantages associated with a particular national model of governance (Hall and Soskice 2001). The current study adds a corollary hypothesis: if domestic groups deem national institutional designs to be constituting (or will likely become) institutional *dis*advantages, they will support new layers of governance if these are thought to be beneficial in facilitating domestic reform.

In the context of the ECS case, the following hypotheses would be particularly relevant.

a) *Structure of Preferences (synchronous and diachronic)*

At a general level, member-states are expected to cluster in ways that group them along their particular variety of capitalism – e.g. Germany vs. Britain. Justifications for their positions are expected to be based in explicit references to the effects of the ECS on their ability to sustain desired *domestic* designs. Moreover, in countries undertaking significant domestic reforms as a consequence of a revaluation of the merits of their existing institutional assets, changes in their preferences over the ECS ought also be apparent. Such changes in preferences should also be justified in explicit references to domestic institutional designs.

b) *Preference Intensity*

The greater the perceived threat of ECS designs to the sustainability of national institutional advantages, the stronger a country will object to common supranational rules. Similarly, the more likely ECS designs will conform to domestic arrangements, the stronger ought the support be for common EU regulations.

c) *Issue-Areas*

Clear variations in states preferences ought to be observed along issue-areas. Specifically, the more integral a domestic institution is to the sustainability of a country's comparative institutional advantages, the stronger ought its support or rejection be for specific ECS provisions. Thus, for example, we expect states to be more concerned with how the ECS would affect core areas of their particular variety of capitalism (industrial relations and corporate governance; see Hall and Soskice 2001) than in areas that are not as integral to the sustainability of institutional complementarities.

## **THE EUROPEAN COMPANY STATUTE**

The European Company Statute offers publicly owned (stock) companies operating in more than one member state the option of being incorporated as a single company. Rather than being subject to different national laws in each member state where a subsidiary is located, a company can chose to operate under one set of EU rules with unified management and reporting systems throughout the entire union. This means that companies can avoid the cost of setting-up and administering networks of subsidiaries throughout Europe and that they can more easily move their activities

across national boundaries.<sup>3</sup> Companies opting to incorporate under the ECS will have the letters SE precede or follow their name (SE, which stands for *societas europaea*, is the Latin form for “European company”).

In order to be valid in all member-states under Community law, the ECS had to be based in a Regulation (rather than Directive). Three issues in particular prevented unanimous agreement on a Regulation until 2001. Chief among these was the issue of employee representation on company boards. While several member-states grant employees seats on company boards (e.g. Germany, Austria, Netherlands, Sweden), other members make no such provisions (e.g. Britain, Ireland). Finding an agreement in which the rights of employees in the former category would not be diluted, and where companies in the latter category would not be forced to accept the higher standards of the former, proved to be the source of the most protracted disagreement.

A second source of disagreement concerned what type of companies would be able to make use of the ECS. In particular, debate centered around whether existing companies could opt to exchange their existing national foundation of incorporation in favor of a European one. If a company could simply convert its national legal existence into a transnational one, it could potentially choose any location for incorporation while maintaining its productive activities in its existing place. This would be similar to a flag-of-convenience arrangement, and was strongly opposed by member-states with higher regulatory and tax burdens.

The third major source of contention revolved around taxation, including whether or not there would be a single tax for all SEs, whether losses in one country could be counted against gains in another country, or whether SEs should be taxed in each country in which they operate.

The history of the ECS can be divided into three distinct phases; one that roughly coincided with the consolidation of the European Economic Community (1965-82), a second that overlapped with the implementation of the internal market program (1988-96), and a final phase that corresponds to the period of institutional consolidation in the EU (1997-2004).

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<sup>3</sup> If a corporation with multiple subsidiaries in several countries wishes to transfer its main offices from country A to country B, it must first close its offices in A *before* opening its new offices in B. The ECS allows a company to avoid this cumbersome process, and thus offers distinctly lower costs of mobility.

### *First Phase, 1965-1982*

In 1965, the French government proposed to the members of the European Economic Community that common legislation be adopted allowing the formation of a European Company. The proposal was reflective of French strategies of modernization after World War II and stressed the benefits of establishing large-scale, European-wide industrial companies. The French argued that such a vehicle would enable scale and scope economies in European companies, as well as help companies develop next-generation technologies. The Commission published a memorandum a year later supporting the French proposal and convened a group of experts to study its feasibility. However, these early initiatives generated little interest among member states. Given their overall strong economic performance in the early post-war decades, they saw no immediate benefit in a uniform or single company law.

The Commission renewed the debate in 1970 when it presented the first formal proposal for a statute. In response to discussions over how to deal with the diverse national systems of interest representation, the Commission suggested that SEs have a mandatory two-tier structure that included executive and supervisory boards. This mirrored the German model, and the Commission suggested that employees would select a third of its board-members and that two thirds be chosen by shareholders. It also suggested that European Works Councils with co-determination rights be established, and that collective agreements on working conditions be negotiated between SEs and unions. Following a generally favorable reception in the Economic and Social Committee (1972) and the European Parliament (1974), a revised proposal for a Regulation was presented in 1975. To allay concerns in member-states with weak or no systems of employee representation, the new Commission proposal suggested greater parity in terms of board appointments.<sup>4</sup> After member-states were unable to agree on the content of the revised proposal, it was shelved in 1982.

In addition to disagreements over the structure of worker participation, extensive criticism was levied against the Commission proposal because of its complexity.<sup>5</sup> European firms were generally opposed because of the suggested mechanisms for board representation. Moreover, the 1970s saw a general economic downturn and companies reasoned that greater benefits would be had from national industrial policies that were aimed at the modernization of national firms.

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<sup>4</sup> A third each of the board were to be selected by employees and shareholders autonomously, and the final third would be appointed jointly.

<sup>5</sup> Unlike the 21-page final proposal that was adopted in 2001, the Commission proposal from 1970 was over 700 pages long!

### *Second Phase, 1985-1996*

In the mid-1980s, the European Union (then European Communities) relaunched its efforts to create a single market for goods, services, and labor. Interest in the ECS reemerged, and was identified in the Commission White Paper on the internal market as an “essential component” to ensuring that firms would gain the full benefits from an integrated market (Commission 1985). In 1988, the Commission thus prepared a new proposal for the ECS.

The new Commission proposal stressed the benefits from a single supranational framework for businesses, the advantages of the ECS over the complexity of existing merger arrangements, as well as significant tax advantages to companies. Member-states responded to the Commission proposal along familiar lines. States with extensive systems for worker participation such as Germany, Netherlands, Denmark and Luxembourg expressed support for the proposal. Countries with liberal market economies—Ireland and the UK—were vociferous opponents. Their opposition was anchored in worries that the ECS would bring “through the back-door” solutions antithetical to liberal designs and erode their competitive advantage (Sir John’s Letter, 20 September 1988).<sup>6</sup>

In order to facilitate an agreement, the Council asked the Commission to prepare a new proposal. In its new proposal, the Commission offered a novel innovation to break the impasse (OJC 263, 16.10.1989). It suggested that terms of company incorporation be dealt with in a Regulation that would be binding on all member-states, and that a separate Directive be devoted to the representation issue.<sup>7</sup> This Directive, which was characterized by the Commission as an “indissociable complement” to the Regulation, spelled out several optional systems of worker participation that member-states could chose from. The Commission reasoned that the strategy of separating the Regulation and the Directive would isolate the contentious worker participation issue from the technicalities of how SEs would be

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<sup>6</sup> Countries like France and Italy that had less extensive arrangements for worker participations than Germany, but more than Britain, expressed support for the Commission proposal.

<sup>7</sup> Regulations and Directives are two of the Council’s three legislative instruments. While regulations establish rules and guidelines that are binding in their entirety on all member-states, directives are binding in terms of the result member-states must achieve, but let members chose the means of implementation. The third instrument—decisions—are binding agreements that are directed at enterprises and individuals.

formed, and that the optional nature of the Directive would allay fears in member-states with weak forms of worker representation.<sup>8</sup>

Despite the Commission innovation and a watered down proposal that made several concessions to the UK, an agreement could not be reached over several years of negotiations. In essence, a deal could not be struck because Britain and Germany expressed fear—for different reasons—that the existing ECS proposal would undermine central components of their respective corporate systems. While the British feared that the ECS would force a “a continental model” on their companies, the Germans raised concerns that companies would set up fictitious SE headquarters in places with laxer rules while continuing their operations at home. Even strong pressure from business and the impending completion of the internal market failed to convince governments to accept the new proposal.

#### *Third Phase, 1997-2004*

In 1997 the Commission convened a “high level expert group on workers involvement” to find a solution to the ECS impasse. Named after its Chair, Etienne Davignon, the Group argued that member-states’ systems of worker participation were too diverse and that attempts to foster harmonization were fruitless. Its main solution to the participation issue was that management of each SE negotiate with its employees and jointly agree on what system of representation should govern the company. In case management and employees failed to reach an agreement, the Davignon Group recommended that a set of standard rules be used as the default.

While the Group’s report received a favorable reception, member-states disagreed over the inclusion of a “zero-option,” which would allow managers and workers to agree not to have any formalized system of representation. With the British and Portuguese strongly favoring the zero-option, and Germany, Austria, Denmark, Finland, Sweden, Luxembourg, and the Netherlands opposed, no compromise could be reached. Moreover, disagreement emerged on whether existing companies should be allowed to transform themselves into an SE. Germany and the others opposed such an arrangement for reasons they had long cited; they maintained that easy conversions would be a Trojan horse that would allow companies to circumvent national laws by merely registering elsewhere.

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<sup>8</sup> In practice, the Directive allowed member-states to chose between several different systems of worker participation, ranging from extensive board representation to solutions giving workers only limited information and consultation rights.

Renewed negotiations followed, with states central to an agreement each holding the Council Presidency over a three year period. Luxembourg, Britain, Austria, and Germany all made ECS a priority, but were unable to broker an agreement. A compromise was finally reached at the Intergovernmental Conference in Nice (December 2000). The agreement maintains the separation of the Regulation and the Directive. The latter gives member states the option of whether or not to transpose into national law a fall-back reference provision (that would apply if agreements between management and employee representations cannot be reached). The final agreement also prevents existing companies from transforming themselves into SEs and excludes tax incentives.

The formal agreement to adopt the Regulation and the Directive took place in 2001 during a meeting of Social Affairs Ministers, and following negotiations with the European Parliament, the European Company Statute came into force on 8 October 2004. Since its operation, six companies have formed SEs under the European Company Statute.

## DISCUSSION

The ECS differs in several important ways from most legislative processes that have aimed at promoting greater integration within the EU. Most importantly, the ECS process and the outcome of negotiations do not correspond to any of the three strategies that member-states have most commonly used when attempting to reconcile institutional diversity among themselves.

The very early strategy of developing a *strong community instrument* that would replace national company law with a single supranational code was quickly dismissed. It would have required member-states to give up institutional designs they considered valuable, as well as necessitate the construction of several new supranational institutions, including a court system that could regulate firm activities. A second common approach, the *harmonization strategy*, was widely invoked in the early stages.<sup>9</sup> However, it too was rejected since member-states could not agree on what system they should coordinate around. In early deliberations, efforts were made to model ECS provisions on worker participation on a German model, but this prevented a consensus arrangement given the strong opposition in liberal market economies. Finally, employing a *strategy of mutual recognition*—which became the cornerstone of market integration in the 1980s—also failed. The mutual recognition route failed as it would facilitate a particularly problematic version of institutional competition; it was perceived to represent threats to *both* the coordinated and liberal market economy designs.

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<sup>9</sup> The harmonization strategy still figures prominently in other areas of company law, but was consistently rejected in the ECS case.

In contrast to cases where member states have used one of the three strategies, the European Company Statute illustrates states' commitment to a solution that would not so much force or encourage countries to alter their systems, but allow them to protect existing national designs. The final agreement, then, was one that entrenched significant and diverse elements of national company law, while also excluding provisions that would encourage greater institutional competition across national borders. The former dimension is most apparent in the Directive on worker participation, which eliminated the zero-option and gave companies strong incentives to adopt models with significant worker representation. The latter part is most evident in the exclusion of tax incentives when forming the ECS and in the limited type of companies that can become SEs.<sup>10</sup>

This outcome tells us a great deal about the importance member-states have attached historically to maintaining core institutional designs in their respective variety of capitalism. In earlier work, I have suggested that member-states' preferences over the structure of the EU, as well as their relative willingness to accept compromises within the EU, is heavily shaped by the extent to which they can protect the comparative institutional advantages associated with their particular version of advanced capitalism (Fioretos 2001). The ECS case confirms this proposition, as well as the more detailed hypotheses in Section II. The ECS case also lends support to two central propositions in the historical institutionalist vein.

First, it underscores the importance of historical contingency in shaping a state's approach to institutional reform. Consider for a moment a counterfactual: would coordinated market economies have objected to the proposals pushed by Britain if they had not yet established their extensive systems of worker representation? The answer would most likely be no -- British designs offered several advantages in terms of lower administrative costs for firms. Had the worker participation models that are so integral to the coordinated market economies not existed, Germany and other coordinated market economies would have been more likely to accept British proposals. In other words, strong path dependent trajectories at the national level

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<sup>10</sup> The tax issue concerned whether or not companies would be able to choose a single location of taxation (presumably where it would be lowest) and thus avoid the historic arrangement where each subsidiary pays taxes in its respective locale. The final agreement excluded the option for existing companies to transform themselves into SEs. SEs are taxed in the same ways as are MNCs; that is, taxes are levied through national fiscal provisions on companies or branches operating within national borders. The Statute allows companies to form an SE in one of four ways: (a) through the merger of two or more existing companies based in at least two member-states; (b) through the creation of a holding company that is formed by public or private companies from at least two member-states; (c) through the creation of a subsidiary company from at least two member-states; and (d) through the transformation of an existing public company that for at least two years has had a subsidiary in another member-state.

continued to shape the structure of EU legislative arrangements despite the emergence of a dense regulatory environment that many have argued acquired its own causal significance.

Second, the ECS case lends support to the historical institutionalist hypothesis of institutional layering. Eric Schickler and Kathleen Thelen have argued that actors with stakes in existing designs will often attempt to steer the process of development towards ensuring continuity by accepting new structures as a means to consolidate existing designs. The ECS is a great illustration of this logic: the provisions entailed in the Statute constitutes a new layer of governance that more than anything else was a result of negotiations in which groups in diverse countries sought to ensure that the national designs they valued would remain structurally intact. Institutional layering is also thought to bring about piecemeal institutional development, sometimes off the existing path. Also this dynamic is apparent in the ECS case, as states sought to make use of the ECS to facilitate and manage a process of incremental domestic reform.

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