Completing the Single Market in financial services: the politics of competing advocacy coalitions*

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Abstract

Why has the completion of the single market in financial services proved so difficult and time consuming? This paper addresses this question by applying a revised version of the 'advocacy coalition framework', modified so as to incorporate the role of material interests as well as ideas, to the empirical record of the policy-making processes of key pieces of legislation dealing with securities trading in the EU.

It is argued that in almost all the Lamfalussy directives, the main (but, by no means, the only) line of division was between a 'Northern European' coalition and a 'Southern European' one. This was due to differences in the national regulatory frameworks, the configuration of national financial systems and their competitiveness (hence, 'interests'). However, the tension was also due to different belief systems (hence, 'ideas') about financial services regulation.

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Introduction

More than half a century after the signing of the Treaty of Rome and the re-launch of the single market programme in the mid 1980s to be completed in 1992, financial market integration was far from being achieved in the European Union (EU) in the early 21 century (for an overview of financial market integration in Europe since the 1960s see Story and Walter 1997, Maes 2007; other literature focusing on the 1980s and the early 1990s is reviewed in Section 2). Moreover, as elaborated in this paper, several financial directives negotiated throughout the 2000s proved to be as politically controversial as the previous sets of directives agreed in the mid 1980s and early 1990s. This is puzzling. Why has the completion of the single market in financial services proved so difficult and time consuming? Can any lessons be drawn for the completion of the single market in other sectors?

The Financial Services Action Plan (FSAP) and the introduction of the single currency in 1999 gave new momentum to financial market integration in the EU. Compared to banking and insurance, securities is the sector of most intense activity in the 2000s, partly because market integration had lagged behind in this field (Story and Walter 1997) and a period of catch-up was therefore overdue, and partly because technical innovations increased the potential for cross-border securities trading (Underhill 1997). Moreover, unlike the banking sector, where international rules, such as the Basel II Accord, are well developed due to the activity of the Basel Committee on Banking Supervision (Wood 2005), securities markets are subject to limited international regulation. Hence, EU regulatory activity in the securities sector was all the more necessary.

Most of the 42 measures proposed in the FSAP for completing the single market in financial services concerned securities trading, and they subsequently found their way into four so-called 'Lamfalussy directives', named after the process through which they were negotiated and implemented (on the Lamfalussy architecture see Committee of Wise Men 2001, Mügge 2006, Quaglia 2007). These directives were: the Prospectus directive (2003), the Market Abuse directive (2003), the Transparency directive (2004) and the Market in Financial Instruments directive (MiFID) (2004). This paper analyses the policy-making processes of two key pieces of legislation necessary for the completion of the single market in securities: the Prospectus directive (2003) and the Market in Financial Instruments directive (MiFID) (2004). Out of the four Lamfalussy directives, these were those with the greatest economic impact and the most politically controversial. This work does not examine the so-called level 2 implementing measures of these directives (on the difference between level 1 and level 2 legislation see Committee of Wise Men 2001).

As pointed out in Section 2 that reviews the literature on the politics of financial market integration in the EU, existing explanations have so far focused on one set of actors - the Commission, the member states, industry, mainly transnational companies - highlighting the importance of economic interests in shaping financial services regulation. This research takes a different theoretical approach, using a revised version of the 'advocacy coalition framework' (Sabatier 1998), modified so as to incorporate the role of material interests as well as ideas, as elaborated in Section 3.

It is argued that in the making of these directives, the main (but, by no means, the only) line of division was between a 'Northern European' coalition (hereafter referred to as 'Northern coalition') and a 'Southern European' one (hereafter referred to as 'Southern coalition'). This was due to differences in the national regulatory frameworks, the configuration of national financial systems and their competitiveness (hence, 'interests'). However, the tension was also due to different 'belief systems' (hence, 'ideas') about financial services regulation. Basically, there was a 'market-making', 'principle-based' approach, exposed by policy-makers and stakeholders in the UK, Ireland, the Netherlands and the Scandinavian countries; and a 'market-shaping', 'rule-based' approach of continental Europe (France, Belgium and the Mediterranean countries) with Germany in-between due to the presence of competing advocacy coalitions domestically.

These competing belief systems concerning financial services regulation proved to be one of the main hindrances to be overcome in the making of an integrated market in securities. The rules set in place for the completion of the single market in the early 2000s were the result of negotiations between these two coalitions, and were based on a series of compromises, even though the new rules tended to be closer to the preferences of the Northern coalition. This outcome is explained by the bargaining power of its members, which in turn was affected by the changes in the policy environment and some learning that took place across coalitions.

This paper makes two main contributions to the scholarly literature on the completion of single market and to the political economy literature more broadly. It teases out and elaborates the belief systems of policy makers and examines the composition of and the interaction between two main advocacy coalitions shaping the politics of financial market regulation in the EU. Second, it argues that the long-standing divide between Northern Europe and Southern Europe concerning financial market integration is not only due to dissimilar (often competing) economic interests. It is also due to different ideas about financial services regulation, even though the ideational distance has been reduced over time.

2. State of the art on the politics of financial market integration in the EU

Several different answers have been given by political scientists as to what drives financial market integration in the EU. Story and Walter (1997) stressed the intergovernmental character of the negotiations concerning financial market regulation in the EU in the 1970s, 1980s and early 1990s. Their work regarded financial market integration as the 'battle of the systems' (which is part of the title of the book), whereby the member states were keen to set EU rules that were in line with their domestic regulatory approach and did not create comparative disadvantages or adjustment costs to national industry and the public authorities. A similar approach was also taken by Underhill (1997), who, like Story and Walter, highlighted how the 'triangle' of the three main financial systems in the EU - the British, the French and the German - played out and shaped EU financial regulation in the 1980s and early 1990s.

A second explanation considers the Commission as the core supranational actor pushing through financial market integration (Posner 2005, Jabko 2006). A third explanation focuses on the role of the private sector, in particular transnational capital

(Van Apeldoorn 2002; Bieling 2003, Mügge 2006; Macartney forthcoming). Other scholars have focused on networks of regulators in the EU (Coen and Thatcher 2008; De Visscher et al. 2008; Quaglia 2008a), an approach which, however, has limited explanatory power in the making of level 1 legislation, even though it is more fruitful when applied to level 2 legislation.

Each of these approaches has some explanatory power concerning certain aspects of financial market integration and specific stages of the policy-making process of the main pieces of legislation regulating financial services in the EU, as elaborated in section 6. For example, they shed light onto the agenda setting of the Commission at the pre-legislative and drafting stage; the pace setting of transnational industry in calling for financial market integration; the intergovernamental character of the decision-making process in the Council, where the battle of the systems and the preferences of domestic industry come to the fore; and the committee governance at work in the implementation stage. However, what all these explanations have in common is that they tend to focus on one set of actors – the member states (to be precise, the three main member states), the Commission and transnational industry – and stress the importance of material economic interests in shaping the political conflicts concerning financial market regulation in the EU.

This paper argues that in doing so they have overlooked an important part of the explanation: the 'belief systems' of policy makers. This research adopts a different theoretical approach, using a revised version of the 'advocacy coalition framework', modified so as to incorporate the role of material interests as well as ideas, as elaborated in Section 3. This approach has been chosen to shed light onto the politics of financial market regulation in the EU because it adopts a pluralistic view of the policy process and outcome that fits well with the multi-level governance of the EU (on multi-level governance see Hooghe and Marks 2001, Bache and Flinders 2004). In fact, advocacy coalitions consist of public and private actors, situated at different levels of governance: national, EU and international (on the use of the advocacy coalition framework in EU policy-making see Radaelli 1999, Dudley and Richardson 1999). Moreover, the advocacy coalition framework offers the possibility of considering the role played by non-material factors, such as ideas, in shaping financial market integration in the EU.

With specific reference to market regulation, Vogel (1996: 20) highlights the importance of ideas or ‘regimes orientation’, defined as ‘state actors’ beliefs about the proper scope, goals, and methods of government intervention in the economy, and about how this intervention affects economic performance’. However, it is not only state actors that are involved in this process, it also affects private actors (industry). Hancher and Moran (1989: 4) use the broader expression of regulatory ‘culture’ about ‘the rules of the regulatory game’: that is the ‘purpose of regulation’, ‘legitimate participants and their relations with each other’. Such culture tends to be context specific, as it varies across time, countries and sector (Hancher and Moran 1989). EU regulation is an arena where different regulatory approaches come to the fore and confront each other, which is why EU regulation is often a ‘patchwork’ of national regulatory styles (Heritier 1996: 149).

3. The advocacy coalition framework in theory and practice

An advocacy coalition is formed by 'actors from various governmental and private organizations who both (a) share a set of normative and causal beliefs and (b) engage in a nontrivial degree of co-ordinated activity over time' (Sabatier 1998: 103). One or more coalitions can be present within a policy subsystem, which is composed by a set of policy-makers and stakeholders who are actively concerned with a certain issue, regularly seeking to influence public policy related to it. As Sabatier (1998: 103) specifies, 'the belief system' of an advocacy coalition is organised into a 'hierarchical, tripartite structure': i) the 'deep core' of the shared belief system includes basic ontological and normative beliefs; ii) the 'policy core' beliefs, which represent the causal perceptions by the coalition (the definition of the problem, its causes and solutions) and are its fundamental 'glue'; and iii) the secondary aspects of the coalition's belief system, comprising instrumental considerations on how to implement the policy core (e.g. minor decisions concerning budgetary allocations, administrative regulations) (Surel 2000), and which can vary somewhat among different members.

An important issue that needs to be discussed with reference to this theoretical approach is the role of interests as opposed to - or distinct from - ideas and values. As originally elaborated, advocacy coalitions are primarily value-based coalitions (Dudley and Richardson 1999). Members of the coalitions are assumed to be instrumentally rational, following the course of action that is more likely to achieve the objectives determined by their cognitive and normative beliefs (Sabatier 1998: 109). Yet, some authors point out that ideas and interests are 'not separate entities, only analytically separable ones' (Jacobsen 1995: 309, see also Dudley and Richardson 1999), especially in the economic field. Economic ideas matter because they are ‘clusters of ideas/interests’ (Jacobsen 1995: 309) that help actors to define their objectives.

In many policy-oriented studies and empirically grounded research, especially in the economic field, it is difficult to neatly separate ideas and interests and it can be somewhat naïve to identify coalitions based purely on values or ideas. At the same time, as this paper argues, to identify coalitions based purely on interests might overlook an important part of the explanation. On the one hand, there are massive and powerful economic interests at stake in financial services. On the other hand, ideas in the form of technical knowledge (Radaelli 1995, 1999) and policy paradigms (Hall 1993)[1] are important in this complex and ‘technical’ policy area.

Interests can be quite easily incorporated into the advocacy coalition framework, which also considers power, in that rival coalitions compete for power in the policy subsystem in which they operate. The framework postulates that changes in the policy environment - such as changes in socioeconomic and political conditions (Sabatier and Jenkins-Smith 1999) - can trigger a shift the power distribution among coalitions and their members (Kuebler 2001). Moreover, Sabatier (1998: 116) acknowledges that distributional conflicts are important especially for ‘material groups’, the members of which seek to maximise their own material self interest. This type of groups represents the vast majority of actors in the financial services subsystem.

[1] A policy paradigm can be defined as a shared body of causal ideas concerning a certain policy area. A useful distinction can be made between the most normative part of the paradigm, and ideas about the main policy objectives, instruments and strategies (Hall 1993). To a large extent this resembles the tripartite division of beliefs used in the advocacy coalition framework, examined below.

This paper does not test an interest-based explanation versus an idea-based explanation, feeding into the rationalist - constructivist divide (Checkel 1997, Jupille et al. 2003). Instead, it uses the analytical framework of advocacy coalitions, paying attention to the belief systems and the interests underpinning those coalitions as well as the change of the policy environment in order to shed light onto the complex process of the making of the single market in financial services.

The remainder of this section outlines the two principal advocacy coalitions active in the regulation of financial services in the EU, identifies the main members of each coalition, and teases out the various components of their belief system. The mapping of these coalitions and their belief systems was carried out through more than 40 semi-structured interviews with policy makers and stakeholders located in several member states and EU institutions. The subsequent sections apply the framework to the empirical record, highlighting the interplay of the coalitions in the policy process and their influence on the outcome.

The completion of the single market in financial services is characterised by the presence of two competing advocacy coalitions: the ‘Northern European’ one, which coalesce around the UK, and includes Ireland, the Netherlands, Luxemburg and the Scandinavian countries and the ‘Southern European’ one, which coalesce around France and Italy, and includes Belgium and the other Mediterranean countries. These coalitions espouse two belief systems, which also affect the perceptions of interests of their members and vice versa. In other words, the belief systems of the coalitions play a role in shaping their understanding of the context in which they are situated (constraints and opportunities).

The ‘deep core’ of the shared belief system of each coalition includes basic ontological and normative beliefs about the market, which can be summarised as ‘market trust’ for the Northern coalition and ‘market distrust’ for the Southern one.

The ‘policy core’ beliefs concern:

(i) the definition of the problem: whereas completing the single market is more or less a shared objective for both coalitions (though with a different degree of intensity, being more important for the Northern group), the Northern coalition prioritises market liberalisation, mainly through market-making measures that define conditions for market access and operation, stimulating competition and market efficiency (cf Knill and Lehmkuhl 1999). The Southern coalition prioritises re-regulation at the EU level, through market-shaping measures that pursue policy objectives other than market liberalisation, such as consumer protection and financial stability, with a view to complement the liberalisation process;

(ii) the content of regulation: light-touch regulation, principle-based, and competition-friendly is endorsed by the Northern group, whereas prescriptive regulation, rule-based, prioritising consumer protection is favoured by the Southern one;

(iii) the relationship between the public authorities and industry: the Northern group believes in private sector governance (cf Knill and Lehmkuhl 2002), based on the involvement of industry through consultation, drafting and implementing soft law; the Southern group believes in the steering action of the public authorities, to be kept at arm’s length from the private sector.

The secondary aspects of the coalition's belief system vary somewhat among different members. They partly depend on the specific situation in which the various members of each coalition find themselves, such as the degree of competitiveness, the market share and organisational structure for private actors; the organisational structure and institutional prerogatives for public actors. These secondary beliefs are not considered in this paper, given the considerable number of policy-makers and stakeholders involved.

4. The Prospectuses directive (2003)

The Prospectus directive allowed capital to be raised throughout the EU on the basis of one set of documents -the prospectus - and gave bond issuers a choice of regulator. Pre-existing rules concerning the mutual recognition of prospectuses were largely ineffective in practice, as different versions of the prospectus had to be prepared for each member state (Deutsche Bank 2002). The directive also gave competence to a single authority in the member state to supervise compliance with the provisions.

The draft directive officially proposed by the Commission in May 2001 was criticised by industry, which lamented that the draft had not be subjected to a consultation procedure before being formally adopted by the Commission (*Financial Times*, 7 September 2001, 16 June 2001, see also EBF et al. 2002). Three main criticisms articulated by the industry and the public authorities of the Northern European member states were subsequently taken on board by the European Parliament (EP), to be precise the Committee on Economic and Monetary Affairs of the EP (EP 2002).

The first issue was the scope of the directive, whereby the Northern coalition, which favoured ‘light-regulation’, highlighted the insufficient number of exemptions included in the directive (EP 2002). This issue was linked to the definition of ‘qualified investors’, in that this coalition wanted a broader definition of this type of investors, for example including certain private investors (Deutsche Bank 2002). This is because less burdensome provisions for the issuer usually applies whenever the investor is a ‘qualified investor’, which requires less legal protection, as compared to small non-qualified investors.

The second issue was ‘the home country principle’ to determine the competent authority for the approval of the prospectus (EP 2002). The European Commission, backed by France, Italy and Spain had initially proposed that all equity and most debt issuers could go for approval only to their national regulator, which would thus enjoy a sort of monopoly, instead of leaving it to the market, giving issuers the possibility of choosing the regulator for approval (*Financial Times*, 5 November 2002, interview, London, 12 May 2007). The Northern coalition wanted the issuers to be given the choice of which authority to submit the prospectus to for approval. On the one hand, the concern of the Northern coalition was that some regulators – in particular those from the Mediterranean countries - might insist on the use of the national market as a condition of approval (letter of Christopher Huhne, Member of the European Parliament, MEP, and rapporteur of this directive, *Financial Times,* 5 November 2002). On the other hand, the concern of Southern regulators and the Commission was that the freedom for issuers to choose the regulator from which to seek approval might trigger a ‘race to the bottom’, as issuers would shop for easy approvals (*Financial Times,* 5 November 2002; interviews, Brussels, 13-14 June 2007).

The third issue was the duration of the vetting period (EP 2002), which the Northern coalition wanted as limited as possible, whereas the Southern coalition wanted to give the public authorities more time to evaluate the prospectus. Finally, there were issues concerning certain features of the prospectus' content, cross-border use and updating (Deutsche Bank 2002). Moreover, whereas the obligation to publish a prospectus did not apply to securities offered only to qualified investors, the Mediterranean countries insisted to have detailed information provided for retailers. Basically, the debate was between a 'heavy' prospectus (detailed and prescriptive) and a 'light' prospectus (principle-based) (interview, London, 12 May 2007).

The EP, which received intense lobbying from industry, and the Northern member states asked for significant amendments concerning the points mentioned above in first reading in February 2002. The Council was internally divided between the Northern group and the Southern one. In August 2002, the Commission presented an amended proposal in response to amendments proposed by the EP, some member states and industry. Negotiations resumed in the Council and between the Council and the EP. In the end, exemptions related to qualified investors were extended to certain private investors with relevant expertise and the threshold value for exemptions was lowered, as proposed by the EP. A compromise between the position of the EP and part of the Council, which was also a compromise between the two coalitions, was reached on the duration on of the vetting period, and the competent authorities were enabled to grant exemptions from disclosure requirements for some enterprises (Ferran 2004). Eventually, an agreement based on a package deal between the EP and the Council was put together, whereby companies that issued bonds (but not shares) above Euros 1,000 would have a choice of regulator, which would de facto give freedom of choice to the vast majority of issuers (*Financial Times*, 1 July 2003).

As pointed out in several interviews, besides being a clash of national interests - the national governments were keen to set in place rules that were most advantageous for their financial centres - it was also a matter of different belief systems, based on different deep normative beliefs: market trust and market distrust. As for policy core beliefs, the Northern coalition privileged a ‘market-making’ regulatory approach, based on ‘light-touch’ rules, competition (also amongst supervisory authorities) and freedom of choice for industry. The Southern coalition preferred a ‘market-shaping’ regulatory approach, based on prescriptive rules, with emphasis on consumer protection and limited choice for industry.

In Northern Europe and Anglo Saxon countries, the prospectus is considered as an information tool, not a consumer protection tool: it is ‘light’ and it is not vetted by regulators. In Southern Europe, including France, the prospectus is seen as a consumer protection tool: the information in it has to be detailed and is vetted by the regulators (interview, London, 12 May 2007). This also highlights different visions of the role of the public authorities vis a vis the market. The Northern approach stresses the ability of the market to regulate itself within the limits sets by light touch regulation. The Southern approach stresses the public authorities’ role in steering and monitoring the market.

5. The Markets in Financial Instruments directive (MiFID) (2004)

The MiFID was a core part of the FSAP, being described by financial press as the 'new Big Bang' in financial services (*Financial Times,* 26 October 2006). It was proposed in November 2002 to update the existing Investment Services directive (ISD) issued in 1993, which only applied to a specified number of financial instruments and investment services. All the firms previously covered by the Investment Services directive are subject to the MiFID but new categories of firm fall within the remit of the MiFID, such as investment banks, stock brokers and broker dealers, futures and options firms, commodity firms, and portfolio managers. Moreover, retail banks and building societies are subject to the MiFID for some parts of their business such as the sale of securities, or investment products (Ferran 2004). The directive set common rules for securities and derivatives markets, permitting investment firms to operate throughout the EU by using a 'single passport', which allowed financial firms to conduct business across Europe with the approval of their home authorities.

Investment firms were enabled to process client orders outside regulated markets (first and foremost, stock exchanges), which was previously impossible in some member states. This was the so called 'concentration rule', which had been one of the main bones of contention in the negotiations of the ISD in 1993, as it was a priority for France and the Southern European countries, which had this rule in place (Coleman and Underhill 1998, Underhill 1997). The public authorities in these countries believed that the market for securities trading should be carefully regulated and monitored, hence their legislation prescribed routing all orders for securities trading through regulated markets (stock exchanges) (interviews, Rome, 10-11 December 2007; Paris 18-19 July 2007; Brussels, 13, 25 June 2007).

In so doing, they also protected their national stock exchanges from competition from ‘multilateral trading facilities’ (i.e. broadly non-exchange trading platforms) and ‘systematic internalisers’ (i.e. banks or investment firms that systematically execute client orders internally on own account, rather than sending them to exchanges). Such competition was already in place in some member states, such as the UK. This approach is competition friendly, even though it can reduce investor protection if adequate pre-trade and post-trade requirements are not set in place (for a debate on this issue see the various contributions to the volume edited by Ferrarini and Wymeersch 2006). This was the most controversial issue in the negotiations of the MiFID.

The second controversial issue, which was related to the first one, was ‘pre-trade transparency’ that referred to publishing the prices of securities, hence the obligation by which investment firms have to reveal to the markets details of client orders. If the firms are trading on their own account, they should provide some indication of the terms on which they themselves stand ready to buy or sell a specified share (Ferrarini and Wymeersch 2006). As pointed out in several interviews, this issue was particularly important for the Southern coalition, which wanted clear rules for all the market players, including investment banks and financial firms, which are by definition ‘non regulated markets’. Oversimplifying only slightly, whereas the Northern coalition wanted to keep them by and large ‘unregulated’, opposing pre-trade transparency requirements, the Southern coalition wanted to impose prescriptive rules concerning pre-trade transparency, presented as a tool for investor protection.

The difficulty was to produce pre-trade transparency requirements which were workable, because if the obligations were too onerous to comply with, investment firms would not compete with exchanges - they would not 'internalise', i.e. execute share trades off-exchange (interviews, Frankfurt, 10 and 12 September 2007; London, 2 April and 20 April 2007; Brussels, 27 June 2007). However, without pre-trade transparency obligations, there would not be a levelled playing field between stock exchanges and banks (interviews, Brussels, 24 October 2007; 13-14 June and 29 June 2007; Paris, 19 July 2007).

In November 2002 the Commission presented an official draft of the directive that was closer to the positions of the Southern coalition (Ferran 2004). According to the *Financial Times* (19 November 2002), this was due to high political intervention by the then President of the Commission, Romano Prodi, who had been lobbied by the French and Italian stock exchanges. The draft raised the objection of Northern member states, some MEPs and parts of the industry, especially the investment firms in the UK as well as investment banks, several of which are US-owned, but based in London.

The Commission’s draft was approved by the Council by Qualified Majority Voting (QMV) after the rather unusual decision of the Italian Presidency to call for a vote, rather than continuing negotiations in an attempt to reach a consensus, as it is generally common practice. This was despite the dissent of the Northern coalition, namely the UK, Ireland, Luxembourg and the Nordic countries, with Germany switching position towards the Southern coalition, despite the fact that internalisation was practised by many German private banks (*Financial Times*, 9-11 October 2003, *The Banker,* 1 November 2003). The presidency was seen as having a vested interest in pushing through the proposal as it had been formulated (i.e. limiting internalisation), despite the opposition of countries that have a large financial sector (interview, Brussels, 14 June 2007). The EP, with the backing of Northern member states, first and foremost the UK, managed to have important amendments included in second reading (Ciani 2006).

In the Council, preferences differed widely, ranging from the removal of the relevant articles concerning pre trade transparency to extending its provision (Deutsche Bank 2003). Under an earlier position taken by the ECOFIN Council, stockbrokers would have had to publish advance prices for potential trades of over €3 million, which the MEPs claimed was too risky (EP 2004). In the end, the principle of pre-trade transparency was maintained for firms that are termed 'systematic internaliser' for 'liquid shares' and for transactions up to a certain threshold, defined as 'standard market size'¸ meaning that very large trading positions will not have to be divulged. It should be noted that the precise definition of these terms was the subject of a heated debate during the adoption of the level 2 implementing measures by the so-called Lamfalussy committees.

Amongst the member states, the positions and the policy preferences of the German authorities are the most difficult to characterise. The position of the German government on this issue was unclear and unstable because domestically there were competing policy preferences of policy-makers and stakeholders that were part of the two advocacy coalitions active at the EU level (for similar dynamics in the negotiation of the Capital Requirements directive see Quaglia 2008b, see also

Grossman 2006). Whereas the most domestically-oriented part of the banking system (namely the savings banks and the cooperatives) shared the policy preferences of the Southern group, the large private banks shared the policy preferences of the Northern group (interviews, Berlin, 23 April 2008; Frankfurt 10-12 September 2007). The federal state structure, the competition amongst ministers and the role of party political competition compounded the definition of the German position on this directive (interview, Paris, 18 July 2007). This also explains why the Germans somewhat switched position, voting against the UK and Luxemburg, when the Italian presidency called a vote on MiFID in 2003.

The EP proved an important channel for industry to articulate its policy preferences and indeed private financial interests, in particular EU and national peak associations and large market players sought intensive interaction with MEPs. Reportedly, the UK and Finish MEPs (the two rapporteurs of the directive were British and Finish) were very active in promoting a market-making, competition-friendly approach (interview, Brussels, 28 March 2007, 13-13 June 2007).

The directive basically pitted two coalitions against each other. This was evident in the making of level 1 legislation, but it also surfaced in the adoption of some level 2 measures, which are not discussed in this paper. On the one side, the national governments and industry in continental Europe tried to limit the extent of market opening, first resisting the end of the concentration rule and subsequently trying to shape the market, imposing detailed pre and post trade transparency rules, with a view to protecting national stock exchanges, which feared the competition of the large (mainly British-based) investment banks and stock exchanges (*Financial Times,* 13

March 2006; *The Economist*, 9 September 2006). However, the pre and post trade transparency rules also served the purpose of consumer protection, especially for small investors. On the other side, the UK financial services industry and the national authorities were keen to promote market opening (market-making), ending the concentration rule, with minimal transparency requirements, with a view to promote competition, gaining unrestricted access to Southern European markets.

6. Explaining the completion of the single market in financial services

In an overall assessment, to what extent is the advocacy coalition framework useful to explain the completion of the single market in financial services? Does this shed novel light onto the policy process and outcome? To address these questions, it is necessary to ask which were the most important actors and why? How did policy-makers and stakeholders define their policy preferences? And how were such preferences pursued in the policy process and with what outcome?

The Commission was particularly influential at the agenda setting stage, meaning in drafting the directives, which however had the support of the national governments. Following the terminology used in other studies adopting an advocacy coalition framework (cf Dudley and Richardson 1999), the Commission was a ‘policy broker’ (Sabatier 1998). However, whenever the draft regulation produced by the Commission was not in line with the policy preferences of one of the two competing coalitions identified, the rules had to be substantially redrafted by the Commission in second reading.

The EP was an important channel through which industry was able to articulate its policy preferences, as revealed in several interviews. MEPs were lobbied by and actively encouraged interaction with industry, seeking information and expertise (cf Bouwen 2004), producing reports and trying to understand the issues. MEPs were accessible and willing to listen to business, working across party lines and national lines. The European Parliament, and particularly the relevant committee, proved to be closer to the Northern coalition, exhibiting a market-friendly approach, receptive of the preferences put forward by the most competitive parts of the financial industry, generally located in the UK and to some extent in Germany and France. Since three out of four directives in the securities sector were adopted in second reading, the EP was able to have many of its proposed amendments incorporated into the final draft, albeit many member states also supported those changes.

The member states (to be precise, the national governments, particularly the Treasury and Finance Ministries) were key players at the decision making stage because the ECOFIN Council had ultimate decision making power, together with the EP. The coalitions of member states varied depending on the directive being negotiated and the specific issues dealt with, even though the traditional line of friction was between countries, such as the UK, Ireland, the Netherlands, and the Nordic countries embracing a market-making, competition-friendly, principle-based approach; and the market-shaping, rule-based, investor protection approach adopted by France, Italy, and the other Mediterranean countries; with Germany switching position - and hence coalition - depending on the specific content of the legislation being negotiated.

The positions of the national governments in the negotiations reflected the preferences of powerful domestic groups, especially in those countries, such as the UK, where there is traditionally an intense and constructive interaction between the public authorities and industry (Josselin 1997, Moran 1991). In some cases, it also reflected the preferences of the public authorities, even when they differed from those exposed by the national industry, or part if it, in particular in countries, such as Germany, which has a federal structure (viz the MiFID and the large private banks). This was particularly the case in France and Italy, where there is traditionally a strong steering action by the state with limited consultation with the private sector (Josselin 1997, Grossman 2005), albeit this has began to change in the last decades or so (interview, Paris, 18 July 2007, Brussels, 27 June 2007).

The large member states, which are also those with the largest financial sector in the EU, were the most influential in the Council, followed by some of the old member states with a relatively large financial sector, and were followed by the new member states that have a smaller financial sector, which also tends to be foreign owned. Moreover, the new member states joined the EU in 2004, when the negotiations on the Lamflaussy directives were either already ended or close to be completed. It will be interesting to see how they position themselves in the future, whether they will become part of one of the two existing coalitions, reshaping it, or whether a new coalition will emerge. After all, enlargement can be regarded as a considerable change of the policy environment, altering the power distribution amongst the members of the policy subsystem.

In lobbying on securities governance in the EU, there was a sort of implicit division of competences (cf Greenwood 2003). National associations and individual firms mainly interacted with the national authorities, whereas EU level associations interacted with EU level authorities (the Commission, the EP) (cf Grossman 2004). However, the most active national associations, such as the British Bankers Association or the German private banks association (the latter has a well staffed office in Brussels), and some international companies, which either have offices in Brussels or use the services of lobbying firms based there, also lobbied at the EU level, usually (but by no means only) the MEPs and the Commission's officials of their own nationality. This was less the case for other national associations, which have a very limited experience of lobbying in Brussels and/or prefer to rely on the action of the national public authorities.

In addition, there were international associations, many of which US-based, but having an office in London. The International Swaps and Derivatives Association (ISDA), the International Capital Market Association (ICMA), formed by the merger of the International Primary Market Association and International Securities Market Association (formerly known as Association of International Bond Dealers), the Bond Market Association (which in 2006 merged with the Securities Industry Association, creating the Securities Industry and Financial Markets Association), the Future and Options Association. These organisations often take joint positions, or similar positions expressed individually so as to increase the number of responses to consultation.

Given the economic significance of the issues dealt with, the focal points of agreement for the formation of coalitions in the negotiations were generally given by overlapping or compatible interests (hence, they were coalitions of ‘interests’) even though the prevailing beliefs of policy-makers also played a role. The two competing belief systems can be characterised as follows. The Anglo Saxon approach is market-making, in favour of light-touch, principles-based, competition-friendly regulation, even when this implies a trade off with consumer protection. This approach is rooted in common law and is based on market trust. The Continental approach is market-shaping, rules-based and heavily regulated, with emphasis on consumer protection, even when this reduces competition. This approach is rooted in the Napoleonic code and is based on market distrust. In the governance of financial services, the EU is moving towards principle-based regulation, but this creates frictions between the two belief systems and the policy-makers and stakeholders subscribing to them.

Nonetheless, it is difficult to clearly separate belief systems (hence, ultimately ideas) from the features of the national financial system and regulatory issues related to the competitiveness of industry or specific preferences of market players (hence, interests). British policy-makers have traditionally adopted an internationalised free market approach, but this is also influenced by the large number of foreign owned companies (especially from the US) located in the City. French, Italian, Spanish policy-makers embrace a market-shaping inward-oriented approach, which is interconnected to the limited competitiveness of their financial sector. German policy-makers also subscribe to a market-shaping policy, but given the competitiveness of part of their financial sector (private investment banks and financial conglomerates) tend to be more market oriented and competition friendly than France, Italy and Spain, even though this also depends on the specific issues being negotiated.

This remark also partly addresses a potential methodological pitfall of this research: the role played by ‘belief systems’ (or regulatory paradigms) would have more explanatory power if there were instances in which ideas and interests suggested different choices to policy makers, with the ideational component carrying more weight in the policy process. Yet, precisely because regulatory paradigms and market configuration mutually affect each other it is not possible to find clear instances in which these two factors pointed in opposite directions, which is why this paper does not juxtapose interests versus ideas. Both sets of factors influence the completion of the single market in financial services.

The negotiations that took place between the two coalitions in the early 2000s resembled traditional EU bargaining based on trade offs, compromises (eg the home country supervisory approach for shares but not for bonds in the Prospectus directives, the definition of ‘liquid shares’ and ‘standard market’ size in the MiFID etc) and constructive ambiguity (eg decision on controversial issues were postponed, in some case national discretion was inserted in the text etc.). Although both coalitions managed to influence the policy process, the very completion of the single market in financial services was a clear success of the Northern coalition (Mügge 2006, Bieling 2003). Moreover, the new rules are to a considerable extent based on the belief system of this coalition. In the competition between these two coalitions, the Northern coalition by and large prevailed because of two interconnected reasons: the evolution of the policy environment and a process of learning (cf Radaelli 1999 in the case of EU tax harmonisation), both of which altered the bargaining power of its members.

As far as changes in the policy environment are concerned, the Northern coalition was empowered by the introduction of single currency, which increased financial market integration in the EU, and by the renewed competition between the EU and US in this field. In this environment, the completion of the single market in financial services became a priority for the EU and the market-making, competition-friendly approach was regarded as the most successful, providing a competitive model for the EU. In turn, this had implication for the learning process taking place between the coalitions and their members, but further research is needed on this.

Conclusion

The directives passed in the early 2000s and examined in this paper were designed to substantially increase financial market integration in the EU. The making of these directives, and especially the Prospectus and the MiFID, was characterised by the presence, the interactions and the influence in the policy process and eventually in the outcomes of two competing coalitions. On the one side, there was a market-making coalition, formed by Northern member states, their public authorities, industry, and many MEPs. On the other side, there was the market-shaping coalition, formed by Southern member states, parts of their industry and some MEPs.

The outcomes of the negotiations were often rather ‘odd’ compromise solutions between the positions exposed by these two coalitions, or the issue was left open, to be decided later on, as ‘the devil is in the details’ as one policy-maker colourfully put it (interview, Brussels, 27 March 2007). In some cases, the shortcoming of the compromise solutions adopted became apparent only when the directives were implemented. For example, the 'simplified' 'European prospectus' that was the objective of the Prospectus directive was not very simplified, because the directive was excessively convoluted. In other cases, the problem was the excessive use of national discretion and/or gold-plating by the national authorities.

Besides being slowed down by dissimilar (at times opposite) interests of the main policy-makers and stakeholders, the completion of the single market in securities was also rendered more complex by different (often competing) belief systems exposed by the main actors about securities trading regulation. Paraphrasing the title of the book of Story and Walters (1997): *Political Economy of Financial Integration in Europe: The Battle of the Systems*, financial market integration in the EU in the 21st century was not only the battle of the systems, it was also the battle of ideas (to be precise, belief systems) about the regulation of securities trading and financial markets more generally. The literature has so far focused on the role of interests in shaping financial market integration, whereas this research argues that the role of ideas in the form of regulatory paradigms, should also be considered for a thorough explanation of the politics of financial services regulation in the EU.

The main lesson to be drawn for the completion of the single market is that policy-makers and academics need to pay attention to ideas (or belief systems) as well as interests. Policy-makers are aware of this – in the financial services sector there are now several EU initiatives designed to promote the creation of a shared supervisory and regulatory 'culture' across the EU (this expression is used in many policy documents, as well as being stressed in several interviews). Academics should endeavour to combine or integrate ideas and interests in their studies in a more systematic way. An adapted version of the advocacy coalition framework can be instrumental in doing so. It would be interesting to extend this analysis to other sectors of the single market.

What are the prospects for the future? The completion of the single market in financial services is well under way but it is far from being completed. The coalitions are likely to remain active in shaping the EU market in financial services. There are two main open questions. First, there is the interesting question of how the new member states will position themselves. Second, the financial turmoil of 2007-2008 in Europe and worldwide might provide some ammunition to the advocates of a more prescriptive, less market-friendly approach to financial services regulation.

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