Widen the market, narrow the competition: the emergence of supranational governance in EU capital markets

Mügge, D.K.

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The Emergence of Supranational Governance in EU Capital Markets

Daniel Mügge
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The emergence of supranational governance in EU capital markets
Promotiecommissie

Promotor: Prof. dr. G.R.D. Underhill

Overige leden: Dr. B.M. Burgoon
               Prof. dr. G.C.A. Junne
               Prof. dr. S.P. Lütz
               Prof. dr. J.H.F. Story

Faculteit der Maatschappij en Gedragswetenschappen
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Science fiction, a literary genre of which I am still fond, thrives on thought experiments. Among the all-time favourites is the time machine, which gives people a chance to revisit and revise past decisions. With the finished thesis on my desk, how do the five years of its genesis measure up? If I were given the chance, would I chose another university at which to write it, another team of supervisors to guide me, another topic to explore? Knowing what I know about PhDs now, would I aspire to one at all? The lack of regrets about any of these decisions gives me a satisfaction that goes much deeper than the immediate relief of completing a project that has defined my intellectual life for half a decade. The credit belongs to those people who have made this experience more enriching than I could have possibly asked for.

Geoffrey Underhill has introduced me to money and finance as political artefacts. How money works its (good and evil) magic in societies, and who the sorcerers are that try to bend it to suit their ends remains a mystery that has only become more intriguing over the years. More than anyone else’s, Geoffrey’s view on political economy has impregnated my own. Far beyond being just one domain of inquiry among others in the social sciences, it is a way of seeing and understanding social reality. The immodesty that speaks from this vision has always appealed to me, because in spite of the unavoidably circumscribed scope of concrete research projects, it imposes few limits on intellectual curiosity. I have learned to see political economy more as a vocation than as a profession.

That includes an awareness that thanking Geoffrey for all the blood, sweat and (hopefully few) tears that this project has cost him runs the danger of belittling the grander contribution he has made to my intellectual life. If I thank him for his unwavering readiness to provide assistance when I needed it nevertheless, then because his dedication to my PhD project stands as a model if I should ever be given the chance to supervise one myself. It will not be easy to match.

The official title of Brian Burgoon’s part in my project—that of second supervisor—comes nowhere near doing justice to the part he has played in it. It goes beyond invaluable academic counsel and an office door that was always open to receive me with whatever problem I had. Indeed, Brian’s role far transcends this thesis; with hindsight, his contribution to my understanding of social science in general weighs at least equally heavy. In spite of my undoubted failings measured by this standard, his admonition to strive for arguments that are no less than crystal clear has served as a guiding light ever since I grasped its centrality for scholarship. And from him I have learned that faith in one’s own academic convictions need not, indeed should not preclude a sincere curiosity for those views that differ, no matter how fundamentally. My
admiration for the exemplary breadth of his scholarly interest only increased as over the years I
realized just how rare it is in academia.

Brian’s leadership of the International Political Economy PhD club also taught all of us
lucky enough to be its members the art of constructive criticism. Again, it was only after
experiences outside our Amsterdam group that I understood how special it was that we learned
to see giving and receiving criticism as an intellectual pleasure. It was Brian who created that
spirit, and it has followed me far beyond our IPE club meetings. I see it as a duty to pass it on
where I can.

In 2006, Arne Niemann completed my supervisory team when he joined the University of
Amsterdam. Seemingly without any hesitation, he jumped on the moving train that my thesis was
by then. Arne brought an expertise and specialization to the table that could not have fitted my
research better. Approaching my project from a European integration perspective, he further
strengthened my ability to see it that way, as well. In that way, Arne has made a crucial
contribution to my effort to make this a truly cross-disciplinary project.

If the completion of this thesis was a less solitary intellectual endeavour than that as
which PhD projects are commonly portrayed, then credits are due primarily to the IPE PhD club
that has brought together young, enthusiastic scholars from both Amsterdam universities. In
addition to its current members that includes many who left Amsterdam long before I finished
my project, most notably Damian Raess. The dedication to each others work that has
characterized the IPE club has been a constant source of inspiration. Combined with the
companionship of Corina, Jasper and Luc as my office neighbours, it created a spirit of
community capable of smoothing the rough edges of life as a PhD student.

The sense of purpose to our research projects emerged most clearly from my countless
discussions with James Perry, invariably over a beer in one of Amsterdam’s many cozy cafés. In
their best moments, our arguments climbed to a level of intensity that would leave us simply
exhausted once our encounters with the mystery that is capitalism had to end and it was time to
head home. They were a crucial ingredient of my time as a PhD student, one of the kind that
elevates tasty dishes to culinary delights even if added only in minute quantities.

None of these experiences would have come my way without my teachers at the
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not just the science of politics.

After I started my PhD trajectory, the Amsterdam School for Social science Research
hosted me and my project for more than four years. I have always experienced the generosity with which it has funded my intellectual curiosity as a great privilege for which I remain deeply thankful, not least to all those working there. Hans Sonneveld, the school’s director when I arrived, provided fatherly guidance on questions that can easily overwhelm fledging PhD students and José Komen took masterly care of the administrative and financial aspects of our existence there. My move to the department of political science at the University of Amsterdam with its collegiality has only strengthened my resolve to pursue an academic scholarly career. The breadth of views and approaches in the International Relations corner of the department, which I have come to know best, betray the intellectual heterogeneity that makes Amsterdam special and that I have come to value so much.

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an invaluable resource for this dissertation. Jörn-Carsten’s readiness to provide me with the fruits of his work to help me improve mine stands as an example of admirable intellectual solidarity.

Particularly in the final, most intense stages a PhD project is bound to put personal friendships under considerable strain, especially those sustained over long distances. For all its merits, the thesis has made me a less social person over the past one or two years than I would have liked to be and hope to be again in the future. I am therefore grateful for the understanding my friends have shown for a degree of withdrawal that viewed from the outside must have been rather incomprehensible. Harking back to my school days, Arne, Simon and Thomas have kept the faith and always given me something to fall back onto that had refreshingly little to do with academia. It is my sincere hope that with just a little more time on my hands in the future, we can together reap the rewards of friendships that have not stopped growing over the years, against all odds. The same is true for Johanna, Johannes and Tom, who have turned Berlin into my third home town even though I have left it more than five years ago, Eyal, who has been my Amsterdam companion for many years and Don, who has been close to my heart ever since he shared his house in South Carolina with me 15 years ago.

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Amsterdam
April 2008
Merchants and master manufacturers are, in this order, the two classes of people who commonly employ the largest capitals, and who by their wealth draw to themselves the greatest share of the public consideration. As during their whole lives they are engaged in plans and projects, they have frequently more acuteness of understanding than the greater part of country gentlemen. [T]heir thoughts, however, are commonly exercised rather about the interest of their own particular branch of business, than about that of the society [...]. Their superiority over the country gentleman is not so much in their knowledge of the public interest, as in their having a better knowledge of their own interest than he has of his. It is by this superior knowledge of their own interest that they have frequently imposed upon his generosity, and persuaded him to give up both his own interest and that of the public, from a very simple but honest conviction that their interest, and not his, was the interest of the public. The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public. To widen the market and to narrow the competition, is always the interest of the dealers. [...] The proposal of any new law or regulation of commerce which comes from this order ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention.

Adam Smith, 1776

*The Wealth of Nations*, Chapter XI
CHAPTER 1: INTRODUCTION

EU capital markets have changed fundamentally over the past two decades. Alongside the introduction of the euro, the market for financial services has been integrated on a European level. Banks and investment banks that provide investment and capital market services now enjoy cross-border access, while a European industry has emerged centred on the City of London. Rule-setting has also been integrated across borders. Most regulation affecting capital markets now has an EU scope and is decided through EU institutions, while new bodies have been created at the supranational level. In short, the governance of capital markets in Europe—the rules themselves as well as policy-making institutions—have been supranationalized.

The novelty of this supranationalization lies in its supplanting of national governance. In doing so, supranational governance calls into question the viability of national ‘varieties of capitalism’ and the socio-economic compromises that they have traditionally sustained. National financial market policy has always been formulated within an international context, just as domestic financial markets have always been embedded in global financial markets. Until recently, however, financial market governance could be divided into domestic and international components—into a domestic policy process and national laws on the one hand, and international bargaining and agreements on the other. Domestic and international politics thus fit the image of two-level games (Putnam 1988) with governments acting as the transmission belts between them.

This division between the domestic and the international levels in the governance of European capital markets no longer holds true. Few facets of capital markets today remain untouched by EU rules. While global economic developments clearly contributed to regional integration and the concomitant reform of national models of capitalism (Glyn 2006),

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1 In EU policy debates, public officials and private actors use a number of labels for this segment of financial markets interchangeably. ‘Investment services’ is most accurate but technical. ‘Securities markets’ is also used, while ‘capital markets’ is most common. For reasons of accessibility ‘capital markets’ will be used in this text unless the need for further accuracy requires one of the other two.
globalization in and of itself did not spell the end of national diversity or pre-determine regional integration (Schmidt 2002). The supranationalization and harmonisation of capital market governance has been a question of choice, not of economic necessity.

The main question this thesis seeks to answer is what explains that political choice. At stake in such a question is not just the genesis of supranationalization, but also the broader interaction between the political and the economic domains. As a discipline, political economy has traditionally explored the relationship between patterns of governance and market structures and how changes in one may trigger shifts in the other (Underhill 2006). The relationship is far from straightforward, however, and remains poorly understood—as is the supranationalization of EU capital markets as a case study of how ‘markets’ and ‘politics’ interact. In particular, some important exceptions to the contrary, much political economy literature remains insensitive to the mutual constitution of markets and their governance. Approaches to European integration such as neoliberal intergovernmentalism and neofunctionalism tend to underestimate the ‘material’ foundations of (changes in) governance, just as theories that aim to explain financial liberalization underrate and misunderstand the ‘political’ foundations of changing market structures.

This thesis aims to redress such shortcomings, thereby revealing the political-economic roots of EU supranational integration, and in turn contributing to the further understanding of how political governance and market structures interact. Four findings stand out regarding the emergence of supranational capital market governance. First, the politics of capital market integration have been dominated by a small group of political insiders; the preferences of financial firms have ultimately been responsible for the scope and timing of integration. Second, firms’ political preferences were inspired by the impact of regulation and governance on the terms of competition between them, rather than, for example, profits. Third, supranational integration can only be understood by viewing both how agents create structures (collectively binding rules, political institutions and markets) and how these structures simultaneously shape agents’ preferences. Fourth, such ‘structuration’ yields a political economy dynamic wherein
outcomes remain open-ended and are fraught with unintended consequences and thus inner contradictions.

This introductory chapter is structured as follows: first it lays out the central questions guiding the thesis and gives an overview of the empirical case at its heart. It moves on to expose the shortcomings of existing scholarly approaches to European integration and financial liberalization and sketches an alternative analytical framework. It then lays out the core argument of this thesis and highlights its societal and academic relevance. The last two sections discuss the methodological considerations underpinning this research and give a brief overview of the remaining chapters.

Central questions of the thesis

The supranationalization of governance is a radical departure that stands in stark contrast to the more restrictive, essentially nation state-based regime of the early 1990s. This thesis uses this shift to address the general following question:

- How can we best understand changes in patterns of governance in relation to shifting market structures?

Applied to the case at hand, this question can be reformulated as follows:

- What best explains the supranationalization of EU capital market governance?

This question can then be broken down into three further sub-questions:

- Whose preferences have dominated these emerging forms of EU capital market governance?
- What explains these actors’ preferences, their cross-border variation and changes over time?
- What explains the pre-eminence of these actors rather than others?

The European Commission deserves particular attention. Some scholars have argued that the Commission is the engine behind integration in EU capital markets (Gottwald 2005, Posner 2005). In more general terms, the argument that the Commission and other supranational actors can influence the integration process (Nugent 1995, Pollack 1998) conflicts with a position that
still accords member states full control (Moravcsik 1998). This debate generates two final questions:

- What roles have the European Commission and other supranational actors played in the supranationalization of EU capital market governance?
- And how autonomous have the Commission and other supranational actors been in exerting their agency?

**Delimiting the case: the supranationalization of EU capital market governance**

The supranationalization of EU capital market governance lends itself well to an exploration of wider state-market dynamics. Both European financial markets and the political institutions through which they are governed have changed significantly over the past two decades. The case thus serves as a laboratory for analysing political economy dynamics 'in action'. Given the multi-level nature of EU governance in this domain, this study analyzes public-private interactions spanning the national (with an emphasis on France, Germany and the UK) and the supranational levels.

The integration of financial markets was prominent among the European Commission’s arguments stressing the virtues of a single European market in the 1980s. Financial services were relevant not only as services, but also due to their impact on capital flows and investment throughout the European Union. The case with which capital would flow across borders, went the argument, depended on the price of cross-border financial services compared to domestic ones. Cross-border stock market investment, for example, would only become attractive once its costs would approximate those for domestic investment. As the European Commission put it,

> [t]he integration of financial markets across community borders is uniquely important, however, in the sense that it will not only have important effects on the efficiency of the sector itself but also on the efficiency of resource allocation of sectors using financial markets. (European Commission 1988: 86)

The same issue of *European Economy* cited the Price-Waterhouse study commissioned by the Commission to examine financial services. It found that the macro-economic effects of
integrating the market for financial services (1.5 per cent increase in Community GDP) would be more than double the direct effects of lower prices for such services (0.7 per cent) (Ibid.: 161).

The main justification for an integrated market in financial services has been greater efficiency in capital markets and, as a result, higher economic growth. With most exchange controls removed around 1990, integrating markets for financial services became synonymous with integrating European financial markets in general—not least in the jargon used in EU policy-making circles. By analogy, integrating markets for investment services became interchangeable with the integration of capital markets as a whole, a convention that this study follows unless the distinction between the two is relevant.

Member states agreed on common rules for investment services with great difficulty (Brown 1997). The Investment Services Directive (ISD) was adopted in 1993 and scheduled for implementation in 1996, four years after the single market was supposed to take effect. Even by 1998, implementation lagged behind (Wymeersch 1998). ISD negotiations were further complicated by being bundled with the Capital Adequacy Directive.

Three member states—the United Kingdom, Germany and France—dominated the negotiations (Steil 1993, Story and Walter 1997, Underhill 1997). The agreement EU governments eventually reached ensured that they would retain control of European financial regulation. A minimal consensus was the result. Officially, the single market was to be achieved through ‘mutual recognition’. Regulators would exempt firms regulated in other EU member states (the ‘home country’) from compliance with regulations in the ‘host country’. Banks with headquarters in any member state would be given a ‘single passport’ granting EU-wide market access.

The scheme was never implemented. Article 11 of the ISD, which undermined the whole principle, stated:

Member States shall draw up rules of conduct which investment firms shall observe at all times. [...] Without prejudice to any decisions to be taken in the context of the harmonization of the rules of conduct, their
implementation and the supervision of compliance with them shall remain the responsibility of the Member State in which a service is provided.2

Article 11 let member states decide when local rules would need to be applied. Some member states, such as Italy, required foreign firms to set up separately capitalized subsidiaries if they wanted to offer services in their jurisdictions (Colvill 1995). In short, host authorities largely remained in charge of their markets (McCahery 1997, Levitt and Lord 2000: 175-184). The ISD did not create the integrated European regulatory space that had been its official goal.

As European financial markets evolved over the 1990s, the mood among both private and public actors began to shift in favour of further integration. Firms strengthened their representation in Brussels while voices for further action grew louder. The impending introduction of the single European currency and the growth of capital markets in continental Europe appeared to signal that the time had come to complete financial market integration.

By the beginning of the new millennium, a new picture had emerged. Market regulation had been harmonized and the policy-making process had become supranational—meaning that new supranational bodies had assumed central roles in policy-making, even if member states still retained an important role. Already in 1998 the European Council had asked the Commission to compile a report on ‘the way forward’ in financial market integration. The Financial Services Action Plan (FSAP) was the result, tabled by the Commission in May 1999 and endorsed by the European Council a month later. It listed 43 measures in order to complete EU financial market integration until 2005, including ‘upgrading of the ISD’ (European Commission 1999: 23).

Over the following years this ‘upgrading’ evolved into the most substantial overhaul of EU financial market regulation ever. The directive that came to replace the ISD was so different in scope and content that the earlier working title of ISD II was abandoned. It was rechristened the Markets in Financial Instruments Directive (MiFID) and adopted in 2004.

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MiFID negotiations were no less thorny than those for the ISD. Yet they produced a very different regime. The MiFID contains detailed rules on most aspects of capital markets and has effectively harmonized regulation. The liberty of national authorities to impose local rules on foreign operators as they see fit has disappeared; with the MiFID, a single passport in securities markets becomes a real possibility. For all practical purposes, EU securities markets are now governed by a single, EU-level rule set.

The process of rule-making has also been Europeanized. While the EU lacks a single financial regulator, the Stockholm European Council in 2001 agreed to implement a new decision-making procedure known as the ‘Lamfalussy process’ combining ‘comitology’ procedures with institutionalized consultation of an expert committee: the Council and the European Parliament agree on ‘framework legislation’ whereas decisions on the ‘technical details’—the so-called implementing measures—are left to the European Commission, scrutinized by a ‘comitology committee’ staffed by member state representatives and an advisory committee of national experts. These roles are fulfilled by the European Securities Committee (ESC) and Committee of European Securities Regulators (CESR, created for this purpose), respectively. The Lamfalussy process grants the Commission and CESR extensive powers.\(^1\) Even though CESR consists of representatives of national regulatory agencies, its technocratic, problem-solving outlook lets it operate as a rather coherent, supranational body. From being the integration-laggard, securities markets have become the front-runner among financial sectors.

CESR has since been recognized as one of the central bodies in EU capital market policy. It has two core tasks: once framework legislation has been decided in the co-decision procedure, CESR is charged with drafting implementing measures—the detailed legislation. The Commission turns the drafts into official policy proposals and, after scrutiny by the ESC, adopts them. CESR’s advice to the Commission is public, and as CESR is the recognized centre of

\(^1\) Both verbally and in writing, the Committee of European Securities Regulators is known as ‘CESR’ (pronounced like the Roman emperor Caesar), without an article.
expertise within the EU, the Commission is under pressure to justify departures from CESR’s suggestions.

Once the details are agreed, national regulators, who are CESR’s members, coordinate the transposition of EU measures into national law to prevent conflicting national versions of the same EU rule. Because implementation is a national affair, other EU bodies such as the Commission and the EP have no power in this area. By having agreed to the coordination of national rule implementation through CESR, national governments are committed to keep the governance process on a European level to the very end. Although national authorities continue to play a role, both through the Council and through CESR itself, they have largely Europeanized the rule-making process for securities markets. Whence this change of heart in less than a decade?

Limits of the existing literature

This case sits at the interstices of two debates: why do EU member states sometimes delegate policy-making to the supranational level? And why do governments open up financial markets and harmonize domestic rules with other countries? Scholars of European integration and financial market governance have addressed these two questions respectively. While their answers provide helpful starting points for investigation, they leave central questions unanswered.

European integration

Theorists of regional integration have sought to understand why and under which conditions political authority is relocated to higher levels of political aggregation—why, in other words, governments choose to ‘pool’ their sovereignty (Keohane and Hoffman 1991) and potentially delegate authority to supranational bodies, creating multi-level governance structures in the process (see Rosamond 2000, Hooghe and Marks 2001, Wiener and Diez 2004). In the EU context, the debate has traditionally been stereotyped as a clash between neofunctionalism (Haas 1958, Lindberg 1963, Schmitter 1970) and (liberal) intergovernmentalism (Hoffmann 1966,
Moravcsik 1993, 1998). In fact, while proponents of both have been at pains to highlight their differences, the differences are of emphasis. In the words of a prominent proponent of neofunctionalism, Philippe Schmitter,

"If Moravcsik were to concede that the calculation of member-state strategies was affected not only by ‘domestic interests’, but also (and even increasingly) by transnational firms, associations, and movements working through domestic channels, then, his approach would be virtually indistinguishable from neofunctionalism [...]. (Schmitter 2004: 72, endnote 2)

Neofunctionalism and liberal intergovernmentalism agree that actors build supranational institutions because of their expected effects (Schmitter 1970, Scharpf 2001). Nevertheless, two points have proven especially contentious: first, can integration theory say anything systematic about the conditions under which governments find integration desirable? And second, how does integration achieved thus far affect eventual future integration?

The most common answer to the first question—one that is shared with much regime theory (Krasner 1983, Hasenclever et al. 1997)—is that governments integrate policy-making when they face common problems that can be solved more efficiently or effectively through a bundling of forces (Scharpf 1997, 1999). But it remains unclear where and how problems are defined. Neofunctionalist approaches often suggest that nation states simply face them and have clear ideas about desirable solutions (Niemann 2006 is an exception). In many policy areas, however, both the nature of common ‘problems’ and desirable ‘solutions’ are far from obvious (Adler 1991, Hall 1993). Certainly in a complex field such as the governance of capital markets, government preferences are not simply given. Their origins have to be explained.

In addition, scholars who focus on the ‘problem-solving capacity’ of supranational governance seldom specify whose concerns are actually addressed through integration and why some issues come to the fore rather than others. Certainly in the economic sphere, different social groups are likely to have different, if not opposing, interests. Just how national governments aggregate domestic preferences remains vague. Scholars of regional integration
realize that the gains of easier cross-border trade and investment are not distributed evenly throughout society (Schmitter 1970, Stone Sweet and Sandholtz 1998, Mattl 1999). This is even more the case for explicitly critical approaches to European integration (e.g. van Apeldoorn 2002, Bieling 2003, Holman 2004) which argue that the uneven distribution of benefits is not only a side-effect of integration, but one of its driving forces. What unites both kinds of approaches is their tendency to equate effects with causes. They assume that beneficiaries have been instrumental in bringing about regional integration, without showing how or whether this is indeed the case. Knowing who has benefited from supranational capital market governance is insufficient without an argument explaining how these actors have tilted political arrangements in their favour.

The intellectual leap of faith from effects to causes is disconcerting because regional integration—certainly in an organization as complex as the European Union—is prone to producing unintended effects (Pierson 1996). Institutional outcomes do not necessarily reflect the interests of those actors who effected institutional change in the first place (Pierson 2000). This makes it impossible to read political input into supranational institutions and the core agents behind such input from the effects such institutions generate. It calls for an approach to studying supranational governance that traces the actual political process that brought integration about, thereby identifying its core actors and the specific contexts and compromises that shaped regulatory and institutional outcomes.

In light of these difficulties, some scholars have chosen to search for the rationale behind integration not among the macro-effects it produces but in its immediate benefits for those who ultimately decided on it: public officials. Marks et al. (1996) suggest two motivations for government officials to support multi-level governance and the supranationalization of political authority. First, politicians might want to reap the political benefits of more efficient policy provision. Second, they might shift decision-making to the European level because they ’may prefer to avoid responsibility for certain policies’ or because they want ’to insulate [decision-
making] from political pressures’ (Marks et al. 1996: 349). The transfer of responsibility for monetary policy to the European Central Bank (ECB) is an example.

Applied to capital markets, both answers fail to satisfy. Financial market integration does not help to win elections. Nor is financial regulation so onerous for the electorate that political damage can be avoided by shifting decisions to the European level. Finally, even if governments desired to ‘insulate’ financial regulation from their own intervention, it is unclear why this would necessarily lead them to supranational integration. Many national regulators already enjoy a high degree of independence from government—just as the German central bank was already highly independent before the creation of the ECB.

The second contentious question—whether past integration might lead to more integration in the future—has typically been answered positively. A number of potential channels have been identified (recently Niemann 2006). Once created, supranational elites (the European Commission is the obvious example) generate their own ‘supply’ of solutions to problems faced by nation states, possibly exploiting common problems to strengthen the relevance of supranational institutions.

Past integration may also lead formerly domestic actors to develop transnational identities, potentially based on their material interests. Such actors may then push national governments to integrate further—business associations would be a case in point (Cowles 2001). As Feld wrote in the early 1970s,

[a]nother by-product [of previous integration] is the gradual emergence of an expanding, relatively young, Europe oriented business elite as the result of the subtle political socialization process operative in the coordinating mechanisms of collaborating entities. […] [T]hey may be in time influential, through cross-communication with other elites, in soliciting support by the member governments for harmonization measures and for the community system in general. (Feld 1970: 237f)
Feld and his intellectual successors, however, did not sufficiently specify when such a business
elite would push in this direction, and—even more importantly—why governments would heed
its call.

In sum, theories of European integration have tended to underspecify either the
motivation behind supranational governance or the actual process through which diffuse social
preferences are translated into institutional change. At the same time, they have offered no
general theory explaining when past integration generates further integration. These
shortcomings are not necessarily material defects. But they call for empirical inquiry to trace the
actual political process propelling integration forward, instead of relying on stylized depictions of
the role of governments in politics. In addition, they encourage the exploration of other sources
of theoretical guidance to fully understand integration dynamics.

Financial liberalization and integration

Actors with a stake in substantive rules (financial market regulation) can be expected to take an
active interest in procedural rules (policy-making institutions) as the latter preconfigure the former
(Milner and Keohane 1996: 4). The logic of this argument can also be applied to multi-level
governance so that one should expect a relationship between the supranationalization of rule
making procedures and the policy of financial market opening.

Such market opening has not been exclusive to the European Union. As Pauly already
found in the late 1980s,

\[\text{[If relevant [financial market] policies are grouped and compared along a theoretical spectrum ranging from closure and discrimination to openness and nondiscrimination, by the 1980s most states of the OECD moved decisively in the latter direction. (Pauly 1988: 5)}\]

The trend has since continued (J. Williamson and Mahar 1998) and scholars of financial
liberalization have sought to explain it (e.g. Quinn and Inclan 1997, Simmons 2001, Simmons and
Elkins 2004, Singer 2004). The Europeanization of capital market governance, however, is not
easily squared with the approach common in such scholarship. Almost all studies on financial liberalization—including those dealing with European cases—conceive of market liberalization as a unilateral national-level affair. The country-level focus of many studies narrows the range of eligible explanations to an interaction between domestic and ‘systemic’ factors such as technological change or capital mobility. Few studies seriously consider plurilateral or multilateral negotiation as sources of liberalization and thus ignore a central channel through which governments ‘make markets’.

Yet financial market opening is often conditional upon the actions of other governments, as shown by examples from the Pacific region and the WTO (Pauly 1988, Underhill 1993, Sauvé and Gillespie 2000). This is even more the case in the EU: almost all market opening is negotiated and reciprocal. Much extant scholarship thus has a double limitation: it ignores international negotiations and bargaining as a source of market opening. And it ignores the possibility that governments may build political institutions beyond the nation state to address policy concerns, using them as an alternative to unilateral policy change.

With these caveats in mind, what are the driving forces behind financial liberalization that scholars have identified and that might help explain the supranationalization of EU capital market governance? Roughly, the answers can be put into two categories: financial globalisation and domestic politics.

The two most prominent arguments about financial globalisation focus on capital mobility and technological progress. Laurence (2001) for example argues that capital mobility has shifted power away from banks and towards investors. Previously, banks used their weight in domestic policy-making for the purposes of rent-seeking and closing off domestic markets. But since the advent of capital mobility, this has been trumped by the exit option of investors. Hence policy is reformed to reflect investors’ preferences—for example more openness and transparency, lower prices, the abolition of cartels and increased competition. In this perspective, banks are the losers of market opening. International openness and regulatory competition (Esty
and Geradin 2001) lets national policies converge around the imperatives of what Cerny (1990) has called the 'competition state'.

Technology as a driving force receives most attention in the economics and business literature (e.g. Holland et al. 1998, Smith and Walter 2003). Technology has removed obstacles to integration stemming from the geographic dispersion of financial activity or discontinuities between currency areas. The former can easily be bridged with modern information and communication technology. The latter can be neutralized with hedging techniques that advanced financial engineering makes possible. With both barriers removed, goes the argument, the opportunity costs of countries watching global financial developments from the sidelines increase. Hence governments open up their markets.

Both of these arguments are attractive. But they also have weaknesses. Arguments about capital mobility as a driving force have two flaws. First, capital mobility itself is never properly accounted for. Rather than being a ‘thing’ in itself, it is the result of various policy measures that facilitate the movement of capital across borders. In effect, such arguments explain public policy outcomes (the opening of financial markets) with earlier public policy outcomes (introducing capital mobility) without ever going into detail about the underlying political processes and compromises. These approaches remain insensitive to the structuration of the political economy: market structures may influence government policy, but government policy also clearly affects market structures. It is far from obvious that one is ontologically prior to the other.

Equally important, the facts of financial market development do not easily fit the capital mobility hypothesis. Rather than being losers of liberalization, big (investment) banks continued to earn record profits until the financial market upheaval that began in the summer of 2007 (Augar 2005). These profits are due to the fact that, in contrast to the model, large banks are highly mobile. Their presence is global and their global market share continues to increase (Group of Ten 2001). In addition, there is little empirical support for regulatory competition in financial services at either the European or the international level (Hertig 2001, Trachtman 2001).
Finally, investors are not known for their political connections or their involvement in public policy. Regardless of abstract ‘bargaining power’, it is unclear how their preferences are translated into public policy. Approaches stressing capital mobility fail to account for the ‘agency’ through which policy changes are actually brought about.

The technology argument has similar flaws. Undoubtedly, technology matters greatly to financial markets as we know them today (Lee 1998). It is far from obvious, however, that technology simply pushes market developments in one direction or another. Why is the efficiency-enhancing potential of technology exploited in some instances but not in others? Why, to take one example, do investors in some jurisdictions still have to use (and pay) brokers for the execution of stock market trades, even though it has long been technologically feasible to connect them to the market directly (Maboney 2002)? Technology makes market restructuring possible but it does not in itself explain why it happens in some cases and not in others.

In addition, most information technology in financial markets is proprietary. Technology does not simply appear out of nowhere; it is used strategically by firms that invest immense sums in it. Technology is not exogenous to the dynamics among market participants, but rather a ‘box of tools’ the latter use to attain their goals. That makes it a weak explanation for market changes that public policy might ‘adapt’ to. Indeed, governments themselves can use regulation to limit the application of technology. For example, European stock exchanges have traditionally not been allowed to place trading screens in other countries even though this had long been possible. In summary, arguments about system-level properties such as capital mobility or technological progress as a source of policy change ring hollow without analysis of why actors introduce or obstruct either. They are also not very helpful for explaining why governments might favour supranationalization and cross-border integration over national governance and control.

From a normative perspective, regulation of domestic financial markets provides public goods (see e.g. Vittas 1992, Herring and Litan 1995, Goodhart et al. 1998). Politicians and bureaucrats themselves justify regulation and its reform this way. Indeed, addressing market
failures is an important function of market regulation. Even if the danger of financial crises—the most immediate reason for market correction—has long been considered relatively low in the Northern hemisphere, other public functions remain important: the cheap provision of quality financial services and the prevention of fraud that can thrive on ubiquitous information asymmetries.

Even a cursory reading of the evidence, however, suggests that regulatory politics involves more than debate over the optimal production of public goods. Empirically, regulation is rarely a question of the state reigning in market excess. Rather, regulation is jointly produced by public and private actors while regulatory policy reflects diverse societal interests (Braithwaite and Drabos 2000, Clarke 2000). Sceptics argue that this makes ‘regulatory capture’ possible. Building on Stigler’s (1971) classic account, regulation in this perspective is contested primarily between producers and consumers. The latter systematically lose out to the former, he argues: producers have a high stake in regulation and make more determined efforts to influence policy. And because of their smaller numbers, producers can organize more easily. Both reasons together tilt regulation in their favour.

Such an argument, however, does little to explain the variation in institutional change over time and across jurisdictions. It assumes that the central division of interests in regulation runs between consumers and producers. In the realm of securities markets, this is far from clear. Many large financial conglomerates fulfil a range of functions: they act as investment vehicles, analysts, have stakes in clearing houses and securities exchanges, arrange initial public offerings, etc. They are simultaneously consumer and producer, often in overlapping products. The only consumers that truly deserve the label are retail customers. Stigler’s theory predicts, probably correctly, that they regularly lose out in market regulation. But this says little about the rest of regulatory politics. Furthermore, his original idea is not easily reconciled with the trend towards market opening. If producers were still in charge, why would they want to invite foreign competition? Their regulatory preferences and how they would change remain under theorized in Stigler’s
Vogel's insight (1996) that ‘freer markets’ tend to need ‘more rules’ has compounded the problem. Effective market liberalization takes more than just deregulation. From liberalization’s emphasis on enforcing competition in domestic markets, Vogel concludes that governments must have had more room for manoeuvre than theorists of regulatory capture grant them. In his view, governments have updated regulatory systems to keep up with a changing environment. Still, the question remains why governments—allegedly in charge—would choose to harmonise rules and surrender national autonomy in financial market policy-making.

The final angle on regulatory reform in financial markets has been developed by Andrew Sobel (1994), who argues that struggles over regulatory reform are fought neither between producers and consumers of financial services (Stigler et al.), banks and international investors (Laurence), governments and national financial industries (Vogel) or states and imperfect markets (normative approaches). Instead, different groups of domestic producers of financial services struggle over regulation to either protect their own turf (in the case of market incumbents) or invade that of others (market challengers). He points to financial reforms in Japan, the United Kingdom and the United States as examples; in all three countries the division between securities markets and credit markets has been diluted due to conflict between incumbents and challengers. Sobel's approach is convincing for the cases he analyses. But as presented, its applicability is limited. It does not easily lend itself to countries that traditionally have no division between banking and capital markets, for example Germany, or to a lesser degree, France.

More importantly, Sobel's approach, like the others, does not easily accommodate the supranationalization of policy-making and the emergence of multi-level forms of governance. Depending on the dynamic hypothesized to lie behind liberalization, such supranationalization could play very different roles: is it a bulwark against the corrosive effects of global economic pressures, for example regulatory competition? Is it a vehicle for governments seeking to update their regulatory systems optimally? If so, why would they harmonise policy and surrender
autonomy? As pointed out, EU member states in the early 1990s were loath to do either; in many policy fields, this remains the case. Why, then, the shift in capital market governance? The following section outlines how this thesis responds to this question.

**Conceptualizing the political economy of competition politics**

The dynamic at the heart of the supranationalization of EU capital market governance—firms using their political power to manage competition through regulation—can be labelled ‘competition politics’. Competition politics are an instance of social structuration (Giddens 1984) where actors collectively and interactively shape the environment (the ‘structure’) that they confront. This process extends to the political institutions where regulation is made: agents try to influence the institutions, anticipating their effects on rule-making.

Market structures, regulation and political institutions are thus interdependent, a view most political economists would readily accept and one which has been discussed at length within institutional economics (O. Williamson 1987, North 1990), economic sociology (Fligstein 2001, Swedberg 2003) and comparative political economy (Hollingsworth and Boyer 1997, Hall and Soskice 2001). In contrast, what ties the three together—the political agents who struggle over the form which markets will take, the rules that govern them, and the political institutions that give access to some actors but not to others (see Underhill 2006)—have received little systematic attention.

It matters *who* the influential agents are. Markets, their regulation and the political institutions governing them would look rather different depending on who is best able to shape outcomes—investors, retail consumers or regulators. To understand why contemporary EU capital market governance looks the way it does, it is not enough to state that markets, regulation and political institutions are interdependent. The crucial question is *how* they are interdependent.

The conceptual answer to this question, detailed in chapter 2, can be broken down into five sub-questions. First, what explains firm preferences for regulation and a particular shape of the market landscape? Second, what explains the pre-eminence of their preferences relative to
other stakeholders? Third, under what conditions do coalitions for market change emerge?
Fourth, how are agent preferences linked to institutional change, in particular supranational
governance? And fifth, how do the outcomes of this process—market integration and
institutional change—feed back into firm preferences?

Regulation, political institutions and firm preferences

Firms care about regulation because it structures the competitive environment, meaning it sets
the terms of competition among them. Regulation shapes markets, and economic agents have
diverse preferences in this regard. Three dimensions are particularly relevant here: first, regulation
determines the products available on a given market, and their potential substitutes. Second,
regulation determines which kind of firm can offer which kind of (financial) service. Third,
regulation determines how foreign firms are treated relative to domestic ones. For example, can
foreign firms simply sell their products to domestic clients? Do they have to follow domestic
rules? Do they need a local presence or a separately funded subsidiary? Are there special rules
that apply only to foreign firms?

Taken together, these three dimensions of regulation delimit the competitive environment
in which firms interact. When regulation is fixed, firms will adapt to the environment, using their
resources to take maximum advantage of their regulatory environment. Firms that fail to benefit
from restrictions on competition may perish. Successful ones—the ones that eventually dominate
the market segment and become the ‘market incumbents’ (Fligstein 2001)—are likely to support
the way regulation structures competition. Regulation provides security by preventing ruinous
competition. This means that regardless of the original intention behind market rules, a political
constituency will develop that will be against rule change because it profits from current
arrangements. This does not make it impossible to change the competitive environment, but the
political power of market incumbents makes it difficult.
The institutional power of financial firms

Banks’ regulatory preferences only matter to the degree that banks are successful in translating them into public policy. The institutional power (Barnett and Duvall 2005) that enables them to do so derives from their central position in national economies. Complex financial systems enable large-scale division of labour and generate credit, which are crucial ingredients for economic development (Germain 1997). They also allow the state to collect taxes efficiently (Ingham 2004). The state and society at large therefore have an interest in well-functioning and stable financial systems—and this includes thriving banks, which constitute the core of financial systems. States are much more likely to listen to the business concerns of banks than to those of firms in other sectors.

The attention that states bestow on their national financial industries translates into preferential access to public policy. States often closely monitor developments in financial markets and the financial industry. They hold regular consultations with banks and other financial firms to discuss policy. This access to policymaking is a generalizable power resource that banks can use for a wide range of purposes.

In addition to these general sources of political power, banks have specific power resources that depend on the model of capitalism in which they operate. In coordinated market economies (Hall and Soskice 2001), financial markets—and the firms operating within them—often have special economic functions. For example, banks are used as channels for central banks’ monetary policy. States often target credit at specific social or economic sectors to stimulate development or investment. Banks have also played an important role in industrial policy; in Japan and Germany, two prominent examples of coordinated market economies, banks were given central positions in a web of corporate cross-shareholdings (Yamamura and Streeck 2003). The pre-eminent role of banks in national economies entailed close connections with the state and preferential access to policy-making in addition to an enormous direct influence on economic outcomes through their business activities.
Finally, firms in financial services, as in other industries, can receive special political consideration due to their economic relevance—for corporate taxes or employment. In the UK, the share of financial services in total GDP is over 10 per cent; directly and indirectly, financial services generate a lot of employment. As is the case with cars in Germany and agriculture in France, the state will heed the business interests of prominent sectors. Where regulation limits the domestic access of foreign firms, international regulatory politics resembles trade politics. Just as governments defend the interests of their national champions in trade negotiations, they take heed of financial firms’ preferences when financial market rules are negotiated with other countries.

In a number of ways, then, the interests of financial market incumbents have been built into state preferences. Regulatory policy is not a domain in which regulators and regulated stand opposed. Rather, the state and market incumbents jointly develop the rules that govern markets, temper competition and thereby generate the stability that both cherish (Clarke 2000).

**Integrating markets**

The view presented thus far is more static than what prevails in reality. At the heart of this thesis is not stability, but change—in regulation, political institutions and market structures. How do transnational rule harmonisation and supranational governance fit into the perspective developed thus far?

Change in competition-relevant rules depends on change in market incumbents’ preferences. Put simply, incumbents are likely to support changing rules if they see greater chances for economic success in the new economic landscape. In Sobel’s (1994) account, commercial banks in the US, the UK and Japan were performing poorly. Firms active in capital markets, in contrast, were earning record profits. With little to lose and much to gain, commercial banks in all three countries pried open capital markets to gain a share of that business. Kroszner and Strahan (1999) tell a similar story for inter-state branching in the US: banks had reached their limits of growth within state borders and began lobbying for easier access in other states and
other sectors. In the end they were successful. Market liberalization becomes a function of market incumbents reaching limits of growth and seeking opportunities elsewhere.

Transnational market integration affects existing firms and the political basis of support for stability or further change. Smaller and mid-sized firms competing with large ones are likely to lose out in market integration, and either vanish or find a niche. Either way, their political influence will likely wane. The political support for a protectionist regulatory regime fades as supporters of integration come to seek cross-border markets and are able to assert their preferences (cf. Milner 1988).

This logic applies to EU market integration as well. On the one hand, relatively weak regulatory barriers—like the need to comply with local rules—can be sufficient to make market entry unattractive to outsiders. Even in the single market, governments can use market directives to keep competition at bay. On the other hand, the single market can provide growth opportunities firms do not enjoy domestically. Examples include telecoms, utilities and airlines. Particularly for economies of scale, interest in integration will be strong.

*Supranational governance*

In the context of the European Union, preferences for supranational governance relate to those on market integration. As understood here, supranational governance means even detailed rules for a particular political domain are decided collectively at the EU level, with supranational actors having considerable influence over them. In a multi-level governance setting, governance will rarely lie completely at the national or supranational levels. A body such as CESR combines supranational and international elements; in its daily operations, it functions as an organization whose primary allegiance is to EU capital markets as a whole. Supranational governance can thus also be thought of negatively as the absence of national or international governance.

Firms that favour market integration will likely prefer supranational governance for a number of reasons: transnationally harmonized rules facilitate cross-border market access while
nationally idiosyncratic rules obstruct it. As Scharpf (1997) has pointed out, supranational governance can increase the ‘problem-solving’ capacity of organisations such as the EU by reducing collective action problems. Agreement on collective rules, and thus transnational regulatory harmonization, is facilitated by supranational governance. Needless to say, such harmonization requires consensus among powerful actors on the ‘problems’ and their ‘solutions’.

Over time supranational governance also tends to decrease the political power of those actors who oppose market integration. Pro-integration firms share a political agenda with—and are the natural constituency of—supranational actors such as the Commission. The Commission in turn looks for allies to support its cause vis-à-vis other EU bodies, for example the European Council and the EP. Smaller firms with protectionist inclinations have difficulty legitimizing their position in supranational forums and have to rely on national governments to represent their interests. As Stone Sweet and Sandholtz (1998) have pointed out, all this makes economic beneficiaries of integration likely supporters of supranational governance.

The technocratic bias of EU governance, with its preference for open markets, increases this tendency. The same is true for expertise. Supranational bodies, and to a lesser degree national ones, depend on banks for market expertise. The effectiveness of regulation depends on the behaviour it triggers among market participants. Rather than proceeding via trial and error, regulators discuss policy design with banks in advance, often through regular consultations. Banks of course have their own self-interested perspectives on issues, and it is therefore not always easy to tell the difference between them and disinterested technical advice. The staffing limits of supranational bodies make them vulnerable to subtle manipulation.

Large firms have further advantages in Brussels. Collective action problems have long made it difficult for large groups—for example consumers—to have their interests represented in domestic political systems (cf. Olson 1965). It is even more difficult at the EU level, where the number of relevant political actors has multiplied. In addition to the EP, the Commission and
CESR, the support of numerous governments is needed to get policy agreed. Navigating the institutional jungle requires expertise and resources, both of which large firms have.

This does not mean that the Commission—the principal supranational body of the European Union—has no independent room for manoeuvre with respect to the integration process. It can influence the public agenda, control the flow of information and, if matters hang in balance, play actors off against each other (Pierson 1996, Pollack 1998). The Commission can catalyse integration, and in our case, has used its powers accordingly (cf. Gottwald 2005). The agency of the Commission, however, is limited. It could not have moved integration forward if the financial industry—and thus member states—had opposed it.

*Structuration dynamics*

The perspective advanced here emphasizes the agency and preferences of actors with privileged access to the state and policy-making. Agency and preferences are tied to developments in actors’ political, institutional and economic environments. It matters how potential allies and opponents are situated in the field. In addition, the influence of particular actors depends on their position in political institutions and the make-up of states (Krasner 1984, Ikenberry 1988). Actors also find that their economic environment constrains their options. Shifts in political, institutional or economic structures can change policy preferences and thus trigger agency.

Giddens (1984) coined the concept ‘structuration’ for this feedback loop between structure and agency. The dynamic at the heart of this thesis is one of market structuration: actors—both public and private—aim to change market structures in light of their preferences; these preferences in turn bear the strong imprint of past changes in market rules, political institutions and actors’ economic environment. Both regulation and policy-making institutions can be understood as tools in the market-structuring project that public and private actors pursue. Because actors can use political power to advance their economic interests, and their economic power to advance their political interests, an equilibrium can emerge in which a ‘fit’
develops between market structures, market rules and political institutions. The resulting
ensemble is what Underhill (2001, see also Underhill and Zhang 2005) has called a state-market
condominium. Indeed, the stability of this ensemble is often seen as the norm, or point of
departure, for analysis in comparative political economy (Hall and Soskice 2001), studies of the
state (Krasner 1984, Cerny 1990), economic sociology (Fligstein 2001) and critical approaches to
political economy focusing on hegemony (Cox 1996).

For the supranationalization of governance and transnational market integration, two
ideal-typical ‘constellations’ of rules, market structures, political institutions and actors can be
discerned: an ‘international constellation’ and a ‘supranational constellation’. In the international
constellation, tightly knit national policy communities, markets fragmented along national lines
and nationally idiosyncratic regulation complement each other. The opposite is the case for the
supranational constellation: rules are harmonized, markets integrated, and policy communities
open and internationalized.

The shift from one constellation to the other—realized by agents who are aware of the
complementarities and who ‘translate’ shifting market structures or new regulatory preferences
into institutional change—is far from smooth. With agency as the crucial link in the structuration
chain, theoretical complementarities do not lead to neat structural adaptation. Both the market
structures and the political environments actors face are too complex for them to always devise
straightforward strategies. Actors make mistakes. Firms may miscalculate their chances of success
in foreign markets. The complexity of EU institutions makes it difficult to predict political
outcomes even in light of known political inputs. In addition, political institutions and market
structures can be influenced by factors that lie outside the structuration dynamic in question.
Potential ruptures in the feedback loop make the study of empirical detail as crucial as the study
of encompassing political economy dynamics.
The argument: competition politics in EU capital markets

As an application of this competition politics framework, the core argument of this thesis can be summarized as follows: the supranationalization of EU capital market governance can best be explained by the shifting preferences of and alliances between a small group of private actors—banks and investment banks active in capital markets—and their public sector interlocutors. The political preferences of these private actors have been formed in response to the expected impact of regulatory and institutional change on their competitive position, rather than just profits per se. These preferences shifted in favour of integration as firms’ market environment changed; many of them began to perceive a competitive advantage in transnational market integration whereas they had previously preferred regulatory protectionism. True to the structuration perspective at the heart of this thesis, market transformation was itself the result of regulatory changes which private-public coalitions had pushed through since the mid-1980s.

The overall result of this mutual constitution of market structures and patterns of governance—mediated by a small group of self-interested actors—has been a state-market constellation where the ‘scope’ of markets once more matches that of political institutions. Also informally, large financial firms cultivated their ties with supranational bodies such as the European Commission at the expense of traditional connections with national governments, even if banks’ domestic influence continued to loom large. This does not mean that integration was a smooth process: the importance of agency in effecting change has meant that both the process of change as well as the end-result—the regime that governs EU capital markets at the time of writing—are riddled with inner contradictions, inconsistencies and unintended consequences.

How does a competition politics approach account for the supranationalization of capital market governance in the EU? The remainder of this section spells out this thesis’ answer to that question. Around 1990 continental European banks were focused largely on their domestic markets. Only the American investment banks conducting their business out of London had
significant European operations and clear ambitions to expand them. Weighing the benefits of effective cross-border integration (market access abroad) against its costs (heightened competition in home markets), most continental firms strongly preferred a protectionist regime over true market opening. Nationally idiosyncratic rules and national discretion were thus left intact.

Deteriorating profit margins in the credit business, a global stock market boom and growing, if limited, international market openness triggered a strategic re-orientation among many large banks in Europe throughout the 1990s. Many developed European—if not global—ambitions, while the capital market business was discovered as a source of profits in its own right. Their preferences shifted in favour of EU market integration and reduced transaction costs for cross-border operations and hence in favour of rule harmonization and more supranational governance.

How could such a small group of firms command such influence over capital market governance? This thesis does not argue that governments—or the European Commission, for that matter—were puppets of the financial industry. It does argue, however, that as one among many stakeholders in capital market policy, banks have had power resources at their disposal that have given their interests disproportionate weight in policy-making (Lindblom 1977). They have been the central private actors in public-private alliances which first obstructed and later pushed for market integration by political means.

Domestically, firms in the financial sector have long enjoyed privileged access to policy-making. In Germany and France, the central role of banks in the management of national economies turned them into insiders in economic policy. Large German banks assisted the Bundesbank in monetary policy. They provided long-term financing to domestic industry and were at the heart of the net of cross-shareholdings known as Deutschland AG. French banks were important channels for government distribution of credit throughout the economy, even after many were privatized in the late 1980s. The history of state intervention and public
ownership in French finance had also generated close personal ties between the state and its banks. In the UK, the financial sector’s influence over government policy stemmed mainly from the government’s interest in a thriving City: financial services account for more than 10 per cent of UK GDP, much of it concentrated in London. In all three countries, the interests of national financial industries were built into government policy. Agreement in the European Union largely depended on the homogeneity of views within the industry itself.

This is not to suggest that banks of various national origins active in EU capital markets have always held similar preferences. Indeed, the conflicting interests of banks largely explains the restrictive regime that emerged in the early 1990s. And later, while conflicts remained, fault lines no longer ran along national borders. Instead, large banks from across Europe were jointly pitted against smaller firms and increasingly against national stock exchanges too. Among the top banks—as well as large bourses—a consensus emerged in favour of cross-border market access. As chapter 5 details, with more than 90 per cent of the EU capital market business concentrated in the hands of less than two dozen firms, agreement among them constituted a de facto industry consensus. Through their privileged access to government policy, this consensus informed government opinion to a degree that would have been unthinkable in most other sectors.

Financial firms trumped other stakeholders in Brussels as well. As they successively developed pro-integration preferences, they discovered the European Commission and later the European Parliament (EP) to be natural allies. Neither needed to be convinced of the desirability of further integration. Firms nevertheless lobbied heavily, both individually and through organizations such as the European Banking Federation (EBF) and the London Investment Banking Association (LIBA). The Commission created consultation committees with industry leaders to find out where, in their view, the single market ‘worked’ and where it did not.

Equally important, banks’ political weight in domestic politics made them sought-after political allies for the Commission; against their resistance, progress in capital market integration was all but impossible. The industry voiced its support both for the abolition of cross-border
barriers and for more technocratic, supranational governance—in national capitals as well.

The under-representation of other societal stakeholders was the flip-side of this intensive industry input. Most obviously, smaller banks from around the EU have had little voice in negotiations, both individually and through business associations. As the European industry consolidated on the back of regulatory market integration and a new European ‘Champions League’ of investment banks emerged, small banks have been the most visible losers of this process. But other financial market stakeholders have also been (surprisingly) absent: non-financial corporations that issue securities, institutional investors such as pension funds, and of course retail consumers. Most importantly, the central role of policy community insiders squeezed out the interests of a broader public—a point driven home by the consequences which the credit crises erupting in the summer of 2007 have already had for economic growth and employment in Europe.

The European Commission’s role has thus been one of a catalyst. It has been a focal point for supporters of capital market integration and its policy initiatives have provided political space for integration to go forward. Skilful manoeuvring has also allowed the Commission to inject its own priorities into policy. However, without the support of the European financial industry, the Commission’s efforts would have led nowhere. They would have been stymied, just as they had been in capital market negotiations around 1990 and in many other policy fields since. The visibility of the Commission’s role in capital market policy has belied its political dependence on the most powerful constituency in capital markets: the banks.

Taken together, this means that competition among firms within European capital markets has been key to the way the governance of these markets has developed. As the business outlook and activities of European firms became more international, market governance was supranationalized. Market transnationalization and supranational governance moved in sync; market participants were the link between the two. Two caveats apply, however: this link is not unidirectional, and it is not deterministic.
Banks’ preferences and attempts to influence market rules depended on the threats and opportunities they perceived. For example, the stock market boom in the second half of the 1990s fed EU-wide capital market enthusiasm and optimism among banks and governments. It inspired banks to further push integration and helped sway governments in favour of market opening. In this way, market developments themselves fed into governance change, mediated by the interests, perceptions and political power of firms. At the same time, in the decade preceding the stock market boom, banks in Continental Europe had lobbied heavily for the rule changes that had made it possible for stock markets to become so prominent in the first place. The process is thus one of structuration: market developments, political agency and institutional change influence each other over time. Market transnationalization has encouraged supranational governance, and supranational governance has been used to further boost market integration.

Because the link between market transnationalization and supranational governance involves political struggle and agency, the relationship between the two was not always straightforward. With hindsight, actors have made strategic mistakes and miscalculations. For example, many mid-sized banks supported capital market integration, believing they could profit from it. In the end, the majority of them—for example Dresdner Bank, Commerzbank and Crédit Lyonnais—abandoned their European (let alone global) ambitions. But market integration had in the meantime become a fact. Public actors also miscalculated: in the late 1990s the German and French governments saw Frankfurt and Paris as serious competitors to London, something that helps explain their support for integration at the time. It turned out to be wholly unrealistic but market integration had been signed up to.

The most prominent example, however, has been the demutualization of European bourses. As both members and owners of stock exchanges, banks turned them into independent, for-profit firms during the 1990s. In doing so, they unwittingly created what a decade later were to become their fiercest competitors for share trading. When the ISD was renegotiated in the early 2000s, stock exchanges formed the most vocal and effective opposition to banks’ wishes for
a liberal trading regime. The eventual outcome of those negotiations, the Markets in Financial
Instruments Directive, bore the clear imprint of the competitive preferences of bourses—a group
of actors that had not even existed as independent firms a decade earlier. Unintended
consequences and the unpredictability of market evolution and political processes have thus
played their part in creating current arrangements. And they underline the importance of agency
relative to mechanisms operating at the macro-level.

Scholarly and societal relevance

The central contribution of this thesis lies in its conception of competition politics—a process of
market structuration through which a small group of public and private actors translate their
political preferences into market change. By showing how market structuration and regulation
form an integrated process, and can only be fully understood as such, it goes beyond the insights
of the various theoretical approaches on which it draws.

The competition politics perspective advanced here challenges core tenets of common
views on European integration and financial market liberalization. With respect to the former,
this thesis shows that integration has been driven and shaped by the material interests of a small
group of identifiable actors—not by free-floating identities, supranational loyalties or the hope to
optimize the provision of public policy which neofunctionalist approaches routinely highlight. By
redefining the place of national governments in economic governance it defies the neoliberal
intergovernmentalist idea that these governments, or their purely domestic constituencies, were
still in charge. Both the competitive dynamics as well as the patterns of political association and
exercise of power in this case have clear transnational and supranational dimensions. And by
showing the relevance of political agency (and its unintended consequences) for integration, it
contradicts more structuralist versions of historical materialism and deterministic views of
political economic change.

This last point is also the main contribution to our understanding of financial market
change, and liberalization in particular. This thesis does not deny that market structures and
factors such as technology have an impact on changing rules and governance patterns. But it shows how these factors matter by way of agents who use regulatory and institutional changes as means to attain their commercial and political ends. Without an understanding of the these ends and the resources actors command to implement them, any picture of financial liberalization will remain incomplete.

The importance of political agency—and thus political choice—for changes in both governance patterns and ultimately market structures as well immediately raises normative questions: is the influence of banks over capital market governance a reason for concern? What does the argument imply about the legitimacy of how capital markets are governed in the EU? The answer to this last question can be split into two parts: output-oriented legitimacy—the degree to which ‘the common welfare’ of the broader public is promoted—and input legitimacy—the degree to which current arrangements reflect the ‘authentic preferences of the members of a community’ (Scharpf 1999: 6).

From the perspective of output-oriented legitimacy, smoothly functioning capital markets are preferable to those that are crisis-prone. Market complexity means that expertise is indispensable for effective policy. Involving financial firms—where expertise is most concentrated—can therefore help to improve policy. Beyond this, the effect of private influence over public policy is ambiguous. It is not obvious which kind of policy promotes the ‘common welfare’ or, indeed, just what that common welfare is. After all, financial regulation has quite disparate effects: it may increase or decrease the chance of financial crises. But it also influences the distribution of credit in society. Through promoting stock market listings, regulation may push firms to concentrate on short-term profits and lay off employees. It may create new investment opportunities for individuals but also promote financial products whose risks they do not understand. The interests of debtors and creditors, investors, managers, workers and banks themselves are at odds on these questions, and ‘the common welfare of the constituency in question’ is elusive. In other words, the pre-eminence of private actors in capital market
governance cannot simply be justified by reference to ‘better’ policy. For whom is it ‘better’?
Financial innovation can clearly generate public benefits. Money and credit have certainly
multiplied societies’ potential for welfare. At the same time, financial innovation as a means for
to generate profits also often stands at the heart of periodic crises (Galbraith 1975; Partnoy
2002); the subprime mortgage meltdown is only the most recent example. Even though the full
effects of supranational capital market governance in Europe have yet to emerge, such examples
instil caution about policy communities in which a small group of inside firms wields such power.
The question thus arises how well the interests of different social groups are represented in
policy-making or, to put it simply, how democratic current arrangements are.

The centrality of private interests in public policy is not easily squared with democratic
expectations. The argument here is not that banks and public actors have conspired against the
general public, but that the political process is systematically tilted in favour of banks, regardless
of the awareness and intentions of public actors. Pluralist notions of supranational ‘governance
with the people’ (Schmidt 2004)—meaning governance with social interest groups rather than
direct democracy or parliamentary representation—raise questions. In spite of (largely futile)
efforts by the Commission to involve ‘the man on the street’ in the policy process, the interests
of social constituencies outside the financial industry are underrepresented in capital market
governance.

Private involvement in public policy-making would be less problematic if it was
subordinated to rigorous democratic control that ensures policy would eventually promote the
‘authentic preferences’ of EU citizens. However, parliamentary representation—national or
European—provides little assurance. National parliaments are only marginally involved in EU
capital market policy. The domain is shared by finance ministries, regulatory agencies and central
banks—the actors involved in the negotiation of EU rules. National parliaments normally have to
ratify the laws implementing the results of these negotiations. Even if national parliaments could
exercise more oversight in theory, the complexity of the negotiations and subject matter render it quite meaningless in practice.

The EP is much more closely involved in EU rule-making; through co-decision, it has real power. However, it has its own shortcomings. First, it has a pro-integration bias: while it may be open to different ideas of what European policy should be, it is unlikely to conclude that there should be no, or only weak, EU policy in a particular field. Second, European politics plays a subordinate role in European parliamentary elections, where national issues dominate. The EP thus does not accurately represent the EU-relevant opinions of EU citizens. Third, and maybe most importantly, the complexity of financial market regulation and the vagueness of policy goals (market efficiency, ‘levelling the playing field’, investor protection, etc.) make MEPs even more dependent on outside expertise than the European Commission. MEPs will not always be able to tell the difference between firms’ disinterested expertise and strategic lobbying.

The technocratization of capital market governance, mainly through the involvement of CESR, has further institutionalized a particular vision of what are legitimate policy goals and how they can best be attained. For example, CESR members take investor protection seriously and see it as a legitimate goal of public policy. In contrast, it is considered illegitimate, if not outright ridiculous, to use financial market regulation to shield corporations from hostile takeovers. It would constitute the kind of ‘political interventionism’ technocratic policy is meant to prevent.

The institutionalization of supranational technocratic governance compromises the democratic legitimacy of capital market policy. Policy goals that do not fall within a narrow vision of what financial regulation should do—increase market efficiency, including the promotion of investor protection—are systematically excluded, regardless of whether they reflect the authentic preferences of EU citizens or not.

From a democratic perspective, the most worrying aspect of current arrangements is not that financial firms try to influence policy in their own favour. What is more worrying is that these attempts are not balanced by the interests of other stakeholders, and that the resulting pre-
eminence of banks remains largely invisible from the outside. The first step towards improving legitimacy in the field is thus a better understanding of how financial market governance works in the EU, and how it has become what it is today.

**Methodological considerations**

The aim of this thesis is to identify the ‘prime dynamics’ (Rosenau 1986) behind the supranationalization of EU capital market governance. In the most general sense, the thesis only covers a single case. On this level, comparative tools such as those suggested by King et al. (1994) will not be available to ‘test’ the argument. This difficulty results from the question at the core of the thesis. If, as argued here, a complex structuration dynamic best explains the shift in capital market governance, it makes little sense to carve up social reality into segments that individually might be more amenable to comparison and ‘testing’. Established theories—of financial liberalization, European integration, comparative political economy, institutional dynamics, etc.—cannot by themselves account for the variation we are interested in. With an exclusive focus on any one of them, the big picture is lost.

The dissertation’s approach to corroboration therefore builds on several strategies. The approach advanced here, it is claimed, explains supranationalization better than alternative approaches, such as theories that build on conceptions of national interest, the public good and the pressures emanating from financial globalization. For example, some EU scholars have argued that the European Commission has been the driving force behind EU financial market integration (Posner 2005, cf. Gottwald 2005). This thesis shows that while (highly visible) Commission support was an important condition for integration, it was not a sufficient one—after all, the Commission had been in favour of integration all along. Rather, the core variation that explains integration over time has been the political support of the financial industry and firms’ ability to form successful alliances with key public actors. This is not to say that competition politics can account for every detail in the political process. The emphasis on structuration creates room for irregularities within the theory advanced here. In fact, competition
politics not only allows for such irregularities—it expects them, due to the conceptual pre
eminence of political agency over macro-level processes.

Such ‘congruence methods’ (George and Bennett 2005: 181ff) compare the empirical
evidence against the predictions of (rival) theories. They can make valuable contributions,
particularly as the theoretical framework here generates predictions over numerous units of
analysis: the preference formation and political strategies of firms, preference aggregation
through state apparatuses, the political salience of particular issues due to their impact on the
competitive landscape, etc. For all these ‘intervening variables’, this thesis can find variation
within the sub-cases of its larger case. Most obviously, there is variation over time. This includes
the explanandum of the thesis—the supranationalization of capital market governance—and
other shifts over time—firm interests and market structures—that form part of the explanation.
There is also variation between countries, notably between the three discussed in detail:
Germany, France and the United Kingdom. Their political institutions, market structures and
industry interests differ, and these explain variation in their positions on market integration.
There is also variation between firms: large firms with international operations have different
interests from small, domestic ones. In the early 1990s, universal banks’ preferences differed
from those of securities houses; a decade later, investment banks’ positions differed from those
of stock exchanges.

The study also uses ad hoc comparisons to strengthen the argument at crucial points (cf.
Gerring 2007). Most of these concern comparisons with other, related sectors. The trajectory
within capital markets is particularly surprising when compared to banking, where early
agreement was easy and little happened in ensuing years. At the same time, comparison of the
MiFID with the clearing and settlement sub-sector shows that even with the new institutions in
place, transnational agreement on rules cannot be reached so long as competitive issues in the
industry remain unresolved.

Both the time-frame this thesis covers and the theoretical approach which underlies it call

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for a variety of sources. A great deal of research has already been done on the period up to the mid-1990s. This study draws on both the empirical material assembled in that literature and its analytical insights. These include academic publications in the narrow sense, as well as publications of international organizations, public bodies and think tanks such as the OECD, the European Central Bank and the Centre for European Policy Studies.

In addition, this thesis’ subject has been covered in the specialized financial press over the past two decades. The Financial Times and The Economist, for example, provide a wealth of factual information on market developments. More specialized publications such as The Banker, Euromoney, European Banker and the Financial Regulation Report supply valuable background information, for example on political negotiations. They also provide a level of detail that academic publications rarely achieve.

Filtered by the preferences of private and public actors, market trends and developments are central to explaining changes in governance institutions. The ‘market-side’ of the empirical argument draws considerably on quantitative data. There are, however, limits to the usefulness of such data for this study. While statistics on macro market developments such as stock market indices are widely available, reliable time series statistics on trade in financial services, let alone investment banking, are difficult to obtain. Because financial firms use different methods for reporting their activities, finding common yardsticks for quantifying the relative importance of their foreign business, for example, is difficult. Where possible, figures on variables relevant to this study are used to assess the strength of the argument, for example trends in industry change. But these do not lend themselves to statistical procedures such as multivariate regression analysis. The quality of available statistics and their usefulness will be further discussed in chapter 5, where their potential to contribute to analysis is greatest.

Unsurprisingly, the scholarly literature on EU capital market governance is relatively thin on developments in the past decade. Here, much information can be gleaned from policy documents in which the European Union is awash, including draft directives, consultative
documents and the responses it gets from such consultations. Governments make their positions known through press releases and the speeches of its public officials. Industry associations also publish a wealth of material. The language used in these publications often requires a thorough understanding of the subject to discern political positions in the midst of technical jargon. But especially when compared, these documents often betray the political position of their authors.

At the same time, the theoretical approach of this thesis points to a better understanding of political processes as a core element of explaining political and market change. The aim is to go beyond demonstrating variation in key variables—market structures, political institutions, industry preferences, lobbying efforts, etc.—and to show empirically how they are connected and feed into each other. Through the use of ‘process tracing’ methods (Bennett and George 2005: 6), the ambition is not reveal not only causal effects, but also causal mechanisms (Gerring 2007: 37ff). The sources listed thus far provide only limited insights in this regard, certainly with respect to the more recent events covered in chapters 6 through 8. This gap has been filled with over 50 unstructured in-depth interviews with policymakers and financial market insiders. Because of the dearth of scholarly literature about the episodes they cover, those three chapters also provide more empirical depth than their predecessors.

The interviews for this research were conducted in Brussels, London, Frankfurt, Paris, Bonn, Berlin and The Hague (for an overview of those interviews actually referenced in this thesis, see the table at the end of this thesis). Respondents included Commission representatives, MEPs, the EU-embassies of central member states, CESR, the most important lobbying organisations¹, public officials in France, Germany and the UK, lobbyists of individual (investment) banks and exchanges and a member of the Lamfalussy Committee. The role of respondents as informants explains the unstructured character of the interviews: ex ante, it was

¹ These included the London Investment Banking Association, the European Banking Federation, the European Savings Banks Group, the International Capital Market Association, Association Française des Entreprises d’Investissement, the Future and Options Association, the British Bankers Association, the Bundesverband deutscher Banken, the Federation of European Securities Exchanges, the European Securitisation Forum, the Investment Management Association and Association of Private Client Investment Managers and Stockbrokers.
often impossible to determine on which specific issue a respondent would have and be willing to share most relevant information, and to maximise their usefulness, interviews had to be kept highly flexible.

Many of the issues discussed are politically sensitive. To allow respondents to be frank and forthcoming with information, the interviews were generally conducted under Chatham House Rules: content can be quoted, but only in a way that does not reveal the identity of the respondent. A number of interviews were not recorded but reconstructed directly after the conversations on the basis of detailed notes. The concomitant loss in data reliability was compensated by a presumed higher readiness of respondents to speak freely, share relevant information and hence by a stronger internal validity of this study’s findings. Because the capital markets policy community is small—its core comprises no more than 150 people who generally know each other—respondents’ concrete identities remain opaque in most citations.

Overview of the thesis

After chapter 2 has detailed the theoretical foundations of the study, chapter 3 presents the domestic side of the international constellation. It shows how the institutional power of domestic market incumbents in Germany, France and the UK brought them privileged access to government policy. It also shows how competition politics within national markets was central to regulatory reform and the 1980s wave of financial liberalization. Liberalization was not enforced against the interests of powerful domestic banks, but with their backing. Liberalization was not about ‘freeing’ markets and introducing more competition, but remaking markets in line with changing domestic political forces.

Chapter 4 analyses the first round of single market negotiations for investment services. It shows how unresolved competitive issues between national financial industries were the main obstacle to the kind of swift and encompassing agreement that emerged in the field of banking proper. The constellation of competitive interests in EU capital markets—essentially a
fragmentation along national borders—made national governments the main public actors in EU negotiations. The Commission, and its wish for deeper integration, was effectively sidelined.

Chapter 5 shows how the market side of the international constellation changed over the course of the 1990s. Many national market incumbents developed transnational business ambitions; large continental banks that had hitherto relied largely on their credit businesses reoriented themselves towards investment banking. This reorientation was no simple ‘adaptation’ to cross-border market integration or to ‘globalization pressures’—banks actively sought out new business opportunities and internationalized capital markets in the process. Market integration in the 1990s moreover built upon the regulatory changes agreed since the mid-1980s—which the banks themselves had backed.

Chapter 6 shows how a pro-integration consensus—and a sense of being in the same boat—emerged among the large firms active in Europe. Leading investment banks started designating lobbyists especially for European affairs and intensified their links with supranational bodies, which now emerged as their natural public sector allies in the quest for deeper integration. Semi-formal contacts between the Commission and leading industry players—most conspicuously through the Financial Services Strategy Review Group—led to the Financial Services Action Plan (FSAP), a ‘to-do list’ for the completion of the single financial market, the first draft of which was published by the Commission in 1998. A concerted effort by this transnational public-private alliance to convince national governments of the worthiness of this initiative led to EU member states endorsing it in 1999.

Once the EU legislative programme had been agreed, institutional change emerged on the political agenda. Whereas national control over domestic regulation and market access had previously trumped rule harmonization and market integration, the balance now reversed. Chapter 7 recounts the installation of supranational and technocratic governance as a ‘remedy’ to ‘political interventionism’ in EU capital market decision-making. Industry representatives lobbied for governance arrangements that would both match emerging transnational market structures
and accord them maximum influence. With the adoption of the Lamfalussy process, two new supranational committees were installed—the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR). Especially the latter has altered the way in which EU capital markets are governed.

Rounding off the empirical body of this thesis, chapter 8 explores these new patterns of governance ‘in action’. As part of the FSAP programme, the ISD was renegotiated and eventually replaced by the Markets in Financial Instruments Directive (MiFID). Supranational bodies and transnational industry associations were now the key players—a far cry from the days when governments and national financial industries faced off in negotiations for the ISD. The MiFID negotiations, however, revealed that with the coming of supranational governance, competition politics had anything but disappeared. MiFID negotiations pitted transnational public-private alliances against each other, most notably large investment banks against stock exchanges. As a prime example of market structuration, this chapter demonstrates how demutualization—a strategic decision made by banks as owners of stock exchanges—fed back into market governance and thus the contemporary regulatory regime. The final section of this chapter shows how in the case of clearing and settlement, continued industry fragmentation frustrated Commission attempts to introduce supranational rules. The competitive interests of financial firms still prevailed.
CHAPTER 2: COMPETITION POLITICS AND SUPRANATIONAL INTEGRATION: A STRUCTURAL APPROACH

At the heart of this thesis stands a question that has been fundamental, if not defining, for political economy as an academic field (cf. Underhill 2000): what is the relationship between the domains nowadays often denoted as ‘the economy’ and ‘politics’? Many scholars have pointed out the tenuousness of this distinction (see Chavagneux 2001), which has itself only taken firm intellectual roots in the 20th century (Mitchell 2002: 80ff, cf. Krätke and Underhill 2006). Avoiding the artificial economy-politics distinction, the issue is one of the mutual constitution of market structures and patterns of governance (Cerny 1990, Strange 1988, Underhill 2006).

The supranationalization of EU capital market governance lends itself well to the empirical exploration of this issue. Both capital market structures and their governance have changed enormously since the mid-1980s. What is less clear is how these two transformations should be explained if the two domains are conceptualized as intimately connected. The theoretical literatures dealing with regional integration and financial market opening identify a wide range of explanatory factors, but as this chapter shows, on their own terms they remain insufficient to account for the changes that have been observable.

This chapter therefore has two aims. Building on the discussion in the introduction, it first reviews the various strands of theory relevant to the case at hand and exposes their shortcomings. In particular, they fail to incorporate and properly theorize the agency of a small group of well-connected private and public actors as the crucial link between changing market structures and transformations in governance patterns. This link, so goes the argument here, lies in the political and economic stakes these actors have in the way political institutions and regulatory regimes structure inter-firm competition and thereby market access between countries and different market sectors. Regulatory and institutional preferences, in turn, are themselves inspired by the market environment that actors confront, generating what has been called
'structuration' (e.g. Giddens 1984, Wendt 1987). Over time, this thesis argues, changes in either market structures or patterns of governance can only be understood with an eye to this larger whole.

The second part of this chapter builds an analytical approach suitable to explaining the supranationalization of capital market governance based on these central insights—an approach that will be called 'competition politics' for short. While scholars of International Political Economy (Cerny 2000, Hobson and Ramesh 2002, Underhill 2006) and European integration (Christiansen and Jørgensen 1999, Niemann 2006) have repeatedly called for an appreciation of the structuration concept, its empirical application to date has been rare. The approach developed in this chapter helps bridge that gap.

**European integration**

With the emergence of supranational governance in EU capital markets as the empirical anchor of this thesis, theories of European integration are the natural place to begin an exploration of scholarly approaches. Ever since Haas’ seminal monograph on *The Uniting of Europe* (1958), states’ willingness to integrate policy-making and potentially transfer authority to the supranational level has been a subject of academic debate (early on Lindberg 1963, Hoffmann 1966, Schmitter 1969, 1970, for overviews, see e.g. Rosamond 2000, Wiener and Diez 2004).

One popular explanation was formulated as liberal intergovernmentalism (Moravcsik 1991, 1993, 1998). Regional integration, this approach argued, was in essence comparable to the building of international regimes traditionally studied in International Relations (Krasner 1983, Haggard and Simmons 1987, Hasenclever et al. 1997). In a nutshell, regional integration served national interests. Moravcsik’s own contribution to this strand of thinking was a heavy emphasis on the domestic sources of governments’ preferences (Moravcsik 1997, cf. Weiss 2003), which together with international institutions’ potential for providing collective goods explained observable patterns of governance (cf. Keohane 1988, Scharpf 1997a).
In principle, two kinds of criticisms have been levelled against liberal intergovernmentalism—that it misrepresents the functioning of existing supranational institutions and that it misunderstands the process that led to their emergence in the first place (on the distinction, cf. Jachtenfuchs 2001). Many scholars of multi-level governance (MLG) have argued that regional integration has compromised the sovereignty of EU member states more than is compatible with Moravcsik’s depiction of European politics as a purely intergovernmental affair (Marks et al. 1996, Risse-Kappen 1996, Kohler-Koch and Eising 1999, Hooghe and Marks 2001, Peters and Pierre 2001). The degree to which supranational bodies such as the European Court of Justice or the European Commission have escaped direct government control makes it implausible to think of the former purely as agents of member states, who act as principals (cf. Pollack 1997). In addition, informal political institutions have also grown beyond the nation state as supranational bodies were developed (e.g. Cowles et al. 2001). In short, the world of ‘two-level games’ (Putnam 1988) to which liberal intergovernmentalism is indebted is an inappropriate representation of both formal and informal flows of political authority in the European Union.

The second charge against liberal intergovernmentalism is that it has little to say about regional integration as a systematic process. It has failed to theorize the conditions under which past regime formation could feed back into ‘domestic interests’—either through the redefinition of individual actors’ interests or their identities—and thus unleash a dynamic of its own. The early neofunctionalist integration theorists had tried to do just that but in the eyes of Ernst Haas, widely credited as the founding father of the scholarly field, had remained unsuccessful. As Western European governments failed to cooperate in the face of the economic crisis of the 1970s, he declared regional integration theory obsolescent.

With the re-launch of European integration since the mid-1980s (Tsoukalis 1997, Dinan 1999), theorizing building on neofunctionalism has enjoyed a revival (Sandholtz and Stone Sweet 1998, Niemann 2006). Also Haas himself revised his earlier, negative judgement in the preface to the 2004 edition of The Uniting of Europe. Neofunctionalism has often been misunderstood and
caricatured, however, thanks to functionalism’s common association with an apolitical
automatism in the evolution of political institutions, which clashes with more political readings of
EU history (e.g. van Apeldoorn 2002). But this is not what neofunctionalists claimed or claim. It
is therefore worthwhile revisiting some if its central tenets.

Schmitter’s (2005) summaries of Haas’ original propositions largely overlap with his own
theory of regional integration (Schmitter 1970). Those most relevant for this thesis are
recapitulated below; they are complemented by related, often more recent, insights from EU
integration and governance studies.

○ “States are not the exclusive and may no longer be the predominant actors in the
regional/international system.” (Schmitter 2005: 259, emphasis in original) The façade of
states—understood here as national state governments—as the most visible actors may
only mask a temporary equilibrium of different social groups, for example classes. In
addition, non-state actors can oppose or promote integration independently of
government action.

In his original formulation of integration theory, Schmitter pointed out that change in the
constellation of actors over time can itself be the result of previous integration:

The most important transformation in the structure of the model during
these stages occurs in the nature of national actors. Up to this point they
have been treated as units with a single integrative or disintegrative
strategy during any crisis. Now they begin to appear as differentiated actors,
as a plurality of negotiating units (classes, status groups, sub-regions,
cíentelas, bureaucratic agencies, ideological clusters, etc.). [...] These
“subnational” fragmented actors [...] will begin to form stable
“transnational coalitions” of support and opposition to particular
measures. The policy vector now becomes the product of alliances that
cut across national boundaries [...]. National governmental actors may
continue to play the preponderant role in the concatenation of strategies,
but they can be circumscribed, if not circumvented, by coalitions of
other governmental actors with subnational groups and regional
(cíentias.
(Schmitter 1970: 864f, emphasis in original)
It is widely acknowledged that the most important non-state actors directly participating in EU policy-making are firms and business associations (Feld 1970, Cowles 1995, van Apeldoorn 2002). Over the past decade, business lobbying in Brussels has grown exponentially (van Schendelen 2002, Greenwood 2003, cf. Coen 2007) while business actors increasingly organize transnationally (Coen 1998, for financial services, see e.g. Grossman 2004).

In addition to the changed preferences of many business actors, this fragmented view of the state mirrors how the EU-component of policy-making has grown over the past two decades in a range of fields (Kohler-Koch and Eising 1999, Hooghe and Marks 2001) and how supranational actors have created opportunities for the direct participation of societal actors—what Schmidt (2004) has called ‘government with the people’—through consultation procedures, expert committees, etc. For the purpose of analysis, then, there is no reason ex ante to focus exclusively on (unified) public actors, neither on the national nor on the supranational level.

- “Decisions about integration are normally taken with very imperfect knowledge of their consequences and frequently under the pressure of deadlines or impending crises.” (Schmitter 2005: 259, emphasis in original) Actors therefore frequently miscalculate the results of their own political efforts.

‘Knowledge’—both as a product of political processes and a resource to influence them—has attracted increased attention within EU integration studies since the second half of the 1990s (Risse 2004). Fusing the ideas that genuine deliberation at the EU-level is both more democratic and produces better policy than hard-nosed strategic bargaining, scholars have searched for the conditions under which such deliberation can emerge (Joerges and Neyer 1997, Neyer 2003, cf. Schmalz-Bruns 1999). For example, Niemann (2004) has argued that high issue complexity, the shared ‘life world’ of a policy community’s members and a low degree of politicization all promote communicative action (cf. Risse 2000). The composition of the policy community itself can of course be highly political by excluding important stakeholders; communication between insiders may actually reflect the institutionalized limits of their discussion. Consensus reached
through communicative action may still be the result of an unrecognized intellectual hegemony (Hay and Rosamond 2002, McNamara 2002), while the complexity of an issue area such as banking may force policymakers to rely on experts (McKenzie and Khalidi 1996) and potentially expose them to self-interested manipulation. Regardless of just how strong these ‘knowledge’-effects are in practice, they call for close empirical attention to the process of rule making and supranational integration, rather than just an imputation of ‘rational’ interests into actors.

- “Since actors in the integration process cannot be confined to [actors at the national level], a theory of it should also explicitly include a role for supranational persons, secretariats and associations.” (Schmitter 2005: 260, emphasis in original)

Departing from the realist/liberal intergovernmentalist proposition that member states are in control of EU integration (Moravcsik 1993, 1998), scholars have explored ways in which supranational EU bodies—especially the Commission—may themselves have an influence on the integration process and why member states would allow such an erosion of their sovereignty (e.g. Marks et al. 1996, Pollack 1997, Hooghe and Marks 2001). One branch of this debate has mirrored discussions among institutionalist scholars more generally (Hall and Taylor 1996) and questioned what sort of control ‘principals’ still have over the institutions they have created (cf. Jupille and Caporaso 1999, Pollack 2004). Where rational institutionalists argued that by and large, institutions can still be understood as ‘instruments’ of those who have established them (Scharpf 1997a, 2001), historical institutionalists have pointed to ways in which they eventually outgrow the intentions of the creators (Pierson 2000a, 2000b, cf. Jervis 1997).

By now, it is hardly disputed that both the ECJ and the Commission enjoy room for manoeuvre (Pierson 1996, Pollack 1998). In a review of Nordlinger’s On the Autonomy of the Democratic State (1981), Krasner lists the ways in which state actors—they are equally applicable to supranational actors such as the Commission—can exercise independent influence on policy:

[they] may initiate policy and provide access for particular societal groups [and] reinforce a weak level of convergence [of social preferences] by manipulating information, inflating the success of ongoing programs,
setting agendas, appealing to widely shared symbols, playing upon deference to official expertise, and deflecting potential opposition.
(Krasner 1984: 231)

What is less clear is how supranational actors’ room for manoeuvre relates to other factors. Gottwald (2005) for example argues that the supranationalization of capital market governance is largely attributable to the agency of the Commission. However, he does not specify how the visible actions of the Commission relate to the much less visible economic and political environment in which it operates. Similarly, Posner (2005) has shown how the Commission was crucial to setting up EASDAQ, the European version of the American NASDAQ stock market. But again, it remains unclear how much this (eventually unsuccessful) initiative relied on contingent environmental factors. In our case, two initiatives to integrate European markets for investment services produced strikingly different results while the Commission was supportive of integration both times. An explanation for integration will therefore have to be sought elsewhere; the Commission is by definition involved in every successful EU legislative project.

- “Interests, rather than common ideals or identity, are the driving force behind the integration process [.]” (Schmitter 2005: 259, emphasis in original) The interests of actors can change in the course of the integration process, often in light of the (potentially unequal) distribution of its benefits.

The idea that actors’ pro-integration inclinations can be both the source and the result of actual integration is central to neofunctionalism as a theory. To see interests as the driving force behind integration is not particularly controversial (see, however, Neyer 2003; Niemann 2006: 24), especially if interests are not seen as objectively given and integration is understood as a mix of creating joint gains (‘problem-solving’ in Scharpf’s language) and conflicts over the distribution of these gains (‘distributive bargaining’, Scharpf 2001, cf. Garrett 1992). What is controversial, however, is whose interests actually count in the supranationalization of governance.

Critical approaches to EU integration, for example, see conflicting class interests at the heart of European integration (e.g. van Apeldoorn 2002, Bieling 2003, Cafruny and Ryner 2007).
Supranational governance here is a result of and mechanism for the transnational integration of capitalist relations of production. By emphasizing the functionality of supranational governance for a particular set of societal interests, the analysis dovetails with neofunctionalism. At the same time, the approach leaves little room for the independent effects of either political or economic institutions, and it therefore offers insufficient theoretical guidance to the actual political process by which collective actors translate their economic interests into institutional change.

Supranationalists also see the interests of particular social groups behind integration.

Stone Sweet and Sandholtz for example argue that:

supranational governance serves the interests of (i) those individuals, groups, and firms who transact across borders, and (ii) those who are advantaged by European rules, and disadvantaged by national rules, in specific policy domains. (Stone Sweet and Sandholtz 1998: 4)

In contrast to critical theorists, they are relatively agnostic about the potential societal alliances that may promote or oppose integration:

Some elite groups (leadership of political parties, industry associations, and labour federations) begin to recognize that problems of substantial interest cannot be solved at the national level. These groups push for the transfer of policy competence to a supranational body, finding each other and establishing cross-national coalitions along the way. If the problem is important enough and pro-integration elites are able to mount sufficient political leverage, governments establish supranational institutions. (Stone Sweet and Sandholtz 1998: 5)

While this argument is plausible, it cannot in itself account for two crucial ingredients of the dynamic it describes: just what are the ‘problems of substantial interest’ that motivate these elite groups to push for supranational integration? And equally important, why can some groups ‘mount sufficient political leverage’ to implement their vision on supranational integration while others cannot? Even though neofunctionalism and its theoretical offspring posit a general positive relationship between supranational integration and the cross-border integration of social and economic space, they underspecify the concrete actors and processes that act as ‘transmission belts’ between the two. Sandholtz (1993) himself has pointed out that different
theories were needed to explain and connect integration dynamics and domestic preference formation, so this lacuna is not a material defect of neofunctionalism and related theories. It does, however, necessitate an exploration of the political economy dynamics in the policy field in question to fully understand the emergence and functioning of supranational governance.

Financial market liberalization and regulation

The supranationalization of EU capital market governance has had the cross-border integration of financial markets as its professed goal. Such market-opening has not been limited to the European Union, however, and given the global trend towards financial liberalization (J. Williamson and Mahar 1998), many scholars have first looked to the international level for the driving forces behind it. In particular, they have drawn inspiration from debates in International Political Economy that have identified capital mobility as the driving force behind ‘globalization’ and domestic change in general (affirmatively Gill and Law 1989, Andrews 1994, Pauly 1995, Keohane and Milner 1996, Garrett 1998, sceptically Swank 2002, Mosley 2003, for an overview see Berger 2000).

Laurence (2001) has combined this insight with the notion of regulatory competition (Esty and Geradin 2001, McCahery and Geradin 2004 for a critical assessment), which builds on Tiebout’s original contribution about patterns of local taxation and expenditures. Tiebout (1956) argued that if citizens were free to settle in any of a number of municipalities, they would choose the one offering the ‘optimal’ mix of costs (taxes) and benefits (desirable municipal expenditures). To attract mobile citizens from elsewhere or prevent emigration, municipalities would adapt their taxation and expenditure regime to match citizens’ preferences (cf. D. Vogel 1995, Lazer 2001).

Laurence has interpreted recent waves of financial market liberalization in this vein (2001). In his eyes, inter-jurisdictional capital mobility has allowed investors to break the previous, often cartel-like grip of local financial services producers on national markets and regulatory regimes. In the face of capital mobility, governments opened national markets and invited foreign competition, much to the chagrin of domestic financial firms, whom Laurence has
seen as the primary losers of financial liberalization.

The empirical record is not easily squared with this argument. Studies of regulatory
competition in financial services generate mixed evidence, at best (Hertig 2001, Jackson and Pan
most importantly, rather than being losers of financial integration, large investment banks have
continued to post record profits as markets were opened up (cf. Augar 2005).

The core failure of Laurence’s argument lies in its disregard for the actual policy process
that is supposed to translate abstract macro-forces (capital mobility) into policy change. Of the
four ‘pathways of influence’ of internationalisation on domestic politics he suggests, one stands
central: the ‘threat of exit’ of mobile asset holders. Yet it remains unclear how these threats
matter to policy makers, especially given these asset holders’ lack of embeddedness in the actual
policy process. The most concrete suggestion Laurence makes is that domestic banks, who are
well established in national policy communities and allegedly worry about their business, ‘lobby
policy makers on behalf of mobile-asset consumers whose business the service providers want to
keep or win’ (Laurence 2001: 193). Here, the argument falters: if indeed large banks have been
beneficiaries of market opening, as empirical evidence strongly suggests, it becomes much more
plausible that their lobbying has been self-interested rather than cow-towing to mobile investors.
The regulatory competition dynamic that forces change on unwilling banks and governments
becomes unconvincing as the source of market-opening.

Indeed, it is misleading to construe capital mobility as an exogenous force to begin with.
Helleiner has shown (1994) how central financial market developments over the recent decades
have been the result of conscious public policy, rather than being induced by outside forces.
Rather than being able to explain financial market opening with capital mobility, the question
puzzle lies in the political choice of governments to introduce capital mobility in the first place.

In addition, models of regulatory competition generally ignore the fact that governments
not only compete with each other but can also cooperate (McCahey and Geradin 2004). To the
extent that regulatory competition is seen as undesirable, governments can establish regimes to
uphold higher standards (Krasner 1983, Hasenleve et al. 1997). And indeed, states have
cooperated to agree on common rules in a number of financial domains (Porter 1993, Underhill
1993, Porter 2005: 31ff). Regardless of whether such regimes spring more from a desire to
produce collective goods cooperatively or from distributive struggles (Kapstein 1992, Nabors and
Oatley 1998, Singer 2004), market opening can be the result of multilateral bargaining as much as
of unilateral adaptation (Simmons 2001).

In the case of EU member states, governments have chosen a mix of both strategies.
Most market opening in the 1980s was unilateral (see Cerny 1989 for France, Moran 1991 for the
UK, Story 1997, Lütz 2000 for Germany). Agreeing EU-wide rules, in contrast, is by definition a
multilateral affair. Here liberalization is an instance of negotiated market opening—something
that most comparative studies (prominently S. Vogel 1996) cannot accommodate because they
model liberalization as a domestic political adaptation to changes in the global environment (cf.
Keohane and Milner 1996). Regardless of whether market opening is a unilateral or multi-lateral
affair, these shortcomings call for a much more in-depth appraisal of the actual policy processes
and concrete actors who lobby, draft policy proposals and bargain to effect it.

This also applies to the second popular ‘top-down’ explanation of financial market
change, technological progress (overviews of such arguments can be found in Cybo-Ottone et al.
2000, R. Lee 2002). This line of argument is particularly common in the business literature (e.g.
Holland et al. 1998, I. Walter and Smith 2000, R. Smith and Walter 2003). The general idea is that
technology undermines the boundaries between national financial markets and at the same time
generates economies of scale that increase the welfare gains associated with market integration.

There can be no doubt that technological innovation has changed the face of financial
markets. But arguments that attribute causal power to it have clear weaknesses (Sobel 1999: 8ff).
Technology is an instrument that purposeful actors use to attain their own ends (e.g. Henwood
1997: 137ff, Partnoy 2002), even if success is never assured (Goldstein 1995). In this sense, it is
no more than a means towards an end that emerges from a dynamic distinct from technological progress—be it the struggle between capital and labour, between different firms, between firms and governments, or between debtors and creditors.

Technological progress by itself cannot explain why existing innovations are applied in some cases and not in others. For example, why do institutional investors still have to pay intermediaries to trade shares for them when they could as well communicate directly with exchanges (Mahoney 2002)? And what has motivated governments to obstruct the use of technology, for example the setting up of remote trading screens (Mügge 2006)? In short, technology is an insufficient explanation for financial change without an account of the motivations of those who regulate its application and, indeed, financial markets as a whole.

Normative theories of financial regulation draw on neo-classical economic thinking to explain the necessity of such regulation as well as the desirability of clear limits to state intervention in ‘markets’. In this view, market failures stemming from systemic risk, ‘moral hazard’ and ‘adverse selection’ (Akerlof 1970) serve as the central justification for otherwise illegitimate state interference in the marketplace (Herring and Litan 1995, Goodhart et al. 1998). Governments provide collective goods: they increase the safety of the financial system as a whole, increase the allocative efficiency of financial markets through the alleviation of information asymmetries, and thereby boost overall welfare (Gertler 1988).

Yet such a normative view again leaves regulation underdetermined (Laurence 2001: 30ff). For example, governments can design stringent rules to prevent individual bank failures—an approach likely to entail limits to competition, driving up costs for consumers. Alternatively, governments can provide a general ‘insurance’ for institutions that fail, and leave them exposed to more competition, which is likely to lower costs but also increases the chance of future failure. Normative theories fail to explain why one would be preferred over the other.

Stigler’s theory of ‘regulatory capture’ addresses this gap, arguing that regulation regularly falls prey to self-interested manipulation by regulators and the regulated (Stigler 1971). Regulation
not only provides collective goods, but entails costs and benefits that are distributed unevenly throughout society. Independent of its alleged goals, regulation is contested between social groups aiming to secure benefits for themselves and shift costs onto others:

[The] problem of regulation is the problem of discovering when and why an industry (or other group of like-minded people) is able to use the state for its purposes, or is singled out by the state to be used for alien purposes. (Stigler 1971: 4)

Stigler envisioned four kinds of ‘favourites’ that industries desire from governments: money (through direct or indirect subsidies), controls on market entry, limits on the availability of substitutes for their own products combined with an encouragement of the consumption of complements, and price controls. Over time, he argued, government officials were likely to build their own ‘constituencies’ with whom they entertain reciprocally beneficial relationships. Stigler’s vision on what policy makers received in return for granting privileged access to policy-making remained narrow, however:

The industry which seeks regulation must be prepared to pay with the two things a [political] party needs: votes and resources. (Stigler 1971: 12)

Conceiving ‘politics’ in terms of elections led Stigler to conclude that in the struggle over the costs of regulation, producers would regularly win out over consumers. Producers are relatively small in number but have high individual stakes in ‘their’ field of regulation. Individually, they are willing to invest significantly in tilting policy in their favour, he argued. The costs of competition-restricting regulation, in contrast, are spread over a large group of consumers, whose individual burden from a specific measure is relatively small. Individual producers thus have a higher incentive to lobby regulators than do individual consumers. Second, also owing to the difference in numbers, producers find it easier than consumers to organize and mobilize collectively (cf. Olson 1965). Third, in industries with significant employment, producers might be able to mobilize the votes of their employees based on the extension of political favours. These three factors taken together, Stigler argued, would systematically advantage producers and tilt
regulation in their favour.

Stigler's image of regulatory capture had a number of shortcomings, though. First, even though it is plausible that consumers are generally losers from regulatory capture, it is not clear that domestic producers are the only societal actors vying for influence of regulatory policy or, for that matter, that they do so in a united front. Producers are after all rivals of each other. Sobel (1994) has used an approach that focuses on competition between providers of financial services to explain reform trajectories in British, Japanese and US capital markets in the 1970s and 80s. He concluded that market liberalization resulted from domestic struggles over market domination; international pressure was secondary. In all three cases commercial banks had been excluded from the lucrative capital market business. When for idiosyncratic and exogenous reasons they faced problems of profitability related to market saturation, they challenged the market position of the securities houses and brokers—the market incumbents—by lobbying for market opening. In all three cases, commercial banks were successful. Kroszner and Strahan (1999, 2000) have found similar dynamics behind the abolition of inter-state branching restrictions in the US.

Sobel's perspective shares a second shortcoming of Stigler's approach, however. Neither can easily account for the opening of national markets to foreign competitors. In both cases it is argued that national policy insiders dominate regulatory policy making. If that is true, why would they allow foreign firms in? Finally, Stigler operated with a highly simplified model of politics, one that saw public and private actors connected by money, votes and regulatory favours. That, however, grossly misrepresents the way regulatory policy functions in practice. A thorough understanding of regulatory politics has therefore much to learn from scholarship that has put policy processes and the actual functioning of the state under the analytical magnifying glass.

Private and public actors in regulatory policy

In the pluralist view that underlies Stigler's model,
[The government is seen as a cash register that totals up and then averages the preferences and political power of societal actors. (Krasner 1984: 227)

As Krasner himself points out, this is an inadequate description of the American state, let alone of more corporatist ones, for at least two reasons: political institutions have independent effects and the state can be a powerful actor in its own right.

What has come to be known as historical institutionalism has pointed out that political institutions are neither reducible to societal forces at any given moment—as functionalist, rational-choice institutionalism had suggested—nor, for that matter, to the intentions of their originators (Skocpol 1985, Pierson 2000b). Institutions are hard to change (‘sticky’ in the jargon), and by benefiting some societal groups more than others, create their own constituencies which invest in their reproduction (Pierson 2000a). Path dependency is the result.

As Hall and Taylor (1996) point out, both sides of this debate have a point: on the one hand, actors when they establish institutions are likely to have clear intentions. And though path dependencies can clearly be identified in political-economic research, paths shift and can be broken, often for reasons that remain poorly integrated into historical institutionalist models (Deeg 2001, Crouch and Farrell 2004). On the other hand, whether these institutions then deliver the results the actors hoped for depends on factors that must be established empirically.

Political institutions above all matter for regulatory politics because they structure societal groups’ access to policy-making (Pierre and Peters 2002). Empirically, policy communities that cover specific issue areas are relatively circumscribed, while their institutions function to keep outsiders out. Political institutions thus give members of policy communities what Barnett and Duvall (2005) call ‘institutional power’—power that can be used for a broad variety of ends not necessarily related to the reasons for the existence of the institution.

Banks’ institutional power has mainly derived from the varying roles they have played in national economies (e.g. Zysman 1983, Crouch and Streek 1997, Allen and Gale 2000). For example, Germany’s coordinated market economy was linked to a corporatist political system
that enabled the positive coordination of economic policies (Schmitter 1979, Jayasuriya 2001). France's state-led economy was mirrored in highly centralized structures with the state, and in the case of financial markets the Trésor, at their apex (Loriaux 1991, Schmidt 1996, Lalone 2005). Finally, lack of coordination between economic policy fields in Britain after the Thatcher revolution translated into weak political institutions to connect the government with economic associations, be they trade unions or business groups. These patterns, originally embedded in national varieties of capitalism, also emerge in the governance of securities markets (Coleman 1996).

In his analysis of financial market regulation, Vogel (1996) has identified national varieties of capitalism as central factors in the different trajectories financial liberalization took, including in the three countries most relevant to this thesis: the UK, Germany and France. He concludes that all three faced similar external pressures for adaptation but their responses were path dependent: the UK—already a liberal economy—further opened its markets whereas Germany and France 'strategically reinforced' their governments' steering roles in theirs. However, Vogel does not clarify whether path dependency is best understood as an adaptation of dysfunctional economic institutions or the result of an institutional legacy that empowers specific actors.

The former view draws on institutional complementarities in national 'varieties of capitalism' (Hall and Soskice 2001b). Due to the co-evolution of economic institutions, so the argument, financial markets have come to 'fit' their economic environments. These institutional complementarities have often generated positive externalities and have thus increased overall welfare. State actors with a stake in overall economic performance should favour reproducing advantageous national regulatory regimes or adapting them to those changes in the global environment that compromise their optimality (on such 'adaptive pressures', see e.g. Schmidt 2002, Glyn 2006, for a critical view see Hay and Rosamond 2002).

Yet comparative political economists still debate whether this is a valid depiction of national varieties of capitalism and the factors that are decisive for their convergence or

As is the case within other institutions, the role of knowledge in policy-making is a double-edged sword. It has independent effects, for example by structuring access and pre-selecting policy solutions (P. Haas 1992, Hall 1993, Zito 2001). In highly complex policy fields, actors with expertise and a clear sense of their own interests are likely to be at an advantage over less well-informed actors with only vague preferences. On the other hand, actors can purposefully generate and manipulate knowledge for their own ends. How the ‘independent’ effects of knowledge compare to its instrumentalization by purposeful actors can thus differ from case to case and is therefore again a question for empirical research.

Comparative studies of financial market policy-making (e.g. Moran 1991, Coleman 1996, Josselin 1997, Lütz 2002) show that central banks, finance ministries, regulatory agencies and the regulated themselves often form the inner circle of policy communities. The policy communities matter to political outcomes because they

limit participation in the policy process, [...] define the roles of actors, [...] define which issues will be included and excluded from the policy agenda, [through] the rules of the game [...] shape the behaviour of actors, [...] privilege certain interests, not only by according them access but also by favouring their preferred policy outcomes [and] substitute private government for public accountability. (Rhodes 1997: 10)

In contrast, the wider public, other stakeholders and national parliaments are normally at the fringes of policy-making. These studies also shatter the idea that regulation is a tug-of-war between the regulators and the regulated (cf. Clarke 2000). Historically, what is nowadays considered regulation has been mostly effected by guilds (for an overview cf. Braithwaite and Drabos 2000). Also today, rather than opposing each other, private and public actors form ‘advocacy coalitions’ (Sabatier 1988, 1999) that jointly pursue shared policy objectives. Given the
conceptual and historical blurring of the public-private divide, ‘[in] this world the language of regulatory capture is largely devoid of meaning’ (Hancher and Moran 1989: 276)—regardless of Stigler’s valuable insights about the impact of particularistic interests on regulation.

If regulation is to be located, then, we may say that it exists on a political space between law and society, a space inhabited by the state, private interest groups and regulatory agencies, some public, some private, some mixed. (Clarke 2000: 21)

If this blurring of the line between the public and the private is taken seriously, then certainly in a historical view, theories of institutional change or market opening that are based on a stark public-private distinction clearly fall short. Private and public actors form coalitions both to shape markets in their own interest and to craft political institutions that help them attain their goals and solidify their grip on public policy. In the long-term process of this mutual constitution, little remains fixed: the responsibilities of ‘public’ and ‘private’ actors in policy-making change, as do the levels of aggregation at which they come together. It is in this sense that the state—the crystallization of the political economy struggles unfolding in society—can be understood as ‘the problem of international political economy’ (Underhill 2006: 16, emphasis in original, cf. Cerny 1990).

**The competition politics approach**

Most of the theories discussed so far have described different parts of the political economy elephant that they study well, to borrow Puchala’s (1972) phrase. But they have insufficiently appreciated the mutual constitution of patterns of governance, market structures and market rules with purposeful actors as the nexus between them (see figure 1). The final part of this chapter proposes a framework to financial market governance that aims to address that shortcoming. It not only suggests that the different theories discussed all deserve to be appreciated, and that the processes they describe simultaneously contribute to real world political economy outcomes. It argues that they can be synthesized to describe one integrated, larger dynamic—competition politics.
Regulation, political institutions and firm preferences

Regulation structures the behaviour of economic agents and thereby markets. Indeed, market sectors dealing in intangibles such as investment services are effectively ‘regulation-defined’ (Vieor 1987). But what ends does regulation serve? In the passage that prefaces this thesis, Adam Smith already argued that producers in particular sectors oppose efficiency-enhancing competition when he wrote:

[the] interest of the dealers [...] in any particular branch of trade of manufactures, is always in some respects different from, and even opposite to, that of the public. To widen the market and narrow the competition, is always in the interest of the dealers [...]. The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with greatest precaution. (A. Smith 1937 [1776]: 250)

But how important are these producer interests for financial market regulation? As a number of studies of domestic regulatory reform have found, they can be considerable (Sobel 1994, Kroszner and Strahan 1999, 2000, Vitols 2004, for an overview, see Hardy 2006). To sustain
prices for their products and thus their profits, producers use regulation, not so much against consumers, but against each other. Fligstein has argued that in an economic-sociological perspective, the primary function of regulation is to prevent ruinous competition (Fligstein and Mara-Drita 1996, Fligstein 2001). From the perspective of firms, keeping competitors out and thereby securing rents and organizational survival are core aspects of regulatory regimes (for a similar argument from a firm-perspective, see Shaffer 1995).

For market incumbents and their (potential) challengers, then, the central quality of regulation is that it sets the terms of competition (Underhill 2003: 765f, see also Underhill 1998): it determines who is allowed to compete in which market segment under which conditions. In wholesale financial markets, regulation plays a much larger role in reproducing prevailing market structures than in other sectors where factors such as ownership of scarce resources, inherited product differentiations (potentially bolstered by patents), and hard-to-change customer relationships form larger impediments to change. Regulation forms one of the main obstacles for large players that command both the necessary financial resources and reputation to establish themselves in new markets or segments. To use Stigler's language, 'capturing' financial market regulators—or preventing their capture by others—becomes an integral part of companies' business strategies. Struggles over regulation are struggles over market shapes—the way different segments and fields of economic activity are delineated.

This does not mean that banks' strategies derive neatly from their environments. Studies of their strategy-formulation have shown that no single theory can capture the different environmental, institutional and firm-level factors that play a role (Milbourn et al. 1999, Flier 2003). As political strategies normally derive from business objectives, both firms' policy preferences and the vigour with which they pursue them do not always reflect their 'objective' situation in the market place. Disruptive events are often necessary to break organizational and cognitive inertia. It is therefore difficult to predict when environmental change will translate into a review of strategy. But as Flier's study (2003) shows, once the review takes place, environmental
and institutional factors play an important role in determining the direction of change (cf. Hillman and Hitt 1999).

The institutional power of financial firms

Over time, the population of firms adapts to their market environment; those firms that come to dominate a market segment owing to the rules that govern it will become the natural constituency in favour of its reproduction (cf. Fligstein 2001). But how are these preferences inserted into the actual policy process? In the case of banks, their central role in national economies will generate privileged access to public actors. Financial firms jointly create regulation with regulators, they cooperate with governments in selling the latter’s debt, they are, in short, in integral part of the apparatus through which most governments directly or indirectly implement economic policy. This makes banks insiders in the relevant policy communities.

The institutional power deriving from banks’ membership in these policy communities, in turn, allows them to further solidify their market position by regulatory means; at the least, preferential access to political resources forms a de facto insurance against unwelcome market intrusion by firms outside the group of market incumbents—both domestic and foreign. The relationship is reciprocal, then: market incumbency generates the political resources to reproduce itself.

Integrating markets

Of course, this depiction of state-market dynamics vastly overstates market stability. In past decades, the trend has clearly been in the direction of market opening, not only in financial markets but across a wide range of economic sectors. How can such liberalization be squared with an emphasis on firms’ own control over the terms of competition? The answer lies in the negotiated character of much market opening, whether through the World Trade Organization, regional trade agreements, bilateral agreements or agreement on common standards such as financial regulation as in the case of this thesis (Abbott and Snidal 2001).
The fact that much regulatory change with market-opening effects is negotiated gives it a quality akin to trade politics (cf. Busch 2001). When market-opening is reciprocal, the most competitive firms in all jurisdictions involved stand to gain, commonly at the expense of smaller players with a domestic focus (cf. Krugman 1986). Cross-border market integration by regulatory means may therefore once market incumbents have reached domestic limits to growth and identified cross-border expansion as they way ahead (Milner and Yoffie 1989). Because the price to pay—increased competition ‘at home’—is disproportionately borne by smaller firms, coalitions in support of opening may emerge in all jurisdictions involved. The European Roundtable of Industrialists, a vocal supporter of the single market project in the late 1980s, has been repeatedly analysed in this vein (Sandholtz and Zysman 1989, Cowles 1995, van Apeldoorn 2002).

*Supranational governance*

In this context, supranational institutions matter because they affect the ease with which such cross-border market-opening can be attained. This much is undisputed even among liberal intergovernmentalists (Moravcsik 1993). Supranational institutions lower transaction and monitoring costs and solve collective action problems (cf. Scharpf 1997a). The agreement of harmonized rules, one of the most common and far-reaching forms of cross-border market integration, has such a potential for distributive bargaining that some degree of centralized authority can greatly enhance efficiency in finding a workable compromise.

That is not the only reason that firms interested in market integration push for supranational governance. Because supranational bodies themselves enjoy room for manoeuvre in policy-making, they provide an opportunity for actors with a stake in supranational governance to build alliances with what are in this respect natural allies. Indeed, as policy-making is transferred from the national to the supranational level, the influence of pro-integration actors rises whereas that of its opponents, who still rely on national governments, decreases. The installation of supranational bodies is more than just adding an extra layer of governance that
otherwise leaves patterns of governance unaltered. It is the formalization of political authority at a level of aggregation that matches the interests and market structures subject to these institutions. It is, in short, a transnationalization of the state in the face of altered competitive dynamics in the market place.

**Structuration dynamics**

This feedback between patterns of governance and market structures gives structuration its momentum. Market structures inspire actors to reproduce political institutions or work towards their transformation depending on the impact that rules made through these institutions have on the competitive landscape. Changes in the competitive landscape, in turn, affect both the economic might of firms—including their (potential) status as a market incumbent—and associated with that the political resources they command at different levels of governance. The overall model is graphically summarized in figure 2 on the following page.

Because structuration is not ruled by a single dynamic (cf. Cerny 2006), equilibriums between structures and agents’ place in them are likely to be temporary, if they exist at all. Even the ‘fit’ between the nation state and the global economy of embedded liberalism (Ruggie 1982) was more transitory than is often suggested (Frieden 1991, Cerny 1995). The Bretton Woods system, the pinnacle of this order in financial markets, was fully operational for no more than a decade before countervailing forces and underlying tensions inspired the US to initiate its demise in the late 1960s (Eichengreen 1998). Because change in political institutions is typically relatively abrupt, the co-evolution of the two can nevertheless be conceptualized as one of ‘punctuated equilibriums’ (True et al. 1999, cf. Krasner 1984, Crouch and Farrell 2004). With a new set of political institutions created at the supranational level, it may be that at least for the time being, patterns of governance have settled into a stable state converging around the bodies of the European Union. Whether, when and how market transformations may inspire agents to upset this institutional arrangement yet again will be for future research to show.
Figure 2: A schematic depiction of EU financial market structuration
Even though the supranationalization of governance is the explanandum of this study, it is seen as one side of the transformation of what Underhill (2003, see also Underhill and Zhang 2005, Underhill 2007) has called the state-market condominium. Figure 2 is a flow-model of structuration dynamics for capital market governance. Actors’ preferences, filtered by political institutions, are turned into regulatory policy, which affects economic behaviour and thus overall market structures. Changes in this economic environment can, in turn, affect actors’ preferences. As the figure shows, two factors are denoted as ‘distinct but interdependent’. In practice, the distinction between factors that are endogenous and exogenous to a dynamic is less clear cut than the dichotomy suggests (cf. Jervis 1997). Global market developments are not separate from EU trends, especially in capital markets, where London currently challenges New York as the most important global financial centre (Corporation of London 2005, McKinsey 2007). European financial markets are not footnotes to global finance; they are central to it. And as has been elaborated above, varieties of capitalism can inform actors’ preferences and leave their imprint on domestic and eventually cross-border political institutions, even as comparative political economists debate the degree to which they have fallen prey to economic globalization and the transformation of financial markets.

Conclusion

The competition politics framework that this chapter has elaborated aims to connect abstract notions of structuration in political economy with concrete insights from a broad range of theoretical literatures, including those dealing with European integration, financial liberalization and regulation, policy-making, the emergence and functioning of political institutions and national varieties of capitalism. In addition to showing how theories from these fields can be synthesized, the competition politics approach generates four specific contributions to our understanding of political economy that return throughout the thesis.

First, the governance of financial markets—both in terms of substantive regulation and governing institutions—is the product of an elitist form of private interest politics. To be sure,
private actors have to forge successful alliances with public actors to achieve their aims. But as
this chapter has argued, financial market incumbents typically command sufficient institutional
type to do so. This emphasis on insider politics contradicts both the idea that financial market
governance was guided by an overarching collective interest or that it was the outcome of a
political struggle among broad coalitions.

Second, such private interest politics generate a dynamic that can be called ‘competition
politics’. Firms’ regulatory preferences are primarily informed by their desire to control and
manage the competitive landscape within which they operate, rather than for example profit
maximization. Socio-economic approaches have emphasized the stability in market structures
that can result from regulation as an instrument for restraining competition (Fligstein 2001). The
approach advocated here, in contrast, sees competition politics both as an instrument for the
reproduction of existing market structures and as a force behind cross-border governance and
market integration.

Third, this dynamic defies simplistic categorizations that see either structural forces at
work or a small group of agents designing market structures at will. Rather, competition politics
is an instance of market structuration: actors simultaneously use both economic and political
resources to affect the market structures they confront in line with their preferences. At the same
time, actors’ policy preferences and the resources they command to further them are influenced
by the political and economic market structures within which agents operate. Changes over time
in the political institutions that govern markets, including supranational integration, thus need to
be analysed with an eye both for the way in which agents’ preferences shape structures
(collectively binding rules, political institutions and markets) and the way in which these structures
inspire and constrain agents.

Fourth, the resulting stance on supranational integration emphasizes actors’ material
interests and the transnational political-economic context in which they are embedded; at the
same time, it highlights the open-endedness of the interaction between market structures and
patterns of governance is central to competition politics. This weighting of material interests challenges approaches that see free-floating identities, the supranational loyalties of bureaucrats, the independent effects of institutions or the more efficient provision of public policy as the driving forces behind supranational integration. The approach is transnational in scope because both the competitive dynamics at play as well as the patterns of political association and exercise of power defy the liberal intergovernmentalist notion that member states and their governments were still the core actors in EU integration. And it is open-ended because the attendant complexities, uncertainties and unintended consequences infuse supranational integration with more vagaries and internal contradictions than transnational historical materialists allow. Indeed, it is precisely this non-linearity of supranational integration that motivates the empirical tracing of supranational capital market governance back to its origins in the mid-1980s—the point at which the following chapter will pick up the historical thread.
CHAPTER 3: BANKS’ INSTITUTIONAL POWER AND DOMESTIC FINANCIAL 
MARKET REFORM IN THE 1980s

Scholars of financial markets often portray the 1980s as the decade when finance went global and 
markets were deregulated (e.g. Strange 1998, R. Smith and Walter 2003). Financial regulation was 
already in flux when capital market opening appeared on the EU agenda in the second half of the 
1980s. In a way, the EU seemed to be jumping onto a moving train.

This wave of domestic market opening has important consequences for analysing EU 
capital market integration. Most obviously, it may be that EU-level developments were 
epiphenomenal to domestic regulatory reforms. From this perspective, core changes took place at 
the national level while EU politics were only a side-line to the main story. The pattern of EU 
negotiations and regulation, however, do not support this view. The European regime that 
member states agreed in the early 1990s contained many protectionist clauses. In important 
respects, it was not an extension of national market liberalization, but contained elements 
pointing in the opposite direction. So how can the two be squared?

When viewed through the lens of competition politics, the tension between national 
market liberalization and protectionist rules at the European level disappears. Both, I argue, bear 
the imprint of financial market incumbents’ strategic considerations. While the coming chapters 
support this claim in terms of EU-level politics, this one shows how it rings true for liberalization 
at the national level. In doing so, it addresses the apparent tension between an explanation of EU 
politics stressing strategic agency on the one hand and of national changes supposedly driven by 
global market structures on the other. The chapter’s reappraisal of the ‘decade of deregulation’ 
shows how the two complement rather than contradict each other.

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3 In the 1990s, the European Community (EC) was incorporated in the European Union (EU), the label commonly 
used since then. For the sake of consistency, ‘EU’ will be used also for time periods when strictly spoken, ‘EC’ would 
be the correct label.
The question of whether regulatory reforms are best understood as de-regulation—the simple abolition of rules—or re-regulation—the creation of new rules, possibly to substitute old ones (cf. Cerny 1994, S. Vogel 1996) will be side-stepped. The debate only makes sense when re-regulation is equated with state control over markets and de-regulation with its loss. As the previous chapter argued, such a state-market dichotomy oversimplifies regulatory politics and ignores how public and private actors are often political partners within what Underhill (2003) has called state-market condominiums. It is thus hardly surprising that financial market reforms have included both de-regulation and re-regulation and a mix of market opening and protectionism.

This chapter has a dual importance for the thesis as a whole. First, it shows that EU capital market integration did not unfold against a backdrop of universal financial liberalization driven by global market forces. Rather, the backdrop was one of regulatory reforms heavily influenced by the strategic re-orientation of national financial champions. While domestic reforms reveal national policy-making dynamics, comparing the UK, France and Germany shows the influence of domestic political institutions and different market structures on policy outputs. Second, the analysis exposes the institutional power of financial market incumbents. In this way, the chapter lays bare the domestic side of the international constellation through which national financial industries and ‘their’ governments jointly governed capital markets in Europe at the time.

The chapter begins with a comparative overview of European securities markets at the end of the 1980s. The following three sections then reassess regulatory reforms in Germany, France and the UK. They expose the importance of competition politics and show how national varieties of capitalism left their mark on market structures, political institutions and the interests of both public and private actors.

**European capital markets at the end of the 1980s**

A comparison of European financial systems and structures at the end of the 1980s shows the
UK in an exceptional position in terms of capital market development (I. Walter and Smith 1989, Gardener and Molyneux 1990). In line with most other European countries, the French and the German financial systems were dominated by bank credit and debt securities, with stock markets playing a secondary role. In the UK, the picture was reversed. In 1985 French stock market capitalisation stood at a mere 13 per cent of GDP, compared to 24 per cent in West Germany and 60 per cent in the UK (Graham 1987b). This pattern was to continue into the early 1990s (graph 1).

![Financial structures in 1991](image)

**Graph 1. Source: European Commission 2003**

Elsewhere in the EU, markets for non-government securities were dwarfed by credit markets; only the (small) Benelux countries formed something of an exception. Even Italy, the fourth-largest EU economy at the time, had no significant market for non-government securities (Colvill 1995). For most European countries this meant that their financial institutions and market places had few prospects for ever becoming internationally important. Within European securities markets, the Swiss were the only ones in the same league as Germany, France and the UK—and they remained outside the EU.
The prominence of capital markets in the UK put the City in a leading position in Europe. In 1992, it boasted 44.1 per cent of the EU’s market capitalisation, more than Frankfurt, Paris and Amsterdam combined. Around the same time, 43 per cent of London’s equity turnover was in foreign shares; on the continent, the figure was negligible. Over 95 per cent of EU foreign equity turnover went through the City, with German shares accounting for roughly 25 per cent and French ones for half of that (Steil 1993: 3).

The City stuck out in other ways too. To establish the global reputations of firms in the securities business, *Euromoney* polled financial institutions in 1990 and 1991 and asked them to name their favourites. US institutions came out on top with 1,803 votes followed by the UK with 1,213. In contrast, Germany (175) and France (112) fared dismally (Sobel 1994: 132f). The firms’ reputations matched that of their home markets. Quantitative studies comparing European financial centres have invariably found London on top with Frankfurt and Paris on the second tier, often alongside Zurich (Bindemann 1999: 24ff).

More interesting are the reasons that respondents in Bindemann’s study gave for London’s dominance in Europe (Ibid.: 28ff). Commissions—the price for trading—were not among the top ten of the 23 options presented. Investment firms cared little about locally specific operational costs (rank 20 out of 23) and considered fiscal regulation, which affects prices through taxes like the stamp duty, the least important of all. All this challenges the notion of financial centres competing via the cost of their services—central for example in Laurence’s work (2001). However, it resonates with Sobel’s finding that regulatory reforms show little statistical connection to price developments. Instead, respondents valued the human resources London offered, the diversity and size of its markets, the diversity of its financial products, the presence of international banks, and its transaction volumes as the leading five criteria. Regulation came in sixth place.

The relevance of the financial sector in the national economy differed markedly (graph 2): for employment, the UK was roughly in line with the Community average (3.7 per cent compared
to 2.9 per cent). Financial services’ share of national GDP, however, was more than double that of Germany, and almost triple that of France. The sophistication of London’s capital markets and the concentration of international business in the City caused compensation levels to be significantly higher in the UK than in Germany or France, even though employment levels were roughly similar. In Britain, finance—and still is—a major industry in its own right (cf. The Economist 1988).

Graph 2. Source: Gardner and Molynieux 1990: 13

As will be discussed in detail below, equity markets in Germany and France not only differed in size from those in the UK, they also played different roles in the economy (cf. I. Walter and Smith 1989: 68-93). As a first rough-and-ready distinction, British markets functioned to generate returns for investors and as markets for corporate control. On the continent, they were mainly vehicles for industrial policy, direct in the case of France, mediated by the commercial banks in Germany. Accordingly, acquisitions of listed companies opposed by the target were a rarity in continental Europe. Between 1983 and 1988 (included), a mere three
transactions were completed there, with a total value of $539m (I. Walter and Smith 1989: 60). In
the UK, in contrast, 25 such transactions were completed, with a total value of almost $20bn.

Capital markets in the three countries were entrenched in and supported by detailed
regulation. A comparison of withholding taxes is instructive: in 1988, Germany had a 25 per cent
tax on dividends but none for bond interest payments. It was reverse in the UK, with dividends
untaxed but a 25 per cent tax on gilt interest payments. The German regime thus encouraged
firms to retain earnings and reinvest them. It discouraged holding equity for immediate reward
(and thereby depressed equity prices) but encouraged bond holding instead. The opposite was
ture in the UK. And in France? There, the dividing line ran between resident and foreign holders
of securities: residents paid no tax for either bond interest or dividends; foreigners had to pay up
to 50 per cent for the former and 25 per cent for the latter. The flexible interest withholding tax
for bonds is a classic example of French interventionism, trying to fine-tune foreign investment
in domestic debt. The dividend tax discouraged foreign equity ownership and was meant to keep
business 'in the family'.

The credit markets dominating the French and German financial systems were controlled
by national firms—a pattern typical of continental Europe at the time, with the exception of
Belgium. In 1988, foreign banks accounted for 13.5 per cent of assets in France and no more
than 1.8 per cent of assets in Germany (Gardener and Molyneux 1990: 21). In the UK, foreign-
owned banks accounted for more than half of the total. This pattern is all the more remarkable
when seen against measures of the formal openness of financial systems, which contradict
stereotypical typologies (Grilli 1989). Germany, rather than being in a cluster with other
'coordinated market economies', was ranked by Williamson and Mahar (1998) as the financially
most liberal country in the early 1970s out of the 34 they studied, more liberal than the UK or the
US. Already before the wave of 'deregulation', the authors detected little overt state intervention.
Existing limits to competition rather emerged out of the behaviour of private actors, for example
through self-regulation of national financial industries.
The German example shows how the suppression of competition can work in subtle ways. Foreign financial institutions were in principle allowed to have seats on Frankfurt’s stock exchange from 1982—almost half a decade earlier than on the London Stock Exchange (LSE) and nearly a decade before the full opening of French markets in this respect (I. Walter 1988: 14). But members of the German exchanges needed banking licences, which automatically excluded most foreign brokers. The tight relationships that corporate clients enjoyed with their Hausbanks meant that in spite of the formal openness of German banking, foreigners made few inroads. As mentioned, the share of foreign banks’ assets in 1988 stood at a negligible 1.8 per cent.

The overall picture is one of market fragmentation along national borders and significant differences in financial structures that reflect national varieties of capitalism. These national market places were complemented by the Euromarkets, centred in London, where currencies and securities were traded ‘offshore’ without technically entering the UK’s financial system. These markets grew until the late 1970s but had little impact on domestic markets for financial services. As the coming sections show, this was to change in the 1980s, though the relevance of the Euromarkets for domestic reforms varied.

**Regulatory reform in German managed capitalism**

For Schmidt (2002), Germany is the archetypal example of ‘managed capitalism’, which she contrasts with market capitalism (for example the UK) and state capitalism (France). The typology is reminiscent of Zysman’s (1983: 91), who distinguished between tripartite-negotiated, company-led and state-led models of economic adjustment.

The managed character of German capitalism was evident in its financial system. German banks were instrumental in the implementation of the Bundesbank’s monetary policy as well as the industrial policy of national and regional governments. As has often been noted, such positive coordination (Jayasuriya 2001) of financial market policy with other policy domains generated tight policy communities that bridged the public-private divide (e.g. Coleman 1996). In securities markets, banks were given leeway to set market rules (Lütz 2002).
German industry had traditionally relied on credit rather than equity financing. Firms thus
developed tight links with ‘their’ banks—the so-called Hausbanks (Allen and Gale 2000). Stock
markets functioned as mechanisms to allocate corporate control—not through the market, but
through negotiations between banks, unions and enterprises. Exposure to corporate fortunes
through sizable loans were complemented by shareholdings. These equity stakes placed bank
representatives on supervisory boards and granted access to inside knowledge and decision-
making. In addition, cross-shareholdings tamed potential inter-firm rivalries and thereby limited
corporations’ exposure to competition. German markets for corporate equity were thus more of
an appendix to the economy than its central battleground. As late as 1990, only 14 per cent of
German shares were in foreign hands (Story 1997: 254).

The legal provisions underpinning this system included high capital gains taxes to
encourage long-term cross-shareholdings as well as flexibility in accounting for the depreciation
of assets to limit companies’ need for quick capital. High corporate taxes further promoted the
retention of profits rather than their distribution. Holding equity with an eye for attractive
dividends played only a secondary role in Germany. Conversely, the absence of rules on what
elsewhere was considered insider trading deterred involvement by foreign firms. Deutschland
AG—as the web of German cross-shareholdings became known—throve on personal
connections and informal information channels. This placed system outsiders at a disadvantage
and made Germany relatively unattractive in spite of its impressive economic performance and
formal openness to foreign banks. Transparency and the concept of insider trading were so
unpopular in Frankfurt that Germany stymied EU attempts to introduce binding rules in the
early 1980s (McCahery 1997, Interview 020506).

Nevertheless, reform of the system, which had not seen any legal changes since the late

[In Germany reform has been driven for the most part by the large
banks, who desire to create a "home base" supportive of global player
investment banks on the US model. (Vitols 2003: 18)
With German corporations increasingly relying on their own reserves to finance investment (Story and Walter 1997: 174) and margins in the lending business declining (Overbeck and D'Alessio 1997: 92), banks began searching for new sources of revenue in the early 1980s.

Unable to find enough growth potential in lending and retail banking, they needed to develop fee-based sources of income. Some of this could come from offering services such as consulting to firms, but the big banks quickly determined that their best opportunities lay in financial activities related to capital markets, most importantly underwriting and trading. (Deeg 2001: 23)

Towards this end, capital markets needed to be updated and old restrictions on innovative (and lucrative) financial products lifted. It was in this spirit that the ‘Frankfurt coalition’—with large Frankfurt banks at its helm—initiated reforms in the mid-1980s (Lütz 2002: 235).

The first element of these reforms concerned the admission of new financial instruments—for example floating rate notes and zero coupon bonds—and the updating of market structures to create a full-fledged capital market infrastructure. In principle the Bundesbank was eager to boost Frankfurt as a financial centre. But it entertained second thoughts when innovations began interfering with its own tasks (Evans 1992). For example, the Bundesbank at first resisted calls to introduce Certificates of Deposit (CDs). CDs functioned much like time deposits for lenders, but were tradable. The Bundesbank had used banks' reserve requirements against time deposits as its preferred instrument to expand or contract credit. But CDs, it found, did not fall under reserve requirements (Carr 1985c); were they to replace term deposits, the Bundesbank would lose one of its favourite instruments. When it finally did introduce CDs, the Bundesbank introduced reserve requirements (Carr 1985b), though it eventually compensated national banks by lowering the levels required. In another example, it took the Bundesbank until 1990 to approve German banks' underwriting of debt in foreign currencies raised by German corporations (Wall Street Journal 1990). Hitherto this had not been allowed in Frankfurt; the business had been left to London.
These episodes show how the coordinated character of regulatory policy-making slowed reforms in Germany. This was in contrast to France and the UK, where state domination and greater distance between the state and business, respectively, permitted more rapid change. At the same time, disputes in Germany were usually resolved to the satisfaction of business. When the big banks told the finance ministry that specific rules were hampering the development of capital markets and sending business to foreign firms, their concerns were normally heeded. For example, banks in early 1989 were irate over the introduction of withholding taxes for foreign owners of German securities (Simonian 1988a, 1989a). They protested loudly and the tax was soon abolished.

The coordination of policy between large banks and state institutions was even more evident in the selective market opening to foreign banks. In spite of official market openness, many barriers remained, often hidden in arcane rules. In 1986, after consultation with German banks and the Bundesbank, the government invited foreign banks to participate in the Federal Bond Consortium through which the government placed its debt on the market (Carr 1986). The aim was not so much to let foreigners in, but to increase demand for German government securities, thereby driving down financing costs. Almost a third of the new players came from Japan, easing access to that country's huge savings pool. However, with foreign players' share fixed at 20 per cent of the total, there remained clear limits to competition. Foreign firms were not to challenge domestic dominance of the market.

The fixed share for foreign players was only lifted when Germany faced higher financing needs in the wake of reunification. Now the placing power of foreign players became highly important. The Bundesbank introduced a partial auctioning of bonds in 1990, meaning a loosening of fixed quotas (Campbell 1990). The top tier of German banking, however, did not relinquish this lucrative business without compensation. Deutsche Bank's growing international ambitions (Brady 1992) had been frustrated for years by its inability to get a foot into the American primary government bond market. Now that the Bundesbank was about to grant more
freedoms to foreign institutions, the New York Fed reciprocated by granting Deutsche Bank
‘primary dealer’ status (Harverson and Campbell 1990). Liberalization here was not a unilateral
affair; it took place on a mutual basis. The main losers—certainly in Germany—were the smaller
players such as the cooperatives, which for years had been complaining about the size of their
allotments and received nothing in return for falling commissions.

The issue of reciprocity had come up in other liberalizing measures, belying the idea that
liberalization was a matter of adapting to ‘global pressures’. In 1985, for example, the
Bundesbank had allowed foreign firms to lead-manage foreign issues of DM-denominated bonds
in Frankfurt (Davies 1985).6 This was to bolster Frankfurt’s standing as a financial centre against
the City’s Euromarkets where D-Marks were readily available. Foreign corporations in need of
German currency would in all likelihood approach their national banks first. To attract them to
Frankfurt, they had to be allowed to lead-manage the issues and take the associated fees. German
banks already had such rights in most important countries—except Japan. Thus when the
Bundesbank met with foreign banks in Frankfurt, the Japanese firms were informed that they, in
effect, would be excluded from the new privileges until Japanese authorities made concessions to
German firms (Carr 1985a). Liberalization did not hurt the large German players—they
continued to dominate the Frankfurt market. Rather than introducing stiff competition, one
senior US banker likened foreign lead managers in Frankfurt to ‘gnats buzzing around German
heads’ (Carr 1985d).

The biggest innovation of all was the Deutsche Terminbörse (DTB), a futures and
options exchange opened in 1990 (Campbell and Hargreaves 1990). As with many German
reforms, it came late—the City’s LIFFE had been opened in 1982, France’s MATIF in 1986 and
the Swiss Soffex in 1988. Again, it was to be run and controlled by insiders in the German
financial system. German banks were worried that unless Germany established its own exchange,

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6 A foreign issue in this case refers to selling bonds of non-German corporations denominated in DM to a German audience.
foreign competitors would start offering products referring to German securities, for example equity options and bond futures (Simonian 1987). They also feared that cash markets could follow derivatives trading. The top firms—Deutsche Bank, Dresdner Bank, Commerzbank and Deutsche Girozentrale—thus set up a committee to study the matter. It soon found legal obstacles, including laws that banned futures trading dating from the 1930s.

Dresdner’s chairman, as the head of the German Federation of Private Bankers, then sent the government an official wish list outlining the necessary regulatory changes. Hesitations notwithstanding, the government complied; one year later, most of the required legal changes were in force while the banks themselves worked out the regulatory details (Simonian 1988b). In the meantime, LIFFE had indeed announced the trading of Bund futures. All efforts—including those of the finance ministry itself—now concentrated on keeping business in the German family (Fisher 1988, Interview 020506). Deutsche Bank, in waiting for the DTB to become operational, went as far as renouncing LIFFE’s contract to hedge its Bund exposures. The DTB venture proved successful over the following year, and by the mid-1990s, LIFFE’s Bund contract had lost much of its significance.

One of the problems the DTB encountered was symptomatic of German finance at the time: the launch of the electronic exchange was followed by the question of trading screens in other countries (Lütz 2002: 237f). Foreign authorities, however, were concerned about the lack of a proper regulatory framework. For the DTB to thrive, many now concluded, German regulatory and supervisory structures had to be updated. The banks had had similar experiences in other areas after realizing in the second half of the 1980s that they needed foreign investors to fuel the German capital market business. The demand for (new) shares from the German public was likely to remain limited—in the 1980s, households invested no more than 1.6 per cent of their wealth in stocks (Story and Walter 1997: 173). Reforms to introduce transparency were thus not inspired by global structural pressures and a heightened competition for capital. Banks had a commercial interest in developing capital markets, and given the lack of a domestic customer base,
had to attract foreign investors (cf. Saunderson 1992).

The reform of national bourses followed a similar rationale. Compared to the US and the UK, securities markets were plainly underdeveloped—in effect the playground of a handful of large banks. Trading was done more over the phone than during the short opening hours of the eight regional stock exchanges. This fragmentation—eight bourses for an equity stock that stood at a mere 30 per cent of GDP, with the majority of shares not for sale—had been consciously bolstered by the large banks (Lütz 2003b). Blue chip shares were distributed over four markets—Frankfurt, Stuttgart, Düsseldorf and Munich. The remaining four bourses had been allotted shares to ensure their survival. The governing body for the eight exchanges, the Arbeitskreis der deutschen Wertpapierbörsen, took decisions unanimously. While this impeded change, it enabled a comfortable lack of competition.

To make German stock markets more attractive to outsiders, the large banks resolved to end the dispersed trading. Unsurprisingly, the push to concentrate business in Frankfurt was resisted by the other seven markets. In the struggle that ensued, public officials sided with the private actors closest to them: the federal finance ministry and the regional authorities responsible for Frankfurt supported the large banks; local authorities elsewhere backed ‘their’ exchanges. In the end, the Frankfurt coalition prevailed. The episode was typical of German regulatory politics in that it did not pit ‘the state’ against ‘the market’. Rather, facing each other were advocacy coalitions (Sabatier 1988) comprised of public and private actors.

Indeed, top-level working groups on financial reform included private sector representatives (Handelsblatt 1990). Such public-private cooperation was institutionalized in corporatist bodies such as the Zentraler Kreditausschuss (central credit committee, see Lütz 2003b: 122). Even if leading German banks were beginning to challenge the prevailing ‘conception of control’ (Fligstein 2001) in domestic financial markets, the most important competitive struggles still unfolded between national financial centres and the financial players wedded to them. After all, unlike in France and the UK, large domestic banks already dominated local securities markets.
Rather than prying open markets they had been excluded from, banks pushed an incremental reform programme whose cumulative effects nevertheless changed the financial landscape.

To sum up, the German financial system at the time was jointly managed by public and private actors. The ‘positive coordination’ of finance with national economic policy—monetary and industrial policy in particular—placed severe restrictions on admissible competition, particularly for foreign firms supplying services to German clients. National public and private actors enjoyed a structural correspondence of their interests. This correspondence was to disintegrate over the coming decade. But as long as it lasted, it supported institutional structures that allowed public and private actors to coordinate their activities for mutual benefit.

**Regulatory reform in French state-led capitalism**

The 1980s also witnessed the reform of capital markets in France. While the direction of reform was similar to that in Germany, the political process differed; the differences largely stemmed from the distinct varieties of capitalism that had evolved in the two countries. This not only meant national economic institutions faced distinct pressures and incentives to adapt to changes in the global economy; for this thesis, the *indirect* effects of these national varieties were as important. As a complement to general state interventionism and control of the economy, ‘state autonomy’ (Skocpol 1985) in financial market policy was higher in France than in Germany (Coleman 1996). The idiosyncrasies of French reforms were not only due to the specific character of French economic institutions, a line of reasoning common in functionalist comparative political economy (e.g. Hall and Soskice 2001b, Rajan and Zingales 2003). The historical development of French capitalism had produced specific political institutions that structured the policy process, and which influenced French reforms.

This section also reveals how misleading the distinction between private and public interests in financial market reform can be. The German case showed how private and public actors often rallied around common goals and confronted other public-private advocacy coalitions. In the French case, the public-private distinction is even less useful (cf. Coleman 1994: 82
48). After Mitterrand’s nationalizations in the early and mid-1980s, most of the banking industry was in the hands of the state; brokers, known as *agents de change*, had the status of public officials (Cerny 1989). Little surprise then that capital market reforms in the 1980s were state-driven. Most political and economic power was somehow incorporated into the state’s structure. In addition, the government directly or indirectly controlled two-thirds of listed companies (Graham 1989a). The Trésor, the directorate of the finance ministry responsible for financial markets, was the focal point of the domestic financial elite. Often graduates of the same school (Schmidt 1996: 299), many of its members spent time at the Trésor before taking top public positions or heading state-run or affiliated banks.³ Personal networks provided the social glue for the French policy community, even after formal links between the state and banks began to weaken.

Reforms were masterminded by the Trésor while the motivation was specifically French. Domestic financial markets were unable to provide sufficient credit for the economy. Neither in Germany nor in the UK did the need to attract capital play a central role in regulatory reform. After the breakdown of the final Bretton Woods system around 1970, the French moved from the post-war overdraft economy (the *économie d’endettement*) to the system of *encadrement du crédit* (Loriaux 1991: 38ff). This regime for allocating credit generated its own problems. Through attempts to keep inflation in check, some parts of the economy were chronically short of funds. No less than seventy special government-administered interest rate regimes in 1981 did little to help, but only compounded the problem (Coleman 1997: 279). After the socialist experiment in 1982 and Mitterand’s *grand tournant* the following year, the government resolved to overhaul financial markets.

Two aims of the reform programme stand out: the government wanted to end the micromanagement of credit allocation, the hallmark of the credit system, and to tap foreign sources of funding (Icard and Drumetz 1994). German financial reforms served as the template.

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Universal banking in Germany had generated measured ‘competition’ between different kinds of financial players (savings, commercial and cooperative banks) in different market segments. It had further contributed to a more flexible allocation of savings. The anti-inflationary inclinations of the Bundesbank had also saved Germany the troubles France experienced in the years after the breakdown of Bretton Woods; even with growing capital mobility, it allowed the government to borrow at attractive rates. Being listed also enabled large companies to raise capital without indebting themselves. At the same time, the system of cross-shareholdings permitted coordinated industrial policy and a high degree of national control. Finally, universal banking had brought the big German banks balance sheets that allowed them to compete globally. The German model thus seemed to combine readiness for the new international situation with a degree of government discretion in economic guidance that the French cherished.

The Banking Act of 1984 tore down the barriers between the different segments of the credit market. Institutions ranging from the local Caisses d’Epargne to commercial giants like Banque National de Paris were to ‘compete’ and build their business where they saw fit. This did not mean that the allocation of credit was privatized: the same socialist government that introduced ‘competition’ between banks nationalised all but a handful of them. The conservative government that came to power in 1986 then reversed some of the nationalizations: Paribas was privatized the same year, Société Générale followed in 1987. The abolition of credit restrictions through the Banking Act now meant that banks needed fresh capital (Graham 1987a). Formal privatization was the means towards this end.

The bank privatizations were part of a larger privatization programme that fuelled the Paris stock market boom. Traditionally, French securities markets had played a subordinate role to banking proper—even more so than in Germany. Bank loans had often been subsidised by the state, making equity financing unattractive for corporations. Direct access to the bourse had remained the preserve of so-called agents de change, an oligopoly of stock brokers who enjoyed the status of government officials. In 1978, stock market capitalization stood at a meagre 9 per cent
of GDP (Graham 1987b). By 1985, this had risen to 13 per cent, still low compared to Germany’s 24 per cent and 40 per cent in the US. Government privatizations had a decisive impact: in 1987, 3.8m people signed up for Paribas shares alone while the number of direct shareholders quadrupled due mainly to 14 privatisations that raised FFR72.5bn (The Banker 1988b). While enthusiasm waned in the wake of the global crash later that year, the seeds of a stronger equity culture had been sown.

Securities market reforms throughout the 1980s can be grouped under two headings: a general up-dating of the market, similar to what happened in Germany, and what was soon called the petit Big Bang on the Paris Bourse. In the first instance, reforms consisted of admitting new financial instruments. In the mid-1980s the government approved the introduction of certificates of deposit and commercial paper and loosened exchange controls, aware that Paris might otherwise become a ‘financial backwater’ (Coleman 1997: 275). It thereby succeeded to repatriate much securities business back to France, where many operations had hitherto not been possible (I. Walter 1988: 189). After all, BNP and Paribas had moved their capital market operations to London in light of the greater possibilities there (Graham 1987a).

The biggest innovation, however, was the Marche a Terme d’Instruments Financiers (MATIF), the new futures market opened in 1986. The MATIF was the brainchild of the Trésor and became an internationally recognized success, even as it started as an almost exclusively French affair (Graham 1987d, Story and Walter 1997: 214f). Of the 88 members in 1987, only one could count as truly foreign—American Express. The resolve to open the door to more foreign members was fed by the exchange’s ambition to become a premier centre for the trade of ECU futures (Graham 1987d). As in so many other instances, liberalization was strategic and controlled in the interest of French market incumbents. The idea was to selectively allow foreign financial institutions into the French market, certainly not to integrate them in a homogeneous European financial space.
MATIF’s soaring trade volumes generated great profits for the agents de change and sparked jealousy among the excluded banks. The latter wanted their own markets in futures contracts, rather than being obliged to go through the agents de change. With the conflict escalating, the banks referred it to the Trésor. Heavy state patronage notwithstanding, this struggle fits the pattern of competition politics found in other countries where credit institutions were pushing into hitherto closed securities markets (see Fidler 1987 for Canada, Sobel 1994 for the UK, the US and Japan). When the banks finally prevailed, the head of the stock exchange, Xavier Dupont, spoke of authorities having to put an end to the ‘civil war’ (Graham 1987c).

The struggle continued as the reform initiative passed to the private sector. A mere two years after the settlement, and much to the chagrin of the MATIF and its official sponsors, a consortium of French banks and a Swedish specialist set up a rival exchange, dubbed OMF (Graham 1989b). The sponsoring banks included BNP and Paribas—the two that had already broken ranks by setting up their capital market operations in London—and Crédit Commercial de France, privatised in 1987 (Graham 1988a). These cracks in the public-private front continued to widen as the direct links between the government and financial institutions weakened. But as in Germany, there remained a structural correlation between large banks’ interests and those of public actors. For both, it still made sense to think in terms of ‘national markets’, to associate on that basis, and to form policy preferences accordingly.

The other aspect of French financial market reforms—those regarding the Paris bourse itself—was reminiscent of developments at the LSE. The Stock Exchange Reform Act of 1988 turned the agents de change into private enterprises and limited their brokerage oligopoly until the beginning of 1992 (Lehmann 1997). At the same time, legislation allowed the newly christened sociétés de bourse to raise capital from external sources—necessary if they were to trade on their own account. In effect, this meant that what had happened elsewhere was to be repeated in Paris: large financial players would buy themselves into the stock market by folding specialist firms into their own operations (Graham 1987b). By the end of 1990, close to 80 percent of the small
specialist firms had effectively been bought up.

The removal of bond trading from the stock exchange monopoly in 1987 was no less consequential: the market share of the large banks which would henceforth act as market makers surged to 73 per cent in the first half of 1988 (Graham 1988b). Again, French players got most of the action and were the prime beneficiaries of the 'liberalization' of the market. The development was of course hardly accidental. Up to this point, it closely followed the script written by the Trésor.

The reform of regulatory and supervisory structures formalised the closed-shop characteristics of the French policy community, but unsurprisingly failed to abolish them (cf. Coleman 1996: 97ff). In principle, the proposed structure again resembled the British model, featuring self-regulation plus a statutory body with punitive powers. Towards this end, the authority of the Commission des Opérations de Bourse (COB) was expanded, giving it a role not unlike that of the Securities and Investment Board in the UK (see Moran 1991). Only France approached the model from the other side. Here self-regulation was the new element, taking the form of the Conseil de Bourses de Valeur (CBV) for stock markets. CBV members were stock exchange firms.

'Regulatory competition' between financial centres was most palpable in the Paris bourse’s rivalry with London’s SE AQ International. The latter functioned as a hybrid between a conventional exchange and an information distributor. Operational since 1985 and fully automatic, it allowed market-makers—firms willing to buy and sell a specific range of shares—to quote their prices on a continuous basis, and make these prices known to other parties through the system. Deals would then be made over the telephone; physical trading floor had become obsolete.

By the end of the 1980s, this London-based system had attracted around 30 per cent of trading in French equities. Big players in particular liked the SE AQ because it facilitated trading large swaths of shares at stable prices, so-called block trades. French regulators had traditionally
limited block trading in the name of investor protection. In 1991, firms stepped up the pressure (Dawkins 1991b). The commission studying the matter was chaired by René de la Serre, head of Crédit Commercial de France (CCF) (Dawkins 1991a). A newly privatized second-tier firm, CCF was well positioned to criticize the government for dragging its feet. French top firms had themselves started to use the SEAQ and were ambivalent. When the report came in, the CBV quickly decided to facilitate block trading. But it did not go as far as some reformers would have liked (Rawsthorn 1992).

The authorities knew that the half-hearted measures would be insufficient to stymie the trading of French shares in London. At the same time, it remained unwilling to copy the SEAQ’s model. Instead, they made the question of transparency in securities trading a central issue in European negotiations on the Investment Services Directive, a point we will return to in the following chapter. The episode makes clear, however, how the initiative for reform had begun to shift from the Trésor towards the financial institutions. The harmony of interests between financial institutions and public actors was showing its first serious fissures.

The French politico-economic elite continued to keep a close watch over the ability of foreign institutions to make inroads into the domestic market for financial services, and over the possibility of foreign control over important domestic FSPs. In France’s case, Vogel’s qualification of the reforms as strategic re-regulation is apt (S. Vogel 1996). As many scholars have noted, the centralized state enabled public actors to react swiftly to perceived policy challenges (Coleman 1996, Schmidt 2002). Widespread state ownership, and later patronage, of financial institutions helped. All the same, French authorities sensed they would be unable to compete with London unless they gave up their interventionist agenda and protectionism.

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8 If a financial institution plans a large transaction it is eager to hide its intentions from the market lest prices move against it. It favours lower disclosure standards and a time lag for reporting trades to the authorities, who may publish the data. If financial institutions are allowed this degree of secrecy, however, they may use it to the disadvantage of particularly smaller investors. These investors hear of transactions that may hurt their positions only long after the fact. In addition, lower disclosure rules might encourage all sorts of market rigging and other collusive behaviour among participants. 88
European policy would thus become an increasingly crucial avenue to address hitherto international problems.

**Regulatory reform in British market capitalism**

Capital markets in Britain were likewise overhauled in the 1980s. The politics behind the reforms again differed from those in France and Germany. Such variation should not come as a surprise: the role of capital markets in the British economy differed from that in the continental economies. There was no interventionist economic policy within which capital markets played an important role, certainly after the Thatcher government took over in 1979. The lack of such positive coordination created room for actors other than the government to play key roles in market regulation, not least the industry itself. The flip-side of self-regulation was the institutionalized incapacity of financial firms to dominate government policy once capital market regulation appeared on the political agenda.

The reforms themselves have been well researched and documented (e.g. Moran 1991, Augar 2000). For the purpose of this thesis, two aspects deserve emphasis. First, domestic factors were central (cf. Sobel 1994)—regulatory changes can only be understood by referring to the specificities of the British state and the peculiar structure of the British financial industry at the time. As with Germany and France, this belies purely exogenous, ‘global’ pressures as the main force behind the reforms. Second, competition politics mattered. Once change was in the air, three clusters of firms emerged: established securities markets houses, British clearing banks, and foreign (investment) banks hitherto active in the offshore Euromarkets. Their conflicting interests clearly emerged in during the domestic reforms—and reappeared at the EU level in the years to come.

The capital market structures that have developed in the UK since the 1960s are probably unique in the world. By the mid 1980s, the City of London was playing host to the globally

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9 Clearing banks are banks in the traditional sense: financial institutions involved in deposit-taking and lending. As in the US, they had been excluded from the securities markets business in the UK.
integrated Euromarkets and the top bracket of international financial institutions active there. Alongside the Euromarkets, the City also accommodated the national securities markets—including the London Stock Exchange (LSE)—dominated and controlled by traditional British merchant banks, stock brokers and jobbing firms (cf. Augar 2000). There was thus not one, but two Cities (Thompson 1997). While the names of those active in the Euromarkets twenty years ago still represent the top league of global finance, the names of the top British firms are now mostly forgotten.¹⁰

State guidance of the British economy through the financial sector was negligible (Zysman 1983: 171ff). There was virtually no public ownership of financial institutions while the relationship between the national industry and the clearing and merchant banks was an arm’s length one. State involvement in the capital markets mainly functioned through the Bank of England, which had formal oversight powers. The Bank’s role, however, was ambiguous. Nationalized only in 1946, it functioned as much as an advocate of City interests vis-à-vis Whitehall as the other way around (Ibid.: 200ff). Direct government guidance was virtually absent.

The City functioned as an ‘esoteric’ club (Moran 1984a: 4). Market rules either took the form of industry self-regulation or informal ‘gentleman’s agreements’ among firms or with the Bank of England. The LSE functioned as a members-only club; the execution of client orders and actual share trading were controlled by two oligopolies free to set their own rules. Other capital market functions, such as the issuance of securities, were handled by yet another group of firms, the merchant banks. Their oligopoly was slightly less formalized, but with the Accepting Houses Committee (AHC) the merchant banks had a body through which they could coordinate their activities and agree on common norms and rules. Because the government was barely involved in capital market policy, the firms’ direct political connections with Whitehall were poor. The AHC, for example, did little in the way of serious lobbying (1984b: 177). Other financial

¹⁰ Think of the merchant banks Schroders, Hill Samuel, Samuel Montagu, Charterhouse and Robert Fleming (all among the top ten in 1982/83), the brokers Hoare Govett, James Capel, Settigosour Kemp Gee and Phillips & Drew (top four in 1983) and the jobbing firms Akroyd & Smithers, Weld Durlacher, Pinchin Denny, Smith Brothers and Biggood Bishop (top five in the same year).
sector associations that later rose to prominence such as the British Bankers Association (Filipovic 1997: 125ff) were not yet involved in capital market matters due to the separation of merchant and commercial banking.

The government’s main concern was that the City, and the institutions within it, should thrive. The financial industry’s economic role—in terms of employment, taxes and contribution to the balance of payments—was more important than its position in economic policy (on wealth-generation in the City, see Leyshon and Thrift 1992). This explains the government’s relative indifference to the problems the 1980s capital market reforms created for British firms, and why the firms lacked the institutional power to do anything about it.

The history of the Big Bang—as the LSE rule changes of 1986 became known—differs markedly from what happened in Germany and France. The nickname reflects the magnitude of the changes the reforms triggered in the City’s capital markets, but put in longer-term perspective, little about them betray a coherent government strategy. Two years after a change in its rules in 1976, the Office of Fair Trading (OFT), which was responsible for competition policy, more or less stumbled upon the cartel-like structures of the LSE (Moran 1991). Baffled by what it found, it referred the LSE’s rule book to the Restrictive Practices Court for review. It complained about the single capacity system, fixed commissions and the restricted membership of the exchange (Sobel 1994: 37ff, S. Vogel 1996: 101ff). Unsurprisingly, the LSE and its members were reluctant to surrender their cartel privileges. In contrast to both France and Germany, there was no such thing as automatic government support for the financial industry. The legal proceedings started to run their course.

Almost certain of defeat, the LSE finally succumbed to the government’s demands in 1983, one day before the court was to pronounce its ruling. Nicholas Goodison, LSE chairman, and Cecil Parkinson, head of the Department for Trade and Industry (DTI), struck a deal. Goodison promised to amend the LSE rule books in line with the DTI’s requirements.
Membership was to become more open and fixed commissions would be abolished. In return, the ministry removed the LSE from the jurisdiction of the Restrictive Practices Court.

The initial referral of the LSE to the Restrictive Practices Court was exogenous to any financial market dynamics. But once the dispute broke out, other stakeholders quickly seized the opportunity to push their own agendas. Most importantly, the clearing banks saw their chance to break into a profitable market segment from which they had been excluded. Their efforts were successful. As a main component of the Parkinson-Goodison agreement, the LSE loosened restrictions for non-members to buy themselves into stock market firms, even though the Office of Fair Trading, the initial force behind the reforms, never voiced any complaints on this point.

It was the abolition of these restrictions that made the ‘sell-out’ of the old ‘domestic’ City possible. Even before October 27, 1986—the date of the ‘Big Bang’—most of the City’s stock market firms had lost their independence (Augar 2000). Twenty years later, a British securities industry worth its name no longer exists. In an ironic twist of fate, the British clearing banks that successfully opened British securities markets to outsiders paved the way for a third group of institutions to dominate the City: foreign investment banks. Of the British high street banks that dared to foray into securities markets, only Barclays still plays a significant role.

A spate of scandals in the years before and after 1980 fuelled the impression that informal self-regulation combined with winks and nods from the Bank of England would no longer suffice. The government commissioned a study—what was to become the Gower Report—on how market regulation could be updated. In his report, Professor Gower asked for greater government oversight of the SROs. Keen to preserve their independence, leading City firms opposed the plan, and with the help of the Bank of England, got their way (Moran 1991: 72). Instead of direct government oversight, the SROs came under the purview of a private organization, the Securities and Investment Board (SIB). In view of their fate over the past two decades, the confidence of British financial institutions in the mid-1980s and their dismissal of public oversight appear misplaced; greater participation by public actors may have worked in
their favour through patronage in times of crisis. Instead, the resulting cobweb of self-regulatory bodies generated few shared interests between the government and British securities firms, though they did generate ample confusion and frustration (Lascelles 1988b). A decade after the introduction of the system, it was abolished due to its deficiencies.

The UK reforms integrated the two ‘Cities’—the domestic markets and the Euromarkets (Thompson 1997). London’s openness since the early 1960s had made the provision of non-British financial services an important industry (cf. Helleiner 1994). Only one British firm, S.G. Warburg, played a significant role in these markets; most were American, Japanese, German or Swiss.11 Their activities were deemed ‘offshore’, meaning that the financial flows of these markets remained outside the UK financial system (Burn 1999). The government did not to intervene in their affairs (S. Vogel 1996: 95). After all, continental banks alone employed almost 14,000 people in the City in 1988 (The Banker 1988a) and the industry was on the rise: since the beginning of the decade, the volume of international bonds had more than quadrupled, with the bulk of the activity going through London (I. Walter 1988: 3).

The Euromarkets functioned as an entrance to European markets for foreign firms. These firms—above all the American ones—also introduced a new business culture that was to spread throughout the continent: transaction banking. Hitherto all European financial systems had functioned on the basis of personal or institutional relationships. This was as true for the German Haushank system as for the ‘gentlemanly’ capitalism that prevailed in the City. The American firms turned capital markets into sellers’ markets: they created demand for products where none had existed, poached clients from competitors and broke conventions to boost profits (cf. Partnoy 2002). As chapter five will show, this increased dynamism in financial services reached European firms in the 1990s and helped inspire their reorientation towards a liberal, transnationally integrated EU capital market.

11 Cf. the league table for Euroequities for 1986 and 1987. While the positions vary between the two years, American firms dominate in both. Gardener and Molyneux 1990: 177. For an overview of Eurobonds, see Ibid.: 206.
When the domestic British debate over regulatory reform split over into the Euromarkets, participants there successfully kept public intervention at bay. In 1985, the top Eurobond underwriters created a new business association, the International Primary Market Association (IPMA), to fend off regulatory oversight (Urry 1985). Their bargaining position was strong: at the time, about three-quarters of global Eurobond activity was thought to go through London’s markets—a business twice as large as the one in UK government bonds (Riley 1985). The Securities and Investment Board eventually appointed a weathered practitioner as director of international securities, Richard Britton of Drexel Burnham Lambert. Britton proved sympathetic to industry demands—for example, to allow ‘stabilisation’ in bond markets, a practice dismissed by many as simple market-rigging, and the ‘soft commissions’ of the leading UK investment bank at the time, S.G. Warburg (cf. Wolman 1986, Waller 1990, Waters 1991a). The IPMA was allowed to continue to write its own rules (Mügge 2006).

Domestic capital market reforms made the barriers between international and domestic industries more permeable. American firms in particular made use of the looser LSE rules to either set up their own operations or buy themselves into member firms (Augar 2000). The American firms were well adapted to competition since market restrictions on Wall Street had been eliminated in 1975. Their growing role in British markets quickly fed into the political arena as well.

As the market shares of the firms it represented fell through the mid-1980s, the Accepting Houses Committee—the de facto trade association of the British merchant banks—began to look like an anachronism. In 1987 it changed both its name and structure. Together with the former Issuing Houses Association, it was rechristened the British Merchant Banking and Securities Houses Association (BMBA) (Thomson 1987, Filipovic 1997: 128ff). Foreign members were introduced, though the voting power of non-EU firms was capped (Lascelles 1988a). Six years later, ‘British’ was removed from its name (Financial Times 1994). The BMBA became the London Investment Banking Association (LIBA), and is today one of the most
influential lobby groups in the field.

A closer look at the changes of the mid-1980s shows that despite 'globalisation', firms with a pan-European vision were few in number. Nevertheless, the face of the British securities industry changed fundamentally in the three years between the Parkinson-Goodison agreement and the Big Bang. The majority of the jobbing and broking firms were bought by merchant, investment and clearing banks jostling for position in the post-Big Bang era. But whereas British, American and Swiss firms tried to secure a piece of the broking and market-making pie, firms from other EU countries hardly budged. German and French firms, despite their well-established positions in the Euromarkets, were conspicuously absent from the first round of the sell-out, illustrating how the Euromarkets complemented the essentially domestic focus of these institutions. Insofar as domestic clients valued access to these markets, either as buyers or sellers of securities, large banks were expected to be present, functioning as bridgeheads between national clients and global markets. But, to take an example, French firms had no ambition to arrange deals between two British clients and thus penetrate the domestic UK market. Whereas the market for financial instruments showed clear signs of 'globalisation', the market for financial services retained distinct national biases—certainly in Europe (Corrigan 1990, cf. The Banker 1988a).

Conclusion: European state-market condominiums in comparison
Reforms in Germany, France and the UK bear the clear imprint of their respective varieties of capitalism, which had left their mark on business models and patterns of bank ownership just as political institutions and overall market structures. At one end of the spectrum, state control of the financial sector in France meant reforms followed a coherent plan and were (initially) dominated by state objectives. In contrast, the crucial Big Bang reforms in the UK began almost by accident; strategic objectives played a much smaller role. But as in France, market participants seized opportunities to improve their competitive positions wherever possible. At first sight, the German case seems to rest between the other two: strategic state objectives played a role, but
were not the driving force behind the reforms. What distinguished Germany from both France and the UK was the heavy influence of bank interests on regulatory change. Banks’ organizational autonomy from the state, coupled with privileged access to policy-making, gave them more institutional power than their French and British counterparts. Table 1 summarizes these differences.

As the analysis has shown, the competitive concerns of domestic market incumbents shaped regulatory reforms. To be sure, these concerns depended on national market structures while their influence varied with domestic political institutions. State dominance in France meant that the competitive conflicts between agents de change and commercial banks only surfaced once privatizations began. In Germany the dominance of the universal banks within securities markets ameliorated competitive struggles between groups of market participants; they instead focused their energies on generating new business, both domestically and abroad. Finally, in the UK, the presence of the Euromarkets in the City allowed foreign firms to dominate domestic securities markets within a decade of the Big Bang—even though the original challengers to the domestic cartel had been British clearing banks.

Taken together, these reforms demonstrate how market incumbents’ preferences were slowly shifting in favour of business internationalization, even if reforms remained strategic and dominated by national (business) actors and the market for capital market services remained fragmented along national borders. Banks providing purely domestic services in foreign countries remained rare outside of the UK. The politics surrounding securities markets in Europe in the 1980s could still be described in traditional terms of national policy communities, national markets, national regulatory regimes and international competition (though limited in the realm of services). These politics formed the domestic side of the international constellation, the European dimension of which the next chapter addresses. In these international negotiations, banks were to use the same institutionalized access to policy making that this chapter has exposed for domestic reforms.
<table>
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<tr>
<th>Table 1</th>
<th>Germany</th>
<th>France</th>
<th>United Kingdom</th>
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<tbody>
<tr>
<td><strong>Market structures</strong></td>
<td>Foreign FSPs play negligible role.</td>
<td>Foreign FSPs play small role; higher than in Germany because the French current account deficit necessitates capital inflows and the presence of foreign FSPs to sell French securities.</td>
<td>Divided between a relatively closed and detached domestic financial system, including the LSE, and highly internationalized Euromarkets.</td>
</tr>
<tr>
<td><strong>Embeddedness</strong></td>
<td>High. Banks and system of cross shareholdings essential for industry policy; banks also play important role in monetary policy.</td>
<td>Very high. Financial system used to channel credit and for industrial policy. Extensive state-ownership of FSPs.</td>
<td>Low</td>
</tr>
<tr>
<td><strong>Relationship between public and private actors</strong></td>
<td>Cooperative. Public actors inclined to yield to private pressure.</td>
<td>Almost symbiotic. Top personnel move from government to banks and back with ease. Fissures start to appear in the wake of privatization in the late 1980s.</td>
<td>Mixed. No single discernible 'government' stance. Industry's relationship with BoE often cooperative, but relations with OFT and DTI more adversarial.</td>
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<tr>
<td><strong>Policy-making community</strong></td>
<td>Extensive industry self-regulation; contacts with public actors through common policy community for credit market.</td>
<td>Trésor at the helm; includes top-level bureaucrats and industry representatives.</td>
<td>Industry self-regulation; under indirect government oversight after the FSA.</td>
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CHAPTER 4: NEGOTIATING THE SINGLE MARKET: INTERESTS AND INSTITUTIONS AROUND 1990

Bargaining over the single market for investment services was a protracted and acrimonious affair (Brown 1997). The Commission tabled its first proposal for the Investment Services Directive (ISD) late in 1988; it was finally adopted in May 1993. The second important directive for investment services—the Capital Adequacy Directive (CAD)—was likewise finalized at the turn of 1992/93. At times, negotiations effectively broke down (Waters 1991b). Compared to other financial market sectors such as insurance and banking, the ISD did less than had been hoped to create a single, unified market (Steil 1993, 1998). The result was no accident: it reflected the underlying constellation of competitive interests in Europe at the time. The protectionist impulses of national governments—and of the financial industries that their positions reflected—were too strong and irreconcilable.

The story of the negotiations and this ‘first round’ of European financial market integration has been well told (Steil 1993, Brown 1997, Leyshon and Thrift 1997, Story and Walter 1997, Underhill 1997). The aim of this chapter is therefore not to rehearse it once more, but to put it into theoretical perspective. Its core question is deceptively simple: why did efforts to establish a single European market in investment services fail to live up to official ambitions? In the context of this thesis, the answer to this question forms the backdrop against which the renewed—and this time more successful—integration efforts since the late 1990s are evaluated. Taken on its own, however, the failure presents a puzzle. It cannot simply have been governments’ hesitancy to cede ‘sovereignty’ to a supranational body. In the same year that the ISD was adopted, European governments signed the treaty of Maastricht that would lead most of them to relinquish their national currencies before the end of the decade. Also, the Second Banking Coordinating Directive, the ISD’s sibling for credit markets, took less than a year to elicit agreement from European governments and was formally adopted at the end of 1989. What
made investment services different?

The competition politics approach of this thesis reveals the divergent regulatory preferences of national financial market incumbents in the central EU member states as the core obstacle to effective agreement. Negotiations largely depended on agreement between Germany, France and the UK. Their positions represented the spectrum of opinion at the negotiating table; the nine smaller EU members rallied around them in varying constellations. So agreement among the big three was needed to adopt legislative proposals. Smaller countries could always be brought on board by giving them extra time to ‘adjust’ to the agreed measures. This is precisely what happened with the ISD.

Recognizing the difficulty of agreeing on a single set of harmonized standards, the Commission had chosen mutual recognition as the way forward for the single market project, including financial services (Moravcsik 1998: 354f, Egan 2001). Combined with a single passport and home country control, mutual recognition should unleash regulatory competition and thus further convergence. The theoretical attraction of the approach did not prevent disillusion once it was put into practice. The regulatory competition the regime unleashed was a double-edged sword: governments did compete, and used regulation to do it. But they used regulation not only to attract mobile business, but also to give their own financial players a competitive edge. Regulation turned out to be a tool for protectionism as much as for liberalization.

This chapter details this argument in two steps. The first places the negotiations in historical perspective and situates financial markets in the single market project. Integration efforts in banking proper left their imprint on capital market negotiations as they tilted the ‘playing field’ strongly in favour of universal banks. The second part analyses the negotiations around the ISD and the CAD and the competition politics that dominated them, and it locates these politics in global efforts to craft common rules, for example through the International Organization of Securities Commissions. In spite of their limits, the market-opening the European directives eventually entailed sowed the seeds of a further transnationalization of the
financial industry and thus a shift in large banks’ preferences in favour of EU rules that would go far beyond the original agreements. In structuration terms, the regulatory structures that European public and private actors negotiated in the early 1990s were to inspire new agency half a decade later. In this way, the ISD triggered market changes that would make its own overhaul look all but inevitable less than a decade later. Those developments are left for the remaining chapters of the thesis, however.

Financial services in the Single Market project

Financial services occupy an awkward position in the single market project. Measured against the salience of financial matters in the 1990s, they were conspicuously peripheral to the project when it got underway around 1985. Whereas large European industrial firms played an important role in re-launching the internal market—just how important continues to be debated (Sandholtz and Zysman 1989, Cowles 1995, Moravcsik 1998: 355ff, van Apeldoorn 2002)—financial firms were hardly visible. There is little evidence that they were a driving force behind integration.

Once the single market programme was underway, financial firms’ interest in it remained subdued (de Jonquieres 1988, 1993). Only a small group of international banks took it seriously; among the most prominent were Barclays, ING and Deutsche Bank (Interview 160306.b). The City of London was digesting the effects of the Big Bang and the Financial Services Act. The Euromarkets were so far removed from any regulatory oversight that significant intervention by any public authority, European or otherwise, seemed unlikely. For securities markets, the wake up call came once the Second Banking Coordination Directive enshrined pan-European access for universal banks in 1989 (Interview 030406). ‘Europe’ had left its first imprint on the competitive landscape. From the perspective of firms in the City, negotiations around the CAD and the ISD had to recalibrate the balance between bank and non-bank players. The consequences of 2BCD for securities markets provided incentives to stay at the bargaining table; without them, negotiations may well have broken down.

This was surprising as the failure to create a functioning single market in investment
services came at a time when governments were anything but timid in their integration efforts. The watered down ISD was adopted by the Council in the same year European governments agreed on the Treaty of Maastricht. In areas where agreement could be reached on substance, the intergovernmental nature of EU decision-making formed no obstacle to the adoption of new legal measures. The outcome in investment services could therefore not be attributed to disadvantageous decision-making structures. In other areas, notably the launching of the single market programme itself, the Commission had played an important role as a policy entrepreneur. Yet when it came to securities markets, the Commission was sidelined. The institutional makeup of the EU was not responsible for the limited success in securities markets integration. Its roots lay in competitive issues unique to the sector.

The role of finance in the launch of the single market project

Before the 1980s, the EU had achieved little financial market integration (Nicoll 1993). The First Banking Coordination Directive, adopted in 1977, granted EU financial institutions the right to open branches throughout the Union (Story and Walter 1997: 14). But due to the differences between national financial regimes, it provided banks with few incentives to Europeanize. The directive’s effects on the industry were minimal.

In banking as well as insurance, most EU members were reluctant to comply with what market opening legislation required. Representing frustrated insurance firms, the British Commissioner Tugendhat initiated legal proceedings at the European Court of Justice against a number of continental EU members for their non-compliance in 1983 (Young and Wallace 2000). That same year, the Commission developed plans for a single market in financial services as part of a larger package. They had little immediate effect.

The real push for financial market integration came with the White Paper on the completion of the internal market, tabled by the Commission two weeks before the Milan

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Council in June 1985 (European Commission 1985a). Financial services played a minor role in
the White Paper compared to many industrial sectors. This was even more the case for securities
markets than for banking and insurance. For the 1987-1992 period, the White Paper suggested
only one legislative project in the field: a directive concerning investment advisors
(European Commission 1985b)—a field that turned out to be peripheral to the push for
integrating capital markets over the next two decades (Fisher 1988). The selling point of the
single market vision was the building of a coherent economic space for the production and
consumption of goods. Financial services mattered primarily insofar as they were conducive to
this project.

Most scholars of the single market project agree that giving large corporations the space
to organize their operations on a pan-European basis was central to the 1992 endeavour.
Disagreement centres on the relative importance of different groups of actors: Sandholtz and
Zysman have emphasized the ‘entrepreneurial’ role of the Commission, and how it could
suddenly sell a long-time favourite—the single market—as the solution to Europe’s economic
problems, particularly rising unemployment (Sandholtz and Zysman 1989, cf. Young and Wallace
2000: 91f). The Commission proposed pan-European industrial restructuring in key sectors as an
answer to the industrial rise of Japan. It was aided by a ‘transnational industry coalition [that]
perceived the need for European-level action and supported the Commission’s efforts’

Cowles has focused even more narrowly on support from industry, particularly through
the European Roundtable of Industrialists (ERT, see Cowles 1995). In her reading,

business leaders from the ERT largely were responsible for relaunching
and setting the agenda of the single market programme in the early 1980s.
(Cowles 1995: 503, emphasis in original)

The evidence presented by Cowles and van Apeldoorn shows how the single market idea was
‘alive’ within corporate circles before 1985. Again, both identify ‘competitive threats’ from
American and particularly Japanese producers as key factors (van Apeldoorn 2002: 123f).
In a nutshell, top European corporations wanted to exploit the economies of scale a single market would offer. In doing so, they pushed for the same kind of market re-organizing that this thesis argues happened in securities markets a decade later (see also Fligstein and Mara-Drita 1996).

Departing from a perspective at pains to emphasize ‘national preferences’ in European integration, Moravcsik’s argument on the 1992 project and the Single European Act also stresses the (perceived) imperatives emanating from the restructuring of the global economy:

[N]ational preferences primarily reflected economic interests, and in particular increasing global and regional trade and investment, which exacerbated concerns about international competitiveness. (Moravcsik 1998: 318)

In his subsequent analysis of these ‘national preferences’, the core factor is domestic industry support in the face of common ‘competitive threats’ and perceived transnational opportunities. Thus, regardless of their differences, scholars agree that industry support for the project was crucial—whether it made itself felt domestically, in transnational policy coalitions or as the avant-garde of a transnational capitalist class.

To some degree, financial market integration was subordinated to market integration in the interests of big industry. As Moravcsik found, ‘deregulation in financial services [was] not initially the central part of Cockfield’s White Paper’ (Moravcsik 1998: 336). In transnational as well as domestic political contexts, banks and especially securities houses were not overly enthusiastic. Indeed, one of the earliest integration efforts in wholesale investment services came from the ERT when it set up the European Venture Capital Association to fund pan-European industrial projects in 1984 (Cowles 1995: 508).

In setting the general agenda—including integration of European financial services and particularly investment banking—well-established national policy communities for financial services played minor roles. It was only when work on individual directives began that they reasserted themselves. In this sense, the ignition of the integration process in finance came from
outside the political space whose inner dynamics were later to determine its direction. Because this external impulse did not fall on particularly fruitful ground within the inner circles of financial market politics, integration remained incomplete.

More efficiency in European finance?

The broad aims of the 1992 project [in financial markets] were fairly straightforward: they were to boost the effectiveness and efficiency of European economic activity through the easing of barriers to market processes. (Leyshon and Thrift 1997: 95)

With the benefit of hindsight, the picture was more complicated. In particular, Leyshon and Thrift do not adequately differentiate between the integration of the market for financial instruments (including currencies) and the market for financial services. In practice, most financial instruments are difficult to obtain without an ancillary financial service (for example brokerage) so the difference may seem irrelevant. But the distinction becomes important in assessing alleged policy goals. Whereas policymakers profess to be concerned with optimizing markets so that financial instruments are priced ‘correctly’, financial institutions are much more interested in the prices of the services they sell. The two objectives can be at odds. Take, for example, stock markets: the ‘efficient’ pricing of shares might warrant concentration of their trading in one exchange whereas the efficient pricing of trading services would warrant competition between different exchanges. So what does ‘more efficiency’ in financial markets refer to—the instruments or the services? This under-appreciated distinction continues to haunt financial services integration by allowing actors to call for outright contradictory policies in the name of increased efficiency. What is clear is that as the baton was passed to members of established policy communities, concern over the price of services came to overshadow concerns over the efficient allocation of capital and the pricing of financial instruments.

Most of the studies that tried to quantify the single market’s economic benefits in the second half of the 1980s were ambiguous on this point (Tsoukalis 1997: 68ff), combining ‘static effects’—largely one-off ‘welfare increases’ through price cuts resulting from trade
openness—with ‘dynamic’ ones (Egan 2001: 46ff). In the long run, the second category was
supposed to be much more important: the increased efficiency of production that was to result
from the restructuring of European industry, the exploitation of economies of scale, and lower
X-inefficiencies thanks to higher ‘competitive pressures’.

It was in these dynamic effects of integration that financial services gained prominence
within official accounts of the single market. For example, the so-called Cecchini Report
(Cecchini 1988) estimated that the economic benefits from the financial services sector could be
up to a third of the total benefits from the single market project as cheaper capital would benefit
all sectors (Leyshon and Thrift 1997: 83). Other studies tried to estimate price decreases from
heightened competition. The widely quoted Price Waterhouse study, for example, calculated that
integration would save consumers between 0.3 and 1 per cent of EU GDP on spending on
financial services (see also The Economist 1988). Some observers shared this optimistic vision while
others remained sceptical (Grilli 1989, N. Walter 1989), wondering how the spoils would be
distributed—something about which most studies had little to say (Tsoukalis 1997: 71).14

In any case, while integration enthusiasts trumpeted the economic gains to be derived
from financial market integration, they failed to impress all of the parties negotiating the single
market for investment services. Once discussion turned to details and core policy communities
became involved, overall ‘integration logics’ receded to the background—never mind the abstract
‘Costs of Non-Europe’. As the following sections will show, considerations over the
competitiveness of national financial industries trumped all other issues. But before we turn to
the negotiations, we need to understand the broader ‘legislative environment’ in which they took
place.

13 Strictly speaking, the Checchini report was a privately written study. Having been commissioned by the European
Commission and arguing its case, it became closely associated with the latter. Other important publications also
focused on these dynamic effects, e.g. The Costs of Non-Europe.
14 As it turned out, the sceptics were right; hardly any of the projected gains materialized. See Gardner et al. 2001.
Edging towards a single securities market—capital movements and other prerequisites

Once the Council endorsed the single market project in June 1985 and member states, in a radical departure, ratified the Single European Act in early 1986, the European political apparatus started to digest the roughly 300 legislative measures the 1985 White Paper had suggested. Out of the legislative flurry that ensued, two measures are particularly relevant for understanding securities markets politics: the directive that liberalized capital movements and the Second Banking Coordinating Directive (2BCD).\textsuperscript{15}

The Capital Movements Directive showed that governments were in principle willing to move towards a European financial area. This excludes general obstinacy as an explanation for the modest achievements. The directive was to abolish limits to capital flows and was agreed by the Council in June 1988.\textsuperscript{16} Member states were given a mere two years to comply, while some poorer ones plus France and Italy were treated more leniently (Story and Walter 1997: 20).

Considering how capital mobility could interfere with national economic policy, the most remarkable aspect of this directive was that it was adopted at all.\textsuperscript{17} Surely, if governments could agree on something so fundamental that conflicted with 'economic sovereignty', more mundane questions of cross-border services provision should not pose insurmountable obstacles? The directive on the free movement of capital showed just how far governments in principle were willing to go. As the second half of this chapter shows, however, the conflicting competitive interests of national market incumbents blocked any far-reaching agreement.

The 2BCD, concluded in 1989 after less than two years of negotiations, had serious implications for competition in investment services.\textsuperscript{18} The 2BCD applied to credit institutions the

\textsuperscript{15} Two other directives were concluded in the field of securities—the Insider Trading Directive and the Prospectus Directive. The latter is inconsequential for our case; the former is more interesting. German recalcitrance (which had lasted for years) was broken when the banks started to fear the reputational damage Frankfurt might suffer from continued embarrassing discussions. Because it does not directly bear on the ISD and CAD negotiations, we will come back to it in our discussion of national policy change in chapter six. See McCalhey 1997, Lütz 2003b: 139f.
\textsuperscript{16} Council Directive 88/361/EEC.
\textsuperscript{17} Some countries, notably Germany, the UK and the Benelux countries, already had a fairly permissive regime for cross-border capital flows. But even for them, abandoning national discretion on the matter was a novel departure. Cf. Williamson and Mahar 1998.
\textsuperscript{18} Council Directive 89/646/EEC.
mutual recognition approach that had become central to constructing the single market (cf. Egan 2001: 109ff). From the envisaged implementation date, 1993, a banking licence issued by an EU
member state would function as an EU-wide ‘single passport’. It would allow financial
institutions to carry out functions they performed at home throughout the EU. In negotiations,
Germany had pressed particularly hard to make sure that the capital market business would be
included in its purview (Interview 030406). In effect, the resulting directive gave German and
French universal banks the right to engage in just about everything except insurance on a pan-
European scale (Underhill 1997). For investment business, the 2BCD had shifted the terms of
competition among specialist securities houses and universal banks decidedly in favour of the
latter.

From the perspective of our framework, trouble-free agreement on pan-European market
access for banking business proper would be surprising. Were there no competitive concerns for
the firms involved? There were, but they had already been addressed. To begin with, effective
European competition in retail financial services had never been particularly likely for numerous
reasons: customer loyalty, the role of publicly owned financial institutions such as savings banks
and cooperatives, the need to build up new branch networks, cultural differences, etc. (and it did
not materialize up to this day, see European Commission 2007b). In terms of potential for pan-
European competition, this left wholesale banking.

One central cost factor—and hence competitive issue—revolved around the reserves that
banks had to set aside. Just as negotiations on the 2BCD began, central bankers reached
international agreement on this question in the Basle Committee on Banking Supervision (BCBS)
(Wood 2005). The Capital Accord, as it became known, defined both minimum standards for
how much capital banks needed to set aside and how this capital would be calculated. EU
negotiators only had to transcribe these provisions into European law in the Own Funds
Directive and the Solvency Ratio Directive.\textsuperscript{19} Compared to securities, banking proved an easy nut to crack: the core competitive issues had already been solved through other means (wholesale banking) or were unlikely to arise in the first place (retail banking).

The 2BCD gave continental universal banks free access to European securities markets (Underhill 1997: 111). Because it only applied to credit institutions, this right did not extend to the securities houses and investments banks that dominated the City’s markets, both British and American. British negotiators had consciously detached the regulation of securities houses from banking negotiations in order to keep a tight grip on the former (Interview 230306.b). In hindsight, they miscalculated (Nicoll 1993). Separating banking (where continental member states were strong) from securities markets (where London was the undisputed leader in Europe) backfired. Once continental universal banks had secured pan-European access to securities markets, they had little to lose in later negotiations on investment services (Interview 020506). To be sure, calibrating the competitive balance between banks and non-banks within securities markets was only one of the two issues that came to dominate negotiations. But this competitive ‘overhang’ from banking sector legislation helps account for both the negotiations’ difficulties and the British determination to reach a deal. The deal took another four years to reach.

**Negotiating an European market in investment services**

When negotiations began in 1989, the UK securities industry was busy digesting the impact of the Big Bang and the Financial Services Act. That said, it is too easy to let the changes overshadow the continuities. While ownership structures, business models and regulatory structures had indeed changed (Moran 1991, Augar 2000), the international importance and future ambitions of the City remained (Bindemann 1999). In the late 1980s, the City looked as if it was simply getting better at what it had been doing for almost four decades—attracting securities business from abroad (Burn 1999). The SEAQ International trading system was but its latest success.

The previous chapter argued that while the institutional and policy links between public actors and the financial services industry were relatively weak in the UK, the government was committed to the City as a place of financial service provision. In this respect the government was more concerned with the ‘attractiveness’ of the City as a place to do business than was the case in either France or Germany.

In pushing for the interests of the City’s financial services industry, two core constituencies eventually rallied behind the British government: American (i.e. non-bank and non-EU) investment banks and smaller, (still) independent securities houses that had traditionally been the core of the City’s industry. Continental European banks, in contrast, tended to form alliances with their home governments—regardless of the fact that they had become important City players in their own right. The ‘national’ divisions running through the industry thus prevailed, and were clearly reflected in the intergovernmental character of the negotiations.

In France, impending EU negotiations intersected with a pro-active domestic reform programme; strategic considerations were thus central in the French government’s approach. In contrast, the Thatcher government had championed deregulating European services markets for years, not least to allow the ‘competitive’ British services industry to make headway on the continent. At the same time, it had little use for ‘positive integration’, actively using ‘Europe’ to achieve specific policy goals. Deregulation was part of the Thatcher government’s programme but it—as well as European financial market policy as a whole—was not embedded in a government strategy. France was different: European integration was perceived as allowing both market restructuring and continued public control. The French reforms had anticipated European integration, seen for example in steps towards loosening capital controls and restructuring the brokerage industry. French goals in the negotiations reflected reformers’ ambitions: anchoring the universal banking model in Europe (achieved with the 2BCD), preserving the competitive position of French financial institutions (still state-dominated at the time) and consolidating the position of Paris as a financial centre. This last point united the
preferences of French financial institutions—their fate, it was perceived, was tied to that of Paris—and those of policymakers who wanted to keep as much financial market activity as possible under the public eye.

In its approach to 1992, Germany found itself between France and the UK. German universal banks had embraced the single banking passport that extended to securities markets. For them, this was a major victory. But due to their relatively strong position in the British markets, German banks were reluctant to call for excessive protectionism within the European financial area. In the end, they came down in favour of ‘laissez-faire’ market integration. Nevertheless, the impending negotiations presented an opportunity to push for advantage. Germany saw its banks locked in a battle with smaller British firms over ‘levelling the playing field’, and pushed for higher capital adequacy requirements—for all financial institutions, irrespective of where services were produced or provided. The French dispute with the British, in contrast, focussed on where services would be provided. While competitive struggles were at the root of both disputes, they showed that French banks remained more wedded to their home markets than their German counterparts.

The Capital Adequacy Directive in global perspective

As an observer who was relatively close to the negotiations around the ISD and the CAD, Philip Brown once remarked that ‘any full history [of the negotiations] would require a combination of a CD-ROM and a three-dimensional chessboard’ (Brown 1997: 128). Alas, Brown’s assessment was probably too optimistic. It already seemed a fair appraisal of events in the EU arena. But while EU member states were busy negotiating the provisions for the single market, no less than four other international forums were busy devising rules—the International Organization of Securities Commissions (IOSCO), the so-called Barnes Committee of the Basle Committee for Banking Supervision, the so-called ‘Hexagonal’ talks between the UK, the US and Japan, and a European securities regulators group convening independently of the EU single market talks
(Waters 1990, P. Lee 1992). The resulting mess was reminiscent of more than a dozen actors playing chess on five boards simultaneously, with different rules governing each game.

Though EU negotiations were embedded in global developments, focusing on the competition politics of negotiating capital adequacy provides us with a relatively clear picture. Two arenas can be distinguished: EU and global financial markets. For the first, negotiating common rules was a sine qua non for issuing a pan-European ‘passport’ to securities firms. The CAD was to provide the minimum harmonization upon which mutual recognition (in the ISD) would be built. This provided incentives for players expecting to benefit from pan-European market access to keep negotiations alive.

This link between common minimum standards and mutual market access was absent at the global level (in IOSCO and the Barnes Committee). Internationally, negotiating capital adequacy rules is a zero-sum game: as competitive advantage is always relative, some players gain while others lose. With the additional transaction costs it would entail (for negotiating and implementing and monitoring standards), and without mechanisms for coercion, agreement appeared unlikely. In the case of capital adequacy standards for banking (Basle), there was still the ‘public, common good’ of allegedly greater systemic stability through agreement (Kapstein 1992). A competitively neutral regime that had something for everybody through higher system stability thus created a theoretical win-set. Even then, it took some arm-twisting by the US and the UK to force others into agreement (Nabors and Oatley 1998).

In securities markets, the ‘systemic stability’ incentive was considerably smaller. If caught in a falling market with illiquid positions, securities firms might falter and cause disruption. Compared to bank failures, however, the impact would be limited. The 1987 stock market crash had led to the failure of some securities firms, most prominently Tuffier & Associates and Drexel Burnham Lambert. Any wider effects, however, were limited (Bush 1990, Graham 1990). Trying to follow the Basle example in securities was bound to be an uphill struggle; it was surprising that it took IOSCO members four years to conclude that compromise was out of reach. That they
kept negotiating had much to do with the awkward three-level constellation within which capital adequacy was discussed.

The core problem in the negotiations around capital adequacy for securities operations was that firms engaged in them had different business models and hence different regulatory preferences depending on how rules influenced their competitive position. The main divide ran between banks and non-bank securities houses (Waters and Kellaway 1990, Underhill 1997). Firms in the securities business are normally required to maintain capital reserves to cover risks associated with market crashes, company failures, settlement problems, etc. Two questions ensue: how should the capital required for a specific market position be calculated? And what counts as ‘capital’ in the first place? Only equity, or subordinated debt as well? These questions matter to firms because capital is a cost factor and affects their profitability. Capital needs to be serviced, in the simplest instance through the payment of dividends to shareholders. In addition, stringent capital adequacy rules might force companies with stretched reserves to unwind securities positions in an unfavourable market environment to stay within the mandated limits (Filipovic 1997: 184). Such rules would thus act as a deterrent for small firms to assume larger risks, and thereby ‘tilt’ the playing field against them.

The securities business was conducted under the auspices of two different regulatory regimes. On the one hand, universal banks, for example in Germany, were regulated by banking authorities. The rules for how much capital they needed to put aside to cover the risk from their securities operations was an integral part of the rules governing banks. In addition, most universal banks could use a single pool of capital to cover exposures in both their credit and securities businesses. On the other hand, non-bank securities firms—‘pure’ brokers and investment banks offering a wider range of services—were covered by rules specifically devised for capital markets. In the UK, the required level for capital cushions was rather low, not least due to firms’ small

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20 Subordinated debt leaves the creditor with fewer rights to recover the principal in times of distress, allowing the debtor company to use the money to service other liabilities first. In return, subordinated debt generates a higher yield for the creditor.
average size and the sector’s history of self-regulation. Securities firms thus tried to influence ‘their’ governments to push for standards that would skew the terms of competition vis-à-vis the banks in their favour. The banks tried to do exactly the opposite.

The IOSCO negotiations well illustrate this (Filipovic 1997: 141ff). In 1989 its most powerful body, the Technical Committee, which brings together securities regulators from the core global markets, tabled a report on ‘Capital Adequacy Standards for Securities Firms’ at IOSCO’s annual conference in Venice (Waters 1989a). At the eleventh hour, the German delegation withdrew its support for the text, claiming that the deal ‘could possibly damage the vital interests of German banks’. The most contentious issue was the treatment of subordinated debt as capital and whether amounts thus recognized should be limited (Filipovic 1997: 183). The Germans—indirectly supported by other countries with universal banks (France and Switzerland in particular)—desired tight ceilings to limit capital-scarce investment firms’ ability to ‘leverage’ their core capital in the short run.

The German representatives at the negotiating table, however, were not government regulators in the proper sense, but representatives of the Federation of German Stock Exchanges. The stock exchanges, as pointed out in the previous chapter, were controlled by the large Frankfurt banks. The regulated themselves were thus making foreign regulatory policy, and left little doubt about their own stake in it. German public actors were involved only post hoc to back the positions of private actors (Simonian 1989b). The cracks in intergovernmental imagery now become evident: the German government was taking a strong position on the international stage but the underlying conflict was actually a ‘private’ one. In the event, the German Federation gave in to the report’s publication on the condition that further negotiations would follow quickly and that the conference made clear no agreement had been reached (Waters 1989b). The German
finance ministry and the Bundesbank publicly backed their clientele less than a week later, again
citing unpalatable competitive implications.21

Industry interests were clearly perceptible within the British delegation as well. As
Filipovic found,

'[t]he [Securities and Futures Authority] maintains close links with its
membership, to a degree beyond that of most regulators in other
countries. This is especially the case when it come to concrete issues of
great salience. For example, commenting on the EC proposal for a
Capital Adequacy Directive, the SFA International Capital Committee …
"attached considerable importance to consultation with the membership,
and the Chairman of the Committee wrote to all firms on two occasions
to inform them of the developments, to highlight issues of concern and
to solicit their views". (Filipovic 1997: 141)22

The self-regulating members of the SFA, acting as a branch of the SIB, were again sitting more or
less directly at the negotiating table. The failure of the 1989 conference was directly attributable to
irreconcilable private interests. After the collapse, IOSCO’s technical committee made practically
no movement on the issue for three years. As will be seen below, the revival of negotiations in
1992 was short-lived—a prelude to their final breakdown.

Competitive struggles between securities firms and banks equally dominated CAD
negotiations in the EU arena. The conflicts were broadly similar, and led to stalled negotiations
after 1989. In contrast to IOSCO negotiations, however, the promise of effective market
integration gave parties an incentive to keep going. The Investment Services Directive was to
provide non-bank securities houses with the pan-European passports that banks had won with
the 2BCD. In the words of Sir Leon Brittan, EU Commission Vice President in charge of
financial institutions, the CAD was to be ‘the key that [would] unlock the ISD’ (P. Lee 1992).

21 Less than two months later, Rolf Breuer, Deutsche Bank board member, publicly deplored the lack of public
authorities to represent Germany at forums such as IOSCO. The reason he gave was to better secure ‘German’
(banks’) interests. The call for ‘public intervention’ came from private actors first, for they feared the competitive
implications of rule-making where private representative bodies lacked the weight to influence outcomes. Simonian
1989c.
22 The quote within the quote is taken from a SFA report.
The Investment Services Directive

The ISD was to enshrine ‘mutual recognition’ in securities markets regulation and provide securities firms with a single passport (Ashall 1993, Steil 1993: 22ff, Brown 1997, Story and Walter 1997, Underhill 1997, Steil 1998). In theory, the ‘levelling [or rather: calibrating] of the playing field’ through ‘minimum standards’ was to happen through the CAD. But in practice it was not simply a question of one directive building upon the other. Rather, the ISD was used to settle additional competitive issues, of which two stand out: the question of on- and off-exchange securities trading and the application of conduct-of-business-rules (CBRs) by host rather than home authorities.

The German camp had tried to exact a price for the single passport in the form of tough capital requirements for non-bank securities firms. Their strategy reflected specific German market structures: many of the financial institutions advocating regulatory protectionism were already well-established in the City (Deutsche Bank, the most prominent example, had moved its investment banking headquarters there in 1984). The perceived need to ‘update’ Frankfurt to repatriate or retain business was thus balanced by German banks’ stakes in well-established London markets—so long as they would be allowed to operate there under advantageous conditions. The point was not that foreign firms were per se unwelcome in Germany. But the German finance ministry was clearly worried that foreign ‘financial engineers’, as one respondent working for the German government at the time put it, would swamp the domestic industry (Interview 020506).

The French position was less ambiguous. Furthering the interests of French banks almost fully coincided with boosting Paris at the expense of London. At French insistence, a ‘concentration principle’ was inserted into the ISD that basically allowed countries to oblige its residents to trade domestic securities on ‘regulated exchanges’. The aim was to repatriate the trading of French securities from London’s ‘unregulated’ SEAQ International market, where almost a third of it had migrated. Here the French were supported by the ‘Club-Med’—a group
of southern European countries including Italy, Portugal, Belgium, Spain and Greece (The Banker 1991). Their motivation was similar to that of France: preventing the exodus of share trading to London.

Wedded to the ‘concentration principle’ was another provision aimed at London’s markets: the French insistence on ‘transparency’ in trading. As discussed in the previous chapter, block trading in particular had migrated to London because lower transparency requirements made it easier for dealers to liquidate large swaths of shares without adversely affecting market prices. Unwilling to go down the same road themselves, the French insisted on raising price transparency requirements throughout the EU to thwart SEAQ trading practices. London’s financial community, unsurprisingly, was unhappy with the proposals. The British Merchant Banking and Securities Houses Association (BAMBA) for example took a very ‘liberal’ position on the ISD and pressed for ‘a flexible approach for information disclosure and publication of trade details on behalf of market-makers’ (Filipovic 1997: 129). As with the concentration principle, the German position was closer to that of the British than the French (Waters 1991b, Ashall 1993: 99). This reflected the dominance of the big banks in the German securities business, whereas in France a separate brokerage industry still existed. In addition, German banks were quite active on the SEAQ. In contrast to the French, they faced no opposition at home from a host of smaller financial institutions excluded from the lucrative SEAQ business.

The final major point of contention in the ISD concerned the principle of home country supervision. The idea was straightforward: to facilitate cross-border business operations and to relieve firms of having to report to two (home and host) authorities, home authorities should perform the supervisory function for the financial group as a whole. In combination with the mutual recognition principle, this was to make most dealings with the host authorities unnecessary after initial registration. Fearing the interference of foreign governments with cross-border business, the BMBA early on supported the home country control principle (Hutton

23 Large institutions are generally better equipped to engage in the relatively risky business on the SEAQ, particularly when large positions that cannot be ‘netted’ or ‘hedged’ for regulatory purposes are involved.
In the name of protecting national investors, the French disagreed. At least retail investors, they argued, needed to be protected by host country rules lest they suffer from excessively loose regulation in financial firms’ home countries. With all these conflicting interests, both 1990 and 1991 saw practically no movement in the negotiations.

The bargaining positions of the different parties reflected the interests of the most influential coalitions in their national financial industries. *Euromoney*, one of the industry’s leading magazines, reached the same conclusion in 1992:

> [T]he capital adequacy directive for securities firms is not really about prudent regulation, or level playing fields. It boils down to vested interests trying to skew the regulations to obtain a competitive advantage. (P. Lee 1992: 33)

When the Commission submitted a revised version of the CAD in 1992, it admitted as much when it explained that ‘amendments [had been] made to achieve more equality in the treatment of credit institutions and investment firms’ (Filipovic 1997: 184). It was an acknowledgement that fine tuning this balance was what the legislative process was all about.

The regulatory protectionism dominating the negotiations was far from erratic or haphazard. In the first instance, it mirrored competition politics—made more virulent by the close ties between private and public actors. Chapter three highlighted the correlation between the embeddedness of financial markets in national economies, the institutionalization of links between public and private actors and relative protectionism in financial market policy. The influence of private-public coalitions on the negotiations merely reinforced pre-existing tendencies.

It was no accident that the French government intervened so vehemently on behalf of its industry. Protectionism and close public-private links were two sides of the same coin—two aspects of what Underhill has called the state-market condominium (Underhill 2001, 2003). The liberal stance of the British government vis-à-vis foreign firms (i.e. the weakness of protectionist impulses) was likewise the flip side of its weak links with the British financial industry. We thus
return to one of the general arguments of this thesis: political institutions cannot be understood independently of the concrete politics they mediate. Over time, they are mutually interdependent.

In the event, EU member states’ different regulatory structures and associational institutions made a big difference. Here the contrast between the regulators’ club IOSCO and the intergovernmental structure of the EU is telling. In IOSCO, the City industry’s interests were represented through the UK SIB, a respected securities markets regulator second in standing only to the SEC and in intense contact with the industry through the remnants of the self-regulatory system (Moran 1991). The informal character of self-regulation in Germany, in contrast, saw German banks fight a rear-guard action in IOSCO. Though sufficient to undermine agreement at the last moment, informal self-regulation made life difficult for the banks, regardless of ex post backing by the Bundesbank and the finance ministry.

Matters worked differently in the EU arena. Here German banks’ informal ties with public actors proper (the central bank and the government itself) paid off because their interests were well represented from the start, not least in the negotiation of the 2BCD. In contrast, the self-regulatory structure the British securities industry had developed did little to help it push its regulatory cause, while the industry’s comparatively weak ties to the British government, particularly the DTI, weakened its access to EU negotiations.

The embeddedness of financial markets and the importance of national regulatory systems for economic policy also made themselves apparent, though less than the competition politics themselves. As pointed out above, embeddedness affected negotiations through the ties that public actors in coordinated market economies had established with the financial industry. Governments sometimes invoked the ‘public interest’, for example to justify host authorities’ retention of certain regulatory and supervisory rights vis-à-vis foreign firms. But such cases generally referred to ‘public goods’ like systemic stability or investor protection rather than to a nationally idiosyncratic approach to economic policy.
A European deal shatters global ambitions

Movement returned to the negotiations on capital adequacy for securities firms in early 1992. Surprisingly, the movement was initially within IOSCO rather than the EU (Waters 1992d). IOSCO members met with representatives of the Basle Committee on Banking Supervision to hammer out a deal (Waters 1992c) and reached basic agreement on almost everything, successfully amalgamating the different regulatory ‘philosophies’ that had often been evoked to justify disagreement. Only the all-important numbers remained in dispute: the precise ratio of subordinated debt to equity capital permissible for regulatory purposes and the amount of capital necessary to back up equity and other market risks.

On the former, the fault line ran between banking supervisors eager to limit subordinated debt-as-capital and securities market regulators (essentially the SIB and the SEC) who favoured more generous limits. The fault lines for the latter differed: a clear divide opened up between the SEC on one side (backed by the ‘universal bank lobby’, which like the SEC favoured high capital charges) and British and French regulators on the other (P. Lee 1992: 35). Traditionally, the SEC had required firms to hold sufficient capital to withstand firm-level ‘worst case’ scenarios; the British approach, in contrast, was concerned with disruption of the market at large and therefore required less reserves. On both subordinated debt and reserve levels, negotiators once again proved to be advocates of their domestic market incumbents.

While bickering over numbers in IOSCO and the BCBS continued, the EU finally scored a breakthrough. The Commission tabled a revised version of the CAD in May 1992 that fine-tuned the question of subordinated debt-as-capital by introducing a new category: ‘tier three capital’, consisting of short-term subordinated debt that would be treated differently from both equity and long-term subordinated debt (Waters 1992a). The precise numbers were to be decided later by the Council but the new proposal contained a general framework: both securities houses
and banks would have to separate their securities holdings and trading from the rest of their business in a ‘trading book’ for which the CAD charges would apply.\textsuperscript{24}

IOSCO negotiations now stalled as the potential EU deal gained in clarity. In particular, the SEC grew sceptical as the momentum at the European level excluded it—and the interests it represented—from the discussions (Waters 1992b). When Great Britain acceded to the EU presidency in July 1992, she was determined to end the standstill. UK negotiators managed to rally support for a Common Position on the CAD among all ECOFIN members by November. Agreement on a two per cent capital charge on gross securities holdings—acceptable to EU members—was far below the four per cent that Richard Breeden, SEC chairman, had always advocated. Now that the EU countries had locked themselves in through joint agreement, the SEC effectively withdrew support for the IOSCO-BCBS initiative (Corrigan 1992). The lock-in had decreased the EU’s ‘win-set’ to such an extent that compromise in global negotiations was now impossible (cf. Putnam 1988). Indeed, less than half a year later—tellingly coinciding with the official adoption of the CAD in Brussels—IOSCO’s attempts to reach a capital adequacy compromise were formally abandoned (Bacon 1993, Waters 1993).

Once the CAD was agreed, movement accelerated on the ISD as well. In fact, core aspects of the new ‘Commission proposal’ had been negotiated directly between the French and British delegations (Interview 030406). After the usual last minute bargains, it was finally adopted in May 1993 (for details, see Usher 2000). In the CAD, the problem had boiled down to numbers. Settlement was now reached with an approach where the capital reserves of firms with significant securities operations would consist of two ‘building blocks’—two per cent for the gross positions and another eight per cent for the net positions (Euromoney 1992). In the case of the ISD, the most sensitive questions lay in definitions. What constituted a ‘regulated market’ for trading? The agreed definition saw the SEAQ on the edge of inclusion. The question of who

\textsuperscript{24} This compromise meant that securities houses were to face bank-style capital charges on those parts of their operations that were not part of the trading book itself (for example foreign exchange liabilities and expected future overheads). Again, City firms were irate. See Euromoney 1992.
counted as a ‘professional investor’ was even more delicate. Market participants falling outside this designation would come under the control of host authorities, who were left free to establish rules for firms operating in their jurisdictions; the principle of home country supervision and mutual recognition of home country rules could thus easily be fudged. And with a ‘professional’ in the field of investment services left undefined, a legal patchwork was poised to persist. While home country supervision was the official rule, “[member] states ensured that the balance tilted in favour of host country supervision” (Story and Walter 1997: 266). McCahery has argued that the mutual recognition approach to co-operative regulatory control is unlikely to be effective unless member states pursue similar policy interests. (McCahery 1997: 70)

This, however, was not the case.

The implementation date for the ISD was stretched far into the future. January 1996 was the deadline only for those countries that had supported relatively open markets to begin with. France, Spain, Italy and Portugal only agreed to the ISD on the condition that they be granted several more years before they would have to accept ‘single passports’ (Steil 1993: 23). Writing in 1993, Steil aptly summed up the thrust of the negotiated results:

Not surprisingly [...], several key sections of the ISD are political compromises reflecting the determination of member state governments to protect their domestic industry’s competitive position, rather than provisions for ensuring a stable and efficient European financial market. (Steil 1993: 22)

Conclusion

What does all this reveal about European integration and the relationship between market integration and levels of governance? On the surface, negotiation dynamics resembled liberal intergovernmentalist patterns. The success of negotiations depended on national governments, while intergovernmental dissent—despite the Commission’s eagerness to see negotiations advance—stalled progress for several years. The prospect of overall welfare gains as identified in
the 1985 White Paper (European Commission 1985a) and the Cecchini Report (Cecchini 1988) did not carry sufficient weight to elicit agreement.

Yet liberal intergovernmentalism tells us little about the underlying social forces at work. Moravcsik’s questions predetermine his answers: the focus on intergovernmental politics, not surprisingly, analytically privileges intergovernmental politics. Such analysis, however, misses the underlying conflict. National governments acted as agents. The interesting question concerns their principals. Moravesik (1997) himself has acknowledged that far from being given, ‘national interests’ are the outcome of domestic politics. But the image he invokes—of national positions formulated through domestic deliberation—is misleading.

Capital market politics were not a case of top-down consultation (the state aggregating the opinions of its constituencies), nor is it a case of bottom-up public debate. The distance separating the organized interests of the financial industry and the public actors articulating them was less than Moravesik’s imagery suggests. Through more or less explicit industry self-regulation (Germany and the UK), or the state functioning as majority owner of large financial institutions as well as regulator (France), the financial industry’s interests are ‘built into’ what from the outside appears as ‘the state’. Banks are insiders in the respective policy communities, not just one stakeholder among others.

In addition, their interests have had a clear transnational dimension. Preferences expressed as ‘national positions’ have been the result of competitive struggles that transcend national and, as the role of the BCBS and IOSCO showed, even European borders. In the trade-off between effective market integration and regulatory protectionism, many actors chose the latter. Nevertheless, financial markets—notably the Euromarkets—were much more integrated than the international politics of European financial market negotiations suggest. Governments did not act as interfaces between sheltered domestic political processes and international policy coordination. The intergovernmental character of the negotiations can be attributed to the constellation of interests within European securities markets—and not to their taking place in a
world that conforms to the axiomatic division between the domestic and the international that intergovernmentalism as a theory is built on.

Put differently, the specific structure of the struggle over the terms of competition—waged on a transnational plane—was responsible for the intergovernmental character of EU capital market politics. This intergovernmental character was the dependent variable, and can be attributed to the overall politico-economic constellation—what we have called the ‘international constellation’. This ‘international constellation’ combined: (1) financial markets still fragmented along national borders, (2) political institutions converging around government apparatuses, and (3) strong ties between financial markets and national ‘varieties of capitalism’. As the previous chapter argued, these three dimensions had co-evolved historically—even if the increasing internationalization of financial markets was starting to unravel the links between them.

Once the CAD and the ISD were concluded, it was up to governments to implement the measures they had agreed—which they proved reluctant to do. Nevertheless, the agreed changes set in motion a further ‘Europeanization’ of market structures. Those actors who had hoped for more far-reaching market integration in the first place did not have to wait for the ISD’s lengthy implementation period to pass. As European capital market structures shifted throughout the 1990s in response to the strategic reorientation of many market incumbents, pressure was building for a second round of market integration—one that would generate not only detailed agreement on supranational rules, but a new institutional framework in which governments surrendered significant elements of national control over capital market regulation. How this happened is the theme of the chapters to come.
CHAPTER 5: REVISITING THE 1990s CAPITAL MARKET REVOLUTION IN EUROPE

The face of European finance was transformed in the 1990s. Continental European equity markets moved from the fringes of national economies into the limelight. Banks previously focused on their domestic markets began to build cross-border investment banking empires. Stock exchanges were transformed from members-only clubs into for-profit companies. This chapter explores the relationship of these changes to the supranationalization of EU capital market governance.

On the broadest level, this thesis argues that in ‘competition politics’ the evolution of market structures, the business strategies of leading firms, regulatory policy and patterns of governance are mutually interdependent. This chapter addresses a specific part of this larger feedback loop: the co-evolution of market structures and the business strategies of core (investment) banks in Europe in the 1990s. While the behaviour of financial firms is commonly depicted as adaptation to changes in their environments (e.g. R. Smith and Walter 2003), changes in (macro-)market structures not only cause change in firm behaviour—they result from them as well. In a market dominated by a dozen (investment) banks, changes in their behaviour will translate into altered market patterns.

In highly concentrated markets, firms do not confront ‘market structures’ as something external to them. Rather, the strategic behaviour of core firms plays a central role in structuring markets and explaining core changes in them. The first part of this chapter therefore takes issue with the view that market evolution ‘determined’ adaptation in firm behaviour. It would be more accurate to say that the changes firms perceived or anticipated in their environment inspired (further) modifications of their business strategies. In addition, changing market structures bore the impression of both national and European-level regulatory reforms of the preceding years—reforms in which firms themselves had been strongly involved. Market changes were thus not ontologically prior and exogenous to the reorientation of national market incumbents, which was
later to translate into further pressure for regulatory and institutional change.

This chapter goes on to explain the internationalization of capital market business throughout the 1990s. This cross-border expansion of firms was both a response to and an anticipation of further opportunities as international capital markets grew in size. In addition to past regulatory reform itself, European universal banks were inspired by US competition and the decline of profits in the traditional lending business to internationalize and amplify their capital market operations. For the American investment banks, this was an extension of existing strategy; for most continental firms, it was a major reorientation. The new business interests were most apparent in the resources invested by continental firms to expand their international investment banking operations.

Given its focus, this chapter in principle lends itself to the use of quantitative data. But as the next section argues, the available data has serious limitations. The following sections then address changes in German and French capital markets, the main factors behind their rise, the Europeanization of the investment banking industry, and a specific development in EU capital markets relevant to contemporary politics: the demutualization of stock exchanges. Regulatory changes were crucial in all of these developments.

**Measuring change in EU investment banking markets**

This chapter considers the relationship between three factors: macro market structures, business strategies and regulatory change. Data on the first two are less reliable than may appear at first sight. How do we, in hindsight, identify the business strategies of firms? Documents produced by the firm at the time may seem the answer but annual reports and other public pronouncements of corporate strategy have their shortcomings. The image they provide of firms’ strategies may be distorted by their aim to please investors. If European investment banking is the fashion of the day, managers may wish to score easy points by declaring it a priority regardless of their true intentions.
Annual reports, with their numerical overviews of business activities, contain potentially more relevant data. For example, the relevance of international versus domestic business and capital market versus traditional banking activities might be measured by their contribution to the firm’s overall profits. Such measures, however, are a weak proxy for corporate strategy. After all, entry into new market segments identified as strategic priorities are normally costly—they initially generate little revenue. It is the expectation of profits that motivates firms to enter new markets, not their immediate realization.

In addition, firms differ both in the manner and the level of detail with which they report their capital market operations. They may employ different criteria depending on where their cross-border financial services are ‘booked’—abroad or at home. International differences in both taxation and accounting regulation are likely to affect figures. Accounts are rarely sufficiently detailed to distinguish business segments with volatile profits (particularly proprietary trading) from others such as underwriting or brokerage. In sum, strategy announcements and operational data are not fully reliable as sources for determining corporate strategy.

Finally, time inconsistency—organizations may be motivated by their expectations of the future as much as by events of the past—complicates the task of identifying causes for changes in corporate behaviour more generally. For example, firms may anticipate regulatory reforms and buy into a new market before new laws come into effect. In spite of the timing, one could still argue that legal changes triggered the change in behaviour.

For aggregate macro data, the picture is also bleaker than one might suspect. Quantitative measures for all aspects of banking markets are aplenty. For example, OECD data on credit businesses have their own NACE category, allowing systematic exploration of the sector’s profile over time. But no such thing exists for various aspects of investment banking. In data collections using the NACE industry categorization, they are likely to be lumped under ‘Other monetary intermediation’. Eurostat, the leading institution for comparative data on the EU, only has financial services data for ‘credit institutions’, ‘insurance services’ and ‘pension funds’. Capital
market services do not appear as a separate category.25 The absence of useful macro measures for the development of the investment banking industry (as opposed to capital markets, see below) explains the dearth of studies in this field, particularly quantitative ones. Again, much has been written about banking proper, but next to nothing about investment banking.

Macro measures of developments in markets for specific financial instruments offer a mixed picture: obviously, data on the issuance, stock, valuation and trading of particular (kinds of) securities are widely available, most obviously in the form of time series for stock market indexes such as those published by the Bank for International Settlements. Data on financial services provision is more difficult to come by. There is no agreement on what constitutes cross-border financial service provision, and how firms should treat it in their corporate accounts (OECD 2000).26 National accounting systems differ to such an extent that international comparison is hampered. For example, French figures for trade in financial services in the early 1990s are widely seen as unrealistic and unreliable.27

Valid and reliable measures of that holy grail of single market policy—market integration—are even more difficult to find. The strategy commonly used by the European Commission is to compare prices for similar products throughout the Union. However, international price differentials are influenced by numerous factors that are difficult to separate analytically. In wholesale finance, banks typically supply several services to their clients simultaneously. Even when available, the ‘price tags’ for individual services may not reflect the true internal cost calculations of banks. Apart from the most commodified services, products are often too complex to compare. And when prices decline for these commodified services, for example brokerage or underwriting, it is likely the result of commodification itself rather than

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25 This applies to most stylized comparative overviews as well as to generalized comparisons of the ‘trade openness’ of European countries in these service sectors. Gjersem’s OECD working paper, to give only one example, has measures for trade openness in banking (that is, credit) and insurance services only. See Gjersem 2003: 12.

26 On how ‘trade in services’ defies established notions of territoriality—and thereby also measurement systems based on them—see Ruggie 1993. Ruggie approvingly quotes Jagdish Bhagwati who suggests dropping the notion altogether. See Bhagwati 1987.

27 In the relevant OECD publication, readers are cautioned that the figures appear anomalous. See OECD 2000: 28. In the corresponding WTO publication, they are simply omitted. See World Trade Organization 1997: 13.
international market integration. After all, sophisticated firms that use cutting-edge services to
generate profits use ‘cheap’ off-the-shelf products to squeeze their smaller competitors out of the
market. Thus even where reliable and comparable price data are available, they are not a
particularly valid proxy for market integration. The first serious attempt to generate an
encompassing picture of market integration in EU financial services (European Commission
2005b) therefore combined available data from different studies to generate an overall
‘impression’ of current developments. A single measure of market integration is nowhere in
sight.

Due to these limitations, this chapter focuses primarily on qualitative data and existing
research, even though quantitative measures (where available) will be used for corroboration.
Arguably, the best indicator of firms’ strategies are their material investments. More specifically,
heavy investment in international investment banking justifies the claim that a firm has identified
it as an important part of its strategy. Luckily, the number of firms that play a significant role in
EU capital markets (measured by a market share of more than, say, 2 per cent) is small;
international expansion can thus be assessed on a case-by-case basis. If it emerges that all these
companies invested heavily in international capital market operations—as is indeed the case—this
is probably as good of an indicator of a general shift in the industry’s strategy as the data is likely
to allow.

**Market concentration as a source of economic and political power**

Market concentration within EU investment banking heavily influences the economic and
political dynamics within the sector. The fact that less than a dozen firms control more than half
the market in just about every market segment means that forms of economic interaction other
than those allowed or suggested by traditional economic models are possible; in a nutshell, firms

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24 The most comprehensive collection of data on EU ‘financial integration’, drawing on a variety of sources (ECB, 
OECD, FISE, ISMA, ISDA, etc.), has been compiled by the Commission itself. The compilations are a great step
forward even if fundamental definitional issues remain unaddressed. European Commission 2005b.
can interact strategically rather than just parametrically (on the distinction, see Abell 2003). In highly concentrated markets, for example, firms can collude to narrow markets and dictate prices. This concentration is even greater for stock exchanges, discussed separately towards the end of this chapter.

This concentration within the industry has political consequences. It gives banks considerable political clout in their home markets. It further allows the opinions of a handful of firms to stand in for what ‘the market’ thinks. If the top dozen banks agree on a position in consultations with the European Commission, this is taken as consensus in the industry. Concentration also means that firms find it easy to cooperate politically: they can use industry associations to coordinate their political strategy and smooth out internal differences. As the following chapter will show, the legitimacy of the Commission’s actions largely depends on the preferences and support of stakeholders. This makes a consensus that represents, say, 90 percent of market share in a particular market segment difficult to resist.

So how have European investment banking markets been carved up? A glance at industry figures dispels the myth that the world of finance approximates orthodox economists’ ideal of the ‘market’. Underwriting in both equities and bonds is instructive: the Group of Ten found that throughout the 1990s, the top five firms captured between 44 and 50 per cent of the combined global market (Group of Ten 2001: 55f). US firms dominated the industry, not least as the global preponderance of US stock markets grew in the 1990s due to the dot.com bubble. US equities market capitalization as a share of global market capitalization rose from 32.7 per cent in 1990 to 49.1 per cent in 1998 (R. Smith and Walter 2003: 148). In US IPOs, the three top firms, Merrill Lynch, Morgan Stanley and Goldman Sachs, captured more than 50 per cent of the market (Group of Ten 2001: 454f).

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21 Under parametric conditions the environment that actors confront (including for example price levels that appear as ‘given’ for individuals) is not responsive to the actions that they take. Under strategic conditions, actors can illicit reactions from others and try to calculate those (for example in an oligopoly).
European markets were likewise heavily concentrated throughout the 1990s. In 1995, the top 20 underwriters for bond issues in euros (or legacy currencies) had no less than 98.9 per cent market share—and 95.8 per cent of that was attributable to euro area firms (Cabral et al. 2002: 27, see also Santos and Tsatsaronis 2003). The US firms among the top 20, in contrast, only commanded 2.1 per cent of the market. By 2000 the top 20 still had almost 95 per cent of the market, but now only 43.2 per cent was booked by euro zone firms whereas 40.6 per cent had gone to the American banks. In absolute terms, the business volume of the European firms had remained roughly constant through those five years, whereas that of the US firms increased rapidly. Since then, matters have stabilized. In 2004, the seven European firms among the top ten corporate bond underwriters in euros held 45.7 per cent of the market (Casey and Lannoo 2005: 34). Equity underwriting shows a roughly similar if less pronounced picture. Between 1995 and 2000, the market share of euro zone firms among the top 20 fell from 64.2 to 41.4 per cent, whereas that of US players rose from 10.8 to 35.7 per cent (Cabral et al. 2002: 28). By 2000, US investment banks had captured an estimated 70 per cent of the fee-income on ‘European capital markets and corporate finance transactions’ (R. Smith and Walter 2003: 367). Such concentration, however, was not a new phenomenon. For euro legacy currencies between 1994 and 1998, the top 5 firms in countries such as France, the Netherlands and Italy never had combined market shares below 70 per cent (Santos and Tsatsaronis 2003: 10).

The rise of capital markets and investment banking in Europe

The real boost to European capital markets came in the second half of the 1990s when stock market capitalizations, share trading volumes and bond issuance sky-rocketed. The opportunities

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30 Examples that will not be discussed in further detail but are important to complete the picture include secured money markets, where the top quintile of participants consistently held over 80 per cent of the market share between 2000 and 2004. Over the same period, the top 10 players held 60 per cent of the repo market. In over-the-counter forward rate derivatives, the market activity share of the top quintile of players approached 95 per cent in 2004. European Commission 2005b.

31 2001 shows a similar picture, even if slightly less pronounced. The respective figures are 46.6 per cent for euro-area firms and 32 per cent for American ones.

32 The top four were Deutsche Bank, BNP Paribas, Barclays and Société Générale (in that order); the other three EU firms among the top ten were ABN Amro, Dresdner KW and HSBC.
created by this boom convinced many banks hitherto focused on domestic credit markets to reorient themselves. The boom was largely the result of previous political choices: domestic coalitions had pushed through regulatory changes to enable the development of national capital markets (see chapter 3), governments had chosen to privatize everything from utilities to telecoms, and firms had revamped business structures in anticipation of future opportunities.

The stock market boom was the most noticeable development within continental financial markets; major stock market indexes quadrupled over the 1990s. The market capitalization of the London Stock Exchange tripled (see graph 2). Nor was the boom specific to Europe. Market capitalization of the New York Stock Exchange (reproduced in the graph for comparison) also quadrupled over the course of the decade, reflecting the transatlantic correlation of stock market developments reaching back to the 1960s (Dumênil and Lévy 2005: 36). The Hong Kong market rose seven-fold; many other emerging markets showed similar increases, even if some never recovered from the crises that spread from Asia after mid-1997.
Did rising stock markets in continental Europe signal a change in financial structures from bank-based financial systems towards capital market-based systems (Rajan and Zingales 2003)? Morin, for example, has argued that France in this period witnessed a shift from a ‘financial network economy’ towards a ‘financial market economy’ (Morin 2000, see also Clift 2004). At its peak, French stock markets indeed reached levels that had only been known in Anglo-Saxon economies: in 1999, market capitalization stood at 110 per cent of GDP (Commission des Operations de Bourse 1999: 18).

But once financial structures are considered in broader terms, we see that other aspects—the weight of bank loans and debt securities (mainly bonds) relative to GDP—remained relatively stable (graphs 3 – 5). Around 2000, roughly 60 per cent of financial flows in Europe still passed through the balance sheets of banks; in the US, the figure was 25 percent, down from 75 per cent in the 1950s (R. Smith and Walter 2003: 361). Continental Europe was thus still far from what prevailed in the US or the UK.

The rise in stock market values—one of the core business opportunities for investment banks new and old—did not imply ‘deep’ financial transformation. For the German case, Vitols found that

de[changes] can be characterized as changes at the margin rather than a fundamental transformation of a bank-based financial system. Elements of a US-style market-based regulatory system have in fact been introduced in Germany, and the large banks have made considerable efforts to build up their market-based activities. However, with the exception of a flurry of new company listings on the stock market (initial public offerings, or IPOs) during the bubble years of 1998-2000 and the introduction of a moderate form of "shareholder value" by large listed companies, remarkably little has changed in the pattern of corporate finance in Germany in the past decade. (Vitols 2004: 1f, cf. Deeg 2001)

Nevertheless, the stock market boom generated a kind of excitement from which governments were not immune—what Alan Greenspan famously characterized as ‘irrational
Graph 3. Source: European Commission 2003, also for France and UK.

Graph 4

Graph 5
exuberance'. As the next chapter will show, the stock market boom also created a political window of opportunity for banks and other actors in favour of future market integration. One German government official at the time recalls how

we also had the hope that we would be able to challenge London to some degree. That was the boom of the DTB [the German derivatives exchange], also of the Deutsche Börse. And the banks were also actively playing along. That lasted for two, three years. Then we realized that we could not keep up and that in fact, we had to be careful that we didn’t lose too much ground. (Interview 020506, authors translation from German)

Governments fuelled the stock market boom with large-scale privatizations, which in turn led them and many others to believe that a revolution was sweeping European finance. The French government, for example, had already privatized some major banks and sold France Telecom (1998) and Air France (1999) on the stock markets just as they were reaching their heights. In Germany, the public listing of Deutsche Telekom in late 1996 was one of the catalysts for the stock market boom. The value of the company's shares rose seven-fold in less than four years and fuelled an optimism that seemed unbreakable.

The boom was still gathering steam at the end of the 1990s when key decisions were taken over the future of EU capital market governance. The issuance of European corporate bonds really took off after 1997; it rose by 70 per cent in 1999 alone (Belaisch et al. 2001: 37). The international portion of this business was growing too: between 1998 and 1999, the issuance of international bonds more than doubled to over $536bn (Danthine et al. 2000: 57), though domestic bonds still outweighed international ones four-to-one.

These changes were paralleled by transformation within the investment banking industry. Where the picture at the beginning of the 1990s was one of highly concentrated, nationally focused capital market industries (where they existed at all), most of the important firms developed European—and sometimes even global—ambitions over the next decade. To be sure,
many of these firms had long been represented in international financial centres, particularly in London. Their foreign outlets, however, were important primarily for servicing the needs of domestic customers. At least in the ambition of the leading continental banks, the distinction between national and international markets now vanished in favour of a transnationally integrated market place. This brought them closer to the American investment banks which had been pursuing an international strategy through the City of London since the 1980s.

As pointed out above, this shift in business strategy is harder to trace than one might suspect. This section therefore focuses on actual corporate expansion through overseas investment, typically in the form of corporate acquisitions. Where available, other indicators of strategy shifts will be used to corroborate the findings. In particular, Slager (2004) has studied the internationalization strategies of the most important banks in the United States and Europe. The firms under scrutiny typically engage in both the traditional credit business and investment banking; his Trans Nationality Index (TNI) unfortunately does not distinguish between the two.31 Nevertheless, it serves as a useful indicator of overall corporate strategy—where the trend is clear enough.

European investment banking markets are concentrated, not only in a small number of firms, but geographically as well: all the relevant banks (indirectly in the case of US investment banks) are based in the UK, France, Germany, the Netherlands and Switzerland. As we will see, all domestic incumbents in the investment banking business developed international strategies in the 1990s. For the sake of simplicity, the banks are grouped by home country; the results are summarized in the appendix of this thesis, with European market shares in 2001. Taken together with the most important US firms, these banks were responsible for around 80 per cent of the market in both bonds and equities. For comparison, the table also lists the Eurobond market shares for these firms in 1986 (or their precursors, in cases of later mergers or acquisitions). The

31 The TNI is the mean of three ratios: foreign assets/total assets, foreign income/total income and foreign staff/total staff. For details, see Slager 2004: 55ff.
firms that remain dominant in the new millennium then had a cumulative market share of over 56 per cent. A high degree of continuity thus prevailed among US and European firms; Japanese firms, which had more than 20 per cent of the market in 1986, hardly play a role in European markets today (cf. Auger 2005).

The Dutch banks
In both Dutch and international capital markets, ABN Amro has been by far the most important Dutch bank. It was born of a merger between two domestic firms in 1991. This merger gave the new firm sufficient capital to embark on an internationalization strategy that was formulated in the early 1990s and which included becoming a ‘global player’ in the field of investment banking (de Vries et al. 1999: 463, cf. Slager 2004: 236). The strategy was motivated not least by the saturation of the Dutch banking market (Ibanez and Molynex 2002: 52) combined with the declining profit margins in the credit business that affected banks throughout Europe.

To achieve its aim, ABN Amro invested heavily in building an international investment banking operation, even if profitability was initially low (de Vries et al. 1999: 471). In 1992 it bought the London brokerage Hoare Govett; three years later, it expanded into Scandinavia with the acquisition of Alfred Berg A/B. ABN Amro then entered into investment banking joint ventures in Italy and Spain and finally started a joint venture with the Rothschild investment banks in 1996. By 2000, ABN Amro had 60 per cent of its activities abroad (Slager 2004: 224) and its TNI rose from a little more than 30 in the early 1990s to over 70 in 2000 (Ibid.: 233).

The German banks
Deutsche Bank was probably the first continental European bank that systematically expanded throughout Europe and made international investment banking one of the pillars of its corporate strategy (Slager 2004: 313, cf. also chapter 3). By the early 1990s, the bank clearly had strong European and even global ambitions, even if only 10 per cent of its profits came from non-German European subsidiaries (Brady 1992). One executive declared at the time that ‘our aim is
to become the leading banking and securities house in Europe’ (Ibid.).

Two strategic decisions exemplify Deutsche Bank’s strategy: in 1989, it bought one of the leading City merchant banks, Morgan Grenfell, for £900m—a price that was considered exorbitant at the time (Augar 2000). Five years later, in 1994, it decided to move all of its investment banking operations to London and merge it into a single unit, thus obliterating the distinction between German and non-German business (Fisher and Cohen 1994). In the same year it also created corporate banking units in Italy (Financial Regulation Report 1994b).

The years that followed brought further expansion, this time into North America—a decision that was crucial for the consolidation of Deutsche Bank’s position as one of the few firms still on par with the leading American investment banks. In 1999 it bought the Wall Street investment bank Bankers Trust and the investment boutique Alex. Brown. The new head of Deutsche Bank’s North America division, Carter McClelland, explained:

The US investment banks have begun to enter the European market. Only seven years ago firms such as Goldman Sachs, Morgan Stanley and Merrill Lynch only had small bridgeheads in Europe. Nowadays, these firms can boast with relatively large and successful market positions there thanks to a focussed expansion strategy, extensive securities sales networks and an aggressive, American-style investment banking. In such an environment Deutsche Bank simply cannot wait. (McClelland 1997, translation of the original German quote by the author)

As was the case with ABN Amro, Deutsche Bank’s TNI increased significantly over the 1990s, from a little more than 20 to around 60 in 2000.

The two smaller members of the ‘big three’ German commercial banks also pursued Europeanization strategies, though less ambitious than Deutsche Bank’s. Dresdner Bank was late entering the acquisitions game when in 1995 it bought one of the few ‘old’ City firms that remained independent, Kleinwort Benson. The latter’s prestige immediately established Dresdner Bank in the City, and towards the end of the decade it even appeared among the top 10 in some league tables. Commerzbank never made any major acquisitions in the City but chose to build its own operations instead. While it had moved all of its non-DM trading and sales to London in
1994 (European Banker 1994b), the decision to expand only came in 1998 when it started investing heavily and doubled its investment banking staff to more than 500. Even the state-owned Landesbanken fell for the attraction of investment banking: both the Hessische Landesbank (Helaba) and the Westdeutsche Landesbank (WestLB) began investing in their London operations in the mid-1990s (European Banker 1995a). The latter bought the City brokerage Panmure Gordon in 1996 (Slager 2004: 327). After the dot.com bubble burst, most of the smaller banks’ forays into investment banking were exposed as costly and unrealistic adventures (Jenkins 2004). At the time, however, faith that this was the business of the future was pervasive.

The French banks
The growing French presence abroad over the course of the 1990s featured five main players: Banque National de Paris (BNP), Paribas, Société Générale (SG), Crédit Lyonnais (CL) and Indosuez (European Banker 1994a). The most ‘sophisticated’ and commercially oriented, Paribas was the first to develop an international capital market focus. It set up operations in London in 1984 and in the mid-1990s extended its strategic focus to include the US market (Kraus 1994). It bought JP Morgan’s European custody business in 1995 and further boosted its US securities team in 1997. The three-way takeover battle between Paribas, SG and BNP that dominated the French banking scene in 1998 and 1999 temporarily diverted attention away from international expansion (Bream 1998). BNP’s takeover of Paribas in 1999, it was hoped, would soon give it a leading position in European equities (Slager 2004: 343).

Société Générale also followed an expansion strategy that brought it within the European top 20 by the end of the 1990s. It bought the securities house Strauss Turnbull in 1993; three years later it acquired a majority stake in Crosby securities in Hong Kong. It added the banking business of Hambros merchant bank in the UK as well as two small Wall Street investment banks to its operations in 1997 and 1998.

Crédit Lyonnais internationalized even more aggressively, driven both by the state strategy to create a national champion equalling Deutsche Bank and the personal ambitions of its
chief executive, Jean-Yves Haberer (Story and Walter 1997: 197ff). The bank, however, failed spectacularly in the mid-1990s and was dismembered by the French government, which still owned it (Coleman 2001). Indosuez, finally, was taken over by Crédit Agricole (CA) in 1996. In keeping with its status as a mutual bank, CA put less emphasis on internationalization and used the newly acquired investment banking capacity mainly to service its domestic clients. Nevertheless, it started to become more active internationally after it took over what remained of Crédit Lyonnais’ investment banking, fused under the Calyon brand in 2004.

**Banks from other European countries**

The UK and Switzerland are the only other European countries from which banks with serious pan-European or global ambitions emerged. Firms from Italy or Spain never made significant attempts to enter London’s international capital markets (European Banker 1995b). At the time of writing, Barclays is the only British commercial bank that still plays a significant role in investment banking. All merchant banks, brokers and jobbing firms were bought up by larger, mostly foreign firms in the decade following the Big Bang in 1986. With the sale of S.G. Warburg to the Swiss Banking Corporation (SBC) in 1995, the last of the big merchant banks lost its independence. Only three years later, SBC was taken over by Union Bank of Switzerland, making UBS a major player in investment banking, too. Barclays scaled down its formerly global ambitions with its subsidiary Barclays de Zoete Wedd (BZW) in 1997 after poor management had led to mounting and seemingly unstoppable losses (Augar 2000). Until then, Barclays had been the most ambitious British firm, certainly the most active one in Brussels lobbying (Ipsen 1995).

The final firm with a significant role in European (and indeed global) capital markets is Credit Suisse First Boston (CSFB), formed as a joint venture between Credit Suisse and First Boston in 1978. In the mid-1990s, Credit Suisse took over First Boston and made CSFB—by then an established brand name in investment banking—its capital markets subsidiary. Even
though CSFB is formally a Swiss firm, in practice it operates and is perceived as a Wall Street investment bank.

**Explaining internationalization**

The emergence of a cross-border European investment banking industry can be traced to a variety of causes: the decline of traditional credit as a source of profits, domestic and legal changes that provided new (if circumscribed) opportunities for banks, the rise of competition from US firms, the (pending) introduction of the euro, and not least, the growth of business in investment banking itself. What is noteworthy about these sources of business internationalization (discussed in detail below) is that most of them are endogenous to competitive dynamics within the industry. Market internationalization was bolstered by political decisions such as market liberalization—in which banks themselves played a significant role. The rise of US competition was crucial for it suggested corporate expansion and internationalization as routes to business success for European firms. And the growth of business in capital markets was itself partially endogenous to banks’ changing business models as much of the international business was in fact inter-bank. In this way, regulatory developments, market changes and firms’ strategic reorientation are interrelated facets of one integrated, if open-ended structuration dynamic.

*Strategic reorientation as a source of market transformation*

Interest margins (in broad terms, profits made through deposit-taking and lending) in Europe had been falling since the 1970s. Throughout the Eurozone, they declined from almost 2.5 per cent in the mid-1980s to a little more than 1.5 per cent in the mid-1990s (de Haan and Prast 1999: 16). Between 1994 and 1998, they halved again in both France and Germany (Danthine et al. 2000: 63). Net interest margins as a source of revenue for French banks declined from 70 to 53 per cent between 1992 and 1998; for Germany, the corresponding figures were 75 and 63 per cent (Belaisch et al. 2001: 24).
The traditional basis of income for banks was thus eroding, necessitating a search for new sources of revenue. The profit margins of the highly commoditized credit business looked even paler in comparison to the more ‘value-added’ products that American firms had pioneered since the early 1980s (see e.g. Partnoy 2002). For many firms, the strategic consequence was to refocus on these more lucrative activities, particularly in international investment banking. As Berger et al. found, this also applied to Europe:

A wave of nonfinancial M&A activity in Europe has already precipitated fierce competition for advisory business. Intra-European merger and acquisition activity between 1985 and 1988 averaged $43 billion a year versus $280 billion a year between 1995 and 1998. In order for European universal banks to compete for this business—particularly against U.S. investment banks that have acquired substantial expertise in the M&A advisory business—they either have to develop this expertise internally or have to acquire it externally. It appears, for example, that in part Deutsche Bank has acquired this expertise by purchasing British and U.S. investment banks (Morgan Grenfell and Alex. Brown). (A. Berger et al. 2000: 80f)

The reversal of the relative importance of credit versus fee-based business over the previous two decades (graph 6) was thus not only driven by deteriorating interest margins but by the active development of fee-generating business. Between 1997 and 1999, for example, the net commission income of banking institutions in the EU rose annually by 19 per cent (Eurostat 2001: 9). As seen previously, many of the larger European banks had identified the expansion of such business as strategic priorities much earlier.
Graph 6: Source: OECD Bank Profitability, 1998 and 2002 editions

Unsurprisingly, this trend was most pronounced for the very largest banks (graph 7). The share of non-interest income within gross income for the six largest German and the five largest French banks reached more than 50 percent in the period 1996-2000, compared to a little over 35 per cent a decade earlier (Slager 2004).

Graph 7. Source: OECD statistics

This rising importance of investment banking for continental universal banks had two consequences. First, they grew more interested in developing such activities in their home markets. Second, they became more aware of pan-European competitive issues: the threat of
foreigners taking over for the smaller banks, and the limits to the cross-border market access achieved thus far for the larger ones. In this way, banks’ strategic reorientation affected their regulatory preferences, analyzed in more detail in chapter 6.

Still, the question remains what motivated banks to expand as intensively as they did (Cabral et al. 2002, Boot 2003). The basic puzzle of consolidation is that there is little evidence that it enhances shareholder value (for such an argument, see e.g. R. Smith and Walter 2003); if anything, it seems to destroy it (Group of Ten 2001: 254f). A large number of studies have researched economies of scale and economies of scope in financial services and in banking in particular (for an overview, see A. Berger et al. 1999). They almost invariably conclude that economies of scale only exist at the lower end of the size scale while banks with more than $10bn in assets are likely to suffer from diseconomies of scale (A. Berger et al. 1999: 158). While the literature that explicitly focuses on securities markets is much thinner, findings from the early 1990s resonate with those from financial services in general, namely that the unit-cost curve is U-shaped (Lawrence Goldberg et al. 1991). One might argue that advances in IT could have mitigated the eventual rising of unit-costs at the right end of the curve but even then it would not justify consolidation. Data processing economies of scale can often be captured through outsourcing—as indeed happened in many instances, for example in the Irish Stock Exchange using the German Xetra system for trading. Equally, economies of scope are difficult to detect; if anything, the prevailing opinion is that diseconomies of scope are more likely.

The issue looks rather different, however, once we view financial firms not only as adapting to market structures but as their makers. If there is any ‘value’ in consolidation, it lies in its strategic potential (Milbourn et al. 1999). Boot came to a similar conclusion:

[1]he important issue is that strategic considerations are the driving force behind the current wave of consolidation. As I argue, these considerations may have rather little to do with true scale or scope

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34 For comparison, Commerzbank, a medium-sized bank by global standards, had more than $280bn in assets in 1995. Ibid.: 189.
economies. Rather, learning, first-mover advantages, and strategic
advantages of market power and associated “deep pockets” may explain
the current wave of consolidation and the broad scope of many players
in the industry. [...] Strategic positioning might, for the moment, be the
rule of the game and an optimal response to the uncertainties and rapid
(and unpredictable) changes facing financial institutions today. (Boot
2003: 39, emphasis in original)

Banks’ behaviour is thus consistent with a market structuration view in which they not only react
to allegedly ‘exogenous’ market changes but are themselves drivers of market transformation
through their strategic behaviour. The market concentration in investment banking only further
amplifies this market-making effect of corporate strategy.

In light of the uncertainties Boot pointed to in the quote above, (perceived)
developments within a firm’s peer group are central to understanding such corporate strategy.
Perceived opportunity costs in the guise of a fear to ‘miss out’ on important trends may be
sufficient to lead CEOs down strategic avenues that they would otherwise not have considered.
The scramble among City brokers, jobbers and merchant banks that followed the loosening of
UK rules after 1983 is instructive (Augar 2000).

Many [banks] feel that a presence in investment banking might be
important for their existence as powerful banks in the future. They are
willing to accept — for the moment at least — relatively low returns on
those activities. The potential, but uncertain, vital role of these activities
in the future defines them as a strategic option. (Boot 2003: 71)

This uncertainty stems from banks—rather than responding to existing demand—anticipating
market developments or nurturing them themselves, for example in the derivatives business
(Partnay 2002). After all, the investment banking strategies of the largest European players had
their origins in the late 1980s and early 1990s, before these markets took off. The anticipatory
dimension of these strategies is underscored by their frequent failure; continental universal banks
in particular burnt their fingers (and money) in a business with which they had little experience
(see e.g. Jenkins 2004).

Even when ‘markets’ did develop, it would be highly misleading to think of the demand
for international investment banking services—both on the sell-side (issuers) and buy-side (investors)—as exogenous to the financial services industry itself. As Berger et al. argue, the development of new financial products has primarily created markets for intermediaries rather than end users of these products. (A. Berger et al. 2000: 81f)

Banks massive exposure to complex derivatives such as collateralized debt obligations (CDOs) and mortgage-backed securities that has become apparent since the outburst of the credit crisis in the summer of 2007 has only underscored this point.

In their in-depth study of European bond markets, Casey and Lannoo found the prime issuers of international bonds to be financial institutions themselves:

International debt issues are largely, and in some EU member states overwhelmingly, dominated by financial institution issues. This result should come as no surprise, since financial institutions continue to be the main source of finance for European firms, and thereby engage in large-scale lending activities for which they must find sources of funding. Due to their expertise in, knowledge of, and experience with financial markets, banks and other financial intermediaries have a long experience of tapping international capital markets for funding purposes. (Casey and Lannoo 2005: 13)3

This is a well-documented but nonetheless remarkable finding. It is largely financial institutions themselves that use international markets to raise funds that they then lend on domestically. In effect this widens the pool of savers to whom financial institutions can sell their own liabilities, placing Spanish savers in competition with German and Finnish ones. In contrast, almost 90 per cent of loans in 2002 still went to banks’ domestic, rather than foreign, customers (Cabral et al. 2002: 37). This home-bias is not surprising given the costs involved in assessing the quality of (potential) loans, particularly where such information is not available ‘off the shelf’ through analysts or rating agencies.

3 It may be worth adding that corporate bonds issued by non-financials account for more than 10 per cent of total international bonds in only four countries in the EU – the three Scandinavian members and France. Financial institutions borrow more in these markets than their respective governments in all but two countries, Greece and Finland.
In international bonds issued by financial institutions, the EU share of the global total further increased between 1999 and 2004, from 50 to 60 per cent (Casey and Lanno 2005: 14). Almost two-thirds of these bonds are European in origin. This shows that financial institutions still play a central role in channelling capital through the continent, mediating between savers and borrowers not by taking deposits—the lack of pan-European retail networks account for that—but by borrowing at competitive rates themselves.

As noted above, corporate bond issues have increased markedly. But they are dwarfed in comparison to debt sold by financial institutions. In the late 1990s, corporate bonds accounted for roughly 10 per cent of total international bonds (European Commission 2005b: I-11). The demand for capital by sovereign debtors and financial firms—not corporations—has propelled the growth of international markets.

But what about the buy-side—those who invest in international securities? In equities, both investment and pension funds have a growing share of non-domestic holdings in their assets: their share was over 50 per cent in 2000 (European Commission 2005b: II-19). In continental Europe, more than 50 per cent of asset managers (weighted by assets) are owned by banks, and another 20 per cent by bancassurance conglomerates.36 Even in the UK, banks, insurance firms and conglomerates own almost 80 per cent of asset managers. In some European countries, banks control almost 80 per cent of the fund management industry (A. Berger et al. 2000: 81f). This shows that the financial industry did not participate in the rise of capital markets in Europe as an exogenous ‘given’; their strategic decisions lay behind and generated market developments.

*Market structuration through regulatory reforms*

Even though the strategic reorientation of financial firms was the most visible source of market transformation, legal changes that had begun in the mid-1980s and continued in the wake of the

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36 Almost all of the rest are owned by insurance firms. European Commission 2005b.
ISD were a crucial backdrop to these developments. True to the structuration perspective of this thesis, the regulatory preferences of public-private coalitions thus fed back into market evolution. Given the diverse political interests of financial market stakeholders, the effects of reform were contradictory. On the one hand, new rules were often designed and used to defend particular financial centres and the interests of the incumbents within them. On the other hand, the largest firms pushed for and eventually exploited opportunities that the ISD in particular gave them to expand throughout Europe. Legal changes thus both encouraged and hindered expansion. It was precisely this combination that proved unsustainable over the long run.

The ISD was meant to introduce two basic innovations: the possibility of remote access to securities exchanges (discussed in the next section) and permission for investment banks to supply financial services throughout the EU under home country rules. Relieved of having to comply with two sets of rules, foreign firms would be encouraged to set up branches in foreign markets. However, if the service in question could also be provided from abroad, for example electronically, firms could close their foreign subsidiaries and service their markets from a single location.\(^7\) In the end, agglomeration effects ensured that the latter prevailed (cf. Bindemann 1999) but certainly in the mid-1990s, both strategies were explored—and faced difficulties.

For example, American firms such as Merrill Lynch were immediately encouraged by new EU legislation to spread across the continent (*Private Banker International* 1996). That, however, was easier said than done. Article 11 of the ISD stipulated that member states could draw up their own conduct of business rules; firms trying to spread out from London soon discovered that member states were ready to use such provisions to halt unwanted change. Investment banks had to establish separate businesses in different member states, individually capitalized and with separate reports (Interview 070406). While such moves protected national incumbents, it also hampered the development of local capital markets and in the end helped

\(^7\) One example is the Union Bank of Finland pulling out of France, for under the single market rules it can provide services from London. See *European Banker* 1995c.
London prevail of contenders such as Frankfurt or Paris. Some countries went so far as to dust off old laws to keep competition at bay—the SIMS law in Italy being the most extreme case. Under these rules, a firm had to be based in Italy to sell securities to Italian residents (Colvill 1995). Goldman Sachs, for example, had only one or two investment bankers permanently based in Milan; others were flown in from London when needed. The SIMS law forced Goldman Sachs—and many others—to build up fully-fledged, operationally independent firms in Italy, which were only re-integrated into the rest of their European operations at the beginning of the millennium. Provisions such as the Italian SIMS law plainly contradicted the ISD but there was little firms could do. In this particular case, Goldman Sachs was applying for primary dealership in Italian government bonds and a lawsuit against the ministry of finance would not have helped its cause.

Indeed, firms soon realized that even if they were willing to pursue legal action, success was anything but assured. In a case that stuck in bankers’ memories, Barclays tried to sue the French government in the early 1990s for forbidding it to pay interest on chequing accounts in its new French banking operation (Interview 160306.b, Interview 070406). The bank felt this was in clear contradiction to EU rules and sought assurances from the Commission that it would support Barclays in court. When things came to a head, however, the Commission backed down.

In the case of the ISD, France actually met the 1996 implementation deadline (Financial Regulation Report 1996c) and combined this with a streamlining of supervisory structures (Financial Regulation Report 1995a). Yet in key respects, the French law on the ‘modernization of financial activities’ violated the official spirit, if not the letter, of the ISD. Locally operating firms still had to follow the rules of the Conseil des Marchés Financiers, an arrangement meant to undermine the competitive ‘threat’ of US firms (Bream 1998). Services rendered to the state and the Banque de France—which were, after all, the two largest market participants—fell outside the scope of the new law. It also implemented the concentration rule by stipulating that most securities transactions had to be carried out through regulated markets where these existed. Nevertheless,
the new law abolished the monopoly on the negotiation of transferable securities that the société de bourse had hitherto held (Demarigny 1998: 277).

Things went even more slowly in Germany (Shirreff 1997). ISD implementation had been promised for 1996, the original target date (European Banker 1996b). But rule changes became law only two years later (Financial Regulation Report 1998b) due to the conscious government strategy of pushing back the ‘new realities’ (Interview 020506). After all, one of the ISD’s core provisions allowed firms to provide services from a distance: rather than going through local subsidiaries, they could open branches or even provide services without local representation. Developments triggered by the 2BCD were worrying: Merrill Lynch, for example, had closed its subsidiary in Frankfurt in the mid-1990s to service Germany through the branch of its subsidiary in Ireland (Shirreff 1997). Indeed, of the 695 ISD passport applications the German securities supervisor received in 1996, more than 600 came from London and virtually all of them (690) were asking for permission to provide financial services across borders (Bundesaufsichtsamt für den Wertpapierhandel 1997: 33f). To be sure, not all were British or American firms. But it showed that many firms preferred to provide pan-European services from a single location—the City. No surprise, then, that American investment banks were particularly irritated about the slow pace with which Germany—traditionally one of the most ‘liberal’ financial markets in Europe (J. Williamson and Mahar 1998)—reformed its laws and regulations (Financial Times 1997).

That said, it would oversimplify the picture to think of governments as either eager or reluctant to reform financial markets. As chapter 3 argued, reforms were above all strategic, meaning they were attuned to the attainment of specific ends and the satisfaction of particular interests. In 1994 the Second Law for the Promotion of Financial Markets had created the first German securities markets supervisor, the Bundesaufsichtsamt für den Wertpapierhandel (BaWe). In doing so, it acted on the realization within both government and industry that ‘internationally acceptable’ supervisory structures were necessary if international business was to come Frankfurt’s way (see also chapter 4 on the CAD negotiations). For example, the Deutsche Börse
in the early 1990s had sought official recognition as a stock exchange from UK authorities; citing the lack of proper regulatory and supervisory structures, the British repeatedly turned it down (Interview 240506:b). For actors with stakes in internationalizing Frankfurt, introducing oversight structures more in line with international standards thus made perfect sense. Also in 1994, the German government relaxed entry rules for American banks, which were henceforth treated almost as EU firms (Financial Regulation Report 1994c). Paralleling other market-opening steps, the decision was not unilateral but was negotiated with the US government.

At the same time, many concerns of both foreign and large domestic players remained unaddressed, particularly discrepancies between different national rule sets (e.g. for reserve requirements). Banks had placed their hopes on the coming Third Law on the Promotion of Financial Markets to address them (The Banker 1996a). As it turned out, this law was only one of three accepted by the German parliament to boost capital markets, for example by simplifying equity issues (Financial Regulation Report 1998a). As the sense of competition between Frankfurt and London grew, the government realized that a legal environment conducive to financial innovation was crucial.

In any case, by the late 1990s London was more clearly than ever emerging as the centre of gravity for wholesale business. One City investment banker remembers the development as follows:

What was actually happening—many other investment banks did it—was to pull back trading activities from elsewhere in Europe to one location. And nearly every institution that decided to adopt this model chose to carry out their trading from London. You would keep your sales forces within the jurisdictions. But if you were trading Italian government debt or French equities, you would, so far as the law permitted you to do so, do it from London. And that has been the model. And this was driven by two things. One was the fact that the euro was coming in at the time. And everyone could see that that would create a bond market that was driven more by maturities than by national boundaries. And that meant that ideally, all the traders who were previously trading in different jurisdictions in individual countries would go to one location. And so you had your trading desk in London
transmogrified into this multicultural flower. And the other driver which was coupled with that was that most countries started to liberalize their rules with respect to who could be a primary dealer in securities. And that was driven one by the fact that the euro was coming along, two by the fact that the big international players were beginning to be recognized by the governments as the people who actually had the distribution strength to disseminate their bonds, and three by pressure from those large entities and elsewhere to open up the primary dealerships which had traditionally been held by the big banks in the particular jurisdictions, France, Spain, Germany… The point about all of these is that the only element that was an EU element was the euro. All the other elements had more to do with business strategies. Having said that, the creation of the euro was a very strong element. Technology was another driver as well. It was easier to deal remotely, too. (Interview 140306.b, emphasis added)

As pointed out previously, legal changes in Europe invited new business strategies. But where legal reforms had been the result of compromise between different stakeholders—in particular between firms with different competitive interests—inconsistencies in the new legislation soon became apparent. These enticed investment firms to push for further change—the topic of the next chapter.

**European Bourses: From Members-only clubs to profit-seeking firms**

The rise of independent, for-profit securities exchanges was the second major transformation in the capital market industry in the 1990s, and it was the flip-side of (investment) banks starting to disembeled from ‘national economies’ and market places and increasingly focus on cross-border business, instead. This so-called demutualization was to have a crucial impact on the future renegotiation of the ISD (discussed in chapter 8), in which bourses emerged as fierce competitors to the new European investment banking incumbents. True to the structuration perspective of this thesis, also in the case of demutualization the strategic decision that (investment) banks made in the 1990s were to come back to haunt them in EU-level regulatory negotiations a decade later.

As Lee has noted, exchanges occupy a peculiar position:

> If there is one factor that is universally accepted as being the most important determinant of both exchange behaviour and market
structure, it is competition. The ubiquity of the term has not meant, however, that its nature is clear. [...] A Manichean view of exchanges either competing or alternatively cooperating, is too simplistic to represent usefully how exchanges actually relate to each other. (R. Lee 1998: 49)

Historically, bourses have developed as members-only clubs wherein competition was tightly controlled by private interests (Braithwaite and Drahos 2000: 145). Members fixed commissions and divided business amongst themselves, for example by assigning the trading of particular stocks to individual firms or persons (Pagano and Steil 1996). Exchanges, governed by the interests of their members, have thus always tried to protect their monopolies. In theory, this is underpinned by the tendency of trading to concentrate on the most liquid exchange (Schwartz 1996). But as Schwartz points out, things are less clear-cut in practice. Different intermediaries, and even different stock exchange members, may have different interests regarding the concentration of trading on a single platform.

Over time, however, exchanges have faced creeping competition from other trading venues, first from ‘alternative trading systems’ (or ‘ATS’, such as Instinet) and eventually from intermediaries (R. Lee 2002). ATS usually have lower transparency requirements and allow big intermediaries to sell large swaths of securities without prices immediately moving against them. Large banks thus have conflicting interests as far as exchanges-as-clubs are concerned. They may appreciate the limits they pose to competition. At the same time, the costs these exchanges generate, both directly for their services and indirectly through adverse price effects, may be considered too high. The result has often been that large intermediaries take part of their trading to alternative venues, thereby fuelling competition for exchanges that they themselves used to dominate. The story of SEAQ International, recounted in detail in chapter 3, is a case in point (Pagano and Steil 1996: 5ff). In the early 1990s, the member firms of established exchanges opted for the application of new electronic systems to repatriate trading, for example IBIS in Germany and CAC in France. Before long, SEAQ’s market share dwindled.

Once this competitive challenge to established exchanges had been thwarted (even if large
firms continued to do deals off-exchange, over the telephone), many of the smaller member firms saw little need for further investment in trading technology. They were, in short, rather content with the status quo. But not so the larger members. With the prevailing one member-one vote system, they regularly saw their own interests, for example in developing vibrant domestic equity markets, thwarted by what they saw as the conservatism of smaller members. In the early 1990s, these cracks started to become more visible. In Germany, the president of the Frankfurt stock exchange was traditionally a private banker from a small firm. But in 1992, after one such president's term had ended, Rolf Breuer, board member of Deutsche Bank, took over the post in a sign of clear impatience with developments at the bourse.

Divisions increased when the ISD—for which firms such as Deutsche Bank had lobbied—further opened the possibility of granting foreign firms 'remote access'. Such a move obviously meant loss of business for local firms, which could henceforth be by-passed by foreign brokers. Unsurprisingly, the idea of remote access created resistance particularly among smaller exchange members who feared losing order flow (Interview 240506.b). Thus reaching agreement among Deutsche Börse's members to offer remote access to other firms proved difficult, though smaller firms were eventually convinced by arguments that the overall share-trading pie would grow sufficiently to offset the threat of growing competition. Plans were quickly made to install access points in London and Zurich (European Banker 1996c). For larger firms, the overall calculation in any case looked different: while they might lose market share in their (former) home markets, they stood to gain from openness through access abroad.

Indeed, even though the ISD gave exchanges the right to set up screens abroad, the Stockholm exchange—outside the EU at the time—had already pioneered such remote access (Financial Regulation Report 1996b, Pagano and Steil 1996: 41f). This, however, only happened once the exchange had been privatised: with 50 per cent ownership in issuers' hands, their interest in gaining exposure to foreign investors trumped the anti-competitive instincts of local brokers. Inside the EU, the Amsterdam exchange was one of the first to use the new ISD rules when in
1994 it allowed CSFB to retain membership even though the investment bank had relocated its Dutch activities to London (Financial Regulation Report 1994a). The exception was granted when CSFB pledged to remain a market maker for at least 25 Amsterdam stocks. The other companies with such a broad offering in Dutch shares were all local or at best European in reach (ABN Amro, Mees Pierson, Suez Nederland and Van Meer James Capel). With CSFB, an established Wall Street investment bank, Amsterdam had the potential to access a wide US investor base. Local traders were nevertheless disgruntled, pushing for remote access to exchanges abroad in return for letting ‘foreigners’ in. Remote access technology was thus applied in line with the commercial and competitive interests of those controlling stock exchanges.

The growing split between the interests of their members and the consequences of this fragmentation of preferences for governance led more and more exchanges towards demutualization—meaning they ceased to be controlled by their members or users and became private companies. As a general pattern, the exchanges which were first to demutualize and modernize their governance structures were those that had faced most competition from ATS. The Amsterdam exchange, for example, traded many shares with international appeal (multinationals such as Unilever and Royal-Dutch/Shell) for which vibrant overseas markets had developed in the early 1990s. It was therefore quick to implement changes, for example by switching all operating systems to English and by demutualizing in 1997 (Interview 211105a).

Other mid-sized exchanges, such as the Borsa Italiana in Milan, took similar steps in the second half of the 1990s (Steil 2002b: 26). In contrast, the world’s major exchanges (the NYSE, the NASDAQ, the LSE, the TSE, the CBOT, the CME, etc.) continued to operate as mutuals, largely due to lower competition and thus less conflictual interests among their members.

From the moment exchanges began operating as for-profit enterprises, their own commercial interests were at the heart of their strategic positioning. Even more so than with intermediaries, exchanges are highly concentrated. The top three exchanges’ share of global market capitalisation was more than 60 per cent throughout the 1990s (Schich and Kikuchi 2003: 154)
109). Similar numbers apply within the EU: in 1995, the LSE, Deutsche Börse and Paris Bourse combined commanded just under 70 per cent of the EU total; in 2001, after Euronext was created—integrating the Amsterdam, Brussels, Paris and Lisbon exchanges—it was almost 75 per cent (Schich and Kikuchi 2003: 110). These concentration ratios have generally remained stable over the past decades, indicating that smaller and larger exchanges by and large kept pace in their growth.

There have been few occasions in which an exchange has managed to capture the trading of a ‘foreign’ security from its home country—certainly among developed countries. LIFFE’s temporary success with Bund futures was an important exception, but after the Deutsche Terminbörse (DTB) began trading with up-to-date technology, business eventually returned to Frankfurt (Interview 020506). The episode also brought home the high costs of head-on competition. Shifting alliances notwithstanding, most exchanges respected the division of business between them and recognized what Fligstein (2001) has called the prevailing ‘conception of control’. Exchanges have mitigated competition by for example sharing technology and forming link ups such as the one between the French MATIF and the German DTB derivatives exchanges in 1994 (Gapper et al. 1996). Potential competition—and the impetus for innovation—thus came not so much from established bourses but alternative trading systems and new start-ups (Interview 240506.b). One of the more noteworthy ones, discussed in more detail in the coming chapter, was EASDAQ—an EU Commission-sponsored copy of the US NASDAQ set up in 1996 (Posner 2005). EASDAQ was the Commission’s attempt, together with the European Venture Capital Association, to kick-start the market for the kind of new ‘high-tech’ issues that fuelled the NASDAQ’s spectacular success in the 1990s (Financial Regulation Report 1996a). The established exchanges, however, immediately responded by setting up their own ‘new markets’ such as the Alternative Investment Market in London, the Neuer Markt in Frankfurt, the Nuevo Mercado in Madrid and the Nouveau Marché in Paris. EASDAQ thus never attracted more than a handful of listings (based in Brussels, most of them were Belgian).
Until late in the 1990s, the history of European exchanges was notable for its scarcity of successful consolidation, that is, the creation of cross-border securities exchanges (see Cybo-Ottone et al. 2000: 239). Most of the cross-border deals were not full mergers but joint ventures or technology sharing arrangements and even these had a history of failure (Pagano and Steil 1996: 39). Euronext, the most prominent cross-border initiative, combined several exchanges under one corporate roof; it did not create a single entity out of them. Nor did uncertainties over regulatory responsibilities for a truly transnational exchange make such ventures more attractive. Nevertheless, most takeover attempts were defeated not because they did not make sense from a wider market perspective (economies of scale, market depth, synergies, etc.), but because those controlling the exchanges felt the numbers did not add up (R. Lee 2002).

The most prominent example from the 1990s is without doubt the attempt to merge the London and Frankfurt stock exchanges. The tie-up between the LSE and the Deutsche Börse announced in early July 1998 was a major earthquake for EU financial markets. The major banks were strongly in favour of such transnational market integration; as chairman of the Deutsche Börse, Deutsche Bank CEO Rolf Breuer was one of the main driving forces behind the deal. The commentator in the European Banker at the time was sure that such an alliance would be ‘unstoppable’ (European Banker 1998). But both banks and other observers underestimated just how independent exchanges had become with demutualization. When the British-German tie-up eventually floundered, it was widely attributed to the particularistic interests of both management teams rather than wider economic rationales. At any rate, the episode demonstrated to investment bankers that exchanges would henceforth be ruled by considerations that could collide with their own interests or, for that matter, with those of other stakeholders including issuers and investors (chapter 8 will discuss such conflicting interests in more detail, for example in the field of clearing and settlement). As one London investment banker reflected with hindsight,

[the banks themselves did not anticipate the speed with which the new
management [of exchanges] would adopt profit-maximising instincts and apply them to their monopolistic position. (Interview 300306)

The years to come would show that the rivalry between for-profit exchanges and their former members and rulers involved more than conflicting commercial interests. Much more important for the supranationalization of EU capital market governance were the political differences that emerged once both groups of firms found themselves to be direct competitors for trading business. In an ironic twist of fate, the banks had created their fiercest competitors through the wave of demutualization over which they themselves had presided.

Conclusion

By the second half of the 1990s, European finance had changed for good. Regardless of the ‘depth’ of the transformation that was taking place, stock markets rose steeply, the M&A advisory business grew rapidly and the issuance of international securities took off. The investment banking industry also transformed, with market incumbents from a handful of continental European countries deciding to build pan-European, and in some cases global, investment banking operations. Whereas around 1990 most were still eager to keep change at bay and American firms in particular off their home turf, they now found themselves buying up City firms, concentrating their investment business in London and investing heavily in sectors such as underwriting, M&A advice and initial public offerings. As the next two chapters will show, the new mood in the industry was central to the re-launching of market integration and the gathering of support for supranational governance institutions.

The changes this chapter discussed were driven by a variety of forces: the interest of banks to develop the capital markets (business) in the face of declining profit margins in the credit business, governments’ eagerness to privatise formerly state-owned enterprises, rising US competition, and the rule changes that were effected in the face of all of these. In key respects, these developments grew out of political-economic dynamics within the EU (investment) banking industry itself, rather than coming to the sector as an exogenous ‘force’, for example in
the guise of globalization or technological ‘progress’. The dynamics within the industry would also dominate the decade to come.

As the following chapter shows, the internationalization of many national market incumbents soon exposed the limits contemporaneous, ISD-based regulation imposed on transnational business strategies. A regulatory regime that bore the imprint of the distribution of preferences in the industry around 1990 was thus to fall prey to the preference shifts that the implantation of that same regime eventually triggered. In effect, firms who had opposed more far-reaching integration in the ISD negotiations either emerged as losers from the new regime in spite of the restrictive provisions they had managed to see inserted into it. Or, as was the case for example for large French banks, through a use of the opportunities that the ISD and national reforms did grant, they internationalized and eventually became supporters of further integration themselves. Both trends weakened competitive struggles along national frontiers and thereby removed the central obstacle to a truly integrated European capital market. They also started to undermine the traditional national alliances that had often, if not always, seen small and large banks as well as stock exchange share regulatory preferences. Even if formal patterns of governance remained unaltered for several years to come, the underlying actor coalitions began to show clear strains.
CHAPTER 6: SHIFTING PREFERENCES AND THE RE-LAUNCH OF FINANCIAL MARKET INTEGRATION

The endorsement of the Financial Services Action Plan (FSAP) by the European Council in 1999 was a milestone in the history of EU financial market integration (e.g. Bieling 2003, McKeen-Edwards et al. 2004, Jabko 2006). The FSAP listed 43 projects the Commission felt needed to be addressed to complete financial market integration. The proposals covered the breadth of financial services from consumer credit and insurance to asset management and bond listings.

In the form of the FSAP, the changes in market structures recounted in the previous chapter started to translate into regulatory change. It marked the beginning of a transition that was to have largely harmonized European rules as its end point. But the FSAP was also an important departure in another respect. It was pushed by a coalition of firms with international ambitions and the European Commission—the first transnational public-private alliance in EU financial markets. Over the years to come, these actors’ shared preferences for integration were to be institutionalized in supranational patterns of governance.

The ‘upgrading’ of the ISD was not high on the list of projects the FSAP suggested. This is noteworthy for in the following years the Market in Financial Instruments Directive (MiFID), as the ISD’s successor was christened, became the centrepiece of financial market reform in Europe. No directive has been more important for the organization of EU capital markets, the future of European financial centres and the prospects of the financial industry’s different branches. No directive has attracted more attention from bank lobbyists. Now, a little less than a decade later, most of the legislative tasks set out in the FSAP have been completed (European Commission 2007a) and in the eyes of practitioners (Securities Expert Group 2004) and the Commission, there is little left to be done other than ‘tidying up’ (European Commission 2005c, see also the industry responses to the Commission proposals in European Commission 2005a).
To be sure, an important step remained in the transition of EU securities markets governance from the ‘international constellation’ towards the transnational one: the formalization of supranational institutions, covered in the next chapter. The momentum for new patterns of governance depended on renewed vigour in legislative activity, which itself stemmed from changed preferences of core constituencies. Here the FSAP played a crucial role in spurring the emergence of the supranational institutions that today govern European capital markets.

The Commission obviously played an important role in the FSAP. It was, after all, a Commission document. But the Commission’s agency was relevant in a wider sense too. In the debate over the leeway of supranational institutions to independently affect policy (Moravcsik 1993, Pierson 1996, Moravcsik 1998, Pollack 1998), the re-launch of financial services integration was clearly an area where the Commission identified room for manoeuvre—and used it skilfully (Gortwald 2005, Posner 2005, Jabko 2006).

However, the European Commission’s visibility in re-launching financial market integration does not confirm whether it was really the crucial driving force. As chapter 4 argued, its support was a necessary but not sufficient condition for integration to move forward. The Commission’s initiatives around the ISD and the CAD were for the most part defeated around 1990; it was left with a regime full of loopholes that fell far short of its original ambitions. What was different this time? This thesis argues that widespread industry support for cross-border integration was the crucial factor: firms pushed the Commission and convinced national governments of the necessity for change. The argument here is not that the industry set the Commission’s agenda. The Commission had already reached its position in favour of further integration—preferably through regulatory harmonization (implying more competencies for EU actors). The argument, rather, is that without industry support for the integration project, it could never have gone forward.

Few written documents containing empirical information on the involvement of private actors in EU policy-making are publicly available. As evidence of corporate influence could cause
serious political damage to the integration project, even the slightly more formal consultations that industry representatives had with the Commission around 1998 were conducted under Chatham House Rules, effectively limiting what participants could communicate about what was said (Gottwald 2005). The Commission also limited the availability of written documents from these consultations, for example by producing the summary of industry opinion itself. Given this scarcity of available material, the first half of this chapter relies on confidential interviews with national and European public officials, regulators, and firm and association lobbyists. The chapter’s second half, which focuses more on the ‘official’ EU policy process, again makes use of public documents and academic studies of EU policy in addition to interview material.

**Shifting industry preferences in the 1990s**

In principle, the more a firm’s business strategy builds on cross-border economic transactions, the more it should support transnational integration (Schmitter 1970, Milner 1988, Stone Sweet and Sandholtz 1998, Mattli 1999). In some cases, firm-level factors may complicate the picture. Managers may have political loyalties that contradict a firm’s business interests. Or they may fail to identify promising opportunities. In general, though, strategies of business internationalization should correlate with a shift policy preferences in favour of easier cross-border market access.

Support for market integration does not fully specify the content of a firm’s policy preferences, however. In the case of regulation for the single European market, there are at least two ways to abolish inter-state barriers. Mutual recognition leaves firms to operate under home country rules; regulatory harmonization mandates all firms to follow a roughly similar rule set.

So what determines firms’ support for or opposition to these strategies? Other things being equal, pro-integration firms from countries with ‘light’ regulatory regimes should prefer mutual recognition to achieve market integration as potential competitors from states with more costly regulatory regimes are disadvantaged. Firms from costly regulatory regimes, in contrast, should favour regulatory harmonization, which puts them and their competitors on an ‘equal footing’, particularly if downward adjustment of regulatory costs associated with the home
country regime is not a desirable or politically viable option. By the same token, opponents of transnational market integration will be in favour of protectionism if the regulatory costs imposed by their home country regime are high, or will be indifferent if the regulatory costs are low, for they will have no competition to fear. We would only expect them to voice opposition when regulatory harmonization looms on the horizon, for it would constitute market opening on relatively unfavourable terms. These different positions are summarized in table 3.

<table>
<thead>
<tr>
<th>In favour of pan-European market access</th>
<th>Relative regulatory cost of home country standards</th>
<th>Relative regulatory cost of home country standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Harmonization</td>
<td>Mutual recognition</td>
</tr>
<tr>
<td>No</td>
<td>Protectionism (equivalent to mutual recognition)</td>
<td>Indifference (wariness vis-a-vis harmonization)</td>
</tr>
</tbody>
</table>

Whether a growing interest in transnational market integration translates into support for regulatory harmonization or mutual recognition should therefore depend on the regulatory regime of the home country and its competitive implications.

The political preferences of investment firms in the 1990s confirm this general pattern. City investment banks—which include American firms operating from the City—in principle preferred mutual recognition to harmonization. It seemed unlikely, to say the least, that a single rule set would be less onerous than what they already had. This explains why many firms were ambivalent about the new legislative fervour of the Commission in the domain of investment services, even though they did support its goal of more market integration. Only the most savvy of investment banks realized early on that rule harmonization would be the price to pay for true European market integration. As one City investment banker observed with the benefit of hindsight:

We were in favour of mutual recognition and competition but the member states would not buy it without massive harmonization. So you
get a much more detailed framework. (Interview 270206)

In contrast, virtually all continental firms favouring market integration supported harmonization as the route towards a unified market; in this way the competitive advantage of the London firms would at least partly be eroded.

It was in the City that the realization that the ISD and the mutual recognition approach were not going to deliver on its promises first sank in because London firms had been its most ardent supporters. That said, firms approached the issue with varying degrees of urgency. Many of the smaller, traditional City institutions were busy digesting the shake-up of their competitive environment, rooted entirely in domestic changes. In comparison, EU matters seemed a sideshow to the real transformation.

EU legislation initially appeared irrelevant to many mid-sized firms. Without ambitions to access clients in the remote corners of Europe, many were content dealing in Eurobonds and Euroequities (Interview 270206). Ironically, the vibrancy of the international business, free of EU rules, allowed smaller firms to underestimate how important these rules could become in the daily running of their businesses. As someone who turned to lobbying in EU investment banking a few years later observed:

In those days, people did not realize that making one small mistake in article 11 of the ISD was quite crucial to consolidate the home-host distinctions and things like that. (Interview 300306) 38

Such misestimations of the importance of EU level developments by the ‘old guard’ of City bankers were also due to another traditional advantage of the City’s business environment. Bankers’ relative freedom from government interference in running their own affairs (Moran 1991) had left them undersensitized to the importance of public regulation—including EU

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38 Article 11 of the ISD stipulates that member states shall draw up conduct of business rules themselves and implement and supervise compliance. With that, firms stay well inside the arms of the host authorities. Also, it stipulates that the professional nature of the client is to be determined by looking at the end-client, not at another investment firm through which the client may have placed his order. Because end-clients are not readily identifiable in inter-bank trades, banks could not a priori claim that they were only dealing with professionals and should therefore be exempt from local conduct of business rules.
rules—in shaping financial markets. It also left them with few resources to influence government policy (Interview 300306). Hitherto the system had run largely on winks and nods from the Bank of England and the personal ties that bound City bankers in self-regulatory organisations. As one investment banker graphically put it:

We didn’t do our homework, collectively, any of us. Historically, regulatory policy has had a very low economic or technical input. Regulators are poor quality people in the government world, compared to central bankers, macro-economic people or even tax designers who are aristocrats in the system. But regulators? Who are they? They are just lawyers, degenerate commercial people… (Interview 300306)

Such attitudes let City firms wake up to the relevance of EU regulatory policy and its potential failings only slowly.

To be sure, this did not apply to all firms. The one large bank active in capital markets that was still in British hands, Barclays, did attempt to stay abreast of regulatory developments in Brussels (Interview 160306.b). All the same, it tended to espouse the EU-sceptical opinions prominent among the small City firms. The real exceptions were the American investment banks that envisioned European futures for themselves. Aware of what they saw as shortcomings within EU rules, they were the first to lobby in Brussels (Interview 070406).

Despite the varying perceptions of urgency, the limitations of the ISD regime did not come to most City firms as a surprise. In 1994, one year after the adoption of the directive, the Bank of England had published research documenting City firms’ fears that the ISD might fall short of its goals (Bank of England 1994). The main problem was uncertainty surrounding the applicability of home versus host country rules that resulted from article 11 in the original ISD:

When your trader in Finland needs more than half an hour to figure out whether a trade would be legal, then you’re simply not going to do it at all. (Interview 070406)

The fact that the ISD did not harmonize conduct of business rules (CBRs) was where, in the words of a senior lobbyist from a Wall Street investment bank, ‘the rubber hits the road’—a
message reiterated by lobbyists to the Commission (Interview 070406). Without harmonized CBRs, they argued, running a pan-European business was bound to remain difficult.

In the late 1990s, one of the things that Citibank would like to do, for certain products, was build a company that could deal on a pan-European basis. And to do that, they needed regulatory approval. And they found that that was far more difficult than they had anticipated. Yes, in principle the ISD already gave them a passport, but in reality [...] how particular products had to be marketed and how you got approval varied widely. And that created a lot of difficulties. (Interview 140306.b)

While some of the old City firms blamed the lack of transnational market access on faulty implementation of the ISD, others saw the problem in the ambiguities of the directive itself:

[European governments] never properly accepted the concept of mutual recognition. And the Commission was too cowardly. Mogg [Commission Director General responsible for financial services] always argued: Give me evidence [of governments breaking the rules]. And we [the financial industry] produced numerous reports on evidence. And then he turned around and said... Some City lawyers said: There isn’t a clear-cut case where we can build an infringement case. There was the Italian case, of course. But Mogg would argue that the directives are framed in such an ambiguous way that you cannot really guarantee that you could successfully go to court. The feeling was that in order to get such a directive as we have adopted, these ambiguities were built in. (Interview 160306.b)

It did not take firms long to complain. As one UK government official at the time put it:

On the wholesale issues the UK authorities, particularly the Treasury, were getting a very clear message from the industry in London that the ISD passport was very inefficient. (Interview 270206)

If opinion in the City was divided between relative indifference towards the ISD and disappointment over the lack of effective mutual recognition, continental firms were divided between favouring regulatory harmonization—an approach that had yet to be tested in investment banking—and outright opposition to market integration. Prominent members of the ‘maximum harmonization’ camp included ABN Amro (Shirreff 1999), Deutsche Bank and ING (Interview 140306.b).
Particularly the German and French firms suffered from varying degrees of what one respondent described as ‘schizophrenia’ (Interview 160306.b). They were torn between the growing pull of the City and a cosmopolitan business perspective on the one hand and embeddedness in and loyalty to the traditional ‘home market’ on the other (Brady 1992). The contradiction was much less relevant for firms from smaller countries, particularly the Netherlands, which had limited home markets to begin with (Interview 270206, cf. Jabko 2006). These differences between the banks became apparent in their lobbying.

**The emergence of EU-level lobbying**

Lobbying around capital market issues in 1990s Brussels was the preserve of the large banks. The alleged beneficiaries of financial market integration—largely non-financial firms in search of capital and investment managers seeking high returns—stayed outside of the political process unfolding in Brussels. As one seasoned City lobbyist summarized:

> The issuers… I mean, where were the issuers [of securities]? Every paper that we [an international trade association in finance] ever wrote talked about the supply side, trying to improve the efficiency of European capital markets. Why? Reduces the cost of access to the capital market. Increases choice for the consumers it lowers price. Actually nothing about profits for the intermediaries. And where is the voice of the consumer? Nothing, nowhere. Absolutely nowhere in that debate. Where is the voice of even the institutional investor? Nowhere. And Europe has huge asset managers. And where were the issuers? Nowhere. (Interview 270206)

The message that ‘the market’ sent to policymakers involved the commercial concerns of financial firms, not the public goods that an integrated capital market might generate.

One of the most seasoned Brussels lobbyists in financial services, John Houston, estimated in 1999 that in the financial services domain, 25 federations and roughly 120 individual lobbyists were present in Brussels (Shirreff 1999). As this included insurance, asset management, stock exchange and many other sub-sectors in addition to banking and investment banking, the number appears small. To make matters more extreme, Houston felt that only 6 per cent of those
federations and lobbyists lobbied actively—that is, one or two federations and not many more than seven lobbyists. Yet, given the concentration in the industry, these few could still represent a significant share of the market and hence wield considerable influence. Most of the lobbyists outside this active group functioned largely as one-way communication channels, relaying information from Brussels trade associations to their members and to the rest ‘waiting for the phone to ring’.

Even when second-tier banks did allocate resources to regulatory developments in Brussels, this often happened in the context of their legal departments, charged with ‘keeping track of EU developments’. This was a far cry from actively trying to shape the policy agenda. After all, when continental banks had most of their capital market operations in London but were still tightly controlled from their headquarters, identifying a clear corporate interest was no easy task. As was the case with securities issuers and institutional investors, ‘objectively identifiable’ interests and stakes in EU capital market policy were not enough to ensure second-tier banks’ voices were heard in Brussels—if, indeed, there was a message at all.

Houston’s list of pro-active firms in mid-1990s Brussels includes ABN Amro, Deutsche Bank, Barclays, Citibank, Morgan Stanley and Goldman Sachs, and among the federations, the European Banking Federation (EBF). Interview respondents largely confirmed this pattern. When prompted for the most active lobbyists, the above list normally surfaced with minor variations: Citibank was not always included while ING sometimes was (Interview 160306.b). In 2006, one US investment bank lobbyist described the circle of ‘peers’ in lobbying as ABN Amro, Barclays, Deutsche Bank, Goldman Sachs, Merrill Lynch, Morgan Stanley and UBS (Interview 070406).

Among them, the American firms stand out as the most active; they were also the first to lobby in Brussels professionally (Interview 270206, Interview 021205.a). Goldman Sachs—described not without admiration by one insider as a ‘very aggressive, very active, very professional organization’ (Interview 300306)—is generally credited with being the first in
Brussels, setting up its ‘European government affairs office’ in 1992/93 (Interview 070406).

Morgan Stanley—the ‘aristocrat’ among the bulge bracket firms—followed in 1995. Furthermore, they tended to stay ahead of the regulatory curve. As one representative of a national lobbying association remembers,

[...]

Among the European firms, Deutsche Bank, ABN Amro and Barclays stand out.

Deutsche set up its Brussels office in the early 1990s; ABN Amro followed with its ‘Liaison Office’ late in 1996 (Mijs and Caparrós Puebla 2002). Barclays lobbyists mainly operated from the City, made easy by the completion of the Eurostar train link between Brussels and London in 1994. As pointed out above, the German and French firms were often seen as having ‘two souls’ in lobbying (Interview 070406). In the early days, this complicated coordination with other firms, particularly the American ones. Even if Deutsche’s London investment bankers shared a common position with them, ‘Frankfurt’ might still not have it. As a result, cooperation across the channel was rare in the beginning.

Part of this split within the investment banking community simply had to do with limits to the overlap of interests. Pro-integration banks still differed on the question of harmonization versus mutual recognition. The savvier of the City-based firms realized that integration without harmonization was unlikely, given the need to get member states on board. Nevertheless, they kept pushing for less intrusive EU rules whereas the French and Germans clearly saw the advantages of far-reaching harmonization. These views were shared by their governments. In an article co-authored by two representatives of Deutsche Börse and the director responsible for capital markets in the German ministry of finance, the goal was ‘welfare-optimization through
harmonization’ guided by the idea of ‘the most far-reaching harmonization of rules and markets to safeguard fair and intensive competition’ (Asmussen et al. 2004: 28, translated from German). The French had even stronger views, advocating not only a shared rule-set but a single European regulator as well (institutional change will be picked up again in the next chapter).

Among the investment banks, French banks adopted a relatively low profile on policy issues. Several factors account for this. Even though French firms were not against market integration, they tended to favour it on different terms than the American investment banks. Taking a strong stand within the London investment banking community would have exposed differences without political gain. While French banks were members of the most important City trade associations, their influence was insufficient to sway these bodies. Not sticking their necks out was thus a sensible strategy. More importantly, French state-market relations, themselves a product of the idiosyncratic evolution of French capitalism (e.g. Schmidt 1996), favoured opinion formation at the national level and reliance on state actors rather than trade associations or lobbyists to push their case in Brussels.

In the UK, if the government takes a position that the industry doesn’t like, then the industry will say so very strongly. In France, there is much more discipline. If the Trésor decides a line, then that is it. That also gives them a strong position in negotiations. Whereas in the UK or in Germany they [the associations] might very well say ‘Well, this is rubbish. We want something else.’ (Interview 021205.a)

As French banks were privatized over the course of the 1990s, they became increasingly involved in financial sector policy. As traditional sectoral associations dropped in relevance for the largest banks (Interview 160506.a, cf. Lalone 2005), they founded more initiative-based organizations, most notably EuroFi, a big bank-sponsored think tank meant to emulate the Finanzplatz Deutschland initiative that had been set up in the early 1990s to boost Frankfurt’s international standing. One respondent characterized the initiative as follows:

You had in France an America-in-phil faction, who were happy to learn English, who went to business schools, were in investment banking or the academic community. You then had the very big banks, like BNP
and SocGen, who were aware of the need to develop an international vocation rather than just stay inward looking, and they were always keen to create a kind of internationally competitive Paris rather like Finanzplatz Deutschland. And they were quickly able to attract the support of the French institutions. (Interview 300306)

The main aim was not to lobby Brussels directly, but to enlist domestic political actors to the goals of openness and internationalization.

Smaller financial market participants—likely to lose out from market integration and the concentration and consolidation that it was bound to usher in—were also notably absent from the Brussels lobbying game in the 1990s. The very small players, including savings banks and cooperative banks, had their own national associations united in the European Savings Bank Group and the European Association of Co-operative Banks. Both were relatively late to take positions on EU issues and remained largely reactive (Interview 061205). Collective action problems—there were thousands of savings banks in Germany alone—delayed their response to new developments, even when common positions could eventually be found (cf. Olson 1965).

The most important reason for small firms’ absence from the Brussels lobbying scene was their opposition to the agenda of the European Commission. Private-public interaction in Brussels became increasingly formalized after 1999 with fixed open consultations, ostensibly ‘representative’ committees of market participants to consult, etc. With its agenda firmly set on the integration path, informal direct lobbying by firms with protectionist impulses seemed a lost cause. Their preferred route was through national associations with access to member state governments, even if collective action problems put them at a disadvantage to larger firms. Furthermore, research suggests that the Commission prefers contact with European business associations to national ones (Bouwen 2002) and direct contact with individual firms to associations in general (Eising 2007). This was clearly the case within financial market integration when the cooperation of large banks was necessary to achieve politically important goals, for example the creation of a Single European Payments Area (Interview 231105).

The growing split between large and small firms left second-tier firms caught in the
middle. National understandings about market orders—conceptions of control in Fligstein’s (2001) terms—began to fray as large firms pursued their own interests. National associations such as the Bundesverband der Deutschen Banken (Association of German [commercial] Banks, BdB) lost their relevance vis-à-vis other industry-government communication channels (cf. Cowles 2001) and left second-tier firms without a body to represent their interests (Interview 220506).

Mijs and Caparrós Puebla summarize the process as follows:

In this world, only 15 or 20 years ago, the national federations represented the sector and the accumulated view was presented to the European institutions by the European federations [...]. Domestic mergers in the late 1980s and early 1990s created a number of large banks in Europe [...]. In the 1990s these banks became more and more ambitious to set up operations outside and throughout Europe. At this time these large banks started to realize the direct impact European legislation had on their business. Today most of the large banks in Europe are represented, either by an office in Brussels or by a specialized department (Mijs and Caparrós Puebla 2002: 262).

National sectoral associations such as the BBA, the BdB and the FBF were not the only ones trying to influence European politics, each in their own way. Other prominent organizations included the London Investment Banking Association (LIBA), the European Banking Federation (EBF) and a number of professional associations focussed largely on wholesale markets such as the International Swaps and Derivatives Association (ISDA) and what eventually became the International Capital Market Association (ICMA). LIBA emerged out of what used to be the Accepting Houses Committee, a club of leading City merchant bankers that had functioned throughout the twentieth century as a quasi-trade association of the industry as well as a link to government and the Bank of England (Thompson 1997). In the course of the 1980s, this bastion of ‘gentlemanly capitalism’ (cf. Augar 2000) changed its composition to reflect the growing importance of foreign, particularly American investment banks; in 1989 it changed its name to the British Merchant Banking and Securities Houses Association (normally abbreviated as BMBA) (Filipovic 1997). Five years later, the name was changed again as ‘British’ no longer reflected the composition of its membership (Observer 1994). It was now christened the London
Investment Banking Association, a trade association with roughly 40 members representing the
top brass of global investment banking.

The high profile of its membership did not mean, however, that BMBIA/LIBA was ahead of regulatory developments in Europe. To the frustration of its members who favoured integration (Interview 070406), the organization in the mid-1990s remained absorbed in domestic UK issues (Interview 300306). In later years, certainly after the re-launch of EU legislative activity in 1999, LIBA shifted its focus towards European matters—with one insider claiming it consumed 80 per cent of LIBA’s resources by 2006. That said, its voice in Brussels as the de facto mouthpiece of the investment banking industry is tarred by the ‘L’ in its name. One US investment banker confided that he had repeatedly tried to have ‘London’ struck from its name (Interview 070406). The British firms among the members, however, were clearly against this. Another respondent voiced regret on the same point:

[I]f LIBA would change its name to European Investment Banking Association, that would improve its abilities in Brussels at the stroke of a pen. (Interview 021205.a)

Though the European Banking Federation (EBF) could boast an ‘E’ in its name, it had difficulty reaching common positions, certainly until the late 1990s. As a federation of national associations of commercial banks, the EBF needed unanimous support for its statements, which were unsurprisingly hard to reach. Over time, however, trade association officials became more pro-active (Interview 160306.b).

Later in the 1990s they changed their strategy. They would come out with their statement and there would be a very obscure footnote saying “Not all members agree with this…” And that was always the French, almost. (Interview 160306.b)

Recognizing the authority with which the EBF could speak in Brussels, an ABN Amro representative took the lead to establish a separate capital markets committee within the federation that could focus on investment banking issues, reach decisions relatively quickly and exploit the apparent representativeness of the EBF.

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EU action and industry-Commission contacts ahead of the FSAP

Contacts between individual banks, industry associations and EU bodies, particularly the Commission, had existed since the inception of the single market programme (Interview 030406). Yet it was only in the mid-1990s that firms began devoting resources to lobbying the Commission and later the Parliament, setting up ‘government affairs’ offices in Brussels and charging lobbyists with influencing EU developments. Even though contacts were still irregular and informal, American firms in particular started to communicate their dissatisfaction with the state of affairs in EU capital market integration.

A sense of dynamism returned to financial services policy in 1995 when the Santer Commission succeeded that of Jacques Delors. David Wright, who worked as an advisor to Santer and became Director of Financial Services Policy and Financial Markets in the Internal Market Directorate General in 1999, emerged as one of the key figures in the renewed drive towards further integration. John Mogg, Director General of that same directorate since 1993, had also played a leading role on the side of the Commission. An exchange representative remembered that they had held informal consultations with industry representatives already in the mid-1990s (Interview 240506.b). There was then interest in some sort of comitology procedure, which would allow the Commission to update bits and pieces of legislation without having to put them to the Council (Wessels 1998, Bergström 2005). Indeed, such an arrangement had been envisioned for the original ISD. But when the ISD deal was finally struck in 1993, member states’ enthusiasm for collective financial services policy was exhausted (Jabko 2006) and the proposals were never followed up.

The most important communication channel between the Commission and industry representatives was an informal group that various respondents as well as four written documents referred to as the Financial Services Strategy Review Group, the Financial Services Strategy Group or the High Level Strategy Review Group (the written sources which could be identified are Shirreff 1999, Bishop 2001, Mijs and Caparrós Puebla 2002, Gotwald 2005). For the sake of
coherence, this account will stick with the first label, abbreviated FSSRG, even though it is uncertain whether this was the one used by its members at the time. The FSSRG was informal and meetings were held under Chatham House rules. No written records of these meetings are available, just as there are no lists of the FSSRG’s members, the dates on which it met, etc. Given the political sensitivity of financial market policy, the Commission made clear efforts to avoid publicity around this group; as soon as word spread, the Commission was quick to make amends by establishing further consultative groups and at least pretending to take into account the opinions of governments and other stakeholders. Even during interviews for this thesis, Commission officials remained deliberately vague on the FSSRG:

In pre-98, there was also a discussion paper, but the process was not as developed as it is now. [...] In the past we had a document. We showed it to a number of people. We asked their reaction, and that was it. [...] There was no formal group pre-FSAP. But we had some people, meetings. It was not formally a group that was established. (Interview 141205)

The FSSRG was convened by the European Commission, and John Mogg specifically, to study ‘what was wrong with the single market’ (Interview 021205.a). As one member described it, the Commission established the FSSRG in 1998

> to draw together the current “wish list” of market participants in the light of the imminent arrival of the euro and the breath-taking pace of technological change since the original work on the Single Market a decade earlier. (Bishop 2001)

FSSRG members consisted of roughly 20 representatives of financial firms that had considerable stakes in a deeply integrated European financial market (Gottwald 2005). ABN Amro for example supplied a member to the group; according to two people working for it at the time, this was considered a major lobbying success (Mijis and Caparrós Puebla 2002: 259).

The FSSRG held little more than half a dozen meetings in which the themes that were later to structure the Financial Services Action Plan were identified. Once it became clear that there was strong support for action within the group, Mogg informed Mario Monti,

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39 Another respondent reported 18 members. Interview 160306.b
Commissioner for the Internal Market and Financial Services, that there were clear suggestions about what should be done and that current political and economic conditions provided a window of opportunity to push for change. The members of the group presented their ideas to Monti, something that reportedly helped secure his support (on this point and the following paragraph, see Gottwald 2005: 127ff).

That Commission officials felt it necessary to consult industry members and involve them in the re-launching of financial market integration already says much about their importance. Once the industry and the Commission had effectively joined forces, getting the Council to agree on the new legislative programme proved much less of a problem. This did not mean that the Commission simply transcribed industry demands. For both political and practical reasons, the report that was eventually put to the Council was drafted by the Commission. This also gave the Commission space to insert some of its own ideas into the document.

As pointed out previously, there was disagreement over the route to further market opening among the pro-integration investment banks: City firms (including the US banks) preferred mutual recognition as envisioned in the original ISD while most continental firms were in the ‘maximum harmonization’ camp (Shirreff 1999). The question of whether new legislation was necessary or desirable thus split the pro-integration banks, with the City clearly against further legislation (Interview 160306.b). The Commission felt differently on this point. For the Commission as an organization, drafting new legislation is its most important power in the EU, effectively its raison d’être. At the same time, it realized that some degree of regulatory harmonization would be the political price to pay for effective market opening.

The question of new legislation, however, only really surfaced in 2000, and by then the re-launch was well under way. Even the FSAP only vaguely referred to an ‘updating’ of the ISD,

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40 One respondent, who was a member of the FSSRG, also remembered having personally presented the findings of the group to both Mogg and Monti.
tucked away among 42 other proposed measures. One representative of the mutual recognition

camp clearly realized that ‘his’ perspective had lost out in the end:

[We [the members of the FSSRG] worked for almost a year, we
identified almost all the flaws in the single market, [...] presented the
results to Monti and Mogg. And we concluded there is need for very
little new legislation. [...] Our main message was ‘enforce’, ‘implement’,
tidy up the ambiguities. Then—and this takes us to the FSAP, around
Vienna, Cardiff, the Commission wanting to relaunch the single
market—then they came out with the FSAP. And we were just amazed.
And they sold this to the UK Treasury on the basis of what practitioners
wanted. This is not what we had asked for. We said: Hardly any new
legislation. We wanted the market to work as intended. But then to say
that this is what practitioners wanted is stretching the truth. We wanted a
single market. We didn’t want the FSAP. It came as a shock. (Interview
160306.b)

Politically, the FSAP and the regulatory harmonization it entailed became the only viable route to
agreement among member states and thus the single market.

The United Kingdom held the EU Presidency in the first half of 1998. The City had made
clear to the Treasury that the single market in financial services was not working as intended. As
one British respondent, seconded by the UK government to the Commission at the time,
remembered,

[the UK was very supportive of the whole approach [to relaunch
financial market integration]. And many of the financial institutions
operating in London were very much in favour. US ones, German ones,
French ones. If you talk to the big banks, ABN Amro, Deutsche Bank,
BNP Paribas, quite often, on these issues, they will have the same
opinion. Their respective governments may not. (Interview 021205.a)

In the UK presidency’s final European Council meeting in Cardiff in June 1998, the Council
asked the Commission to produce an action plan to reinvigorate financial market integration
(European Council 1998a). The basis of the Council decision was a report produced by the
Commission, which drew on discussions in the FSSRG. Ahead of the European Council meeting,
members of the FSSRG had coordinated their lobbying: top-ranking officials wrote to ‘their’

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ministers to point to the importance of the coming Commission communication. As planned, the European Council asked the Commission to make an official report to be presented at the Vienna Council later that year. In the run up to this meeting, industry representatives were again consulted (Shirreff 1999); one respondent working for a large exchange remembered industry members sitting down with the Commission ‘around that time’ and going through the articles of the ISD one by one (Interview 240506.b). The communication that the Commission presented at the European Council meeting, *Financial Services: Building a Framework for Action* (European Commission 1998), was

the Commission-edited summary of the individual demands of the members of John Mogg’s informal groups. (Gottwald 2005: 130, translated from German, DM)

The Vienna European Council endorsed the *Framework for Action* and asked the Commission to draft a concrete proposal for legislative action, to be presented first to ECOFIN, the Council of finance ministers, and then to the Cologne European Council in June 1999 (European Council 1998b). These proposals were to become the *Financial Services Action Plan* (European Commission 1999c).

There was, however, criticism that the Commission’s consultations had been one-sided, with too much focus on market participants from the City (Shirreff 1999, Interview 160306.b). Governments also asked for a greater voice in the preparation of the FSAP. The Commission thus established the Financial Services Policy Group (FSPG) with high-ranking government officials as members and Monti himself as chair (European Commission 1999d). It met for the first time in January 1999 but was widely seen as a form of politically correct window dressing to assuage government concerns (Interview 021205.a). The ISD, the overhaul of which eventually emerged as the most ambitious element of the FSAP, was not even mentioned in the summary of the FSPG’s first meeting; it was certainly not listed as one of the priorities (European Commission 1999d). It is not implausible that the Commission, which chaired the FSPG meetings, deliberately deflected attention from the changes to the existing legislation that it
had in mind. One Commission official remembers that at the time, the ISD was consciously not
included:

On [the] basis of what was in the FSAP, indeed, we [embarked on the
wider reform of the ISD]. In the end, nobody really contested that it was
part of the FSAP. But initially, it [as new legislation] was not part of it,
because it was too recent as legislation. [The original ISD] was regarded
as a failure particularly by the Commission. But it was too recent to be
part of the FSAP. But we followed, and nobody said anything. [...] The
FSAP has also been a success because everybody felt that it was
necessary to do something. There was a consensus on the need to do
something, to integrate financial services. Nobody saw a problem with
incorporating the ISD. (Interview 141205)

At the third meeting of the FSPG, less than two months after its establishment, the Commission
identified

strong support for the proposal to review the Investment Services
Directive to ensure that this core element of the single market
framework measures up to the needs of an integrated financial market
place. The idea of a single authority to monitor and enforce market rules
was floated. There was support for further consideration of the
appropriate infrastructure which will be needed to manage a more
integrated EU wholesale market. (European Commission 1999b)

The Commission had been able to use its prior consultations with industry to argue that ‘the
market’ was supportive of its plans—which was basically correct if for ‘market’ one understood
‘the leading firms in the industry’. As the FSAP was published a little more than three months
after the first meeting of the FSPG, in May 1999, it comes as no surprise that the FSPG’s
influence on the document was slight. Most decisions on what would be included in the list of
areas that needed legislative action had already been taken. In one way or another, an overhaul of
the ISD would be one of them. As it turned out, this overhaul would emerge as the single most
important EU legislative project in financial services in over a decade.

**The FSAP, the ISD and the Forum Groups**

The FSAP authorized the Commission to start work on a whole host of new directives; the
action plan identified no less than 43 areas in need of attention (European Commission 1999c, for an overview, see HM Treasury et al. 2003). Once the Cologne European Council had endorsed its findings (European Council 1999), work could begin to review existing legislation or draft completely new texts. The Commission quickly identified the ISD as one of the core areas of concern (e.g. Monti in Handelsblatt 1999). The Markets in Financial Instruments Directive (MiFID), as the ISD replacement was eventually named, emerged as the keystone of the new regulatory edifice.

State actors were hardly enthusiastic about the FSAP. The arguments with which the Commission and private actors tried to sway them revolved around two themes: ‘getting the most out of the euro’, which was about to be introduced in 1999, and exploiting the growth potential of vibrant capital markets, something that the US stock market boom seemed to irrefutably demonstrate.

State regulatory agencies were noticeably absent in the re-launch of EU financial market integration. In 1997 regulators had initiated their own bottom-up form of cooperation in the Federation of European Securities Commissions (FESCO), loosely modelled on IOSCO (Interview 160506b, Interview 210306). It began work, for instance, on agreeing common definitions for loosely defined terms in the ISD (Federation of European Securities Commissions 2000). But due to anticipated rivalry between the Commission and the regulators over EU rule-setting, the regulators were largely excluded from the FSAP process—surprising given the stated aim of creating better and more efficient regulation.

The connection between the euro and the re-launch of capital market integration was ubiquitous: in the popular press (Davison 2001), in Commission documents such as the FSAP (European Commission 1999c) and in lobbying strategies (Mijs and Caparrós Puebla 2002). At the same time, several lobbyists confided that the euro was less a driving force for market integration than a convenient hook on which to hang it (Interview 050406, Interview 270206, Interview 070406). Discontinuities between currency areas had not been an obstacle to cross-
border market integration before. To be sure, the euro allowed the convergence of interest rates across Europe and narrowed the spread between eurozone government bond yields (European Commission 2005b). But by themselves, these argument did little to strengthen those for deepening market integration that were already on the table.

Nevertheless, governments in Paris and Berlin saw the UK’s decision to stay outside the eurozone as an opportunity for their national capital markets to compete with the City. In the late 1990s, the prospect of London losing business in the wake of the single currency was still taken very seriously (Handelsblatt 1998), a point that was also raised in several interviews. Combined with the location of the European Central Bank in Frankfurt, the potential boost to the German ‘Finanzplatz’ was a major incentive for the German finance ministry to support the FSAP (Interview 020806). It is ironic then that many of the strongest corporate proponents of the euro-argument in support of capital market integration had their bases outside the eurozone—in the City. They correctly foresaw that in an age of electronically integrated financial markets, the location of a bank vis-à-vis a currency zone mattered little. With the benefit of hindsight, the euro was a blessing for the City: national foreign exchange markets were turned upside down, as were futures markets for currencies (much of the currency derivatives business did actually end up in Frankfurt). More importantly, many firms integrated their national bond trading desks into one eurozone trading desk and relocated their traders from national financial centres to their own European headquarters, normally in London (Interview 140306.b). By increasing the scope for conglomerations through the choice of business location (cf. Bindemann 1999), the euro probably did more to hurt Frankfurt and Paris than to aid them.

Just as the euro was a discursive window of opportunity, the argument linking rapid capital market development to higher economic growth must be taken with a grain of salt. At the time, however, the impressive growth in the United States was seen as a result of the boom in capital markets, particularly the provision of venture capital to young, ‘innovative and high-growth’ companies (e.g. Rajan and Zingales 2003). As pointed out in the preceding chapter,
continental European governments were susceptible to reform agendas that promised to create a similar dynamic in Europe, something that became clear in the Lisbon Agenda of 2000 (cf. Sapir 2004). Commission president Santer himself made the case for the importance of risk capital to finance SMEs in front of ECOFIN less than two months before the Cardiff Council (ECOFIN 1998), while similar arguments were used to push for a European version of NASDAQ (Posner 2005). National stock exchanges, too, were quick to set up their own ‘growth markets’. Risk capital provision was seen as a crucial issue and financial market integration sailed easily under that banner.

Getting and keeping governments on board was only half the work, however: in addition to the FSFG, the Commission set up five so-called Forum Groups in the summer of 1999. This was in part due to continental criticism that there had been an Anglo-Saxon bias in the Commission’s consultations with industry. John Mogg thus invited industry associations covering the whole breadth of financial services to nominate members to the Forum Groups—including one on ‘updating the ISD’ (Shirreff 1999)—in which the Commission would consult market participants to identify concrete future steps. The group concerned with the ISD first met in October 1999, at which point the Commission unveiled a Green Paper that set out the issues for discussion (European Commission 1999a). Several respondents who had been involved in the pre-FSAP consultations, however, felt that the Commission had reached its own conclusions—even as the ABN Amro representatives considered it a great success that their representatives were present in four of the five Forum Groups (Interview 160306.b). One US lobbyist showed clear disdain for these Forum Groups, pointing out that his bank had ‘gotten involved’ much earlier (Interview 070406). Yet another one complained that

[the agendas [of the forum groups] were drafted by the Commission and the papers were drafted by the Commission, supposedly on the basis of what the experts said but sometimes that was not the case. [...] The classic one [where this happened] was market abuse where the industry had a very strong opinion, finding that there was absolutely no benefit to European legislation on market abuse. What was needed was better
enforcement on the national level. And the Commission comes out with a directive. No one on that group thought that that was a good idea. In other groups, it was less clear-cut. You always get some industry people who are in favour and some who aren’t. So the Commission is free to pick and choose. (Interview 021205.a)

The question of mutual recognition versus rule harmonization was a good example of this: for its own reasons, the Commission sided with those in the industry who preferred the latter. By 2000, it was busy drafting a new directive to eradicate the shortcomings of the ISD.

**Conclusion: Public and private agency in the re-launch of EU financial market integration**

With the FSAP, the gradual shift in preferences among core constituencies in capital market governance was translated into palpable action. With the action plan, the Commission had won a mandate to draft legislation across a wide range of financial market issues, including those covered by the original ISD. But what does the genesis of this legislative mandate tell us about the political economy of supranational governance? Three kinds of actors played significant roles in this chapter: supranational actors, above all the Commission, national governments, and industry lobbyists, both individually and through trade associations. How is their influence on EU capital market policy to be evaluated?

As pointed out in the introduction to this chapter, North American scholars in particular have emphasised the room for manoeuvre that supranational actors can have in determining policy (Marks et al. 1996, Pierson 1996, Pollack 1997, Posner 2005). Many of their arguments have been in response to the perceived dominance of neoliberal intergovernmentalism (Moravcsik 1991, 1993, 1998). This debate has largely been cast in dichotomous terms—asking whether there is any scope for supranational agency at all—rather than inquiring about how important it may be compared to other actors and factors shaping regional integration. In this sense, the debate has fallen back several decades. For instance Schmitter in 1970 summarized the transformation of political, economic and institutional structures in regional integration as
follows:

The most important transformation in the structure of the model during these stages occurs in the nature of national actors. Up to this point they have been treated as units with a single integrative or disintegrative strategy during any crisis. Now they begin to appear as differentiated actors, as a plurality of negotiating units (classes, status groups, sub-regions, clientels, bureaucratic agencies, ideological clusters, etc.). [..] These “subnational” fragmented actors [...] will begin to form stable “transnational coalitions” of support and opposition to particular measures. The policy vector now becomes the product of alliances that cut across national boundaries [...]. National governmental actors may continue to play the preponderant role in the concatenation of strategies, but they can be circumscribed, if not circumvented, by coalitions of other governmental actors with subnational groups and regional técnicos.

(Schmitter 1970: 864f, emphasis in original)

In many ways, this description still fits the evidence presented in this chapter and, indeed, this thesis as a whole.

State actors have clearly played an important role in re-launching financial market integration. Without their endorsement of the FSAP, the whole project would have stalled. But Schmitter challenges us to look behind the formal procedures and identify the actors and coalitions—social forces in Cox’s (1981) terms—that drive economic and political change. State policy always serves someone’s interests. Possibly but not necessarily these interests are those of a sufficient range of constituencies that one might speak of a public interest being served. Nevertheless, from a political economy perspective the question of who the beneficiaries of state policy are stands centre stage—and its answer is not self-evident.

This chapter has argued that a shift in regulatory preferences among an insider group of leading firms in European investment banking, based on the developments recounted in the preceding chapter, has been the central factor explaining the successful re-launch of market integration. Commission initiatives would have been futile against the unified opposition of market participants. Jabko (2006: 60) has characterized its role in this policy domain as that of a ‘political accelerator of institutional change’.
The measures contained in the FSAP of course did not receive the unanimous backing of the industry. Some measures were stiffly opposed, such as the Market Abuse Directive. Yet from the perspective of this thesis, issues such as insider trading pale in significance to those governed by the ISD. Insider trading and market manipulation rules are seen as a ‘regulatory burden’ by financial firms. They do not, however, reshape the competitive landscape nearly as much as the ISD did. Cross-border market access and the comparative regulatory advantage of for example investment banks versus regulated exchanges were the kinds of issues that really mattered in the long-term perspective of firms in the business. It thus comes as no surprise that ‘upgrading the ISD’ took even longer than the four years spent negotiating the original. The Markets in Financial Instruments Directive (MiFID) was a much longer document that replaced minimum harmonization and mutual recognition with full rule harmonization. As the following chapter shows, member states felt compelled to agree on a new legislative procedure—the Lamfalussy process—to facilitate the design of such an encompassing supranational rule set. Seen from a long-term perspective, this combination of comitology procedures and heavy expert involvement in rule-making completed the transition from the intergovernmental mode of EU governance that prevailed around 1990 to the ‘supranational constellation’ that governs EU capital markets today. To be sure, however, the perceived need for institutional change only arose on the back of the new consensus in favour of integration that this chapter has analysed.
CHAPTER 7: EU CAPITAL MARKET INTEGRATION AND THE EMERGENCE OF SUPRANATIONAL GOVERNANCE

A decade after the re-launch of European financial market integration in 1998, the policy field has been thoroughly Europeanized. The lion’s share of new rules and regulations is now European in origin while national legislative room for manoeuvre is restricted. Two new committees have been created to assist the Commission in drafting new legislation and designing implementing measures. The influence of the European Parliament has been expanded whereas that of the Council has been reduced. Industry consultations now largely take place at the European level and have been formalized through the establishment of several ‘expert committees’ that assist supranational bodies in policy-making. The industry itself uses European associations more than ever before, and only in divisive issues such as clearing and settlement do national positions (and hence national associations) retain precedence. All of this is the flip-side of the transnational ambitions and business models that have emerged within the financial industry over the past two decades. As these changed market structures inspired new regulatory preferences among industry insiders, they generated a constituency in favour of integrated patterns of governance, as well.

This chapter traces the creation of the supranational institutions that govern European capital markets today. Central to the story is the adoption of the so-called Lamfalussy process by the Council in 2001 and the European Parliament in 2002 (see Committee of Wise Men 2001). This new legislative procedure was crucial in institutionalizing the role of two new European committees, the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR). This chapter uses first-hand empirical material—in particular interviews with policymakers and industry representatives—to show how industry support and the competitive implications of governance arrangements were crucial for institutional change. Whereas national financial industries earlier relied on national governments to represent their interests, larger firms now prefer a supranational and much more technocratic approach to rule-
setting. This, it is thought, will enhance the ‘quality’ of regulation while reducing the scope for protectionism.

Theories of supranationalism suggest that the preference for supranational governance reflects a preference for supranational solutions to policy problems (Stone Sweet and Sandholtz 1998). Supranational governance, so the idea, is more likely to overcome collective action problems and distributive struggles and thus generate efficient solutions (Scharpf 1997b, 2001). In the economic realm, this translates into the expectation that the larger the transnational component of a firm’s business or ambitions, the more strongly it will support some form of supranational governance (Schmitter 1970, cf. Weber and Hallerberg 2001). In Mattli’s words,

[as] new technologies increase the scope of markets beyond the boundaries of a single state, actors who stand to gain from wider markets will seek to change an existing governance structure in order to realize these gains to the fullest extent. (Mattli 1999: 46)

This idea is both plausible and borne out by the evidence presented in this chapter.

At the same time, the basic idea would benefit from refinement. The state and political institutions are not just empty shells occupied by societal actors to arrive at collectively binding decisions, as some of the game-theoretic models of multi-level governance suggest (cf. Scharpf 1997a). States, and by extension EU bodies, are large organizations run and controlled by people who themselves have bureaucratic and political objectives (Nordlinger 1981, Krasner 1984, Skocpol 1985). For large firms, patterns of governance should match the scope of their preferred policy solutions but the public actors within them should not become too powerful in their own right. In most cases societal actors with a stake in transnational integration will favour supranational governance without a single supranational entity free to ignore societal pressures. This is particularly true of actors who hope to exert influence. Consumers of financial services may feel they are best served by a Leviathan to protect them from the vagaries of financial innovation and charlatanry. Large firms, in contrast, should prefer an institutional architecture made up of competing public actors whose bureaucratic power depends on industry support.
Supranational cooperation before Lamfalussy

The idea of supranational cooperation in the field of securities markets dates back to the first round of capital market negotiations which produced the ISD and the CAD. The draft directives had envisioned a ‘Securities Committee’ staffed by member state representatives able to update small, specified parts of the legislation together with the Commission. The Commission would draft these updates; the Securities Committee would adopt, reject, or if necessary adapt them. Though this foreshadowed the comitology procedures implemented a little less than a decade later, it differed from it in important respects: the Securities Committee would have allowed member states to renegotiate small, previously decided bits of legislation without having to reopen the overall bargain. In contrast, the Lamfalussy process went a step further and saw member states giving up this power at the expense of supranational actors, not least the Commission itself.

While the implementing powers built into the ISD and CAD were limited, distrust between member states nevertheless led to the scrapping of any reference to a Securities Committee in the directives’ final versions. They only stated that the Council would retain implementing powers until another arrangement was agreed through a separate directive (Financial Regulation Report 1995c). The idea of a Securities Committee had already elicited industry support in the mid-1990s (e.g. Interview 240506.b). As implementing powers were clearly circumscribed, technical aspects could be updated without upsetting the fundamental bargain.

Member states’ appetite for further integration in the field of financial markets had ebbed following agreement on the ISD (Jabko 2006). Nevertheless, the Commission proposed a separate directive to establish a Securities Committee in 1995, reminding member states that in doing so it was only implementing what had been agreed two years earlier (Financial Regulation Report 1995b). Given the extensive powers of the new committee—it promised to keep national governments in control of changes to existing legislation—member states were largely in favour of it. The European Parliament also indicated its support for some form of a Securities
Committee (Financial Regulation Report 1996c). But sensitive to the balance between its own competencies and that of the member states represented in the Council, it envisaged a committee with fewer powers than that proposed by the Commission (Financial Regulation Report 1996d). This conflict remained unresolved in the years that followed (Financial Regulation Report 1997, 1998c), with no actor on the European stage compelled to cut the Gordian knot. By the time the Commission tabled the first draft of its Action Plan in 1998 (European Commission 1998), the ‘committee’ directive had effectively disappeared from the EU agenda.

Partially in response to this lack of progress within the official EU architecture, national regulators began to coordinate their activities. The Federation of European Securities Commissions (FESCO), as the new body was christened, was a joint initiative of the Commission des Operations de Bourse (COB), the French capital market regulator, and Tommaso Padoa-Schioppa, who at the time worked for the Italian regulator CONSOB and is often credited with being one of the visionaries of EU financial market integration and an architect of the euro (Interview 210306). Early in 1997, the COB organized a dinner to which it invited the heads of all European capital markets regulators as well as Commissioner Monti. There it floated the idea of some sort of institutionalized cooperation. Eight months later FESCO was officially established with a secretariat at the COB in Paris (Interview 190506).

FESCO’s practical achievements, however, were limited, largely owing to the regulators’ lack of legal and institutional leeway. It had no formal powers to make rules; at best it could try to agree on common interpretations of European rules where national legislation left it sufficient room. FESCO’s main accomplishment was a multilateral Memorandum of Understanding (MoU), an agreement for cooperation in the fulfilment of regulators’ supervisory tasks that replaced previous bilateral ones. More importantly from the perspective of the financial industry, it tackled the vague definitions that had circumscribed the market-opening effects of the ISD. Article 11 of the directive allowed member states to impose ‘host country rules’ on firms dealing with residents if the latter were ‘retail’ rather than ‘professional’ investors. These terms were
nowhere defined, effectively allowing governments to enlarge the former category as they wished. FESCO tried to find common definitions and indeed published a compromise in 2000 (Federation of European Securities Commissions 2000). In spite of heavy lobbying by financial firms, the agreement still fell short of what leading banks had hoped for (Interview 270206, Mijs and Caparrós Puebla 2002).

With hindsight, one of the most remarkable things about FESCO is that before 1997, there was no forum in which European regulators could coordinate their activities. This shows how far matters have since evolved: national regulators today are embedded in a network with their European partners while supranational cooperation has become an integral part of contemporary regulation, both as a set of rules and through the actual day-to-day operations of the respective national authorities. At the time of writing, the Committee of European Securities Regulators (CESR) is a central actor in EU capital market politics; at the time of the adoption of the FSAP, FESCO as CESR’s predecessor played no significant role in the Commission’s efforts to reinvigorate EU financial market integration.

It would be wrong, however, to judge FESCO’s impact solely against the material changes it produced. FESCO was the first embodiment of a nascent transnational epistemic community for securities markets regulation in Europe (P. Haas 1992, Kapstein 1992). It provided a forum for regulators to meet, exchange ideas and formulate common positions with fewer hesitations than in actual negotiations. As regulators discovered how far their ideas had already converged, FESCO spurred their esprit de corps (Interview 210306).

**Launching institutional change**

Following the adoption of the FSAP, there was widespread feeling that some sort of institutional change to finish its work programme within the envisaged six years was desirable. The Commission had indicated as much in the report itself (European Commission 1999c). One lobbyist for a large bank confided that for him, institutional change had been an integral part of the FSAP enterprise—and thus effective market integration and the reordering of the
competitive landscape—from the beginning (Interview 231105). This support for some form of supranational governance, it emerged, was widespread throughout the industry, even among firms that otherwise were competitive rivals such as large investment banks and stock exchanges. On the question of supranational governance, their transnational business ambitions brought them together.

For many continental firms, the support for institutional change sprang from their interest in pan-European rule harmonization. The Conseil du Marchés Financiers (CMF)’s president Lepetit had called for rule harmonisation in the light of announced stock market consolidations in 1998 (Les Echos 1999). Deutsche Bank’s Rolf Breuer decried the ‘regulatory nightmare’ in European securities markets and bluntly called for a single regulatory institution (The Economist 1999). French banks presented a list of grievances reminiscent of the complaints usually coming from the City of London (Association Française des Banques 2000c). Even the otherwise cautious European Savings Bank Group called on the Commission to ‘examine the burdensome legislative process and in particular the length of the entire procedure’ and suggested the use of comitology (European Savings Banks Group 1998).

The necessity for EU rules to pass through the regular co-decision process, often taking years, was suitable for the low degree of top-down harmonisation envisioned at the time of the ISD. Co-decision now proved unable to cope with detailed legislation. The Association Française des Banques, hitherto one of the more protectionist forces in the field, described its support for change as follows:

Private firms have now began to think in European terms. They are in need of a secure and unified legal framework in order to let the European financial market function efficiently. French banks in particular have developed European and international strategies in the fields of fund management, commercial and investment banking and custody. Thus, current regulation lags behind market developments. The [ISD] is seven years old. It currently constitutes an inadequate response to the changes of the last few years, and therefore a range of legal and regulatory problems currently remain unresolved. (Association Française
des Banques 2000b, translation from French by the author)

The Brussels lobbyist for a large European bank came to a similar conclusion:

The main advantage of this procedure is its flexibility. [...] When we
change a directive according to EU procedures, that is, in co-decision,
then that is not only the framework directive. But the discussion in
parliament goes down into the tiniest detail of a technical nature.
(Interview 231105)

The gap between market evolution and EU provisions widened precisely where detailed
European rules were needed. This comes as no surprise as Story and Walter found the ‘average
adaptive efficiency’ of international public bodies to be lower than for any other group (national
authorities, SROs, etc.) (Story and Walter 1997: 131f). Frustration in the industry grew to the
extent that a group of investment banks, headed by bulge bracket firms Morgan Stanley,
Goldman Sachs and Merrill Lynch, reportedly entertained the idea of drafting their own
standards which could eventually form the basis of a pan-European rule book (The Economist
2000).

In its report, the European committee charged with proposing avenues for institutional
change came to similar conclusions, finding that drafting detailed agreements in the Council more
often than not added unnecessary complexity to the attempt to fit 15 regulatory regimes into one
set of rules (Committee of Wise Men 2001: 14). The resulting ambiguity of the provisions was
easy prey to stretching to fit local arrangements. The Committee report in its final assessment
aptly described the situation:

Whilst part of the problem concerns the incomplete regulatory coverage
at European level, the greater part of the responsibility lies in the way in
which European Union legislation has been decided (or left undecided)
and ‘implemented’ (or not ‘implemented’). The problem is the system
itself. (Committee of Wise Men 2001: 13)

Chapters 3 and 4 of this thesis addressed the links between interest constellations filtered
through national policy communities, the desire to create a single market without rule
harmonisation, and intergovernmental negotiations as the setting of choice to manage regulatory
interdependence. The two former conditions were now of the past, leaving only an inappropriate institutional arrangement unable to live up to changed expectations. While the creation of FESCO was a step in the right direction, it did nothing to change the cumbersome and inefficient co-decision procedure.

**Negotiating Lamfalussy**

Institutional overhaul was to prove difficult. Even if reforms appear sensible from the outside, they tend to be considered in policy-making circles only after solutions within established frameworks have been found grossly insufficient (Hall 1993, Crouch and Farrell 2004). While the overall conditions highlighted the sensibility of basic change, distributional conflicts and distrust resurfaced within negotiations. Even as the financial industry pushed for change, the final row was essentially in governments’ hands (cf. Quaglia 2006).

In the FSAP the Commission had again raised the issue of institutional change in the governance of securities markets, tentatively proposing a single regulatory authority while lamenting ‘the absence of a committee of appropriate standing to assist the EU institutions in the developing and implementing of regulation for investment services and securities markets’ (European Commission 1999c: 14). The idea of installing a regulatory committee following comitology procedures was likewise raised by Howard Davies, head of Britain’s FSA (Financial Services Authority 1999). In March 2000, the European Council convened in Lisbon in an ambitious mood. But while it acknowledged the problems listed in the FSAP and called for their solution over the following five years, it failed to propose institutional mechanisms to achieve this, calling only for ‘more intensive co-operation by EU financial market regulators’ (European Council 2000).

Whenever institutional change in the governance of European securities markets had been debated, one of the—hotly contested—options was the creation of a single regulatory authority. Proud of their newly established FSA and generally wary of European institutions, British authorities as well as most market participants—while in principle supportive of more
pan-European co-ordination—disliked the idea (Financial Services Authority 1999). Apart from rare exceptions such as Deutsche Bank’s Rolf Breuer, industry response was muted. The Federation of European Securities Exchanges (FESE) for example voiced its strong belief that a ‘European SEC’ was not the way to go (Federation of European Securities Exchanges 2000). Contrary to Quaglia’s (2006) findings, this was not an isolated view within the European financial industry. An overly powerful pan-European regulator potentially threatened industry interests while its advantages over a well-thought out committee system were far from obvious.

The idea of a single regulator did, however, find friends in the French financial establishment, notably in political circles (Interview 190506). One of the main reasons was that according to ‘European logic’, the location for such an institution would almost by default be Paris. Germany had only managed to bring the European Central Bank (ECB) to Frankfurt after a face off with France, while the UK, not being a member of the eurozone, had practically watched from the sidelines. France was thus next in line. France was also already hosting FESCO, making Paris the natural choice for a more formalized body for regulatory cooperation in Europe.

One month before France assumed the EU presidency in July 2000, Laurent Fabius, French finance minister, proposed to his ECOFIN colleagues a ‘Committee of Wise Men’ to study the governance of capital markets in Europe. As one Commission official closely involved with the Committee of Wise Men recollects:

The idea was explored—and is still there—of a single regulator for Europe. The French were working at the time to create a single regulator. By creating such a group, one of its resolutions or conclusions would be to have a single regulator. That was why it was the French. (Interview 141205)

Though the single regulator was rarely mentioned explicitly, Fabius’ initiative was widely perceived as a step in that direction. Suspicion further heightened when the name of Alexandre Lamfalussy surfaced as chairman of the committee. Lamfalussy was known as a federalist and strong supporter of supranational arrangements. Especially Britain and Germany—which
opposed a single regulator—were cautious about mandating a report. The core issue was again one of competition: paralleling the tension between mutual recognition and harmonization, a single regulator was perceived in the City as possibly eroding its competitive advantages (Interview 141205). Most of the smaller EU members felt that they stood to gain from the French initiative. For them, the eventual choice would be between moving closer to the regulatory structures of the large European markets, leaving them with most of the costs of convergence, or all parties making concessions to create a single regulatory authority with the EU framework.

But without British and German support, the initiative for a single regulator stood little chance. Rather than abandoning the committee in the face of resistance, Fabius took a more cautious approach and retreated from the idea of a pan-European regulator (Crooks and Norman 2000). Michel Prada, head of the French Autorité des Marches Financières, also conceded late in 2000 that the time for a pan-European regulator had not yet come (Prada 2000). The French climb-down on the issue gained the backing of almost all EU members for the committee of ‘wise men’—only the UK still voiced formal opposition to the idea (Osborn 2000). As noted above, making use of comitology procedures had been advocated by Davies the previous year; the problem for British authorities had been how to pre-empt a report advocating a single regulator. Changing strategy, the Treasury now pushed for the committee’s mandate to be as wide and vague as possible and for Sir Nigel Wicks to be one of the ‘wise men’. Wicks, who had served as the head of the powerful EU monetary committee, shared the general British line of caution in conferring regulatory powers to ‘Brussels’ and to more integrated forms of regulation.

EU finance ministers finally agreed to establish the committee at the ECOFIN meeting on 17 July 2000. Several aspects of the mandate are noteworthy. In its definition of the ‘problem’, reference was mostly made to unsatisfactory implementation and transposition of EU rules; institutional arrangements for rule-making were not explicitly criticised (ECOFIN 2000). The committee was comprised of seven instead of the initially envisaged five members, due to the
British insistence on having Nigel Wicks on the committee. The mandate to consider institutional adjustments was almost hidden at the end of the document; it asked the committee to propose ‘scenarios for adapting current practices to ensure greater convergence and co-operation in day-to-day implementation’. As a disincentive to any proposals for a single authority, prudential supervision was explicitly excluded from the scope of the inquiry.

Less than two months after the mandate was given, the Committee of Wise Men made it clear that it was no longer pursuing the idea of a single regulator (Norman 2000a). The reason given in the first report, published in November 2000, was that it would require a change in the Treaties, and would thus take several years and an intergovernmental conference to accomplish (Committee of Wise Men 2001: 67-114). Lamfalussy himself reiterated the point in an interview with Business Week in January 2001 (Echikson 2001). Political will was simply lacking, with most stakeholders pushing for a comitology solution of some sort. As the head of one business association remembers,

In Europe, we need a system that is not too rigid. If you have a long-term, almost eternal piece of Community legislation, a Directive, you must have the flexibility. And when Lamfalussy and David Wright [Director in charge of financial services at the EU Commission] and his team came here, they sat upstairs and we had them for five and a half hours, we took them straight through this model, and it is pretty much what they came out with. Now whether that was our brilliance I have no idea, but what I am able to say is that we were very heavily involved with Sir Nigel Wicks and some of the other key members of the Lamfalussy group. Once it began to generate activity we were very enthusiastic. And once it began to gather speed we coordinated with our fellow associations in Europe to improve the consultative procedures. (Interview 300306)

As the respondent points out, it is difficult to establish with any certainty how much credit his organization and its allies deserve in giving the Wise Men’s committee its ideas. At the very least, the result was clearly in line with industry thinking. When the preliminary report was published on 7 November 2000, it was met with wide sympathy—as well as relief in its absence of a call for a single authority—from financial industry associations such as the Federation of European
Securities Exchanges (FESE) and the London Investment Banking Association (LIBA) (Norman 2000b).

The essence of the Wise Men Committee’s suggestions became known as the Lamfalussy process, which splits the policy cycle into four ‘levels’ (Committee of Wise Men 2001). The procedure had already been outlined in the initial report; the final version, published in mid-February of the following year, altered it only slightly. With minor deviations, this is the legislative procedure that was implemented; it remains in use at the time of writing.

The approach favoured by the Committee of Wise Men can be characterized as comitology-plus. In common with procedures that are widely applied throughout the EU (Bergström 2005), comitology divides legislation in two: at level 1, the European Parliament and Council decide ‘framework legislation’ through the regular co-decision procedure on the basis of drafts prepared by the Commission. Such framework legislation consciously brackets specific ‘technical’ questions. For these, it confers ‘implementing powers’ to the European Commission, which can then ‘fill in the details’ at level 2. In the variant adopted for capital markets, the Commission’s implementing measures are scrutinized by a ‘regulatory committee’, in this case the European Securities Committee (ESC).

The ESC consists of member state delegates and is meant to ensure that the Commission uses its implementing powers in line with the mandate conferred upon it in the framework legislation; it is effectively meant to function as a ‘watchman’ of the Commission (cf. Dehousse 2003). In line with the general rules agreed by the European Parliament, the European Council and the Commission on the functioning of comitology in 1999, the regulatory committee needs a qualified majority—a supermajority of more than 70 per cent of the weighted votes—to stall the Commission’s plan to adopt a particular implementing measure (cf. Inter-Institutional Monitoring Group 2003: 40). The measure in question is then put before the Council, which has three months to reject the measure definitively, again with a qualified

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majority. Otherwise the Commission can proceed to adopt the measure in its original form. The ESC and the Council can thus reject Commission proposals but cannot amend them or make suggestions of their own, at least not formally. The bluntness of the ESC’s policy instrument is meant to deter its excessive use.

The real innovation of the Lamfalussy process, however, lies in its creation of a second committee, one which easily overshadows the ESC: the Committee of European Securities Regulators, commonly known as CESR. Like its predecessor FESCO, CESR brings together capital market regulators from all the EU member states. But in contrast to FESCO, CESR has a formal role in the European legislative process. Officially it fulfills two functions. First, it advises the Commission on the implementing measures to be adopted on level 2. In concrete terms, it makes suggestions for the gaps that have been left open in framework legislation at level 1. The idea is to have ‘experts’—the regulators—deal with the technical details instead of the Council, the EP or the Commission. Formally, CESR’s role is only advisory at this stage. In practice, however, the Commission is expected to justify its deviations from CESR’s advice, giving CESR a central role in capital market legislation.

CESR’s second function is placed at level 3 of the new procedure. There, CESR is meant to coordinate the transposition of European legislation into national law lest discrepancies in national implementation defeat the goal of a harmonized rule set. Again, CESR cannot exert any formal pressure on member state parliaments when it comes to the adoption of national laws. The idea is to use moral suasion to ensure smooth transposition, and to detect potential defections from commonly agreed rules as early as possible. Finally, at level 4, the Commission is charged with systematically monitoring implementation and, if necessary, using its legal powers to challenge members states in front of the European Court of Justice (ECJ).

The industry response to the publication of these ideas was overwhelmingly positive as they resonated with firms’ preferences. Praise came from both Paris (Association Française des Banques 2000a) and the City. The latter made its views known through the Federal Trust, a UK
think-tank. The Federal Trust report on the Lamfalussy procedure was written by a working
group of 17 people including the chief EU lobbyists of many of the most active banks and
business associations, including Goldman Sachs, Morgan Stanley, Barclays, IIBA, the
International Securities Markets Association and the International Primary Market Association
(Federal Trust 2001a). The secretary general of the Federation of European Securities Exchanges
(FESE) and the former head of the Amsterdam Stock Exchange were also part of the group—
showing that in spite of the competitive struggles to come between investment banks and stock
exchanges, they were thinking in the same direction on the issue of supranational governance.
Other prominent lobbyists soon joined the group, including representatives from the two most
active continental banks, Deutsche Bank and ABN Amro (Federal Trust 2001b).

The working group’s evaluation of extant legislation was damning:

The initial directives were fudged. They were slowly implemented by
most governments and weakly enforced by the Commission. National
bargaining in Council led to a protectionist atmosphere. Regulators did
not trust each other and so Directives became excessively detailed.
(Federal Trust 2001a: 1)

It therefore welcomed the thrust of the latest report. Among the shortcomings it nevertheless
identified, one stuck out: lack of transparency and institutionalized industry consultation. Indeed,
ever since the publication of the first Lamfalussy report, the issue of formal private input into
policy-making had been one of the focal points of industry attention. Lobbyists kept pushing the
point. One of them, who was also a member of the Federal Trust working group, found that

[insisting on that sort of discipline [that consultative procedures are
adhered to] has been one of the single most important things I have ever
done in my life. Because it is alien to any organisation that wants to
retain its power [...]. So we would constantly be talking to Alexander
Schaub [EU Commission Director General for financial services at the
time] and asking: why didn’t we see that thing in advance? Could we
please have longer to reply to it? (Interview 300306)

After the publication of its first report, the Wise Men committee held extensive consultations
with both industry groups and national governments in an effort to make its recommendations
more acceptable and to buttress the report’s legitimacy.

The final report was published on 15 February 2001 and addressed many of the issues that had been raised in the consultations. It clarified the roles of the different parties in the procedure and formalized private sector input (for industry evaluations of the final report, see e.g. Federal Trust 2001b). The British Bankers Association (2001) for example praised the degree to which industry concerns had been taken up by the Wise Men. It was now up to governments and the European Parliament to sign on to the committee’s suggestions.

While the enthusiasm European leaders had mustered at the Lisbon summit had already cooled, momentum was maintained in the overhaul of securities regulation. It was only shortly before the Stockholm Council in March 2001 that governments’ adoption of the proposals was again put in doubt. Given the prominence of British officials in the securities markets department in DG Internal Market, the German government was wary that integration privileging the role of the Commission would benefit the City more than Frankfurt (Brown-Humes and Norman 2001). It resolved to accept the new process only if the bar for member state intervention on level 2 measures was lowered. Fearing yet another dead-lock after the take-over directive had been blocked by the German government for years, the financial industry demanded adoption of the report without delay, with individual companies as well as the European Banking Federation publicly voicing their concerns (de Larosière and Lebègue 2001, Norman 2001a, Walker 2001).

As was the case with legislation, firms were ahead of their governments on institutional issues as well (Quaglia 2006). Agreement was reached at the last minute when the Commission committed itself ‘to avoid going against predominant views which might emerge within the Council on ‘particularly sensitive’ issues (European Council 2001, Groom and Norman 2001). This so-called ‘Aerosol clause’ was widely interpreted as meaning that a simple majority would be enough to block things in the Council (Inter-Institutional Monitoring Group 2003), thus circumventing the ‘official’ comitology rules that require a qualified majority to reject the Commission’s
implementing measures. The effect of this nebulous phrase remains unknown—at the time of writing it has never been invoked—but it is unlikely to deflect the thrust of institutional change.

Nevertheless, the immediate political repercussions were enormous: supranational bodies and institutions had escaped the grasp of their former principals and had begun to live lives of their own (cf. e.g. Pollack 1997, 1998). The European Parliament had already felt underrepresented in the proposed legislative procedures before the Council negotiated extra concessions from the Commission and endorsed the Lamfalussy process (Norman 2001b). After inclusion of the Aerosol clause, the EP clearly saw the inter-institutional balance between itself, the Commission and the Council upset. From the EP’s perspective, it was a matter of principle; it demanded influence equal to that of the Council, including over implementing measures. The political sensitivity of power-sharing between the different Brussels bodies delayed adoption by almost a year.

In effect the EP was demanding the right of ‘call back’—to be able to review the Commission’s implementing measures. Its position was spelt out in an April 2001 letter from Christa Randzio-Plath, Chair of the EP’s Committee on Economic and Monetary Affairs, to Frits Bolkestein, at the time Commissioner for the Internal Market (Randzio-Plath 2001). In its reply the following month, the Commission suggested a range of ‘trust building’ measures between the institutions but refused to give in to the EP’s main demand (Bolkestein 2001). To make matters worse, the Commission had already included comitology procedures within its drafts of the Market Abuse and Prospectus Directives in May 2001, long before institutional matters had been settled (Interview 221105). A month later it established the ESC and CESR, again before any formal agreement had been reached with the EP (European Commission 2001). Both of these steps only increased the EP’s resistance.

In this spat the industry largely sided with the parliament (e.g. Federal Trust 2001a). Lobbyists saw the EP as one of their major partners in Brussels. The EBF for example had repeatedly found the EP a crucial ally (Interview 221105), as had another lobbyist for the
Prospectus directive in particular Interview (140306.b). Yet another lobbyist said the same regarding work on the MiFID, adding that

there is definitively a shift of power, towards the EP. [...] The EP is one of the main ways to get legislation changed. All the amendments are published, and MEPs are quite open to discuss things. In the parliament it is much more clear on the trade-offs. National trades are not that common anymore. (Interview 021205.a)

Indeed, industry representatives had already in 1998 taken the initiative to set up a so-called ‘inter-group’ on financial services, a public-private forum ‘composed of several MEPs and several banks and financial services associations’ (Mijis and Caparrós Puebla 2002: 263). The body’s name was later changed to the European Parliamentary Financial Services Forum (EPFSF), whose members included many of the most important EU lobbyists in finance. But in spite of the breadth suggested by its name, the EPFSF has no consumer representatives or other non-corporate stakeholders among its members.

As pointed out previously, private actors have an interest in the fragmentation of supranational power among public actors and a system of checks and balances that prevents the ‘excessive’ autonomy of any single actor. Public bodies are then not only forced to listen to private interests; in a conflict between public actors, industry support may be crucial and eagerly sought. This is particularly true for the EP, which generally commands less expertise than the Commission or CESR. Within the legislative process, the EP’s power largely lies in the amendments it can make. More than once, amendment proposals were copied directly from lobbyists’ suggestions (Interview 021205.a). This turned into particular embarrassment when several MEPs tabled identical proposals, suggesting a common source outside the EP.

As the dispute between the Commission and the EP continued to smoulder during the summer of 2001, it became increasingly clear that the call-back right the EP demanded would in all likelihood require a change in the Treaties, particularly to Article 202 which concerns the delegation of legislative powers to the Commission (Inter-Institutional Monitoring Group 2003: 41). The search for a different arrangement thus began; a compromise was finally found in the
form of the ‘sunset-clause’ which lets the Commission’s implementing powers expire automatically after four years (European Parliament Committee on Constitutional Affairs 2001). Implementing measures then have to be renewed—a deterrent for the Commission to adopt them in the face of EP opposition, particularly in cases where the EP feels that the Commission is acting ultra vires. Two weeks after the group of MEPs charged with finding a way out of the impasse had published its report, the suggestions were officially adopted by the EP. The Commission gave its assent without delay and the new Lamfalussy procedure could finally be implemented (European Commission 2002).

Supranational governance in practice

On the drawing board the Lamfalussy process has clear supranational elements. But these are tempered by the fact that the two new committees, the ESC and CESR, are composed of member state representatives. How radically does the Lamfalussy process depart from previous governance arrangements?

By agreeing to both the FSAP and the Lamfalussy process, member states have effectively Europeanized capital market governance. With the FSAP completed and the updating of its provisions in the hands of the Commission and CESR, the scope for independent national action in the field of capital market regulation is now miniscule. Only in fields where competitive differences remain very strong—clearing and settlement is a clear example—have no legislative powers been transferred to the Commission. At the very least, governments have ‘pooled’ their sovereignty (Hoffmann 1966).

Yet upon closer inspection the practice of contemporary capital market governance deviates significantly from what the formal layout of the process suggests. This is particularly true in two respects: first, the ESC—officially the ‘watchdog’ of the Commission’s use of its implementing powers—is widely seen as failing in its function. Providing its chairman and effectively running its meetings, the Commission has managed to co-opt the ESC in questions of policy (Interview 131206). The ESC has no independent staff, consultation procedure or powers
to propose actual changes to implementing measures; it does not function as an instrument of member state control. Indeed, one interviewed member state representative worried that regulatory authorities were de facto assuming legislative tasks (Interview 071205.b). The relative weakness of the ESC resonates with what other scholars have found about the functioning of comitology in the EU in general. Concerned with accountability and democratic control, both Rhinard (2002) and Dehousse (2003) are highly sceptical as to whether comitology committees are nearly as effective as they seem on paper.

Lobbyists agree that the ESC plays a small role in contemporary capital market governance. In most interviews the ESC was never mentioned whereas CESR always received considerable attention. As one respondent found,

'[the ESC is for when we have a big problem. They don’t do consultation or anything. It is really CESR…' (Interview 211105.b)

Where, after all, would the ESC get its cue to intervene? National regulators—the experts in the field—are already active in CESR and the issues most dear to national finance ministries have already been addressed in framework legislation at level 1. At best the ESC is an additional veto point interested stakeholders can use to stop unpopular rules—hardly an instrument of ‘national’ oversight.

Second, CESR functions much more as a single, supranational entity than its official committee structure suggests. Representatives of national regulatory authorities expressed a strong esprit de corps in interviews while parties involved were unanimously impressed by the level of cooperation achieved thus far (Interview 160506.b, Interview 160306, Interview 030506, Interview 190506). In the execution of their tasks, BaFin and FSA still function as national authorities. But in policy-making, they invariably see themselves as part of a larger European network. This resonates with the well-established, if elusive, claim by neofunctionalists that the supranationalization of institutions is capable of generating shifts in loyalty among bureaucrats (E. Haas 1958, Risse 2005, Niemann 2006). Collaboration has allowed regulators to assert

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themselves in the face of increasingly integrated financial markets in Europe. Regulatory structures were indeed ‘behind the curve’ and for regulators who take their tasks seriously, being organized on a European level makes sense. It also affects their standing in the wider world of public actors.

This is particularly relevant given the competition among the different bodies involved in European policy-making. Various respondents have pointed to the cool relations between CESR and the Commission; the tension is unsurprising as both feel themselves to be the centre of EU capital markets regulation (Interview 190506). The Commission solicits ‘reports’ from CESR in its level 2 work rather than suggestions for draft legislation. The Commission wants to keep the drafting of legislation for itself, whereas CESR clearly feels it performs more than an ‘advisory’ role. On several occasions the Commission has significantly amended CESR’s advice for level 2 implementing measures (notably for the MiFID), prompting CESR members to claim that ‘politics’ had unduly trumped ‘expertise’ (Interview 160506.b). More positively, the competition between the Commission and CESR has fostered close cooperation among regulators.

Indeed, the regulators themselves appear to have become a force for further integration. Unsurprisingly, few would suggest the establishment of a pan-European regulator which would abolish the independence of national authorities. But intensive cooperation has created possibilities for new arrangements, for example the supervision of cross-border stock exchanges such as Euronext. Close cooperation within CESR has furthermore encouraged the sharing of competencies in ways that would have been considered intrusions onto each other’s turf just a few years earlier. The CESR’s Himalaya Report (Committee of European Securities Regulators 2004) has been the clearest initiative in this direction. Leading European firms had long been calling for a ‘lead-supervisor’ (European Financial Services Round Table 2004), meaning a single authority to supervise a financial conglomerate’s activities throughout Europe. In effect this would extend the idea of the European passport for services provision to supervision as well. It quickly emerged that the lead supervisor idea in its pure form would run a foul of the present
treaty and national laws. But receptive to the idea, CESR’s Himalaya Report outlined possibilities within the legal framework for working towards a similar sort of supervisory structure. Even among leading firms, this was seen as a progressive move.

In a similar spirit CESR set up a mediation mechanism among European regulators in 2006 (Committee of European Securities Regulators 2006b). CESR members thereby commit to a procedure for solving disputes among themselves, for example over the interpretation of common positions. The industry was again delighted by the prospect of a mechanism to iron out mismatches among national rule sets. Even though mediation was not meant as an appeal mechanism, industry firms have asked CESR to allow them access to mediation when they have grievances with the local implementation of EU rules. CESR not only granted such access, even if indirectly, but also allowed firms to use host country regulators to raise problems with their own home authorities (Committee of European Securities Regulators 2006a). Though not an appeal process in name, CESR’s mediation mechanism comes close to one in practice. With it, firms have further emancipated themselves from their home regulators and reinforced the supremacy of CESR as a supranational body.

Conclusion

With the coming into force of the Lamfalussy process, EU capital market governance has largely been supranationalised and at least a temporary equilibrium has emerged between market structures and patterns of governance. Policymakers stopped short of creating a single European regulator, a step that would have required changes in the treaties of the European Union. Formally, member states still retain significant influence in the two new committees at the core of the Lamfalussy process. One of them, the European Securities Committee, has largely failed to fulfil its function as a ‘watchdog’ over the exercise of implementing powers delegated to the European Commission. The second, the Committee of European Securities Regulators, has been very active and visible in EU capital market policy. Though made up of member state regulators, it functions more like a single supranational entity than its design on paper suggests. CESR’s
evolution since its inception fits the neofunctionalist notion of *engrenage*—the supranational socialization of bureaucrats involved in collective governance (Niemann 2006).

Member states have far from abrogated their influence over EU capital market policy; the current decision-making process resembles Schurpf’s image of ‘joint decisions’ much more closely than his image of ‘hierarchical direction’ (Schurpf 2001). Given the centrality of financial markets in economic policy, this comes as no surprise. Within the financial industry as well, only a small minority of firms favoured more far-reaching steps such as a single European regulator. In an industry consultation about the functioning of the Lamfalussy process in 2003, European banks submitted a positive joint response together with the Federation of European Securities Exchanges and a whole host of other transnational professional associations, demonstrating just how broad general industry support for this kind of arrangement was (FESE et al. 2003). Multi-level governance suits transnationally active firms, particularly in light of the perceived ‘danger’ of an overly powerful EU regulator at liberty to ignore industry positions. The present system is replete with access points for industry lobbyists while political competition between public actors turns financial firms into their potential allies. This, however, does not mean that the supranationalization of capital market policy has been a smooth and automatic process—the agency of specific actors remains crucial for understanding the timing and process of change.

Looking back on the emergence of the Lamfalussy process, one Brussels lobbyist observed that

> [I]t is like all great plans, and lobbying is the same. If you have great plans and you try to lobby on something, usually you will achieve something, but it often isn’t really what you set out to do. And that is true of the French, who saw [triggering institutional change] as a means to get some more control of [EU financial market politics]. And to a degree that has happened. Because the Lamfalussy committees are taking back some of the power to the member states. But in practice, because it is a collective taking back, it has not given the individual members states back so much control. (Interview 021205.a)

This chapter has argued that strong industry support for integrated governance was a crucial precondition for its emergence. In keeping with the argument of the previous chapter,
such ‘private influence’ is impossible to isolate as an explanatory factor and hence immeasurable. However, it is indisputable that financial firms were core proponents of the kind of governance structure that eventually emerged. And given firms’ ability to insert their preferences into the EU policy process, it is implausible that member state governments would have endorsed such a process in the face of industry opposition. Indeed, the following chapter will show that even with EU capital markets governance heavily supranationalised, the ability of firms to dominate rule-making has far from disappeared: in the renegotiation of the ISD, competition politics still ruled, only this time with transnational alliances rather than national blocks.
CHAPTER 8: RENEGOTIATING THE ISD IN THE SUPRANATIONAL CONSTELLATION

The introduction of the Lamfalussy process was only one side of the institutional changes that marked the transition of capital market policy in Europe from the ‘international’ constellation to the transnational one. In addition to the adaptation of formal governance structures, state-market relations in the capital markets domain have assumed a transnational character. The industry is now largely organized on a European basis and uses regional trade associations to assert its preferences in the policy process. ‘Brussels’ has emerged as the focal point of lobbying and decision making. The degree to which public-private interactions have been institutionalized at this level is evidence of a (temporary) ‘equilibrium’ between new supranational patterns of governance and the transnational scope of market structures. The first half of this chapter shows just how far this process has evolved.

The chapter’s second half analyses the regulatory changes that have largely completed the cross-border market integration that began two decades earlier. With implementation scheduled for late 2007, the Markets in Financial Instruments Directive (MiFID) has replaced the ISD. This chapter traces the process from the Commission’s initial proposals in 2000 to the MiFID’s endorsement by the Council and the European Parliament in 2004. This case study of ‘Lamfalussy in action’ illustrates how the political climate has shifted from a preference for nationally idiosyncratic regulatory regimes towards supranational harmonization. ISD negotiations had been hampered by the divergent interests of national financial industries, in particular their protectionist impulses. MiFID negotiations, in contrast, featured competition between regulated exchanges and large investment banks. To be sure, both camps favoured cross-border market integration. But they disagreed on the terms under which investment banks would be allowed to act as market-makers in competition with securities exchanges. This resulted in negotiations that were even more drawn out than the original ones for the ISD. MiFID
negotiations showed that competition politics had anything but disappeared with the cross-
border integration of the industry. They had become properly transnational.

This new competitive constellation, which structured negotiations and shaped regulatory
outcomes, is a good example of the structuration process at work within EU capital market
integration: the consequences of strategic decisions made by the banks a decade earlier now
informed competition between investment banks and regulated exchanges. When the banks
‘demutualized’ the exchanges—turning them into independent for-profit entities—they created a
new kind of actor in European financial markets. Regulatory politics after 2000 can only be
understood against the background of the earlier strategic restructuring of the financial industry
and the corresponding shifts in preferences. The chain of events in which core actors set the
stage for each following integration step cuts across ‘states’ and ‘markets’.

The supranationalization of EU capital market governance does not mean, however, that
contemporary patterns of governance determine regulatory outcomes—competition politics
does. There is one important area where the EU still has no competencies: clearing and
settlement. The fragmentation of the industry in this sector is widely seen as a major impediment
to the kind of market integration envisioned by the European Commission. As before, appeals to
wider economic goals were insufficient to sway governments in favour of EU level action.
Instead, the clashing competitive interests of a small number of firms prompted their respective
governments to veto the further supranationalization of policy-making. Given incompatible
competitive interests, Internal Market Commissioner Charlie McCreevy was forced to admit
defeat in 2005, announcing the Commission would abstain from proposing a directive for the
sector. Competition politics still trump where interests remain opposed to the pull of massive
institutional change.

**European lobbying transformed**

The flipside of the formal and informal institutionalization of supranational governance has been
a shift in the way private actors interact with public policymakers. This process began in the mid-
1990s as private actors’ preferences swung in favour of transnational market integration and supranational governance. They opened lobbying offices in Brussels and began cooperating on a European level. Over time, the Europeanization of public-private interaction in capital market policy was driven by the mutual reinforcement of the supply of EU-level policy input and the demand for it that evolved as supranational institutions grew stronger. This is a prime example of structuration at work: the growing relevance of EU bodies demanding input from supranational trade associations is itself a function of the growing market-integration preferences within the industry. In this way, Streeck and Schmitter’s (1981) logic of access and logic of membership in the structuring of private sector input into public policy are two sides of the same coin—even if other factors also play a role, their co-evolution is plain to see.

In capital market governance, these two ‘logics’ have been expressed in the growing transnational organization of business interests and the formalization of public-private relations at the supranational level (cf. Streeck and Schmitter 1991, Cowles 2001). Taken together, these two trends show how after a decade of transformation, private-public associative patterns have stabilized again. As if in a new ‘equilibrium’, the scope of investment banking markets, political institutions and private-public interactions complement each other in the ‘supranational constellation’.

To begin with, the European scope of much of the legislation imposes a new focus on formerly nationally oriented lobbyists. One representative of a City association found that:

[when I arrived here [at the association in 2000] I probably spent 10 per cent of my time on international issues, of which 9 was on Europe and one for the rest of the world. By the time I gave up last year [2005], the figure was probably 80:20, 80 per cent international, 20 per cent domestic. That partially reflects the fact that domestic matters were becoming more routine and we got the full flood of European measures. (Interview 300306)]

The growing relevance of EU level measures led to more lobbying in Brussels, though lobbyists from individual firms tried to avoid acting on their own (Interview 231105). Instead they sought
the broadest possible consensus—if possible through some EU-level association—and then tried to insert their own preferences.

People [lobbyists] know each other's positions. In Brussels they play with open cards. [A Commission official] has enough to coordinate already. What is important for him is that he does not have seven people from different banks come to him with the same message on the same day. So everybody, also the Commission, plays very open. People ask 'Listen, this is my position.' If you have one, that is. 'What is yours?' And then people will be very honest. 'On this issue, we cannot follow you because we have a different business position, different business interests.' Or maybe you even say 'Our opinions are diametrically opposed here.' That was the case for example with the Capital Adequacy Directive between the savings banks and the private banks. But of course, that weakens the voice of the banks as a whole. And where the industry does not speak with one voice, the room for manoeuvre of politics increases. I don't think… It is not impossible, but it is of course more difficult for the Commission and later for the [European] Parliament to push through a proposal that is rejected by all [banks] across the board. (Interview 231105)

Finding such broad industry consensus can be a laborious process, well-illustrated in an example given by Mijs and Caparrós Puebla (2002: 265ff). As already mentioned, one of FESCO’s main achievements was agreement on a common definition for professional and retail investors (Federation of European Securities Commissions 2000). The original definition it proposed fell short of what industry had hoped for: only financial institutions could be professional investors. Even large non-financial corporations fell into the ‘retail’ category, meaning host country conduct of business rules applied (Interview 270206). In response to FESCO’s proposal, ABN AMRO prepared a classification of its own to submit to the European institutions. It presented the proposal to the International Swaps and Derivatives Association (ISDA), LIBA and the EBF, but found getting their approval more difficult than anticipated.

Even if the primary goal was to obtain broad support for our alternative [classification], even in an amended version, from associations, time was running fast and further pressure on FESCO was needed. We therefore decided to engage, parallel to our discussions with associations, in
negotiations with other European banks where decisions could be made in a speedier way. (Mij and Caparrós Puebla 2002: 266)

Again, this took more time than ABN AMRO imagined. Because of the level of detail, each bank had to consult internally on whether the relevant business units ‘could work under the terms proposed’.

In July 2001, eight leading European banks agreed a joint paper proposing to FESCO and to the European Commission an alternative classification. [...] At the same time, the [EBF] had successfully convinced all its national associations of the merits of proposing an alternative definition of professional investor and was discussing in detail our joint paper. The [EBF] finally agreed to send the joint proposal, agreed by eight leading banks and its national associations, to the European Commission and to FESCO in July 2001. (Ibid.: 266)

Using consensus among core players to get whole associations on board could also work the other way around, with the urgency coming from EU bodies rather than industry. One lobbyist gave the example of the Single Euro Payments Area (SEPA), a favourite Commission project due to its (hoped for) visibility for EU citizens (see e.g. European Commission 2008):

Let’s assume that Commission really wants a single European payments area. Then it says: ‘We want that.’ Then the industry says: ‘Hm. That’s difficult, that is going to be expensive.’ Then the Commission says: ‘Yes, but you do have to move a little [on this issue].’ Then the industry says: ‘Okay. We all get together and we build a sort of interest association where we discuss this. That is the European Payment Council, EPC.’ Then every now and then the [European] central bank or McCreevy [Commissioner for the Internal Market at the time] tells you: ‘Now, you should hurry up, otherwise we come with a regulation.’ And then you maybe realize: ‘Oh, now there are very, very many players in the EPC.’ There is no real movement. That means, maybe they are doing good work where they agree technical standards but in essence, they cannot cut the Gordian knot. At that moment it is of course attractive for the Commission to talk, not with us, but possibly our board members and to say ‘Now, you guys have contacts to the other large banks. [...] You are the large players. How do you see all this? What should we believe of these things that we are being told? Where do you see the problems?’ And then it could possibly happen that several large banks say: ‘Well, in principle we understand where all this is going but here and there, there are simply insurmountable obstacles. But if it is really the case that either
we get a regulation or we move some, then this is how far we can go.’
And if then you can tell the Commission: ‘We have the largest twenty
players,’ or even only the ten largest players in Europe behind such a
proposal, then the chance that such an EPC will agree to such an
informally agreed thing is of course much larger. Now that is the game.
(Interview 231105, authors translation from German)

In addition to collective action problems, the overlap of commercial interests among the
members of an association such as the EBF are crucial in determining its ability to act: on the
issue of internalization—central in MiFID negotiations and discussed in more detail below—the
interests of European banks diverged (Interview 211105.b). In contrast, the EBF was effective in
generating consensus on the Market Abuse and Prospectus Directives:

Prospectus is an example. I know that going into the Council meeting
people have told me that they could see that the EBF position paper was
on the desks—not on every desk—but a whole range of governments
were using that as an element of their briefing. And you are aware that in
the prospectus directive, the whole approach completely switched
around, and that was the result of an awful lot of lobbying that was given
the parliament. Particularly on the fixed income side. The EBF, with
IPMA—lobbying from a more London perspective—put in very
substantial amendments and lobbying points. (Interview 140306.b)

The demand for EU-level private sector input has led to the creation of many new bodies
and associations that complete the supranational organization of industry interests. In contrast to
old national corporatist associations, they are either forums for consensus-finding or single-issue
associations. The European Payments Council is a good example of the former, as is the
European Banking Industry Committee (EBIC), the most encompassing trade association in EU
banking. The latter was launched in January 2004 (European Banking Industry Committee 2004)
in response to the Commission’s desire to hear from ‘the industry’ in a single voice.
Unsurprisingly, the range of issues on which there is sector-wide agreement is relatively limited;
most of its output therefore tends to be framed in rather general terms. At the same time, that
the EBIC exists at all says much about the consolidation of interest representation structures at
the European level.

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The European Securities Forum (ESF), also set up in 2004, is one of the more prominent single-issue associations in EU capital markets. It pushes for consolidation in the clearing and settlement industry (Interview 220206). The interests of the investment banks are divided on this issue; the French banks, BNP Paribas in particular, have commercial stakes in the continued fragmentation of the clearing and settlement market. The ESF thus brings together the major investment banks active in Europe save the French ones. It exemplifies the new geometry of interest representation where loyalties and shared background play less of a role than commercial interests. Rather than being channels for top-down communication, ad-hoc interest associations such as the ESF are used instrumentally by shifting alliances of market participants. They complete the spectrum of private EU-level sector associations that meet the public sector demand for policy input.

In addition to the field’s Europeanization, the second major trend in EU capital market lobbying has been the formalization of industry ties with the Commission, CESR and the EP. This mainly comes in the form of regular public consultations and fixed-membership ‘advisory groups’. The formalization of public-private relations largely reflects the desire of firms to be heard and informed at all stages of the policy process.

[T]here was a problem before because [...] it took ages to have a directive adopted and then when it had to be implemented it was already outdated. That was something that everybody recognized. And when Lamfalussy was created, we were still really supportive of that. It is a good thing to have a EU culture in supervising. By working together, they are forced to develop common interpretations, common guidelines, common advice to the Commission. I think [our bank] is one of the few lobbying offices where we really were strong in [replying to] nearly all CESR and CEBS [Committee of European Banking Supervisors] consultations. On MiFID, we have one person working on MiFID, level 2 [of the Lamfalussy process]. So CESR consultations. For CEBS consultation, we did not respond directly, we gave our input to [the EBF]. Yes, it is a lot of work but it is what we have been asking for. So

41 ESF, ‘Members’, As accessed on 19 May 2004 under http://www.eurosf.com
we have to be consistent. It is much more transparent than before. 

(Interview 211105.b)

The opportunity for input that CESR offers is indeed considerable. In 2007 it launched no less than 21 consultations, normally in the form of highly technical documents published on its website. ‘Interested parties’ were then invited to comment. As these documents are usually long, formulating appropriate responses that reflect corporate interests is a full-time job. It is thus hardly surprising that responses only come from the financial industry, non-financial issuers of securities and supervisory bodies. Nevertheless, for large investment banks with transnational operations, having CESR produce countless consultations is preferable to monitoring the proceedings of more than a dozen national regulators (Interview 070406). As one lobbyist observed, 

[The industry demand was also more consultation, more transparency. And CESR has given it to them in bucket loads. There is so much consultation. Also, the CESR members are closer to the industry than to the Commission. In that sense, the industry is quite pleased. Of course, sometimes CESR comes up with rules that are more detailed than the industry thinks are necessary. (Interview 021205.a)

The degree of detail in common rules, another industry representative found, was partially the fault of the industry itself:

So we are talking not only about the framework, but MEPs who are beleaguered by firms and lobbyists, who arrange things down to the smallest technical detail for very different motives. There are for example people who come here and complain that the Commission makes such complicated laws. On the other hand, they come here to try to get things into the directive, because they don’t want their supervisor at home to have too much leeway. They try to arrange things here in Brussels so they don’t have to arrange them in England or in Germany. (Interview 231105, authors translation from German)

For another industry representative, EU-level rule harmonization was part of the overall shift in capital market governance:

[That is the price you pay for increasing recognition. The price is everybody levels up. Now as it happens, for the big firms, it probably
doesn’t matter too much. Because they were already pretty levelled up anyway. If you give them cross-border access, that is a price they are willing to pay. This is a huge political problem for the 99 per cent of banks who are domestically active and will have to pay the price, too. You will see in the next two years a huge outcry from retail banks [...]. The stockbrokers—why should they have to do all this? They don’t trade across borders. It’s all for the price of the big firms. The other part of the deal is the Lamfalussy process. He said that there should be mutual recognition based on trust. It hasn’t so far delivered. We were in favour of mutual recognition and competition but the member states would not buy it without massive harmonization. So you get a much more detailed framework. That on the whole is working. The deal there is [...] we got the transparency. Because our only chance really was to stop the regulators stitching us up in private and imposing… So we desperately wanted public accountability and EP accountability. Some of the bizarre things you have seen in the FSAP is the industry supporting the EP which is not always very reliable. Supporting transparency in the Commission. The Commission did not like it at first. It is still slightly uncomfortable with the length of time it takes to go through this transparency process. And to be fair to CESR, Fabrice [Demarigny, secretary-general of CESR] did a great job. They really do now operate in a transparent manner—and they did not like it in the beginning.

(Interview 270206)

At the time of writing, most battles over consultation and representation have already been fought. All public bodies hold regular hearings and have their expert groups; the majority of these external ‘experts’ are industry representatives. The membership list of the European Securities Markets Expert Group (ESME), the official advisory committee to the Commission, is instructive: all of its 20 members come from financial firms (European Commission 2006b). As expertise is defined in technical terms—and the problem to be solved is nothing less than the optimization of capital markets—the Commission finds the group representative. Other formal ‘advisory groups’ to the Commission and CESR have similar compositions. For example, only one out of the 26 member of the Securities Markets Expert Group which evaluated progress in market integration and legal harmonization was not directly or indirectly an industry representative.

The influence of these groups of ‘experts’ should not be underestimated. According to
ESME, they should provide ‘technical advice [...] on issues of contemporary relevance in EU securities markets’ (European Commission 2006a). This included credit rating agencies (CRAs), in the public spotlight since the summer of 2007. In August, the Commission publicly questioned their role in the credit market crisis that spread out of the US housing market (Buck 2007). Two years earlier, however, heavy lobbying from industry had deterred the Commission from attempting to regulate CRAs (The Banker 2004). The seemingly ‘technical’ can rapidly assume highly political proportions.

On the whole, then, lobbying has come a long way since the early 1990s (Interview 070406).

Back in the days, you could go and lobby the Commission fairly directly, and that was that. Now you have to lobby CESR, the individual member states, the EP. On the one hand, you have a lot more opportunity to lobby, on the other hand, you need to do it well, there is a lot more you have to do. That is one change to ten years ago. Back then, you basically just went to the person on the Commission who was writing the directive. And you succeeded or you failed. But you knew there was one person or a couple of people dealing with this. And the parliament only advised… (Interview 021205.a)

With the multiplication of relevant actors, the frequency of interactions has increased. A lobbyist from a large US investment bank estimated that his firm talked to the Commission ‘basically every week’ (Interview 070406). Sometimes ‘Brussels’ calls on its own—something he claimed was unthinkable a decade earlier.

It brings the EU more towards the US level of legislation. More lobbying. More PR. Government relations work. The whole thing becomes much more professional. Back then it was much more informal, behind closed doors. That is gone. (Interview 021205.a)

Within the architecture of European public-private relations, the role of the European Parliament has grown over the past decade, even if the Commission still stands at the centre of Brussels lobbying (Interview 211105.b). This reflects its increased powers since the Amsterdam
Treaty. MEPs are also popular targets for lobbyists; the other EU bodies can draw on more in-house expertise than MEPs, making them susceptible to external influence:

The MEPs, their main problem is lack of resources, but they want to be seen to be active. So they are quite keen to meet people. You state the case and present your argument. It is still very much how good an argument you can come up with. You sometimes still end up with some maladroit lobbying where you have four or five MEPs putting forward exactly the same kind of amendment [to a Commission directive proposal] in the same language. (Interview 021205.a)

The more experienced parliamentarians are aware of this vulnerability (Interview 071205.a, Interview 120106.b). However, lobbyists found manipulating MEPs can quickly tarnish their reputation and forfeit their most valuable asset: access to policy-making (Interview 011205). One MEP confided that he received so many invitations to London on the back of EU efforts to curb insider trading that he stopped accepting them altogether (Interview 071205.a). There are, then, unwritten rules about how far lobbyists can go. Nevertheless, MEPs in particular remain exposed to corporate influence; their lack of expertise makes them dependent on industry ‘experts’. And given the vagueness of the overarching goals in capital market policy, the key is often to connect one’s specific proposals to those general themes:

For some [MEPs], efficiency is the main thing. The next level is that this will create jobs. For some, you will need to link it to why this is good for your constituency. And in financial markets, the arguments are fairly straightforward. Who could really be against efficiency? You would have a much harder time if you came with a protectionist view. Then you would have to spin some sort of cultural argument. That this would destroy national tradition… But even on consumer protection, some of the more far-sighted firms understand that that is in their interest. They want happy, confident consumers. Otherwise, they are not going to sell anything across borders. (Interview 021205.a)

In sum, EU-level public-private interactions are starting to approach the level of routine that they had hitherto only had in national policy communities. The establishment of new transnational trade associations, fixed-membership ‘expert’ panels and formalized consultative procedures has completed the supranationalization of EU capital market governance. This novel pattern of
governance once more matches the effective scope of many core firms’ business operations and of market structures in which a new group of market incumbents—a European ‘Champions League’—has emerged in investment banking and securities trading.

**Lamfalussy in action: Renegotiating the ISD**

The renegotiation of the ISD, which led to the Markets in Financial Instruments Directive (MiFID), is a case study of the Lamfalussy process’ implications for the governance of European capital markets. The MiFID is widely considered the most important directive for capital markets since the ISD, and probably the most important for European financial markets as a whole. Negotiations for the MiFID not only demonstrated the Lamfalussy process at work; the substantive rules contained in the directive also reflected stakeholders’ changed preferences. The previous chapter showed how the interests of most large firms had coalesced around further cross-border integration of markets and governance, even if some where more enthusiastic about new legislation than others. Once it was decided that the directive was to be rewritten, discussions immediately shifted to the content of new legislation.

The fault lines in the discussions showed how much the competitive landscape and preferences had transformed over the preceding decade. Traditional, national protectionism on the part of banks and stock exchanges played only a minor role. Within these two groups of firms, competitive struggles remained subdued. Regulated exchanges with de facto monopolies over the on-exchange trading of their home market shares posed little threat to each other. Sporadic attempts to break into each other’s markets—as the London Stock Exchange did with its offer to trade Dutch shares in 2003—invariably failed. Among the large investment banks, business models had grown sufficiently similar to make EU level regulation an ineffective tool for competitive struggle, because firms would be affected by regulatory changes in roughly similar ways.

This did not mean that competition politics had been superseded. One source of resistance to the large banks’ preference for market integration—smaller firms—were too few in
number and too ineffectively organized to mount a significant defence. As chapter 5 showed, the number of firms holding significant market share in Europe was small to begin with.

Transnational market integration further put small brokerage houses in Paris, Frankfurt and London on the defensive; many were bought up (e.g. Augar 2000 for the UK, Jabko 2006 for France). Most other EU member states had no investment banking industry to speak of. In addition, the growing divergence between the interests of large and small firms weakened national alliances; the positions of national sectoral associations often remained vague or reflected larger firms' preferences. In short, smaller firms were too weak, both economically and politically, to counter the wave of regulatory harmonization about to sweep over them. As one Commission official concluded, forging agreement on a 'true' passport was helped both by the increasingly global nature of firms in the business and the fact that fewer and fewer of them remained (Interview 141205).

The real competitive struggle in negotiating the MiFID took place between stock exchanges and investment banks over share and bond trading: where was the future of European securities business going to lie? To understand the core issue it is useful to take a step back and consider the evolution of share trading over the previous decade. Historically, bourses functioned as clubs of brokers and market makers (R. Lee 1998, Braithwaite and Drahos 2000). As owners of the exchanges, member firms invariably pocketed any profits that accrued during share trading—whether through their own fees or those charged by the stock exchange. In addition, monopolies on the trading of domestic shares limited competition for trading services: as rulers of the bourse, market incumbents could control access to the business.

Chapter 5 recounted how stock exchanges demutualized over the course of the 1990s. Brokers turned members-only clubs into for-profit firms and sold them, often by listing on the same stock market (Steil 2002a). The new businesses quickly tried to secure as large a share as possible of the revenues associated with securities trading (trading revenues, but also listing fees, clearing and settlement fees, custody fees, etc.). This surprised the investment banks. One
investment banking lobbyist argued that two decades earlier, national exchanges had been

[old boys clubs with a license to effectively print money, probably protected by law. Then, they were refusing to move with the times. They were very reluctant to set up sensible governance structures internally. They failed to get the right chief executives. And then people said ‘It can’t get much worse than it is now.’ But then, we [the investment banks] should have made sure that we had it right. [...] The banks themselves did not anticipate the speed with which the new management [of exchanges] would adopt profit-maximising instincts and apply them to their monopolistic position. (Interview 300306)

Demutualization thus gave a new competitive, political salience to the question of why securities markets should be organized around national exchanges. Investment banks felt they could perform many of their functions. For listing—effectively ‘vetting’ issuers of securities—and for clearing and settlement services, some central entity was desirable. But trading services could just as well be performed by investment banks as market makers. Trading could thus be ‘internalized’ by banks and bypass bourses altogether. It was clear that the old concentration rule would fall in renegotiating the ISD; securities trading on alternative venues would be enshrined in EU law. What remained undecided, however, was how high the bar for non-bourses would be set. Given the commercial stakes for both the stock exchanges and investment banks, ‘systemic internalization’ dominated the negotiations. A Commission official had no doubt on this point:

On MiFID, the real problem was internalization. Because it was about competition, and the competition was between stock exchanges and other forms of markets. That was really the main aspect. (Interview 141205)

The initial Commission proposal, discussed in the Forum Group on the ISD, placed the bar for systemic internalization relatively low. There had never been much doubt that trading data would eventually need to be aggregated at some central point to aid price formation and efficiency, and to allow effective supervision. The argument for market efficiency was hard to trump (cf. Jabko 2006); it was, after all, the official rationale for creating a single European capital market in the first place. Efficiency, however, said little about how information was to be
aggregated or about when such information would have to be communicated to a central authority. The details—and costs—of such ‘post-trade transparency’ were still up for grabs.

‘Pre-trade transparency’ was even thornier: the question of how systemic internalizers would ensure that their clients were receiving the best available price (Interview 021205.b). Given the enormous volume of securities traded each day, even tiny price differentials would generate significant profits for banks and, by implication, damage to their clients. At the same time, by endlessly complicating requirements to ‘shop around’ before matching two trades in-house, pre-trade transparency could be used to make systemic internalization altogether unattractive. Proposals went so far as to require brokers to tape all telephone calls with clients, which could then be used as evidence against investment banks in court.

Although the eventual rules did not include this obligation, investment banks were clearly surprised by the effectiveness of the stock exchanges in mobilizing political actors for their cause. The Federation of European Securities Exchanges (FESE) is widely credited with having played a central role. As its name suggests, it began as a ‘federation’ in the early 1990s. But its character changed over the following decade. As one investment banker observed, not without admiration:

FESE is no longer a club that has national monopolists as members.
Rather, FESE is now a political association of financial services companies which are above all competitive. (Ibid., authors translation from German)

This did not mean that FESE’s members had identical interests. Depending on their own business model and home regulatory regime (cf. R. Lee 1998), some bourses were more intimidated by the prospect of systemic internalization than others. The application of the concentration rule, which forced share trading onto exchanges, was not required under the ISD: member states were free to apply it or not. Among the larger European markets, France and Italy had put it into effect. Thus shielded from competition, the Paris Bourse and Borsa Italiana in Milan had the most to lose from internalization. For them, the MiFID had the potential to, as one exchange lobbyist put it, ‘destroy the market’ (Interview 021205.b).
in MiFID terms, there is no question that the two key jurisdictions in terms of politically lobbying from a different perspective to that of the City were France and Italy. And the other key player in the politics of MiFID was FESE. Driven not just by concerns of, say, Euronext-LIFFE or, say, Borsa Italiana, but also by Deutsche Börse’s concerns. (Interview 140306.b)

The Deutsche Börse, Germany’s central stock exchange, was already functioning in a regulatory environment that permitted off-exchange trading. Trades through alternative channels were reported directly to public oversight authorities, meaning that off-exchange business completely bypassed Deutsche Börse. Investment banks and alternative trading venues such as Instinet were its direct competitors. While the MiFID was unlikely to heighten competition, it had the potential to increase the regulatory burden on off-exchange trading, and thus bring business back to the exchange (Interview 021205.b). Deutsche Börse therefore supported stringent pre-trade and post-trade requirements and, as one stock exchange lobbyist found, it ‘could hide its own commercial interests rather well behind the investor protection argument’ (Ibid., authors translation from German).

The London Stock Exchange was different again, largely due to the regulatory regime under which it operated. A remnant of the times of self-regulation, the LSE still functioned as the central authority through which trading data was aggregated and price information was provided back to banks and other trading venues. For this it charged its clients. Because London had known no concentration rule, the LSE had shifted its primary sources of revenue towards those functions where there was less competition than for trading services (Interview 130306). As with other exchanges, the LSE was not hostile to the idea of rules that would let it keep or regain liquidity (Interview 140306.b). But getting the London bourse to join most other FESE members in opposing internalization was no easy task Interview (021205.b).

This was the competitive constellation as the Commission drafted its legislative proposal. In many respects, the Commission was on the side of the investment banks and the ‘City’ model. The introduction of pan-European competition for trading services was its goal, and this meant
abolishing the exchanges’ monopoly on the trading of securities and the tearing down of regulatory barriers. Investment banks were pleased with the early proposals. Yet national governments—particularly the French and Italian ones—together with FESE managed to tilt the Commission’s text in favour of the exchanges. In a move that saw European capital market politics at its most dramatic, the Commission amended its legislative proposal on the MiFID the night before it was sent to the Council. It once again increased the burden of pre-trade transparency, a shift that was widely seen as a nod from the Italian Commission president Romano Prodi to the interests of his home government and Borsa Italiana (Ibid.). Investment banks were astonished; the MiFID had taken a very different direction from what it had seemed at the outset (Interview 231105). As one Commission official phrased it,

> the idea of pre-trade came in last minute, just before the Commission finalized its proposal. It was actually… Some people say it was produced at the last minute. I suppose… That was not completely untrue, I would say. At some [earlier] points it was not there. (Interview 141205)

The interviewed officials working for DG Internal Market did not seem particularly happy with the last minute changes. But as ‘bureaucrats’ they had to follow the orders of politically chosen Commissioners. In this case, the ‘national’ loyalties of the Commissioners still seemed to trump commitment to the supranational project.

In the Council negotiations that followed, the banks found themselves fighting a rearguard action. The UK government still took what one representative called a ‘City view’ on the MiFID (Interview 120106.c), but with its strong pro-internalization stance, was alone among the larger member states. Whereas Deutsche Bank had bet on its contacts with policy-makers in Brussels, the Deutsche Börse relied on its connections with the national government; as mentioned earlier, it had not even set up a representative office in Brussels (Interview 240506.b). Though the German government did not take as strong a position as either the British or the French ones, it still came out in favour of pre- and post-trade transparency rules that were much more demanding than the investment banks had hoped for (Interview 231105). The big French
banks likewise had much less political capital with their national government than had been the
case a decade earlier. A lobbyist for one of the large French banks felt that the French position
on the pre-trade and post-trade issues was ‘nonsense’, based on ‘fantasy, not facts’ (Interview
160506.a). The French government, he argued, bore significant responsibility for many of the
‘bad’ things about the MiFID.

This disjuncture between large investment banks and their governments on the continent
reflects the disembodiment of national financial industries from what Hall and Soskice have called
coordinated market economies (Hall and Soskice 2001a, cf. Story and Walter 1997). While most
scholars agree that continental varieties of capitalism have not converged on an ‘Anglo-Saxon’
model (Schmidt 2002, 2003, cf. Glyn 2006), the role and positioning of their national financial
industries certainly have changed—both in Germany (Vitols 2003, 2004) and in France (cf. e.g.
Morin 2000, Clift 2004, Culpepper 2006). In both countries, the leading international banks have
increasingly concentrated on their business and left their wider economic functions behind. The
relevance of cross-shareholdings and the position of banks within them, for example, has clearly
decreased since the mid-1990s. In a situation of competition with bourses, still closely wedded to
national financial centres, investment banks could no longer count on their governments’ support
to see their positions through in EU multi-level governance.

Instead, their hopes rested with the European Parliament to demand amendments that
would soften the pre- and post-trade transparency requirements. But it took the banks some time
to organize again, as one representative of a trade association remembers:

I would say we really started working quite effectively some time at the
beginning of 2002. Already in 2001 we were starting to have meetings [...] 
different representatives of industry, banks, [EBF], all kinds of things,
together, from the end of 2001 until the directive finally got adopted [...] 
More than a year, we organized a lot of meetings with presidencies, so
each time there was a new presidency we would lobby them, we went to
the Commission together, we wrote letters together, and most
importantly of course we were able to convince the Parliament, and lots
of different groups in the Parliament, as a whole [...] that in all those key
areas the Commissions proposals had made the wrong decisions. [...] In
the end, a very good number of our suggestions ended up being proposed by the parliament. In the Parliament’s second reading and then in the end, no, in between in the revised Commission proposals, because the Commission actually withdrew its proposal and actually [came out] with a new one. (Interview 221105)

One problem the banks faced was the number of firms standing to profit from internalization: less than a dozen. Uniting the European Banking Federation behind their interests was not going to be easy. Both the French and Italian national banking associations refused to sign up to the pro-internalization line, even if the largest French banks were now in favour (Interview 140306.b). The recalcitrance of the associations restrained the EBF in the statements it could make on behalf of the European commercial banks. With hindsight, another banking lobbyist felt the inability to present a unified position was a missed opportunity:

We were too late dealing with certain conceptual aspects. Had we started hard on the best execution [a central aspect of pre-trade transparency] right at the beginning, there would have been much more of a chance to get the intermediaries largely to agree. But the design [of EU rules] had gone far too far by the time we got in. [...] We started talking seriously, with the French [associations] particularly, in 2002, 2003, but that was too late, already. But it’s a question of personalities. We wouldn’t have talked to the right person if we would have tried earlier because he wasn’t there. The French have gone through a large temperamental change in recent years. The boss of the AFEI [the French association of investment firms] has long despaired over his own government’s inward-looking, protectionist philosophy. He says, ‘We must compete, otherwise we will wither.’ But he doesn’t control the system. The Trésor, the Banque de France, the big commercial interests don’t always agree [with each other]. (Interview 300306)

The compromise that emerged from the co-decision procedure between Council and the European Parliament smoothed the rough edges of the transparency requirements. The competitive struggle between the investment banks and the exchanges ended without clear victors, even as observers were clearly impressed by the political defence the exchanges had managed to muster. In any case, as a banking analyst summarized, ‘the margin of benefit of being a systemic internalizer has been significantly eroded, it would appear’ (Interview 140306.b).
Another lobbyist for a large European bank concluded:

For us the MiFID is not really [a great business opportunity]. That is simply the way it is. For us it is, if you are really mean, we're speaking among ourselves, for us the only advantage is, that the small brokerage houses will suffer much more under the new rules and this transparency with best execution because in relation to turnover and profit the investment expenses are higher for them. (Interview 231105, translated from German by the author)

The implementing measures for the MiFID were only published in early 2006 (Buck 2006) so at the time of researching for this thesis, respondents were in no position to comment on the result. Nevertheless, almost a dozen London-based trade associations—including the London Investment Banking Association—had already launched a project called ‘MiFID Connect’ to develop industry standards for an even implementation of the new rules and to forge a consensus among firms on how MiFID provisions should be interpreted, especially in dealings between financial firms (Interview 140306,b). Where European regulators were bound to stop at the development of harmonized rules, the industry stood ready to take the baton.

The MiFID’s consequences for markets and industry structure remain uncertain. Though tough transparency requirements may have lowered banks’ profit margins in internalization, they will in all likelihood work to the advantage of the largest banks. The investments necessary to make the MiFID work are considerable, and beyond the means of many smaller firms. Nevertheless, most of the large banks have opted for caution and cooperate rather than compete in the challenge they mount to stock exchanges. The five largest brokers in Europe—bringing together more than 50 per cent of the securities brokerage market—have joined forces to set up a common trading platform, dubbed Project Turquoise (Cohen and Gangahar 2007, Tett 2007). With this members-only exchange, brokers have come full circle: having dismantled national share trading clubs in the 1990s wave of demutualization, they have reverted to the old model of user-owned exchanges—only this time on a transnational plane.
Clearing and settlement: the persistence of national competition politics

One crucial area within European capital markets has so far remained largely untouched by European regulation: clearing and settlement (C&S). Both the fragmentation of European post-trade services and the lack of competition in the domain have repeatedly been identified as a barrier to cross-border market integration (e.g. The Giovannini Group 2001, Linda Goldberg et al. 2002). Yet two competitive issues still divide the financial industry and make government agreement on EU-level action impossible: governance structures and consolidation.

The firms providing post-trade services fall under two categories: central counterparties (CCPs) and central securities depositories (CSDs) (see e.g. Cox et al. 2005). When two parties have agreed to a securities trade, for example on a stock exchange, the transaction is commonly arranged via an interlocutor, the CCP, which becomes the actual counterparty to both the seller and the buyer. One to three days normally elapse between the agreement to trade and the actual transaction; to minimize risk in this time-lag as well as to allow the ‘netting’ of buy- and sell-transactions by the same broker, all trades in a particular security are cleared through CCPs. In Europe, the biggest ones are Clearstream, owned by Deutsche Börse, and LCH.Clearnet. CSDs hold the actual securities; they keep book of their ownership and ‘deliver’ them against payment, even if the securities—the tangible pieces of paper—remain immobile in the CSD. Euroclear is the largest CSD in Europe. Finally, market participants who do not want to or cannot deal with CCPs and CSDs directly, for example pension funds, use custodian banks to take care of the payment for and delivery of securities; custodians also collect dividends on shares and perform related services. Custody services are normally provided by large banks. In Europe, the largest custodians are State Street, Bank of New York, JP Morgan and Citigroup. Coming in fifth place, BNP Paribas is by far the largest European firm providing custody services.

From the perspective of efficiency, it is suboptimal to have several CCPs and CSDs in Europe (Goldberg et al. 2002). Banks have to keep balances at all of them. More money has to change hands than would be the case if a single European CCP existed; only then would it be
possible to net for example the sale of Portuguese shares against the purchase of German ones.

In short, many observers see the fragmentation of C&S markets as a barrier to true financial market integration. Most large banks would also like to see further consolidation in the field as it would lower their post-trading expenses. The political question is whether consolidation could be forced on the sector for the sake of financial market integration.

The issue of consolidation is wedded to the second stumbling block, governance structures. Formally, most clearing houses (which often also provide settlement services) are independent from the stock exchanges they serve. For example, Euroclear handles the settlement for trades on Euronext, the stock exchange, but also the London Stock Exchange (LSE). It is largely owned by the users of its services—large banks—and neither the LSE nor Euronext can dictate the prices Euroclear charges for its services. Nor can they legally force parties trading on their systems to use Euroclear for settlement. In contrast, Deutsche Börse owns Clearstream, the company which clears and settles the shares traded on its system. Similar ‘silo’ models that integrate trading and post-trading services exist in Italy and Spain. This vertical integration of the value chain has attracted much criticism: banks and other exchanges claim that Deutsche Börse in particular uses its monopoly over the clearing and settlement of German shares to subsidize services in which it competes with other firms. Deutsche Börse’s clearing and settlement system is widely seen as the central obstacle to pan-European consolidation in the industry.

Unsurprisingly, Deutsche Börse denies the veracity and relevance of both claims (Viermetz 2006).

The Commission had been eager to see movement in this area; it saw (and sees) both the lack of consolidation and the vertical integration in some countries as impediments to financial market integration. In its first ‘issues paper’ for the Forum Group on the ISD, clearing and settlement still appeared as a separate agenda point (European Commission 1999a). In later meetings, it had been dropped (e.g. European Commission 2000). Instead, where clearing and settlement was still mentioned, the Commission emphasized it would fall outside considerations for future legislation (Ibid.: 4). As one Commission official remembers:
At one point we had a provision in the MiFID concerning C&S. In the discussion it was there. That you should have free access to C&S systems. But immediately during the debate… Because many member states said 'It is a difficult issue. It's not appropriate to deal with it simply with an article in the MiFID.' That is why what was in the MiFID disappeared. (Interview 141205)

The German government in particular remains obstinate; at the time of researching for this thesis, in 2006, it was clear it would not accept legislative action in this area (Interview 240506.a). Its position largely matches that of Deutsche Börse—never mind the welfare-enhancing prospects that experts commonly associate with consolidation in the industry.

The German government is not alone in opposing legislation. The French government is also hesitant, though this has less to do with the interests of Euronext than the commercial interests of the French banks—the largest custodians in Europe—and of BNP Paribas in particular. The fragmentation of clearing and settlement systems in Europe means that many settlement-related services are handled by custodians. In effect, the latter profit from what is for the rest an inefficient system. As recounted above, the rapport between the largest French banks and the government had been deteriorating (cf. Lalone 2005). But on this particular issue a lobbyist from a French bank with high stakes in the field reported that his bank and the Trésor had reached a 'good understanding' and that the latter had finally arrived 'at the right position'—meaning scepticism towards EU-level legal action (Interview 160506.a). Lobbyists from non-French banks also observed the influence of for example BNP Paribas on the Trésor's position (Interview 231105). Thus firms’ loyalty to either the home state or to European integration depends on the issue at hand. As another lobbyist noted, ‘[o]n the investment business [the French banks] are [European], on C&S they are not’ (Interview 021205.a).

Most investment banks of any standing in Europe are united in the European Securities Forum (ESF), a single-issue association that lobbies for more ‘efficiency’ in the clearing and settlement industry. Only the French banks are absent. BNP Paribas left the ESF in the fall of 2003 because its commercial interests as a major custodian were no longer compatible with the
goal of the abolition of barriers in the sector (Financial Times 2004). Likewise, in the post-FSAP Expert Group on Securities Markets, which gathers industry representatives to advise the Commission, there was only superficial consensus on ‘tackling’ clearing and settlement.

Everyone agrees on that. But tackled—for some people that means a directive, for others it means doing nothing and letting the ‘market’ do its work. (Interview 141205)

For the time being, the latter approach appears to be carrying the day. European bourses have, however, drawn up a voluntary code of conduct (Buck and Cohen 2006). Whether this will lead to changes in the industry is impossible to predict at the time of writing. The example of clearing and settlement shows, however, how a small number of firms—only two, in the eyes of many observers—can stall the Europeanization of an issue area if it goes against their competitive interests and if they happen to have access to powerful member state governments. Competition politics and material interests still trump the supranational push of the institutions that the Lamfalussy process created.

Conclusion: The transnational constellation in EU capital market governance

After twenty years of transformation, the dust appears to be settling. The work programme of the Financial Services Action Plan has basically been completed (European Commission 2007a) while member states are busy implementing its centre piece, the MiFID. For the coming years, the Commission has committed itself to a ‘regulatory pause’ (European Commission 2005c). Instead of making new rules, both Brussels bureaucrats and industry representatives want a shift towards improving the ‘quality’ of existing rules. A new balance has emerged between market structures and the level and scope of capital markets regulation in the EU. The emphasis on ‘improving’ regulation means much of the future work will take place on ‘level 2’ of the Lamfalussy process where implementing measures can be adapted without renegotiating entire directives. Until a wholly new directive will be negotiated to replace the MiFID, both the Council and the European Parliament will largely be excluded from the evolution of EU regulation. Instead, the Commission, CESR and the core private stakeholders—a small group of transnational financial
firms—will collectively decide the direction of further change. This is where the most radical supranationalization of policy-making lies.

The battles between member states that marked capital market negotiations, and to a lesser degree many other FSAP directives, are a thing of the past. The idea behind splitting legislation in two levels is that it can be adapted without renegotiation. The implications for the practice of Brussels policy-making is only now starting to sink in. Legislation can be adapted more rapidly. The split also means that state-market relations will become highly routinized again with the Commission, CESR and industry representatives as its nodes. Both CESR and the Commission have ‘expert’ committees composed largely of industry representatives to advise them. It will be at this level that political conflicts over capital market regulation will be borne out.

Supranationalization has not meant that competition politics have disappeared from the policy process. Far from it. Constituency interests and competing institutional attachments still demarcate the most important political fault lines and at times constitute the stumbling blocks en route to rule harmonization, as was the case in clearing and settlement. Ironically, both the struggle over systemic internalization and clearing and settlement stem from strategic decisions that banks made a decade earlier. Demutualization spilled over from the ‘economic domain’ into politics and left a strong imprint on the current EU infrastructure for securities trading. How things will now develop is impossible to predict, just as banks failed to foresee the political disadvantages that demutualization would bring years later. What does seem safe to say, however, is that a small elite group of financial firms will remain the most important actor group in determining the future evolution of both EU capital markets and the rules that govern them.
CHAPTER 9: CONCLUSION

This thesis began by asking why the governance of EU capital markets moved from the national to the supranational ‘level’ and what the broader relationship between patterns of governance and market structures was. Studying such a ‘shift’ between levels gives researchers a rare chance not only to observe governance arrangements in operation, but to witness how political, economic and social forces come together to generate new sets of institutions. Tracing the actual process of transition between the ‘international constellation’ and the ‘supranational constellation’ has thus been one of the core ambitions of this thesis.

The emphasis on process tracing is relevant as it is far from clear that the forces generating institutional change can simply inferred from contemporary governance arrangements. Chapter 2 argued the theoretical case for a ‘structuration’ perspective: the agency that effects change in economic and political structures is not reducible to these structures, even if it is clearly influenced by them. The evolution of economic and political structures is therefore non-linear and open-ended. Although broad trends are clearly visible, the conflicting imperatives of different actors and the unintended consequences of political institutions can produce outcomes that no one foresaw or, for that matter, intended quite in that way. Remaining true to political economy dynamics as they unfold in practice forecloses oversimplified models which place all the emphasis on politics in a narrow sense, or on economic dynamics—whether the focus is on national or supranational actors, on agents or structures.

This thesis has approached the supranationalization of EU capital markets governance in such a spirit. The empirical analysis has shown how political institutions structured access to the policy process while shifting market structures inspired changes in the regulatory preferences of core private actors. Member state governments functioned as political vehicles where competitive fault lines traced national borders while the European Commission acted as a catalyst to spur institutional change, providing a focal point for otherwise amorphous social forces. Factors that
were ‘dependent variables’ in one part of the causal chain became ‘independent variables’ at other stages (cf. Ikenberry 1988).

This concluding chapter returns to the questions raised at the very beginning of the thesis and spells out the answers this study has brought to light. The search for the roots of supranational governance was broken down into a range of sub-questions. We wanted to know whose preferences were most important, and why, and why these preferences changed over time. Two further questions inquired into the role of supranational bodies in cross-border integration and their autonomy vis-à-vis other private and public actors. While shedding light on the case at hand, the answers to these questions were also meant to further our general understanding of the relationship between evolving market structures and patterns of governance—one of themes that ultimately stands at the heart of political economy (Underhill 2000).

The breadth of this perspective, however, has not dulled its conclusions regarding the politics of supranational capital market governance. At their heart is a dynamic that can be called competition politics, in which political insider firms employ their institutionalized power resources to control and transform their competitive environment in line with their preferences. Firms use regulatory and institutional barriers to keep competitors out, just as they support regulatory harmonization, supranational governance and other forms of political market opening to gain market access abroad. Such competition management was clearly discernable over the two decades of EU capital market politics studied in this thesis.

Summary of findings

Around 1990, there was little support for cross-border market opening in the European capital markets industry. Some large City investment banks were in favour, particularly American ones, plus Deutsche Bank as the only supporter on the Continent. For most other firms, the cross-border market access that regulatory integration promised seemed more of a threat than an opportunity. European negotiations thus advanced market integration but left states with a reserve of discretionary protectionist rules that allowed governments to impose their own
conduct of business rules on firms operating within their jurisdictions. This result was far from accidental: it reflected the underlying competitive constellation which mainly saw national industries with their own business models pitted against each other.

Even though private interests had a decisive impact on public policy-making, the standard Stiglerian concept of ‘regulatory capture’ proved imprecise. First, Stigler points to producers’ high individual stakes in public policy as well as their more easily managed collective action problems (compared to consumers). Both points are valid. Yet they ignore how particular political interests may already be ‘built into’ the state (Lindblom 1977). This is particularly—though not exclusively—valid for banks because of their pivotal role in economic policy (Zysman 1983). To borrow Krasner’s (1984: 227) metaphor again, states are not neutral ‘cash registers’ that add up the vectors of political power and preferences. States as sets of fragmented political institutions with a diverse set of relationships with societal constituencies co-evolve with these groups that in turn use them to implement their own political interests (Skocpol 1985, Cerny 1990). In the case of economic policy, this includes the state as the codifier and enforcer of limits to inter-firm competition (Fligstein 2001). If political institutions are indeed frozen politics, then the institutions that govern competition are frozen competition politics.43

State-market relations differed considerably across the three countries at the heart of this study: Germany, France and the United Kingdom. So did their institutions regulating market structure and access. But in all three cases, financial firms were closely involved in financial sector policy-making, whether through corporatist structures, through a tight state-business nexus or through self-regulation. Political institutions allowed banks to use regulatory policy to further their economic objectives. This did not entail private actors coaxing government officials into policy positions inimical to their own convictions. More often than not, the long-established proximity between governments, banks and later stock exchanges made the public defence of private interests appear almost natural to the parties involved. Even when the lobbyists

43 I owe the ‘frozen politics’ metaphor to Brian Burgoon.
interviewed for this thesis were unambiguous about the self-interested nature of their policy positions, they still betrayed a sense of entitlement to public actors’ support.

Second, Stiglerian thinking envisions interest politics as battles between large groups of actors, primarily producers and consumers. Stigler clearly realized that group size was inversely related to effectiveness of political organization. Yet ‘regulatory capture’ theory did not envisage an insider politics in which a handful of firms—no more than two dozen in Europe—would drive political dynamics within the sector. Incumbent firms from the most important EU capital markets formed the core of the private half of the policy community while the political struggle over regulation did not involve large societal groups—producers, consumers, investors, classes, etc. The political dynamic at the heart of the supranationalization of EU capital market governance fused ‘competition management’ with insider politics.

EU capital market politics around 1990 still fit Moravcsik’s (1993, 1997) liberal model of international politics. But as this thesis has shown, the intergovernmental character of the ‘two-level game’ (Putnam 1988) did not last. The political transformation over the decade to come showed that intergovernmental politics was contingent upon the division of regulatory preferences along national borders. Whereas around 1990 many continental firms had perceived the ‘City investment banks’ as a threat, less than a decade later they had become models to emulate. The business strategies of many second-tier banks such as Dresdner Bank and Paribas (before its merger with BNP in 1999) also refocused in the direction of international investment banking. As capital markets boomed and governments listed former state-owned enterprises on national bourses, traditionally domestic-oriented banks expanded internationally, most notably through acquisitions in the City itself. As firms exploited the possibilities of the ISD, they came to perceive its limitations as obstacles to their international reorientation.

As the constituency in favour of institutional change grew, associational patterns in the industry began to change. Hitherto banks’ preferences had been aggregated largely at the national level by way of trade associations. In the course of the 1990s, numerous banks opened offices in
Brussels and began directing their political activities to the transnational level. Transnational business associations such as the European Banking Federation and the London Investment Banking Association became new focal points for lobbying activity. The European Commission emerged as the most sought after partner for the coming transformation of EU capital markets.

The role of the European Commission deserves special attention. As the most fully developed of the EU’s supranational bodies, it is the institution that neofunctionalists have most expected to emerge as a driver of integration (Haas 1958, Nugent 1995, Pollack 1998). But in the case at hand, it would be mistaken to equate the Commission’s visibility in EU integration with its capacity to propel the process forward. The Commission functioned as a catalyst by providing a focal point for societal actors who favoured further integration. While it was able to use what leeway it had to insert its own preferences into policy, it proved unable to advance integration if this contradicted the preferences of the core stakeholders in the field—the financial firms. In the first round of negotiations around 1990, the Commission tried to introduce a ‘single passport’ in line with the ambitions of the single market programme and clearly failed (Interview 030406, Interview 131206).

In the second half of the 1990s a consensus emerged in the industry that some form of supranational governance in EU capital markets would be desirable. The heavy involvement of member states thus far had allowed nationally formed political preferences to be inserted into overall policy outcomes with relative ease. At the same time, intergovernmental negotiations (even over technical details) privileged distributional battles over designing effective policy solutions for transnational market integration. Whereas large firms had relied on national governments to inject their preferences into legislation during the first round of negotiations, they now started to decry the ‘politicalisation’ of the policy field. With regulatory preferences having shifted towards market integration, they now favoured a more technical, ‘expertise’-oriented form of governance that would limit the access of small veto players to policy-making.
Even a rudimentary version of comitology procedures had not elicited agreement in the years before 1998, when it was effectively abandoned. Yet by 2000, the mood had shifted. Financial firms now emerged as the most vocal champions of ‘the Lamfalussy process’—a much more far-reaching form of comitology than what had been proposed earlier, complemented by a powerful ‘expert’ committee composed of national regulators. With minor modifications, the process suggested by the Lamfalussy committee was implemented and remains in use at the time of writing.

The Lamfalussy process replicated—but this time at the supranational level—the insider politics that had reigned in national regulatory politics. A select group of financial firms, armed with new preferences born of successful cross-border strategies, had been in close contact with supranational bodies including the Commission since before the tabling of the first Action Plan in 1998. Firms’ preferences were not invariably heeded, if only because on specific points they disagreed among themselves: some continued to favour mutual recognition whereas others preferred rule harmonization. Exchanges and investment banks were clearly at odds over the rules for systemic internalization. Yet the complaint that current levels of consultation are insufficient says more about banks’ inherited sense of entitlement to participate in public policy-making than about the frequency of interactions between private and public actors in Brussels.

What does all this imply for established theories of supranational integration? In the introduction, this thesis’ structurationist approach was summarized under the heading ‘competition politics’. In essence it is a materialist approach: the main factor first obstructing and later furthering integration was the (perceived) material interests of a relatively small group of firms. The ideational or institutional dynamics highlighted by neofunctionalism played subordinate roles. Even though these latter have their place in the developments recounted in this thesis, neither adequately explain the political struggles and outcomes we see in the field—of which clearing and settlement is only the most recent example. Firms’ interests continue to reign supreme.
The theoretical approach of this thesis also has a clear transnational component. Contemporary patterns of governance—including formal institutions—go far beyond the inter-state arrangements that continue to constitute the intellectual anchor of neoliberal intergovernmentalism (Moravcsik 1997, 1998). The societal actors that matter are organized transnationally while policy-making power is concentrated among supranational actors even more than formal flows of accountability suggest. Member state control over capital market policy has been seriously curtailed. This suggests that in the long run, institutional arrangements—including the state—reflect underlying constellations of social forces. As these forces change, so do the political institutions that channel them. Without denying the stickiness of institutions, there is nothing immutable about the state as the primary forum of preference aggregation, certainly not in a field that has seen as rapid a transformation as financial markets has over the past two to three decades.

The thesis' structuration perspective also highlights the open-ended dynamics of the political economy (cf. Cerny 2006). Actors miscalculate the results of their actions. Bankers did not foresee that by demutualizing stock exchanges, they would create fierce competitors. Second-tier banks vastly overestimated their chances in European and global investment banking; they nevertheless provided crucial political support for integration in the late 1990s when they still saw themselves as potential winners in a transnational market place. Even though this thesis draws inspiration from a variety of theoretical approaches to supranational integration, its indebtedness to the notion of structuration makes it sceptical to axiomatic assumptions about the primacy of national governments, automatisms within transnational capitalism, or the non-material drivers of supranational integration.

The second main debate to which this thesis speaks focuses on financial liberalization and market integration. What does the competition politics approach have to say about the field’s more established views on financial market liberalization? While individual theories here do not fall under clearly circumscribed headings, the competition politics approach highlights core
weaknesses that most of these approaches share in spite of their differences. Most importantly, scholarship on financial liberalization rarely has much to say about the political process by which it is effected. In the case of large-n studies that try to capture liberalization dynamics in quantitative measures (Quinn 1997, Abiad and Mody 2003), correlations between variables need not correspond to causal connections. Where rival hypotheses remain plausible in the light of available evidence, it becomes imperative to dip into the policy process to trace political change rather than only to hypothesize it. This is not to deny the value of such studies, but to point to gaps that their methodologies are incapable of filling.

The same is true of the most prominent comparative case studies in the field. They present relatively ‘thick’ descriptions of their variables, with insufficient attention to conceptualizing or even exploring empirically the connection between them. Laurence (2001) for instance has convincingly shown that British and Japanese capital markets have liberalized. His conclusion that the global rise of capital mobility was responsible for this shift, however, remains poorly substantiated. Capital mobility is not a ‘thing’ in itself—it is the result of government policy. Nowhere is it empirically demonstrated just how investors’ preferences translated into political action. Indeed, for the European case, this thesis has found that investors’ access to political goods is much weaker than is often suggested, and that the interests of political insiders—banks in this case—have been much more important. Vogel’s (1996) analysis, which highlights the importance of political and economic institutions in states’ response to globalization ‘pressures’, also falls short on this point.

Process-tracing is even more pertinent if, as this thesis has argued, financial liberalization and supranational integration have to be understood as a structuration process that cuts across the domains traditionally thought of as ‘politics’ and ‘the economy’. The symbiotic evolution of market structures, regulatory regimes, political institutions and firms’ involvement in national economic policy means that over time, these ‘variables’ are interrelated. Structuration implies that rather than seeing these facets of financial markets as rival explanations for observed change, the
challenge is to show how they are systematically integrated. From the perspective of business actors, interactions ‘in’ the market and struggles over the rules that govern these markets are two sides of the same coin.

In this change over time, this thesis has identified coalitions financial firms, allied to public actors, as the core agents of change. They have combined strong regulatory preferences with the political clout necessary to effect policy change. The political institutions that have emerged in quite distinct ‘varieties of capitalism’ all involved banks as insiders in their respective policy communities. In the past two decades of EU capital market politics, this institutional power has been used above all to manage inter-firm competition—a finding that resonates with those of Sobel (1994) and Kroszner and Strahan (1999).

Such competition politics clearly contradict notions that markets tend towards higher efficiency (Crouch and Farrell 2004). Perspectives that conceptualize markets as social spaces in which goods, services and labour are exchanged, normally against money, miss a crucial point. Markets are populated by political actors, often large organizations, which have goals that regularly defy the logic of markets as pure spaces of flows. These actors—including the state itself—use both collectively binding rules and ‘economic agency’ to attain their goals and tilt the terms of competition to their own advantage. How they do that, and how along the way they craft political institutions to solidify their grip on power, remain core questions of political economy analysis (Underhill 2006).

**Normative implications**

What are the normative implications of the changes this thesis has recounted? Put most simply, is the supranationalization of capital market governance in the EU ‘good news’? Following a distinction common in discussions of political legitimacy, the answer can be divided into two parts: the input legitimacy of the new governance arrangements—the chances they offer to shape policy in line with the ‘authentic preferences’ of the governed—and their output legitimacy—the impact they have on the attainment of consensual policy goals (Scharpf 1999: 6).
Let us deal with the output side first. The official raison d’être of the whole single market programme was to boost economic growth and thus employment (European Commission 1985, Cecchini 1988). Financial services also fell under this banner (European Commission 1988a, 1988b). In economic theory, such an effect of market integration is plausible. The classical political economists had already pointed to the welfare-enhancing potential of cross-border market integration—even if this says little about the eventual distribution of the spoils. The empirical evidence on the welfare-enhancing effects of EU financial market integration, however, is thin on the ground. Methodological problems clearly complicate reaching unambiguous conclusions. Nevertheless, the studies that exist already see it as a major success if they can trace increases in financial market integration to legislative change (European Commission 2003, 2005a). The impact all this has on welfare in the EU remains a matter of informed speculation. To say the least, evidence from the US raises doubts about whether an expansion of the financial services sector is not a sign of the redistribution of welfare rather than its overall increase (Krippner 2005). It is far from obvious that the supranationalization of EU capital market governance has generated societal economic benefits that would justify the whole enterprise.

The impact of supranational governance on other goals of financial market policy is equally ambiguous. On the one hand, intense supranational cooperation seems to have given regulators and supervisors tools that allow them to monitor cross-border activity more effectively than had earlier been the case. On the other hand, as this thesis has shown, such cooperation among regulators has been integral to the political project of transnational market integration itself. The net effect of the transition from the international to the supranational constellation for the public oversight of financial markets thus remains doubtful. Again, the problems that have emerged within European banks since the summer of 2007 at least show that regulatory cooperation has far from solved supervisory problems. The new freedoms that banks have are at least partially responsible for the mess we are now in. And the cost is high and rising.

What supranational governance has certainly done, however, is to formalize a
disembedding of capital market policy from national economic policy as a whole. The leeway that national governments have to coordinate capital market policy with other policy domains has shrunk drastically (cf. Jayasuriya 2001). To the degree that such positive coordination was integral to the functioning of historically successful social or industrial policy in coordinated market economies such as Germany or France, supranational capital market governance may have spurred their transformation (cf. Schmidt 2002). At the same time, it would be wrong to attribute a properly causal role to supranational governance itself. The latter has been a correlate of the reorientation of preferences and strategies among the largest European banks, as firms such as Deutsche Bank and BNP Paribas opted out of the tight embrace with their home governments (e.g. Deeg 2001, Culpepper 2006). Nevertheless, to the degree that the new mode of governance institutionalizes a ‘negative coordination’ of policies (Jayasuriya 2001), it limits the options governments have to respond to the political demands of their citizens.

In this way, the supranationalization of EU capital market governance erodes ‘input legitimacy’, as well. Collective policy-making and the institutionalization of a particular, technocratic vision of capital markets limits governments’ ability to manage the ‘externalities’ capital market policy generates—its effects on employment, the availability of credit throughout society, states’ (in)ability to tax particular kinds of capital income, etc. Over the past two decades, a specific version of the ‘public good’ that this policy is supposed to produce has been enshrined in rules and institutions: capital market policy is meant to ensure market stability, support economic growth and protect the users of financial services. Societal preferences that focus on other aspects are hard, if not impossible, to inject into public policy in this field.

The removal of capital market policy from effective democratic control aggravates this trend. By definition, the rise of supranational governance has decreased the leeway of national governments. As chapter 7 argued, this process has gone further in practice than formal flows of accountability suggest. The European Securities Committee, for example, is unlikely to function as an effective bulwark against policy that contradicts nationally formed preferences. What is
more, on the national level political influence has shifted away from parliaments towards
executives. National parliaments still have to ‘implement’ EU-level decisions. But the whole
Lamfalussy process is designed to minimize the scope left to them to adapt supranational rules to
national imperatives, whatever their origin. Certainly on the national level, the democratic deficit
has increased.

The complexity of EU capital market policy—both in substantive and procedural
terms—makes it all but impenetrable for ordinary citizens. Existing consultation mechanisms
provided by the Commission or CESR do little to change this; they are de facto heavily tilted in favou
of industry representatives. Hopes for a broader democratic legitimization of policy
therefore rest on the European Parliament. The EP, however, faces a number of limitations. In
addition to its circumscribed role in policy-making, its capacity to process available information is
limited; the EP has cognitive limits. Capital markets are but a small part of what the EP’s
Economic and Monetary Affairs Committee (ECON) deals with, while MEPs typically have no
more than two or three assistants to supply them with expertise and background information
across all the fields they cover. MEPs are thus at a serious disadvantage to other public actors
such as the Commission, the securities regulators or national finance ministries.

This lack of resources makes MEPs susceptible to lobbying in a way that is beyond their
control. The technicality of the issue area can make it impossible for MEPs to draw a clear line
between expertise that aids the implementation of their policy preferences and self-interested
lobbying. The current practice in the EP is to collectively ostracize lobbyists if it emerges that
they have abused the trust of MEPs (Interview 011205). This may partially alleviate the problem
but it is as much a sign of MEPs’ dependence on others as anything else.

On the whole, then, the supranationalization of capital market governance exhibits
serious legitimacy deficits: most fundamentally, it has institutionalized a particular vision of
legitimate policy goals without installing mechanisms that would allow EU citizens to discover
their own policy preferences, let alone inject them into the policy process. The lack of concern
this raises among members of the established policy community now focused on ‘Brussels’ is as
good a sign of this democratic deficit as any.

Implications for future research

This study points in two directions for future research: a ‘vertical’ extension of the research to
include the ‘global’ level of governance in capital markets and a ‘horizontal’ extension to include
other economic sectors, both financial and non-financial. Both could function as ‘tests’ of the
external validity of the analysis presented here. Alongside potential generalizations, they should
also allow further refinement of the overall argument and a more fine-grained assessment of its
ingredients’ relative importance. This final section will consider the ‘vertical’ and ‘horizontal’
extensions in turn.

There is no reason why the dynamic that this thesis has identified as underlying the
emergence of supranational governance should be limited to the European Union. In line with
regional integration theory more generally, the demand for economic governance beyond the
nation state is seen here as a function of the transnational integration of market structures or,
more precisely, of industry structures (Mattli 1999). The globalization of business strategies
should generate calls for cross-border integration of market spaces by leading firms—a claim that
is hardly disputed in International Political Economy. Such integration could take a variety of
forms, ranging from simple market access abroad via mutual recognition of home country rules
to transnational rule harmonization.

The added value of the competition politics approach is that it identifies those factors
that push cross-border market integration and associated patterns of governance. For the case of
financial services, with which we remain for the moment, it was argued that the regulatory
preferences of national market incumbents—the firms dominating the domestic market
segment—loom large in government policy and thus the structuration of markets and their
governance. The central role of financial institutions in national economies and their privileged
access to public policy is not limited to Europe. The same phenomenon is well-documented in
the (formerly) developmental states of East and South East Asia (Haggard et al. 1993) and in the US. The question therefore is: when would firms’ demand for access abroad translate into mutual market opening through regulatory means?

For an answer, this thesis points to the structure of competition in the relevant sector. We would expect mutual market opening once the most important firms no longer compete with each other on the basis of their provenance, and a transnational ‘conception of control’ (Fligstein 2001) has emerged among them instead. That is, a new group of transnational market incumbents must have evolved for which regulatory barriers are no longer a means for managing competition but obstacles to further expansion, particularly at the expense of smaller firms that continue to thrive in national market niches. If former national incumbents have either developed such a business perspective or have lost their economic significance, so the implication of the competition politics approach, we can expect united calls for the demolition of regulatory barriers and, in more radical cases, integrated institutions for market governance.

In the field of transatlantic investment banking and capital markets, there is strong evidence that just this is happening (Mügge 2006). The largest global investment banks operate from two hubs—Wall Street and the City—regardless of their ‘national background’. Globally, less than a dozen banks dominate the business, and apart from Deutsche Bank, UBS and Credit Suisse, all have an American background. Exchanges have also strengthened their transatlantic ties. The New York Stock Exchange took over Euronext in 2006 while NASDAQ made serious overtures to the London Stock Exchange the following year. For these firms, the regulatory barriers that still exist between the United States and the European Union are no longer competitive assets but a hindrance to the seamless integration of operations in their two most important markets. The competition politics approach suggests that the next steps towards integrated market governance will emerge along the Washington-Brussels axis.

Preliminary evidence supports this intuition. Whereas the SEC has long been loath to coordinate regulatory policy with authorities abroad (cf. Simmons 2001), it has recently begun to
make concessions to EU demands in the name of transatlantic convergence, for example in the field of accounting standards (Jopson 2007). CESR has entered negotiations with the Commodities and Futures Trading Commission, the US derivatives regulator, about facilitating transatlantic market access (Commodities and Futures Trading Commission 2005). And with most of the legislative work from the FSAP completed, one of the key areas for future work identified by the Commission in its 2005-2010 White Paper is the ‘external dimension’, with particular attention to the EU-US regulatory dialogue (European Commission 2005b, Interview 091205.b). Exploring the external role of the supranational bodies charged with policy-making in EU capital markets would not only complete the picture of public policy dynamics in the field, but would also allow a further testing and refinement of the hypotheses that underlie the competition politics approach in the first place.

The potential to refine the approach is even greater in a ‘horizontal extension’ of this study: comparing political dynamics in adjacent financial sectors as well as in wholly unrelated ones. A systematic comparison of banking proper, securities markets, insurance services and asset management—the four main categories into which financial services are divided in EU policy—would allow a much more fine-grained assessment of the importance and precise role of the different ‘variables’ that are relevant in overall market structuration. For example, what impact do non-regulatory barriers to competition, such as ‘cultural’ differences in retail banking, have on integration politics? Is there variation in associational patterns that accounts for differences between policy fields? Has it mattered that, on the whole, insurance companies are less close to governments and hence less able to tilt public policy in their own interest? And does the adoption of Lamfalussy-like arrangements for banking and insurance suggest institutional emulation as an independent force in the supranationalization of governance? Or have these other sectors simply reached a degree of industry transnationalization that made them ‘ripe’ for institutions similar to those in securities markets? A comparative study would allow insights into the functioning of these and numerous other variables and dynamics.
To be sure, there is no reason why such research should be limited to financial markets. At first sight, what makes financial firms 'special' compared to non-financial ones is their proximity to governments. It is far from implausible, however, that firms in other sectors may wield considerable influence over regulatory policy, particularly in sectors dominated by oligopolies or where states were previously dominant—utilities, telecoms, airlines, defence, etc. Indeed, with regard to interstate trade, the literature underscoring this point is abundant.

In any case, an extension of the approach suggested in this thesis, both vertically and horizontally, generates a research programme that links the abstract notion of structuration in political economy with a clear yardstick for empirical investigation. And systematic comparisons between cases, across 'levels' of governance and over time create an inferential leverage that promises to make further contributions to our understanding of how political economies evolve.
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List of interviews

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**Appendix D: Overview of the International Expansion of EU Banks (Continued on Next Page)**
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*Note: Cross-price expression is defined as the ratio of the price of one good to the price of another good.*

*Presentation of GSP exemption rates as of 1987 and 1998, and the increase in basis for 2001 increase in cross-price expression are both factors in determining the eligibility for GSP benefits.*
Summary

Financial markets occupy a central place in national economies around the globe. The money flows that they intermediate and the credit that they provide for business, households and the state are indispensable for economic development. Financial markets, in short, provide the lifeblood of economies, and governments have jealously guarded policymaking in this domain for this reason.

National control over financial markets has not only been a tool for the prevention of crisis and other undesirable excesses, however. It has also allowed governments to tailor financial market policy, and thus markets themselves, to the particular needs of the national economy in question. As countries’ economies evolved in different directions and their national ‘varieties of capitalism’ gained an ever sharper profile, national sovereignty over financial markets proved a crucial asset. For example, Germany could strengthen and fine-tune its bank-based financial system whereas the UK and the US developed, extended and refined their capital markets that seemed to serve these economies’ needs so well.

Given this centrality of financial markets to national economic policy, one should assume that governments are loath to ceding control over them. However, that is precisely what has happened in the European Union over the past 20 years. Not only have more than a dozen countries adopted a common currency and given up national monetary policy. Also financial regulation, fundamental to the reproduction of national ‘brands’ of financial markets, has progressively been transferred to the supranational level. Nowadays, such regulation is no longer designed in national capitals but in Brussels, even if national authorities still play an important role in the process.

Capital markets—as opposed to banking or insurance—have spearheaded this process. In the early 1990s attempts to integrate the market for investment services, as this sector is called in Brussels jargon, still met with serious resistance from national governments. Only with great
difficulty could they agree a framework for common rules, ostensibly meant to facilitate cross-border market access. In fact the Investment Services Directive (ISD), as the 1993 agreement was called, was replete with loopholes that allowed governments to remain in charge and control national financial regulation. A decade later, the situation had changed completely. By then, a successor agreement to the ISD had been negotiated, the Markets in Financial Instruments Directive (MiFID). Instead of the loose framework agreement that the ISD had constituted, the MiFID has harmonized EU capital market rules down to little details. National room for manoeuvre to twist regulation to governments’ own preferences has been minimized. With the MiFID, EU capital markets are effectively regulated by one single set of binding rules.

Even more striking, policymaking itself has been supranationalised. With a new procedure known as the Lamfalussy process two new supranational committees have been created that play significant roles in EU capital market governance. The roles of the European Commission and the European Parliament have equally been strengthened. In contrast, the power of national governments in this field has decreased. National parliaments in particular no longer have much say over financial market policy.

It is this emergence of supranational governance in EU capital markets that stands at the heart of this thesis and that it seeks to explain. This thesis argues that commonplace explanations for the growing role of the EU in economic affairs—alleged ‘globalization pressures’, a concern of governments for their citizens’ greater good or the policy entrepreneurialism of the European Commission—all fail to account this shift in governance. Rather, it demonstrates how the interests of the main actors in capital markets, mostly large banks themselves, have been central to the way these markets have evolved. As insiders in small and closed policy-making circles, the largest national banks have been able to inject their preferences into government policies. In the early 1990s negotiations, the net result was a shallow compromise that prevented easy cross-border access for capital market firms. In contrast, a decade later governments approved rules
that effectively allow banks, investment banks and stock exchanges to offer their services freely throughout the EU.

In this thesis, the dynamic underlying this shift is labelled ‘competition politics’. As is true for most firms, the regulatory preferences of banks and other firms in financial services emerge out of their concern with taming (potential) competition. As Adam Smith famously put it in his 1776 Wealth of Nations: ‘To widen the market and narrow the competition, is always in the interest of the dealers.’ In the early 1990s, even most large continental banks were wary of competition from the City of London and hence obstructed rules that would have given banks extensive cross-border market access. A decade later, the mood in the industry had changed drastically. By then, a new European ‘champions league’ of firms had emerged, including the likes of ABN Amro, Deutsche Bank and BNP Paribas, which were eager to break into international investment banking and hence in favour of market integration just as much as their London counterparts.

This emerging consensus in the industry itself, so the argument of this thesis, has been central to the changes that have led to the supranational governance that prevails in European capital markets today. The overall process, spanning two decades and cutting right across the domains often labelled ‘economics’ and ‘politics’ was thus driven by the two potentially contradictory firm imperatives that Smith identified: widen the market, and narrow the competition.

This central conceptual argument points to at least two further conclusions, one more abstract, the other more concrete. First, it illustrates how treating political economy processes as one integrated whole is essential to understanding them. The politics of European capital market regulation demonstrate that what happens ‘in’ markets—firms innovating and competing with each other—and what happens ‘outside’ of them—the design of and fights over the regulation that structures markets and market access—are two sides of the same coin. Because of the high stakes that firms have ‘in’ markets, they invest more than any other societal stakeholder to
influence the rules that structure them. After all, the thousands of lobbyists stationed in Brussels are there for a reason.

Second, by putting the politics back into the emergence of EU capital market governance, this thesis opens the space for a critical normative assessment of the shift that the past two decades have seen. To say the least, the global credit crisis that continues to engulf global financial markets at the time of writing and that has precipitated the first European economic contraction in almost a decade is a stern warning sign. It should temper a naïve endorsement of ever-increasing reliance on cross-border capital markets and firms’ own preferences as yardsticks for policy. The ultimate consequences of a unified EU capital market policy for national varieties of capitalism and the social compromises they embody remains to be seen. It is difficult to justify, however, that national parliaments as the most developed form of citizen representation have been marginalized to such an extent as they have. The findings of this thesis clearly evidence that the time is ripe for a public debate that explores how financial market policy and democratic deliberation can once again be meaningfully united.
SAMENVATTING

Wereldwijd staan financiële markten centraal in nationale economieën. Geld dat via financiële markten vloeit en kredieten waarmee zij het zakenleven, huishoudens en de staat voorzien, zijn onontbeerlijk voor economische ontwikkeling. Met andere woorden, financiële markten, zijn het kloppende hart van economieën. Om deze reden zijn overheden waakzaam om de controle over dit niet te verliezen.

Nationale controle over financiële markten is niet louter een instrument om economische crisissen te voorkomen; het is ook een middel om financieel marktbeleid, en dus de markt zelf, te vormen naar de behoeften van de nationale economie in kwestie. Omdat nationale economieën van landen zich verschillend ontwikkelden en nationale ‘varieties of capitalism’ zich steeds scherp aftekenden, was nationale soevereiniteit van financiële markten cruciaal geworden. Duitsland bijvoorbeeld, kon zijn op banken gebaseerde financiële systeem versterken, terwijl Groot-Brittannië en de Verenigde Staten hun kapitaalmarkten uittrekkend.

Gegeven de centraliteit van financiële markten voor nationaal economisch beleid, lijkt het aannemelijk dat overheden de controle hierover niet gauw weggeven. Echter is dit exact wat zich in de Europese Unie heeft voorgedaan de afgelopen 20 jaar. Niet alleen is de euro ingevoerd en hebben tientallen landen nationaal monetair beleid opgegeven. Ook financiële regulerings, fundamenteel voor de reproductie van het nationale signatuur van financiële markten, is verschoven naar het supranationale niveau. Vandaag de dag worden financiële markten gereguleerd in Brussel.

Kapitaalmarkten — eerder dan het bankwezen of verzekeringen—hebben dit proces bespoedigd. Begin jaren negentig verzetten nationale overheden zich hevig tegen pogingen in Brussel om nationale markten in investeringsdiensten te integreren. Met moeite konden Europese lidstaten instemmen met een raamwerk voor gemeenschappelijke regels, met als doel om
grensoverschrijdende toegang tot de markt te faciliteren. In feite konden overheden via de achterdure controle blijven uitoefenen op nationaal financieel marktleider na de implementatie van de Richtlijn Beleggingsdiensten (Investment Services Directive - ISD), zoals die in 1993 werd genoemd. Tien jaar later was deze situatie radicaal veranderd; de ISD werd opgevolgd door de Markets in Financial Instruments Directive (MiFID). In tegenstelling tot het losse raamwerk van de ISD, heeft de MiFID de regulering van Europese kapitaalmarkten geïnstitutionaliseerd en tot in detail uiteengezet. Hiermee werd de speelruimte voor nationale overheden om de regelgeving naar eigen hand te zetten geminaliseerd. Met de installatie van de MiFID werden Europese kapitaalmarkten effectief gereguleerd door één pakket van bindende regels.

Opmerkingswaardiger is dat beleidsvorming zelf ook is verschoven naar het supranationale niveau. Via een nieuwe procedure, de Lamfalussy structuur, werden twee supranationale comités opgericht die een bepalende rol spelen in het bestuur van kapitaalmarkten in Europa. De taken van zowel de Europese Commissie en het Europese Parlement werden uitgebreid, terwijl de macht van nationale overheden op dit gebied juist werd ingedamd. Nationale overheden en met name het parlement hebben amper invloed meer op het financieel marktleider.

In deze dissertatie staat de supranationalisering van financieel marktleider in Europa centraal. Deze studie stelt dat gangbare verklaringen voor de groeiende invloed van de Europese Unie op economisch vlak, zoals toenemende globalisering, overheden die de welvaart van burgers waarborgen of het voortvarende beleid van de Europese Commissie, deze veranderingen niet kunnen verklaren. Dit onderzoek toont aan hoe de interesses van de centrale spelers op kapitaalmarkten, in het bijzonder grote banken, ook een doorslaggevende invloed hebben op de ontwikkeling van kapitaalmarkten. Het beleid van nationale overheden weerspiegeld de voorkeuren van de grootste nationale banken. De Europese onderhandelingen van begin jaren negentig slaagden er niet in, de barrières voor grensoverschrijdende handelingen van nationale
financiële bedrijven te verlagen. Tien jaar later implementeerden Europese overheden
daarentegen regels die banken, financieringsmaatschappijen en effectenbeurzen in staat stelden
hun diensten vrij aan te bieden dwars door Europa.

Het dynamische karakter van de supranationalisering van Europees kapitaal marktbeleid
wordt in deze dissertatie ‘competition politics’ genoemd. Banken en andere financiële bedrijven
trachten de invloed op financiële regelgeving van andere belanghebbenden te beperken. Adam
Smith verwoordde dit proces treffend in *Wealth of Nations* in 1776: ‘To widen the market and to
narrow the competition, is always in the interest of the dealers.’ Begin jaren negentig zagen zelfs
de grootste banken op het Europese continent in de ‘City of London’ een concurrent en
streden regels die banken ruimschoots toegang gaven tot grensoverschrijdende dienstverlening.
Nog geen tien jaar later veranderde dit drastisch. Er had zich een nieuwe Europese ‘champions
league’ ontwikkeld. Banken zoals ABN Amro, Deutsche Bank en BNP Paribas, wilden gretig
deelnemen aan het internationale zakenbankieren, waardoor marktintegratie van even groot
belang werd als dat was voor hun concurrenten in Londen.

De groeiende consensus in de financiële industrie, aldus de stelling van deze dissertatie, is
een centrale verklaring voor de veranderingen die hebben geleid tot het supranationale bestuur
dat Europese kapitaalmarkten vandaag domineert. Dit totale proces werd dus gedreven door op
het eerste gezicht twee tegenstrijdige economische imperativen die Smith identificeerde: widen
the market, and narrow the competition.

Deze dissertatie laat dan ook zien dat politiek economische processen als een geïntegreerd
geheel bestudeerd dienen te worden om ze te kunnen begrijpen. De politiek van de regulering
van de Europese kapitaalmarkt toont aan dat wat zich binnen markten afspeelt, zoals innovatie en
competitie tussen bedrijven, en wat er buiten hun gebeurt, zoals de ontwikkelingen van en de
conflicten over regulering, twee kanten van dezelfde medaille zijn. Door het grote belang dat
bedrijven hebben in financiële markten zijn de investeringen om de regels die de markten
structuren hoog. Immers, de duizenden lobbyisten in Brussel zijn daar gestationeerd met een reden.

Daarnaast openen deze conclusies de ruimte voor een kritisch normatief debat over de verschuiving in beleid en bestuur dat deze studie analyseert. De huidige globale krediet crisis die financiële markten op het moment van schrijven beheerst en die de eerste Europese economische krimp sinds tien jaar veroorzaakt is een alarmerend teken. Deze crisis tempert het naïeve vertrouwen op grensoverschrijdende kapitaalmarkten en de eigen voorkeuren van bedrijven als maatstaf voor beleid. De consequentie van een verenigd Europees kapitaal marktbeleid voor uiteenlopende nationale kapitalistische systemen en inherent de sociale compromis is een open vraag. Maar het is moeilijk te verantwoorden dat nationale parlementen als de meest geavanceerde vorm van volksvertegenwoordiging dermate gemarginaliseerd zijn. De bevindingen van deze studie bewijzen dat de tijd rijp is voor een publiek debat dat verkent hoe financieel marktbeleid en democratische deliberatie weer kunnen verenigd.