Reordering the market place: Competition politics in European finance

Daniel Mügge, ASSR, University of Amsterdam

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ABSTRACT

Over the last 15 years, Europe has seen the *liberalization* of national financial markets as well as the *integration* of these markets and their governance through the introduction of the 'Lamfalussy process'. This paper argues that we can best understand these shifts as one integrated project of market-building in Europe, guided by distributional struggles over the terms of mutual markets access.

To comprehend the complex linkage between private and public actors across 'levels' of governance, we have to look beyond macro-theories of integration and financial liberalization upholding an analytical state-market dichotomy and adopt an integrative approach to theory, instead. Using the example of securities markets, this paper argues that what I call 'competition politics' are key to understanding European financial market integration.

Keywords: European integration, single European market, multi-level governance, financial markets, investment banking, regulation, strategic trade theory, protectionism, policy communities.

Address for correspondence:
Daniel Mügge
Amsterdam School for Social science Research (ASSR)
University of Amsterdam
Kloveniersburgwal 48
1012 CX Amsterdam
The Netherlands
d.k.muegge@uva.nl

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INTRODUCTION[1]

Proponents of a single European market recognized early on that finance – the life-blood of developed economies – would be central to the project (Leyshon and Thrift, 1997). At the same time, agreeing on common rules affecting the core of states' economic regulation was bound to be thorny. Negotiating a single securities market around 1990 formed part of a 'battle of the systems' in European finance (Story and Walter, 1997), and recalcitrant governments barely agreed on a lowest common denominator (Steil, 1993). Continental European financial markets remained relatively closed, domestic regulatory systems were largely left in place, and nation-level institutions asserted their control on regulation.

15 years later, EU financial market governance looks strikingly different. Markets have been liberalized, European rules harmonized, and governance integrated supranationally. First, the *substance* of regulation has shifted in a market-opening, 'pro-competitive' direction (see e.g. Lütz, 2002). Insider trading rules have increased market transparency, price cartels have been dismantled, and foreign access facilitated. Second, in the *scope* of regulation, pro-active pan-European harmonization has been substituted for 'mutual recognition' of nationally idiosyncratic rules. The Financial Services Action Plan (FSAP), tabled by the European Commission in 1999, marks this shift. Third, the formal and informal *institutions* for devising regulation have been Europeanised. In 2001, the European Council adopted the 'Lamfalussy process' which gives the new Committee of European Securities Regulators (CESR) and the European Commission more power, whereas through the European Council national governments now play a reduced role.

How should we understand these shifts in European securities markets – market liberalization, rule harmonization, and integration of governance?[2] Are they connected, and if yes, how so? Are they motivated by public actors' pursuit of policy goals? What role do supranational or transnational private actors play? Are governance changes driven by inter-state rivalry, efficiency gains through European integration, or globalisation?

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[2] In European politics, markets for securities and investment banking services have been treated as one policy field. They will be treated similarly here.

Central argument

This article challenges readings of financial liberalization which emphasize structural 'globalisation' pressures (e.g. Laurence, 2001) as well as state-centric understandings of European integration (e.g. Moravcsik, 1998). Such perspectives misconceive the forces driving and limiting change. They ignore how market liberalisation and governance integration are two sides of the same political project: the creation of an integrated European financial market, primarily to the benefit of a new European 'champions league' of financial services providers. At the centre of European financial market politics over the last twenty years lies a struggle over the shape of and firms' access to markets – fought through conflicts over substance and scope of financial regulation, and the policy process behind it.

In May 2005, the head of the International Securities Markets Association, a powerful lobbying body, told a conference that 'a small group of bulge bracket firms' would take 'the lion's share of [European] business' once adopted European legislation was implemented (quoted in *Financial Times fund management* [*FTfm*], 2005). Medium-sized firms, in contrast, would be the big losers as the industry consolidated. This article argues that these intra-industry dynamics are not a accidental by-product of integration and liberalisation, but stand at their very heart.

Several basic insights elucidate the basis of this struggle. First, wholesale financial markets are a far cry from the Smithonian ideal of 'atomised' markets where myriad buyers and sellers meet for one-off transactions. A handful of financial services providers (often less than ten) control the national market in just about every developed country (*The Economist*, 2005). The same is true on a global scale.[3] Second, regulation – delimiting who can do what where under which conditions – defines the terms of competition for these firms. As financial services providers (FSPs) struggle for market share, price competition plays a subordinated role (Augar, 2005). Conflicts over rules defining the terms of market access, capital reserves, accounting procedures, disclosure practices, etc. are much more important. Hardly surprising, FSPs often successfully invest in tilting rules in their own favour. Third, because rules matter

[3] Cf. the 'league tables' published by Thomson Financial. For each of the five categories covered in its September 2003 publication on global capital markets (global equity and bond underwriting, global loans, etc.), the top 10 firms had a combined market share of more than 60% (in some categories more than 80%). In terms of disclosed fees for such deals, the share of top ten firms was more than 65% of the industry total. See Thomson Financial, *Slip and fall*, Press release (New York, 2003).

so much to FSPs, the latter have great stakes in financial markets' governance arrangements – the institutions through which rules are designed in the first place.

In a nutshell, the most fruitful way of looking at European financial market governance is through the lens of inter-firm 'competition politics'. Not to be confused with competition *policies* that allegedly benefit consumers, competition *politics* refers to politics' being dominated by services providers' worrying about their position 'in the market place' compared to (potential) competitors. Such competition politics are central for both regulatory content and policy making institutions.

More fundamentally, this case illustrates how 'states' and 'markets' form a larger integrated whole – what Underhill (2003) has called the state-market condominium. Rules that create and shape 'the marketplace' are structured by the political institutions through which they are made. The way actors' interests are affected by these rules not only feeds back into policy making itself (e.g. through lobbying), but may translate into pressure for institutional change (e.g. relocation or integration of policy making). Changes in political institutions become a function of the dynamics unleashed by the rules that have been created through these institutions in the first place. To the degree that this feedback loop is not random but has systematic properties, understanding regulation, institutional change, and dynamics 'in the marketplace' isolated from each other is bound to miss the deeper nature of regulatory politics.

Structure of the article

The remainder of this article comes in two parts. The first one shows why existing (isolated) approaches to liberalization and integration are insufficient, and suggests a conceptual argument and framework for analyzing European competition politics that integrates hitherto distinct strands of literature: European integration and governance, theories of financial liberalisation, business regulation, policy processes, and IPE literature on (strategic) trade policy.

The second half applies this framework to European securities markets and shows its logic at work. Following competition politics from roughly 1990 to the present it illustrates how the different dimensions of state-market condominiums are systematically linked – market shapes, firms preferences, structures of the local industry, regulatory policy and institutions,

national stances vis-à-vis integration and liberalization, and the strengthening of the supra- and transnational layer in policy making. For the national level, the focus lies on Germany, France and the UK. These countries have not only dominated financial markets and the negotiations, but also represent three distinct financial system traditions (Zysman, 1983), making them interesting cases. This article draws on primary sources (newspaper articles, policy documents and more than 40 interviews with experts and officials), but also calls for a re-appraisal of much evidence presented in existing secondary literature.[4]

THE PUZZLING LIBERALIZATION-INTEGRATION NEXUS

Both the liberalization of financial markets and European integration are established fields of inquiry, but applying their theories to European financial markets leaves important questions unanswered: Why have governments and financial industries resisted cross-border market integration in the early 1990s but embraced it since the end of that decade? And why have governments recently agreed to devolve discretion over financial market policy to EU-level bodies where they refused to do so years earlier?

Financial market liberalization

Following Sobel's (1994) distinction, political arguments about financial liberalization either see 'international pressures' forcing change on domestic settings (outside-in explanations), or highlight national idiosyncrasies in regulatory reform, with external impulses playing a secondary role (inside-out explanations).

One of the most sophisticated 'outside-in' treatments has attributed widespread liberalization to loosened capital controls (Laurence, 2001). Mobile capital 'arbitrages' between jurisdictions and unleashes 'regulatory competition' (Esty and Geradin, 2001). Legislators adjust regulatory burdens to increase domestic investment, and 'best practice' emerges, reflecting the preferences of 'financial capital' –increased competition among their providers. Empirical evidence of regulatory competition in financial services has been mixed, however (Hertig, 2001). Timing and content of market reforms were too disparate – even if going in a similar direction – to be reducible to a single global force. Investment banking as an industry has not lost out to the (now mobile) consumers of its services, but posts record profits (Augar, 2005). And at strategically important points – Germany's stance vis-à-vis takeover rules is an

[4] For reasons of confidentiality and legibility, the interviews are not individually referenced in the text.

example – governments continue to resist a pro-investor logic. In short, explanations emphasizing structural developments (capital mobility, technological change) fail to account for observable variation.

'Inside-out' accounts highlight domestic factors in regulatory reform (Moran, 1991; Sobel, 1994; Coleman, 1996). For idiosyncratic reasons, Vogel (1996) has argued, governments *enforced* 'freer markets' through 'more rules'. While 'interventionist' states have 'strategically reinforced' their grip on national industries, Anglo-Saxon *laissez-faire* economies have travelled down further the pro-competitive road. National reform was best explained by historical policy making trajectories.

Sobel (1994) has cautioned against such generalizations. For him, financial firms' competition for market share is the central dynamic behind regulatory change. Regulation 'creates' – and structures – markets. It defines the terms of competition, and underpins a stable population of market 'incumbents' that are hard to 'challenge'. Once the equilibrium between regulation and market structure is disturbed, market challengers will try to 'pry open' markets using regulatory reform. In Sobel's accounts of British, American and Japanese financial liberalization, large commercial banks used market 'crises' to enter the profitable investment business they had hitherto been excluded from.

In contrast to other views, an alleged *inherent* conflict of interest between market participants and government actors – between 'states' and 'markets' – plays no important role here. Indeed, a long tradition of scholarship has found producer interests to play a major role in regulatory policy regardless of whether they conflict with the 'public interest' (e.g. Stigler, 1971; Becker, 1983; Kroszner and Strahan, 1999). It would be more than surprising for governments to enforce market opening *against* the competition-limiting preferences of industry players. But how can we then make sense of liberalization? Part of the answer lies in the comparative analysis' limited field of vision: Most studies misconceive market liberalization as a unilateral affair and ignore that it is the outcome of multi-lateral negotiations, notably in the EU itself. Alas, where liberalization theories have suffered from a narrow perspective, central approaches to EU integration have their own shortcomings.

European integration

Since the early 1990s, integration theory has by and large given way to theories of multi-level governance (Rosamond, 2000). As Jachtenfuchs (2001) put it, where the shape of the Euro-polity used to be the dependent variable, it has become the independent one. Integration theory is an unfinished project, however. Focusing on the single market, the questions why different governance arrangements have been chosen for different market sectors, and how the timing of institutional change can be explained remain unanswered.

Liberal intergovernmentalism has focused on governments' representing domestically formed national interests (Moravcsik, 1993, 1998). In spite of its merits, intergovernmentalism is per definition ill-suited to analyse policy-making with strong supranational or transnational components (Cowles, 2003, p.104). It can help understanding early negotiations for a single financial market but has much less to say about financial market politics nowadays. In addition, its focus on governments distracts from those societal actors who drive or block change in light of their material interests – in our case financial services providers (for the criticism, see Rosamond, 2000, p. 145ff).

Scharpf's actor-centred institutionalism (Scharpf, 1997, 2001) does tackle supranational integration and explains the shift(s) towards multi-level governance with the higher problem-solving capacity of integrated decision-making procedures under conditions of high interdependence. Again, governments are central actors, implying that their positions aggregate national welfare maximization calculations. This assumption in necessary for elegant game-theoretic considerations to apply. Only if actors are unitary and preference orderings are common and given – more 'problem-solving' is better than less – can we derive patterns of government interaction from a policy field's structure. But what if, for example, consumers and producers were affected differently by financial market reform? Whose 'welfare' counts in governments' willingness to cooperate? And what if actual policy making *de facto* by-passes formal institutions? Only 'zooming in' on the actual policy process and focusing on winners and losers from integration can answer this question.

Even though it is hardly pursued in their own work, Stone Sweet and Sandholtz have provided a useful hunch for a more political take on supranational governance:

> [It] 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. (1998, p. 4)

Yet supranational governance knows not only beneficiaries, it also knows losers. Where it helps completing the single market, stiffer 'competition' may squeeze local firms out of business. In short, supranational governance has distributional impacts that make it more than just a collective action problem. Just how the anticipation of such distributional impacts by different actors feeds into the creation of supranational governance structures remains unexplained by existing integration theories. Weber and Hallerberg (2001) have suggested that firms' preferences for more or less institutional integration depend on the transaction costs in a sector and the perceived level of 'threat' among market players. While the argument carries weight, it fails to address important points: Why would public actors heed private preferences? What role do differing strategies among firms play (e.g. internationalisation versus a domestic focus)? Finally, is it plausible to think of firms' preference formation only as a reaction to exogenous stimuli, or might firms also pro-actively push self-interested integration-agendas?

A BOTTOM-UP CONCEPTUAL FRAMEWORK

This section develops (1) a conceptual approach that addresses such questions and (2) the article's core argument: that changes in regulatory content (in this case 'liberalisation') and governance institutions ('integration' of policy making) are a function of changing competitive dynamics in the 'market place' itself. The approach will be developed bottom-up, starting with the effects of regulation on inter-firm competition and domestic regulatory politics, passing on to external regulatory policy, and finally to the politics of changing governance institutions themselves. In doing so, this section will also show how different dimensions of 'state-market condominiums' are systematically linked and therefore warrant integrated analysis.

Financial regulation between public good and private interests

Normative theories have seen regulation as a public good addressing market failure and imperfections (e.g. Goodhart *et al.*, 1998). While financial regulation serves such functions, these normative theories have a mixed record of explaining actual patterns of regulation. As Laurence (2001, p. 30f) points out, regulatory 'problems' – e.g. the threat of systemic crises – can have multiple solutions with quite different distributional consequences. In addition, even

egregious market failures and abuses rarely elicit the regulatory reactions warranted to adequately protect retail investors, pensioners or plain depositors from future recurrences (cf. Partnoy, 2002). In short, 'public imperatives' leave regulatory regimes underdetermined.

In contrast, so-called 'economic' theories of regulation have argued that rule making is liable to 'regulatory capture' through rent-seeking producers (Stigler, 1971; Becker, 1983). Compared to these, consumers suffer disproportionately from collective action problems due to their relatively large number and small individual stakes in regulation (cf. Olson, 1965). Empirical studies have confirmed government policy's inclination to follow producer interests (for banking, see Kroszner and Strahan, 1999).

Regulation not only outlines the potential for firms' rent-seeking behaviour (a conflict of firms versus consumers), but also demarcates the limits to competition *among* firms. Regulation may or may not allow interstate branching, firms' simultaneous activities in securities and credit markets, price fixing, etc. As Fligstein has noted,

> [much] of the market-making project is to find ways to stabilize and routinize [inter-firm] competition. [..] Finding ways to compete that do not revolve around price competition alone has proved pivotal to producing stability for firms in all advanced industrial societies. (2001, p. 5)

This competition-delimiting function of regulation is particularly important for wholesale financial services: Commodification of many products has left few 'natural' obstacles to fierce price competition. On the other hand, perceived economies of scale and potential gains from the exploitation of market-dominating positions feed a tendency towards industry consolidation with no built-in limits (Augar, 2005). Willingly or not, regulation functions to temper both trends. In stable times, it helps to reproduce a group of 'market incumbents' – those firms dominating a particular market segment. Because regulation defines the limits of competition, regulatory politics becomes one of the main battlefields in inter-firm struggles.

Regulatory policy making

It would be misleading to think of 'states' as regulating pre-existing 'markets'. Regulation 'creates' stable markets where ruinous competition or rapid cartelisation or monopolies would otherwise prevent their emergence. More importantly, financial regulation rarely is the

public affair as which it is often portrayed. Historically, self-regulation has been the rule (Braithwaite and Drahos, 2000, chpts. 8 & 9). Formally 'public' regulation plays a much bigger role nowadays. The tightly knit policy communities through which it is drawn up, however, are peopled by both private and public actors (Coleman, 1996). These policy communities often manage to insulate themselves against intervention by 'politicians proper'. In case of conflict, public and private actors join their forces in 'advocacy coalitions' (Sabatier, 1988): Also in financial markets, regulatory reforms have normally not pitted 'the state' against 'the industry' but some public and private actors against others (see e.g. Moran, 1991; Sobel, 1994; Lütz, 2000). Theorizing regulatory change means understanding how private and public actors come together to produce regulatory policy, not how the latter use regulation to somehow 'tame' or 'control' the former.

Private actors regularly use business associations to influence policy. As Schmitter and Streeck (1981) have pointed out, organizational form depends both on the 'logic of membership' and the 'logic of access'. Private actors can be expected to organize on the basis of shared interests. At the same time, they are bound to organize at the 'level' (national or transnational) at which they have the best chances to tilting policy their way. In the case of European integration that means organizing in a way that allows influencing 'powerful' public actors (the Commission, governments, etc.) and developing an organizational 'fit' with public actors likely to share one's policy agenda. Business associations are 'wedged' between macro-developments in markets and political institutions, and are at the same time used by purposeful actors to change these.

Cross-border service provision and international regulatory politics

Just as regulation 'defines' domestic financial markets (Vietor, 1987), it defines the terms of competition between domestic and foreign FSPs. This function of regulation is particularly prominent in finance because cross-border service provision faces few 'natural' obstacles and recourse to traditional trade barriers is foreclosed through non-discriminatory commitments in the European Community and the General Agreement on Trade in Services. So what might trade theory have to tell us about external regulatory policy?

Milner (1988) has suggested that internationalized firms favour free trade over protectionism while the opposite is true for domestically oriented ones. Focusing on *strategic* trade policy, Milner and Yoffie (1989) have argued that internationally oriented firms in sectors with large

economies of scale and steep learning curves can be expected to *conditionally* support free trade. Both criteria apply to wholesale securities markets. In principle, large firms favour free trade given bi- or multilateral reciprocity. Smaller firms will be hesitant in fear of foreign competition. Because regulatory policy affects cross-border 'competitiveness', international regulatory politics assumes trade policy elements regardless of intention. Markets for financial services again offer good examples (Nabors and Oatley, 1998; Simmons, 2001).

There is no reason why the core of strategic trade theory – the question of (the terms of) mutual market access – could not be applied to the single European market. Governments have effectively blocked its implementation in market segments where they so desired – financial services are once more instructive (Steil, 1998; Wymeersch, 1998). Two conclusions follow: The nature of single market negotiations is in principle hardly different than between other trading partners, and negotiating dynamics depend on sector-specific factors.

Over time, IPE scholars have suggested, growing interdependence leads to calls for lower trade barriers (Milner, 1988; Frieden, 1991) and regional integration (Mattli, 1999). In contrast to Ricardian free trade theory, however, the key is not 'public welfare', but producer interests. Firms face a trade-off between protecting the domestic market versus effective transnational integration – what for short we can call the protectionism-integration trade-off. Unless bargaining positions are highly asymmetric, negotiated market access is likely to be granted on a mutual basis. In the EU, for example, market access elsewhere without foreign competition at home is unlikely. In principle, firms would ideally prefer both protectionism and market access elsewhere, but in European competition politics, they have to choose. Evaluations of firms' preferences therefore need to consider both sides of the coin. Disconnected, the preferences on protectionism ('Yes, please') and on market access elsewhere ('Yes,' again) are hardly instructive. The key lies in the trade-off between the two. In addition to the internationalization of business activities, one central factor in this trade-off for FSPs is capital mobility (Frieden, 1991). It unleashes the business potential of cross-border offerings of financial services and tilts the balance in favour of more integration, particularly on behalf of large firms. In the European case, FSPs' support for monetary and market integration have been mutually reinforcing (Frieden, 1996). As will be seen below, lower transaction costs resulting from the single European currency strengthened the expected gains from further integration.

Translating trade politics back into regulatory policy, the fault line runs between mutual recognition and effective rule harmonisation. Protectionists will prefer mutual recognition. It allows foreign competitors in in principle, but disadvantages them through a double regulatory burden – that of the host and that of the home country. In addition, nationally idiosyncratic rules may favour the domestic business model (universal banks, specialized service providers, etc.). In contrast, once effective rule harmonisation has been achieved, firms no longer face a double regulatory burden. Furthermore, a single rule set opens the prospect of supranationally integrated supervision – something that mutual recognition makes all but unthinkable.

Joining the different theory strands discussed so far produces an integrated picture of regulatory trade politics: Regulation matters to firms because it affects inter-firm competition, domestic as well as cross-border. Theories of regulatory policy making suggest that producers have significant influence on regulation. Strategic trade theory holds that large, internationally oriented firms prefer (reciprocal) free trade whereas small, domestically oriented firms favour (regulatory) protectionism. As firms' business operations internationalize, their free trade support waxes (pro-effective rule harmonization in our case). Internal financial liberalization becomes a function of negotiations on cross-border market integration. The negotiations' success in turn depends on the preferences of 'national' financial industries whose interests governments can be assumed to represent, and the question whether they can agree on cross-border market integration.

So far, the perspective on intra-European 'competition politics' is fully compatible with liberal intergovernmentalism. This article aims to show, however, how such 'competition politics' are not played out through fixed political institutions, but can themselves effect and guide institutional change.

Institutional change

In the first instance, understanding institutional change means understanding why institutions matter for 'competition politics' at all. When public policy entails distributional choices – and market regulation is an example – policy making institutions are inherently political. They preconfigure policy outcomes in at least three ways. First, institutions structure different actors' access to policy. Members of clearly circumscribed policy communities sit at the table whereas other stakeholders do not. Actors will prefer institutions giving themselves and

political allies access while excluding opponents. The fault lines between camps rarely obey the public-private distinction as the respective ‘advocacy coalitions’ consists of both public and private actors (Sabatier, 1988).

Second, the degree of supranational integration of policy making matters. For the case at hand, Scharpf’s distinction between intergovernmental negotiations and ‘joint decision making’ is instructive (Scharpf, 2001): In contrast to the former, the latter knows supranationally integrated elements such as comitology or regulatory committees. As a policy field moves from intergovernmental negotiations to joint decision making governments loosen their grip on rule making in return for a policy process governed by more of a ‘problem-solving’ than a distributional logic (Wessels, 1998). The question, of course, is: Whose ‘problems’ are being solved here? In regulatory politics, I have argued, one can expect firms’ interests to dominate, and large internationalized firms stand to gain most from cross-border openness. To the degree that integrated decision making facilitates agreement, it benefits those who favour increased cross-border openness.

Third, ‘knowledge dynamics’ are connected to institutional change. The emergence of ‘epistemic communities’ can boost international cooperative problem-solving as members share technical understanding, normative frameworks and perceived mandates (Haas, 1992). The complexity of financial regulation leaves ample room for technocratic policy making, disguising distributional implications. Some market players will find application of an epistemic community’s ‘orthodoxy’ inherently advantageous, for example because it highlights transparency or market opening. On the continuum between technocratic and political oversight we should expect these firms to call for the former whereas those disadvantaged by dominant thinking support the latter. Rather than removing policy fields from ‘politics’, technocratization is itself highly political.

Putting the pieces together

The framework developed in this section has put competition politics centre stage. It started from the observation that theories of both liberalization and European integration were insufficient to explain fundamental changes in European financial market regulation and governance since the late 1980s. In both cases, their narrow focus took much of the blame. I have argued, in contrast, that market liberalization and European integration are two sides of the same coin. The argument about integrating hitherto separated perspectives goes much

further, though. Different dimensions of the structured social space that public and private actors jointly inhabit, such as political institutions, private associations, market structures and firms' strategies, approaches to policy making integration and free trade, are inter-linked and – I would argue – systematically so. If one thinks of these dimensions as 'variables' that take different values (e.g. a government's protectionist stance versus a free trade one, or integrated versus fragmented market structures) then these variables co-vary. For different pairs of variables, scholars have established clear links. Even though these relationships often contained self-reinforcing elements – economic interdependence furthers free trade politics, and free trade politics furthers economic interdependence, for example – the narrow focus of some studies has helped to establish apparent 'causal', uni-directional connections. This article, in contrast, consciously goes for the big picture and argues that the whole political economy of (in our case) competition politics is more than the sum of its parts. Different dimensions of state-market condominiums, as Underhill (2003) has called them, do not change independently of one another. Studying them as though they did is bound to continually misrepresent what actually goes on.

For the purpose of this article, I distinguish two ideal-typical 'constellations' in which the settings of the 'variables' that matter to our case complement each other – the 'inter-national constellation' and the 'transnational constellation' (see Table 1). In the sense that they try to illustrate the ideal-typical complementarities between the different dimensions and their underlying logic, they are not unlike the ideal-types developed for the study of 'varieties of capitalism' (e.g. Hall and Soskice, 2001). I will briefly reason through these complementarities here, and then showcase them in operation in the case of European securities markets politics.

Table 1: Dimensions of governance processes and their relationships

	Inter-national constellation	*Transnational constellation*
Main competitive line of conflict	Inter-national	Large versus small
Large firm preferences on the protectionism-integration continuum	Protectionism preferred over integration	Integration preferred over protectionism
Interests of relevant units	Collectively defined at the national level	Independently defined at various levels (national, European, global)
Market structures	Protectionist, highly	Open

	selective opening	
Settings for policy making	Closed domestic policy communities	Open transnational networks
Preferred mode of managing regulatory interdependence	Mutual recognition	Harmonisation
Approach to management of EU regulatory interdependence	Intergovernmental negotiations	Multi-level governance

In the ‘inter-national constellation’, markets are relatively fragmented along borders, and dominated by domestic players. To the degree that a global market exists (e.g. the ‘Euromarkets’), they are relatively disconnected from domestic markets. Regulatory policy is made in closed national policy communities, often dominated by the incumbent firms whose market ‘edge’ it reproduces. National sector associations cement ‘national’ positions of the firms concerned. In such a situation, negotiations over mutual market access (or a ‘single market’) will be marred by the protectionist stance of even large FSPs. Eager to control the process from start to end, governments negotiate outcomes among each other, rather than delegating competencies to technocratic and/or supranational bodies. The ‘minimal’ solution of a mutual recognition regime is the likely outcome.

In the ‘transnational constellation’, the architecture of politics is fundamentally different: With markets largely integrated across borders, the main competitive fault line is between a group of transnationally active firms and what remained of smaller domestic players. The former favour further integration and organize transnationally to push for that goal. As they gain the upper hand, mutual recognition is increasingly replaced by rule harmonization as the main approach to market integration. The disentanglement of national governments and the ‘national financial industry’ crystallizes in stronger independent regulatory agencies and a disembedding of financial regulation from economic policy at large. To further effective market integration and opening, policy making is lifted to the supranational level.

The second half of this article will show how competition politics was the driving force that brought us from an ‘inter-national constellation’ in securities markets politics to a ‘transnational one’.

NEGOTIATING THE SINGLE SECURITIES MARKET

Liberalising finance has been central to the 1992 single market program. Nevertheless, integration followed diverse trajectories. Agreements for credit markets – notably the Second Banking Directive – were concluded by the late 1980s. In contrast, the central agreements for securities markets – the Investment Services Directive (ISD) and the Capital Adequacy Directive (CAD) – were finalised only in 1993, and scheduled for implementation only in 1996 (*Euromoney*, 1993a). Negotiations had been agonising (Brown, 1997), and member states – in particular the dominating ones, the UK, France, and Germany – failed to agree pan-European rules.[5] The mutual recognition approach chosen instead fell short of creating an integrated European financial market as national governments exploited loopholes for regulatory protectionism (Steil, 1998). Member states' implementation record was poor at best; some countries had not implemented a single provision by 1996 (Wymeersch, 1998).

The key to understanding this outcome lies in the combination of financial industries' preference for regulatory protectionism over effective market integration and European institutions that tended to exacerbate distributive struggles. This first round of European competition politics in securities markets fits the 'inter-national constellation' that can be analysed with traditional theories about politics beyond the nation state – liberal intergovernmentalism, two-level games, and strategic trade theory. As will be shown later, the inter-national institutions mediating conflicts over market access were not immune to changing competitive dynamics in the market place.

Regulatory regimes and national financial markets

Around 1990, when the single market was negotiated, European finance consisted of disconnected national markets plus the 'Euromarkets' centred in London (Walter and Smith, 1989; Gardener and Molyneux, 1990). In continental Europe, retail investment in equities was virtually unheard of, and corporate debtors relied on credit rather than capital markets. The 1980s 'globalization of financial markets' belied their continuing fragmentation. Even in the UK itself, the domestic banking system had remained disconnected from the

[5] These three member states not only dominated the negotiations – their financial institutions were dominant at the time, too. Of the Top 20 European banks in 1990, only four were from EC countries other than Germany (with three), the UK (four) and France (six). Institutions from these three countries accounted for more the 75 per cent of the Top 20 European banks' assets. *The Banker*, 'Staying out of uniform', October 1990.

Euromarkets' activities even as the 1986 Big Bang had started to invite foreign competition into the City (Augar, 2000).

These domestic markets were dominated by national players (Grilli, 1989), mostly large banks equally active in credit markets. The French 'petit Big Bang' of 1988 had somewhat liberalized French securities markets, but not with the aim of inviting foreign competition, but to allow French commercial banks to become full universal banks in the German image. Deutsche Bank, for example, served as the template for Crédit Lyonnais' expansion (Coleman, 2001).

National regulatory regimes had remained fairly distinct (cf. Dermine, 1990). In 'coordinated market economies' (Hall and Soskice, 2001) such as France and Germany, financial regulation had been attuned to achieve general economic policy outcomes. French regulation combined political discretion over credit allocation with a role of leading firms in government debt markets and monetary policy (Story and Walter, 1997). In Germany, legal provisions (e.g. capital gains taxes for banks' selling shareholdings) had buttressed the 'Deutschland AG' model of industrial structures; again, large banks assisted the Bundesbank's monetary policy.

Closed national policy communities complemented this symbiosis of state and market actors in finance. In Germany and the UK, self-regulatory organizations gave market incumbents the power to set rules to their own competitive benefit. In France, the triple role of the state as owner, regulator and largest client of large financial corporations made policy circles hard to penetrate from the outside. Private sector policy input flowed via national associations such as the *Bundesverband der deutschen Banken* and the *Association Française des Banques*.

The combination of fragmented markets, regulation's diversity and embeddedness in national contexts, and closed nation-level policy communities formed the domestic side of the 'international constellation' that was to make pan-European agreement to difficult.

A single market in investment services?

Negotiating dynamics for investment services differed markedly from those for credit markets (Underhill, 1997). The latter had been comparatively easy because the central competition-relevant issue – capital reserves – had been solved through the Basle Capital

Accord in 1988. In investment services, competitive struggles brought negotiations to an effective stand-still in late 1990 (*Financial Times* [*FT*], 1991); the final result was only approved by governments in 1993.

Bargaining pitted national governments against each other defending the interests of national financial centres and industries. The main stumbling block for the Capital Adequacy Directive were the terms on which (continental European) universal banks would be allowed to compete against Anglo-American investment banks (*Euromoney*, 1993b). The eventual deal – the 'building block approach' to calculating capital reserves – was calibrated to address this competitive conflict.

The other central issue concerned 'regulated markets'. In the late 1980s, London's SEAQ share trading system had snatched a sizable chunk of trading in continental European blue chip shares (Steil, 1993) – almost a third of French share trading went through its telephone market rather than the Paris Bourse (*FT*, 1991). The French therefore led an initiative to 'concentrate' share trading on 'regulated' markets, defined in a way that excluded telephone markets such as the SEAQ and effectively repatriated share trading business to Paris and local firms. Unsurprisingly, the UK opposed the initiative. The Germans also did, even though the SEAQ had captured market share from German bourses, too. Where the French wanted to boost Paris as a financial centre, German banks were content with intransparent markets such as SEAQ that lent themselves to domination by a handful of big banks, regardless of their location. The higher independence of German FSPs from state-intervention compared to the French made itself felt here. Eventually, the 'concentration principle' was adopted and by the mid 1990s, the SEAQ's significance had dwindled (*FT*, 1995).

The mutual recognition approach in securities markets was replete with loopholes for regulatory protectionism. Member states reserved the right to draw up local 'Conduct of Business' rules, notably for the protection of market participants outside the 'professional investors' category. Yet the ISD never properly defined the concept and thus accorded national authorities discretion over the concept's application. Regardless of the home-country supervision principle, governments 'ensured that the balance tilted in favour of host country supervision' (Story and Walter, 1997, p. 266). Mutual recognition proved an ambiguous route to market integration. It combined partial harmonization – agreement on minimum standards – and *based on that* recognized foreign operating licenses. Mutual recognition therefore

contained considerable leeway for more or less expansive rule harmonization. In investment services, harmonization remained limited and proved ineffective. The meagre integration record for investment services was not pre-determined by the mutual recognition approach, but stemmed from the lack of political will and diverging national agendas. As McCahery has argued, ‘the mutual recognition approach to co-operative regulatory control is unlikely to be effective unless member states pursue similar policy interests’ (McCahery, 1997, p. 70). That was hardly the case, and transposition of the ISD and the CAD into national legislation was lacklustre at best.

The inter-national constellation

The first round of integrating European securities markets can be described in terms of intergovernmentalism (Moravcsik, 1993) and strategic trade policy (Milner and Yoffie, 1989), and it fits the image of two-level games (Putnam, 1988) in an ‘inter-national constellation’. Market integration (or rather the lack thereof) was a function of the competition politics at the time. In the end, many firms favoured protectionism over effective market integration. As governments took years to agree on a European regime, supranational actors were effectively sidelined. The logic of negotiations was distributional, not problem-solving.

Market liberalization happened in the context of European integration. But rather than neatly transposing European agreements into national arrangements, governments strategically liberalised markets with an eye to the interests of influential national players (Steil, 1998). Where liberalization was incompatible with their preferences, governments resisted alleged ‘pressures’ – not only of globalization, but also to implement agreements they had themselves concluded. This illustrates how misguided debates are that seek the causes of regulatory reform either in the ‘state’ or in abstract market forces of some sort or another (e.g. regulatory competition theories). They omit corporations as a key actors, and remain stuck in ‘states versus markets’-clichés where in practice, public and private actors join forces to co-manage competition.

CHANGING MARKETS AND NATIONAL REGIMES

Throughout the 1990s, the ‘inter-national’ constellation in European securities markets politics unravelled. Cross-border business expanded, albeit with obstacles. Owing to this partial integration, in addition to US competition and ongoing securitization, large European

players discovered a common interest in deeper integration. European interest associations were set up or strengthened to lobby for change in Brussels. Meanwhile, national policy communities lost something of their cosiness and informality through the spread of regulatory agencies with more independence from both the national industry and national governments.

Integration, US competition and the Euro

For large FSPs, the balance in the 'domestic protectionism versus European integration'-trade-off shifted in favour of the latter for three reasons: the rise of cross-border activity itself, financial disintermediation and the ensuing intensification of US competition, and the introduction of the Euro. The disconnect between internationalized Euromarkets in London and domestic financial markets had meant that in spite of their 'global player'-image, many large FSPs had been fairly focused on their national markets (Slager, 2004). Regardless of their shortcomings, integrated European financial markets generated opportunities for cross-border expansion. Remaining regulatory barriers made such strategies costly and available only to the largest institutions. Nevertheless, declining margins in continental credit markets fuelled eagerness to expand.

Second, 'securitization' – corporations' increasing use of capital markets instead of bank loans as a means of corporate finance – loosened hitherto stable relations between Hausbanks and their clients. Large corporations started to list on the New York Stock Exchange (Alcatel in 1992, Daimler Benz and Rhone-Poulenc in 1993, AXA in 1996, etc.), and took business with them to US investment banks. European corporate bond issuance multiplied in the years after 1996 (International Monetary Fund, 2004, p. 173). Large scale privatizations of everything from airlines to utilities not only jump-started popular equity cultures on the continent, but also brought in foreign players with their expertise and access to wide investor bases. In short, investment banking hit home, and with it competition from Wall Street's 'bulge bracket' firms. To be sure, in London's Euromarkets firms like Deutsche Bank or Paribas had been competing with American players for years. But now this competition encroached on the domestic business base hitherto insulated from high-flying 'global finance'. The strategic answer of European FSPs was – and has been ever since – inner-European growth. Taking on Wall Street firms on their US home turf looked too daunting – and most of those that tried burnt their fingers (and heaps of capital, see Augar, 2005).

Third, since the 1995 Madrid summit, the advent of a single European currency looked increasingly likely (Dinan, 1999, p. 467). The concomitant elimination of currency risk and transaction costs was bound to spur the integration of wholesale capital markets (Dermine and Hillion, 1999). Indeed, the top bracket of European finance had long advocated monetary integration (Frieden, 1991, p. 441), knowing it would benefit disproportionately from the resulting pan-European business prospects. Taken together, progressing market integration on the ground, securitization, concomitant US competition, and (the prospect of) EMU shifted the trade-off between domestic protectionism and deeper market integration in favour of the latter in the eyes of large FSPs. Below we will see how these shifts fed into a different set of liberalization/integration demands.

Reordering the state-market relationship in securities markets

The rising international focus of important segments of financial industries has been reflected in a disentanglement of hitherto cosy 'state-and-market relations'. Two developments stand out: reforms of regulatory institutions that have put market participants more at arms' length, and the disembedding of regulatory policy from national 'varieties of capitalism'.

In the UK, France and Germany, independent regulatory agencies were created or strengthened. Germany's *Bundesaufsichtsamt für den Wertpapierhandel* (BAWe) opened its doors in 1995, the French *Commission des Operations de Bourse* (COB) saw its independence vis-à-vis the Trésor strengthened in 1996, and the Blair government created the statutory *Financial Services Agency* (FSA) in 1998. These reforms increased the distance between regulators and both politicians proper and market participants. The motives were varied: Germany needed a public regulator for securities markets to be properly represented in the *International Organisation of Securities Commissions* (IOSCO). A year after the BAWe's creation, its head took on the vice-chairmanship of IOSCO's most important committee and could finally represent 'German' interests (Lütz, 2003, p. 156). In France, the strengthening of the COB formed part of the 'updating' of national markets underway since 1988 with the goal of creating globally competitive national champions – in particular Crédit Lyonnais (Loriaux, 1997; Coleman, 2001). In the UK, the Blair government replaced a complex and unruly web of self-regulatory organisations with the streamlined FSA. Reducing complexity and regulatory overlap, the move was welcomed by market participants (Lütz, 2002, p. 228ff). Still, it was only implemented after two years of further lobbying and adjustments to address 'industry concerns'.

What unites these reforms is that regulatory institutions suitable for national protectionism were replaced by others meant to better position and represent local players in an internationalized environment. In all three cases, reforms were not pushed through against industry preferences but with their support. In addition, the independence of regulatory agencies from direct political intervention decreased the scope of governments' using regulation to achieve goals in remote policy fields – for example intervening in a particular takeover. Not least, the rise of independent regulatory agencies was a necessary precondition for a future technocratic pan-European policy coordination that would bypass governments proper (see below). The differences between national reform motives and their strategic character show how institutional change was not dictated by structural pressures but followed national imperatives. In no case was the idea to create more competition in national markets in order to please foreign investors, as Laurence (2001) has suggested. In contrast, the aim was to update markets so that national players would emerge as beneficiaries of change, not the losers.

Mediated through the traditional institutional entanglement, national regulatory idiosyncrasies had underpinned domestic FSPs' role in coordinated market economies – for example monetary policy and industrial policy. Large banks' role in monetary policy had served as an argument for domestic control of regulation in the name of the 'public interest'. In industrial policy, German securities law had deterred banks' offloading the cross-shareholdings at the heart of the 'Deutschland AG' and buttressed the relationship-banking central to Germany's coordinated market economy (Hall and Soskice, 2001). In France, corporations' reliance on bank loans combined with large-scale state ownership of the financial sector allowed for governmental discretion over credit allocation (Loriaux, 1997). While secondary to competition politics, this national embeddedness of financial regulation had formed an impediment to both effective rule harmonization and integrated forms of governance.

Fledging European market integration, financial disintermediation and impending EMU changed all this. The creation of the European central bank absolved domestic FSPs from having to aid monetary policy. Disintermediation in financial markets by definition lowered banks' discretion over corporations' access to funds, so that regulatory structures intended to direct banks' activity lost most of their relevance. The German government, for example, scrapped the withholding tax on banks' shareholdings in order to encourage them to offload

‘ballast’ on their balance sheets (*FT*, 2002) – something unthinkable a decade earlier when buttressing the Deutschland AG had still been a matter of national interest.

In sum, the same developments responsible for changing large FSPs’ perspective on the pros and cons of bolder market integration lowered governments’ imperatives for keeping a tight grip on national regulatory policy. Transformations in European financial markets changed the whole logic of how ‘states’ and ‘markets’ were linked through regulation. In Jayasuriya’s (2001) terms, where financial regulation had been ‘positively integrated’ in national economic policy, it shifted towards ‘negative integration’.

The informal European dimension on the rise—public and private

Where markets and firms’ strategies Europeanized and private and public players disentangled their national ties, they joined forces at the European level, instead. On the public side, the Federation of European Securities Commissions (FESCO) has been the most important innovation; for private actors a range of pan-European associations became the vehicles of choice for lobbying.

In 1997, the new breed of independent regulatory agencies set up FESCO. With this informal association, European co-operation in securities markets regulation and supervision began to by-pass governments as the central nexus. Co-operation was conceptualized less as an inter-governmental issue than a technocratic exercise. Comprising specialists, FESCO formed a nascent ‘epistemic community’. In 1999, the head of the French *Conseil des Marchés Financiers*, Bertrand de Mazière said that reading material from the British FSA, it looked like something ‘we could have written’ (*The Economist*, 1999).

Even without hard ‘power’, FESCO’s technocratic approach enabled it to resolve former impasses: For example, in 2000 it agreed on a definition of a ‘professional investor’, limiting the scope for governments to apply host country rules. The technocratization of regulatory policy through FESCO was hardly ‘market-neutral’. It benefited large players whose position was enhanced by a rigorous application of the regulatory orthodoxy with its bias towards liberalization. Aware of this bias, these actors welcomed a stronger role for FESCO (e.g. Larosière and Lebègue, 2001).

Matters also changed on the side of private actors. Large FSPs' preference for effective integration at the expense of domestic protectionism translated into new associational patterns: Where earlier small and large players had joined forces through national organizations, Europe's top firms created or reinvigorated pan-European associations with circumscribed membership throughout the 1990s – think for example of the European Securitisation Forum (22 members), the European Financial Services Roundtable (20 members), European Primary Dealers Association (20 members), or the Forum of European Asset Managers (14 members). Large firms are heavily represented. ABN Amro, Fortis, UBS, BNP Paribas, Barclays, Allianz (partially via its Dresdner Bank subsidiary), Deutsche Bank and ING are all members of at least three of those four associations.

This 'Europeanization of business-government relations' (Cowles, 2001, p. 159) reflects changing associational 'logics of membership' (Schmitter and Streeck, 1981). The fault lines on the integration-protectionism trade-off increasingly ran between large and small firms. Previously, national industries had been comfortable using national associations to lobby around competitively relevant negotiations (Grossman, 2004). Founded in March 2001 and modelled on the European Roundtable of Industrialists, the European Financial Services Roundtable (EFSR) is the most noteworthy of the new European associations. Rather than lobbying on concrete issues, it aims at the 'completion of the single market in financial services' – a vision clashing with smaller firms. It has favoured rule harmonization 'where feasible' and a pan-European lead-supervisor to lower costs for firms active in a range of countries and sub-sectors, both radical pro-integration strategies (EFSR, 2004).

The fund management industry illustrates well how firm size and internationalisation translates into associational politics: The traditional European association – the Fédération Européenne des Fonds et Sociétés d'Investissement (FEFSI) – had united national investment fund associations, thus also representing smaller companies and countries. The European Asset Management Association (EAMA), in contrast, was set up in 1999 with mostly *individual* members, the list of which read like a 'who is who' in asset management. When the two bodies considered a merger in 2004, voting rights were the sticking point: How much weight would individual members get – as opposed to national associations of mostly smaller firms? The EAMA offer of 30 per cent voting rights for individual members proved unacceptable for the national associations of smaller countries such as Austria, Belgium and Denmark. They feared their associations would be sidelined, but were accused of 'attempting

to shield their local champions from competition' (*FT*, 2004a). National associations representing the European top league of asset managers, namely those of Germany, the UK, France, the Netherlands, Switzerland, Spain and Italy, supported the merger on these terms. The gulf proved to wide to bridge. A merger was eventually agreed, but the global top players were unimpressed. Twelve of them immediately set up a new 'Forum of European Asset Managers' – and this time with corporate members only (*FT*, 2005b).

A changing 'logic of access' (Schmitter and Streeck, 1981) – equally pointing towards pan-European organization of private interests – has been the flip-side of this development. While Europe's multi-level governance system knows numerous access points for lobbyists, the Commission's penchant for further integration made it the natural ally of the pro-integration lobby. In return, Commission Directorates could use private input to boost their position vis-à-vis other public actors in the EU arena.

SUPRANATIONAL INTEGRATION

In 1998, momentum built for a new round of market integration – even though the Investment Services Directive had not even been implemented in many countries. Under British leadership, the Council asked the Commission to produce what was to become the Financial Services Action Plan. This time, the Commission, pan-European interest associations and individual corporate heavyweights took the lead in agenda setting. Comitology was introduced and the expert Committee of European Securities Regulators (CESR) became the focal point of European regulation.

The Financial Services Action Plan

When the UK took over the European presidency in January 1998, financial services were high on its agenda. Financial institutions in the City – by then mostly global players rather than 'British' firms – had become frustrated with the barriers the first round of integration had left in place or even established (*FT*, 1997). The impending introduction of the Euro provided a convenient vehicle for re-establishing 'completion of the single financial market' on the agenda.

In early 1998, the Directorate General responsible for the internal market and financial affairs began reviewing the European framework for financial services, notoriously consulting American investment banks (Shirreff, 1999). Securing a Council mandate under British

heading in June, it tabled a 'Framework for Action' in October, and the final 'Financial Services Action Plan' in May 1999. The Investment Services Directive, it wrote, was 'in urgent need of upgrading if it [was] to serve as the cornerstone of an integrated securities market' (European Commission, 1999). Stretching its mandate to the limit in addressing institutional matters, the Commission found that

> [if] we are successfully to implement the [proposed measures], we will need to overhaul the way we develop financial services legislation and achieve high levels of international cooperation. (Ibid, p. 16)

The findings were hardly surprising. Not only had pan-European associations like the European Banking Federation increased pressure, but large firms such as ABN Amro, Deutsche Bank, Barclays, Citibank, and Morgan Stanley had started lobbying in Brussels individually (Shirreff, 1999). They belonged to the 'maximum harmonization' camp favouring rule harmonization over what Deutsche Bank's Rolf Breuer described as a 'regulatory nightmare' of fragmented markets (*The Economist*, 1999). In line with Mattli's (1999) and Stone Sweet and Sandholtz' (1998) expectations about support for regional integration, large firms were its most ardent advocates. And as Milner (1988) had argued, the internationalization of their business operations increased their support for breaking down barriers to cross-border trade. Private actors who had battled over the Investment Services Directive through 'their own' governments now called on them to end political haggling, and leave regulation to 'depoliticised experts' – for example FESCO.

Lamfalussy

With the Financial Services Action Plan approved, pressure mounted to overhaul the governance in the field – otherwise, it was argued, the over 40 planned measures could never be achieved within the envisaged five years. Under the French presidency, the Council set up a 'Committee of Wise Men' to study European financial market governance in July 2000. The first report of the Lamfalussy committee, named after its chairman, Alexandre Lamfalussy, suggested the introduction of comitology procedures. Legislation was to be split in two levels, with the Council and the European Parliament adopting 'level 1' framework legislation, and specialized committees working out the 'level 2' details, and updating them when necessary. Meeting with sympathy from industry associations such as the Federation of

European Securities Exchanges and the London Investment Banking Association, the report was endorsed by the Nice Council in 2000.

The final report, published after extensive industry consultations, detailed the approach without fundamentally changing it (Committee of Wise Men, 2001). Member states' remaining wariness triggered a wave of corporate displays of support for the plan (*FT*, 2001b; Larosière and Lebègue, 2001). While German financial heavyweights pushed integration and the Lamfalussy process, the German government refused to accept the deal without a 'safety clause' allowing ECOFIN to review level 2-decisions in exceptional circumstances (*FT*, 2001a). EU-oriented financial institutions and 'their' governments had grown far apart.

The central innovation has been the upgrading of FESCO – now called the Committee of European Securities Regulators (CESR) – to the focal point of European legislative initiatives, even if formally its role remains 'advisory'. It is central to drafting of framework legislation, and once approved by the Council and the EP, instrumental to filling in the details. CESR holds most consultations with market participants and is acknowledged as the European centre of expertise on securities markets.

In general, private pro-integration advocates have found a staunch ally in CESR. The head of the influential London Investment Banking Association sees CESR as a potential 'court of appeal' against 'ill considered laws' from the Council and the Commission (*FTfm*, 2004a). The sympathy is reciprocal – and CESR's chairman open to industry perspectives:

> [Market participants say that] they don't need more regulation. Instead they want more coordination and harmonisation of decisions. We [CESR] agree with that. (*FTfm*, 2004b)

Indeed, after the FSAP's several dozen legal measures had been adopted by 2005, industry representatives have called for a regulatory break – and got it (*FT*, 2005c). By and large, the legal provisions and policy making institutions for a transnationally integrated European market are now in place. The focus shifts to ensure their smooth implementation and operation.

The transnational constellation in action

European financial services regulation continues to be contested, but nowadays political struggles hardly resemble their intergovernmental predecessors around 1990. The industry organizes itself on a transnational basis – not a national one. For large FSPs in particular, supranational, relatively technocratic bodies are the access points to the multi-level policy process – not national governments. The nature of the game is still the same as 15 years earlier – influencing regulatory and institutional change in order to retain or extend one's position in the 'market place'. Yet the constellation of regulatory regimes and policy making institutions has changed over time as major firms realized their European ambitions and markets for financial services integrated. In European securities markets competition politics, the competitive fault line runs no longer along national borders, but along the Atlantic. An end to remaining 'protectionist' practices and integration are necessary to allow European top players to grow and match US counterparts. The EU Internal Market Commissioner aptly described this link:

> If we want financial institutions that are global participants in the years to come, a strong competitive domestic market is a basic requirement. (McCreevy, 2005)

CESR takes the lead on central issues today, and as the example of rating agencies shows not necessarily in line with governments' preferences: After a spate of financial scandals (Enron in the US, Parmalat in Europe, etc.) and irritations in corporate Germany (*FT*, 2004b), European politicians demanded regulatory oversight for rating agencies' and asked CESR to study the matter and report by April 2005 (*FT*, 2004a). Yet before EU institutions ever heard back, in December 2004, CESR's members had agreed in the International Organization of Securities Commissions, the global securities regulators' club, that there would be little scrutiny (IOSCO, 2004). In its advice to the Commission, CESR simply reiterated this position (*FT*, 2005a). While disappointing national governments, leading banks saw their position confirmed (cf. *The Banker*, 2004). Crucially for market participants, CESR also negotiates regulatory harmonization (read: mutual market access) with US authorities such as the Securities and Exchange Commission (*FT*, 2004c) and the Commodities and Futures Trading Commission (CFCT, 2005).

Smaller players have been uncomfortable with this new constellation. The consultations of the Inter-Institutional Monitoring Group for Securities Markets, set up in 2002 to evaluate the

Lamfalussy process, illustrate this. Responding to the group's report, the European Savings Banks Group for example felt that it was important

> to ensure that politically-sensitive decisions are not taken without the input of the European Parliament and Council and a democratic debate.[6]

Compare this with the view of the London Investment Banking Association's chairman:

> Having worked for months on getting [the updated version of the Investment Services Directive] in the right shape, to have it completely politicised at the end was enough to turn a Europhile into a Europhobe without stopping at Eurosceptic. (Quoted in *FTfm*,2004a)

The European Financial Services Roundtable made concrete proposals and urged an 'open debate on pros/cons of [a] longer term move to [a] single European supervisory agency' (EFSR, 2003). Governments have outright rejected this option so far, but who knows for how long?

CONCLUSIONS

The liberalization of financial markets, pan-European rule-harmonization, and the transnational integration of governance structures are all part of one political process of market (re)structuring that delineates under which conditions firms can compete against each other. This intra-industry dimension of European integration and financial liberalization – what I have called competition politics – has been ignored by most theories in addressing the two phenomena.

Firms' regulatory preferences have traced changes in market structures. When nationally idiosyncratic financial industries faced each other over the future shape of the European financial area, emphasis was put on defending markets through protectionist regulatory fragmentation. The pan-European investment industry that emerged over the 1990s developed a different outlook. Rather than protecting national markets, integration via rule harmonization became the top priority.

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[6] Responses are available under http://europe.eu.int/comm/internal_market/en/finances/mobil/lamfalussy-comments_en.htm, accessed on February 25, 2004.

The emerging preferences among select firms for rule harmonization translated into pressure for transnational integration of policy making. Supranational institutions with significant, if informal, leeway in policy making craft such pan-European rules more easily. The disembedding of financial regulation from national economic policies has been an important condition for the transnationalization of policy making – but it hardly was a driving force for integration in itself.

State centric approaches to integration and liberalization not only miss the source of changing political preferences, but their rigid focus on 'national interests' leaves no room for the transnational politics of European financial market governance that has become a reality. The fact that for decades material interests and political institutions converged around nation states has mislead many theorists to overly rely on them as analytical anchors and accord them – and the 'domestic' politics within them – an almost ontological status they do not deserve.

Conceptualizing questions of integration and liberalization in terms of 'states versus markets' clouds rather than aids our understanding of them. The case has illustrated how different dimensions of 'state-market condominiums' – national policy making institutions, regulatory regimes, policy communities, political institutions beyond the nation state, market structures themselves, etc. – are systematically linked, and evolve together over time. Rather than assuming an inherent opposition or harmony of private interests and public imperatives, this finding underlines the need of empirical research into dynamics of idiosyncratic constellations of state *and* market actors, and the implicit rationales underpinning them. It calls for an *integration* of different theory strands, using them as tools – not ends in themselves – to explain sub-dynamics of politico-economic transformations that, for better or worse, are more complex than most theories would make us believe.

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