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**Internationalization and the State: Reforming Regulatory
Institutions**

Mark Thatcher

Professor in Comparative and International Politics, LSE

M.Thatcher@lse.ac.uk

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Internationalization and the state: reforming regulatory institutions

Mark Thatcher
London School of Economics

Department of Government
Houghton Street
London WC2A 2AE

m.thatcher@lse.ac.uk

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The effects of international forces on national institutions lie at the heart of many recent debates in comparative political economy and comparative politics. On the one hand, strong globalisationalists', have argued that increased cross-border capital and trade flows were leading to cross-national institutional convergence due to international competition and the need to attract footloose capital.¹ They have predicted that nations will be obliged to adopt 'liberal' economic institutions.

In contrast, historical institutionalist (HI) analyses of economic policy making and politics argued that nations maintain stable and different economic institutions. Early HI studies claim that institutional change is difficult and rare; as a result, despite common international pressures, nations maintain different market and state institutions, with diverse forms and capacities.² More recent HI-inspired work on comparative capitalisms has suggested that institutions evolve but that changes are strongly influenced by existing national institutions, so that even if faced with 'globalisation', nations maintain different 'varieties' or 'models' of capitalism.³ The literatures share common foundations that existing institutions are strongly conditioned by past ones.⁴

¹ Cf. Susan Strange, *Casino Capitalism*. (Oxford: Blackwell 1986), *The Retreat of the State: The Diffusion of Power in the World Economy*. (Cambridge: Cambridge University Press, 1996), DM Andrews, 'Capital Mobility and State Autonomy: Toward a Structural Theory of International Monetary Relations', *International Studies Quarterly*, 38 (1994): 193–218, JB Goodman and L Pauly 'The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets', *World Politics* (1993), 46/1: 50–1993.

² See for instance, Peter Hall, *Governing the Economy* (Cambridge: Polity Press 1986), Frank Dobbin, *Forging Industrial Policy: The United States, Britain and France in the Railway Age* (Cambridge: Cambridge University Press 1994), Sven Steinmo, *Taxation and Democracy* (New Haven: Yale University Press, 1993).

³ Among the vast literature, important recent work on evolutionary institutional change (as distinct from policy) includes Kathleen Thelen, *How institutions evolve : the political economy of skills in Germany, Britain, the United States, and Japan* (Cambridge : Cambridge University Press, 2004), Wolfgang Streeck and Kathleen Thelen eds, *Beyond continuity : institutional change in advanced political economies* (Oxford: Oxford University Press, 2005), John L. Campbell, *Institutional change and globalization* (Princeton, NJ : Princeton University Press, 2004, Vivien S. Schmidt, *The Futures of European Capitalism* (Oxford: Oxford University Press, 2002), Peter Hall and David Soskice eds, *Varieties of capitalism : the institutional foundations of comparative advantage* (New York: Oxford University Press, 2001), Jacob S. Hacker, 'Privatizing Risk without Privatizing the Welfare State: The Hidden Politics of Social Policy Retrenchment in the United States',

This paper examines a central issue in the debate about internationalization and state institutions: the effects of internationalisation of markets on national economic institutions. (It does not examine the effects of institutions on policy making due to constraints of space). In particular, it looks at regulatory institutions that govern domestic markets, such as rules governing competition, ownership of suppliers and the allocation of regulatory powers.⁵ These offer crucial cases for claims that despite powerful similar external pressures nations maintain distinct types of economic institutions due to the influence of previous institutions.

The paper focuses most on HI analyses. There are several reasons for this. First, the concept of globalization has been greatly broadened and enriched since the strong globalisationalists wrote in the early 1990s.⁶ Second, the extent, novelty and even the existence of economic globalization have been strongly questioned.⁷ Finally, the HI literature is sophisticated and well-suited for comparative analyses of state administrations.

The central argument is that HI analyses, despite recent advances, have adopted an over-narrow analysis of market internationalization by focusing on economic globalization and its effects on economic efficiency and firms. They under-estimate institutional change and worse still, appear to undermine historical institutionalist methodology of studying institutions over lengthy periods. However, such deficiencies can and should be remedied by developing the public policy and political analysis of market internationalization and that in so doing, the value of HI methodology becomes clear. Indeed, developing HI analyses of market internationalization provides some responses to wider criticisms of historical institutionalism.

The article therefore seeks to make three contributions to HI analyses. First, it provides a broader treatment of market internationalization by drawing on other literatures, especially work on cross-national policy transfer/diffusion. It suggests that market internationalization can take both economic forms but also 'policy forms' - ie. decisions of overseas or supranational policy makers that create pressures to alter domestic market institutions. It sets out a wider range of mechanisms for their operation such as cross-national learning, fear of regulatory competition, coercion and use of overseas reforms or supranational regulation to legitimate reforms.

Second, it applies the broader approach to market internationalization to a carefully selected case study (regulatory institutions in securities trading in Britain, France and Germany 1965-2008) to develop HI claims. Using historical process tracing it provides two findings that can serve as general hypotheses for testing in other cases. One is that even revolutionary

American Political Science Review (2004), 98: 243-260, Marie-Laure Djelic and Sigrud Quack eds, *Globalization and institutions : redefining the rules of the economic game* (Cheltenham : Edward Elgar, 2003), Paul Pierson, *Politics in Time: history, institutions, and social analysis* (Princeton, N.J. : Princeton University Press, 2004).

⁴ Notably due to path dependence and the importance of largescale but slow processes- see notably Paul Pierson, 2004 *Politics in Time* and Mohoney 2000 and 2003.

⁵ For discussions of different meanings of 'regulation', see Robert Baldwin, Colin Scott, Christopher Hood (eds), *A reader on regulation* (Oxford: OUP, 1998); here the focus is on formal rules and organisational features that structure markets.

⁶ See for instance, Held, D., McGrew, A., Goldblatt, D., and Perraton, J. (1999). *Global Transformations: Politics, Economics, and Culture*. Cambridge: Polity Press.

⁷ See for instance, Hirst, D. and Thompson, G. (1999). *Globalization in Question*. Cambridge: Polity Press or Fligstein, N. (2001). *The Architecture of Markets: An Economic Sociology of Twenty-First Century Capitalist Societies*. Princeton, NJ: Princeton University Press; others treat globalisation as an on-going phenomenon that dates back centuries- in the regulatory field, see for instance Braithwaite, J. and Drahos, P. (2000). *Global Business Regulation*. Cambridge: Cambridge University Press.

technological and economic developments fail to lead to major institutional reforms, a finding consistent with traditional HI claims. Institutional inertia occurred because non-institutional responses were found to pressures arising from economic internationalization and/or institutions widely seen as economically 'inefficient' were maintained because conservative coalitions are able to defend them in the political process.

In contrast, the second finding is that policy forms of internationalization such as reforms in the US and EU regulation, had significant impacts on reform of regulatory institutions. They did so by becoming part of national policy-making processes, altering the strategies and coalitions of domestic actors, offering legitimation for reform and providing reformers with reasons and resources to overcome domestic opposition. Other forms of internationalisation offer opportunities for state actors to reshape market institutions in ways. Thus the article argues that states 'learnt' selectively from reforms in overseas nations in order to establish reform programmes and legitimate them. International regulation offered an effective method of circumventing domestic veto players, as state actors obtain regulation that they wish at a 'higher level' that then allows them to justify domestic reforms.

Third, the article argues that policy forms of internationalization aided the alteration of long-standing institutions that, contrary to HI expectations, resulted in cross-national convergence. However, at the same time, the impacts of internationalization varied across nations and nations reached similar outcomes through different routes in terms of timing, pace, modes of change and strategies. Institutional convergence conceals important contrasts in explanations for changes that HI methods can reveal.

Thus whilst present HI analyses of market internationalization suffer from important limitations, they can and should be enriched with concepts and mechanisms that relate more directly to policy making. When this is done, HI analyses can become extremely valuable for explaining how, when and why internationalisation of markets affects domestic institutional reform and can be used to generate substantive and empirically-testable hypotheses. Indeed, given that nations can reach similar outcomes for different reasons, HI analysis through detailed historical studies within nations is essential to understand those effects. The broader policy and political treatment of internationalization of markets offers responses to general critiques of HI analyses, such as neglect of conflict, the state, ideas and discourse.

To sustain its arguments, the article begins with a critique of HI treatments of market internationalisation and national institutions, before justifying the choice of the case study and then analysing the three forms of internationalization and their effects.

Key elements of HI analyses of market internationalisation and domestic institutions

This section focuses on setting out and then evaluating HI analyses of three salient points concerning internationalization: the definition of internationalisation of markets; the processes whereby it affects national institutional change; its effects on institutions governing markets.

Before doing so, some brief definitions are in order. Historical institutionalism has been widely surveyed and distinguished from other forms of institutionalism.⁸ It is taken here to

⁸ For reviews see Ellen M Immergut and Karen M Anderson, 'Historical Institutionalism and West European Politics', *West European Politics* 31(1-2): 345-69 January-March 2008, Sven Steinmo, 'Historical Institutionalism' in *Approaches in the Social Sciences*, edited by Donatella Della Porta and Michael Keating,

mean studies that explicitly seek to theorise how past institutional developments mark current political decisions.⁹ It includes both traditional historical institutionalism, which has often reacted against rational choice and instead underlined that rationalities are historically constructed, and also recent work on ‘comparative capitalism’ that is strongly based on path dependencies and the influence of inherited national structures.¹⁰ Following many HI works, ‘institutions’ are defined as formalised rules and procedures, notably ‘regulative institutions’ consisting of “legal, constitutional and other rules that regularise behaviour”¹¹ concerning the structure of markets.

Early HI work treated internationalisation of markets as one-off shocks, such as oil crises or world-wide recessions.¹² These gave rise to problems such as inflation, unemployment and exchange rate crises that led to pressures that ranged from domestic dissatisfaction to economic and political crisis. Nevertheless, national market institutions remained resilient: Domestic interests defended existing institutions that were deeply rooted in history and that benefited them. Change was very slow or rare, taking place only at moments of crisis, through a process of ‘punctuated equilibrium’.¹³ Moreover, institutional modification could often be strongly moulded by existing institutions. Thus for instance, new institutions would be copied from existing ones, or inherited arrangements blocked certain reform.¹⁴ Given the difficulty of institutional reform, most attention was directed at how national institutions influenced policy responses to international pressures its effects on institutional developments. Most studies underlined how different institutions such state structures, the presence of corporatist linkages or as banking systems, led to diverse responses, often contrasting ‘Anglo-Saxon’ countries such as the UK and the US, with ‘corporatist ones such as (West) Germany and ‘statist’ ones such as France.¹⁵

Cambridge University Press, (forthcoming, 2008), Campbell ‘Institutional change’, Campbell *Globalization and Institutional Change 2004*, Kathleen Thelen, ‘Historical Institutionalism in Comparative Politics’, *The Annual Review of Political Science* 1999. Palo Alto, CA: Annual Reviews, B. Guy Peters, *Institutional theory in political science: the ‘new institutionalism’* (London: Pinter 1999), ch 4, Ellen M. Immergut, ‘The Theoretical Core of the New Institutionalism’, *Politics and Society*, 25(1) (1998), 5-34).

⁹ Cf the definition of Thelen and Steinmo 1992, p2, “an emphasis on how pre-existing institutions structure contemporary political conflicts and outcomes” and discussion by Immergut 2008, pp353-4.

¹⁰ For an overview of different approaches and critique, see Richard Deeg and Gregory Jackson, ‘Towards a more dynamic theory of capitalist variety’, *Socio-Economic Review* 5(2007): 149-179

¹¹ Campbell, *Institutional Change*, quote p36, cf. p23; cf. Wolfgang Streeck and Kathleen Thelen, ‘Introduction’ in Streeck and Thelen, *Beyond Continuity*, pp.1-39, cf. pp. 9-16, and Kathleen Thelen and Sven Steinmo, ‘Historical institutionalism in comparative politics’, in Sven Steinmo, Kathleen Thelen and Frank Longstreth, eds, *Structuring politics. Historical institutionalism in comparative analysis* (Cambridge: Cambridge University Press, 1992), p. 2; for a different approach analysing the relationship between formal and informal institutions, see P Culpepper, ‘Institutional Change in Contemporary Capitalism’, *World Politics* 57(2): 173-99.

¹² See eg. Peter A. Hall, *Governing the Economy* (Cambridge: Polity Press, 1986), Peter A. Hall and Rosemary C.R. Taylor, ‘Political Science and the Three New Institutionalisms’, *Political Studies*, 44(4), 936-57, Margaret Weir, *Politics and Jobs. The Boundaries of Employment Policy in the United States* (Princeton: Princeton University Press, 1992), Sven Steinmo, *Taxation and Democracy* (New Haven and London: Yale University Press, 1993), Immergut 2008, p350.; for other comparative political economy work that also drew heavily on historically-based national institutions, see Peter Gourevitch *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca, NY: Cornell University Press, 1986) and Peter Katzenstein *Small States in World Markets: Industrial Policy in Europe* (Ithaca, NY: Cornell University Press, 1985).

¹³ Stephen Krasner ‘Approaches to the State. Alternative Conceptions and Historical Dynamics’, *Comparative Politics*, 16: 223–46.

¹⁴ Dobbin F., *Forging industrial policy. The United States, Britain, and France in the railway age* (Cambridge: Cambridge University Press, 1994).

¹⁵ In addition to the references above in footnote XX, see for instance, Zysman, J., *Governments, Markets and Growth* (New York: Cornell University Press, 1983), Zysman, J., ‘How Institutions Create Historically Rooted Trajectories of Growth’, *Industrial and Corporate Change*, 3(1) (1994), 243-283; cf also Dyson, K. and Wilks, S. (eds), *Industrial Crisis* (Oxford: Martin Robertson, 1983).

However, recent HI work has given much greater place to the effects of international market pressures on domestic institutional change. It has often focused on ‘globalisation’.¹⁶ Hall and Soskice (2001) define globalisation as “developments that have made it easier for companies to locate operations abroad”, including trade liberalization, deregulation and expansion of international financial markets, access to and expansion of former communist countries and declining transport and communication costs.¹⁷ Similarly, Campbell (2004: 125) treats economic globalization as an increase in cross-border economic flows, while Streeck and Thelen (2005: 3-4) study the effects of ‘microelectronics, internationalization and globalization’ (such as rising competition in world markets, international agreements on fiscal policies, and new ideologies opposed to collective solutions to economic issues).

These recent HI analyses argue that it is more efficient and politically feasible for nations to meet globalization by gradually reforming existing institutions. Focusing on the needs of firms, Hall and Soskice claim that companies respond to globalization by seeking to ensure comparative economic advantages, which themselves are conditioned by existing ‘institutional complementarities’. Although such complementarities may mean ‘snowballing’ of reform across sectors, they are more likely to prevent radical change and also shape it in path-dependent ways.¹⁸ Thus for instance, in the face of globalization, they suggest that liberal market economies introduce more ‘deregulation’ than coordinated market ones, and indeed “nations often prosper, not by becoming more similar, but by building on their institutional differences”.¹⁹ Other HI analyses emphasise the role of interests, learning and the political process, all shaped by existing institutions, in shaping responses to international pressures. Streeck and Thelen suggest that since existing institutions build up supporting constituencies, it is easier for policy makers to ‘work round’ those institutions through transforming them rather than abolishing them or radically altering their formal structures.²⁰ John Campbell and Colin Crouch analyse how it is easier to recombine institutions, as a form of institutional lego-building, rather than having to start from scratch and create new building blocks.²¹ Even cross-national learning is strongly influenced by existing institutions, which affect how overseas ideas and examples are selected, ‘translated’ and acted upon.²²

¹⁶ For an exception that bring in other factors, particularly Europeanisation, see Schmidt, *The Futures of European Capitalism*.

¹⁷ See also Schmidt *The Futures of European Capitalism*, Suzanne Berger and Ronald Dore, eds, *National diversity and global capitalism* (Ithaca, NY : Cornell University Press, 1996), J. Rogers Hollingsworth and Robert Boyer, eds, *Contemporary capitalism : the embeddedness of institutions* (Cambridge: Cambridge University Press, 1997).

¹⁸ Hall and Soskice 2001: pp62-66, P.A Hall, ‘The Evolution of Varieties of Capitalism in Europe’, in B Hancké, M. Rhodes and M Thatcher (eds), *Beyond Varieties of Capitalism* (Oxford: Oxford University Press, 2007) ; for a discussion of complementarities, see for instance Richard Deeg, Richard Deeg, Complementarity and institutional change in capitalist systems, *Journal of European Public Policy*, Volume 14, Issue 4 June 2007 , pages 611 – 630.

¹⁹ Hall and Soskice, 2001b: 60; see also the literature on path dependency, although this suggests reinforcement of existing directions of change under certain conditions rather than necessarily gradual change- see Paul Pierson, Increasing Returns, Path Dependence, and the Study of Politics, *American Political Science Review*, 94(2) (2000), pp. 251-267, James Mahoney, ‘Path Dependence in Historical Sociology’, *Theory and Society* 29 (2000), pp.5-7-48, Deeg, ‘Change from Within’.

²⁰ See Thelen, *How Institutions Evolve*, Streeck and Thelen, *Beyond Continuity*.

²¹ Campbell, *Institutional Change*; Colin Crouch, *Capitalist diversity and change : recombinant governance and institutional entrepreneurs* (Oxford: Oxford University Press, 2005).

²² See for instance, Campbell, *Institutional Change*, Randall Hansen and Desmond King, ‘Eugenic Ideas, Political Interests, and Policy Variance,’ *World Politics*, 53 (2001), pp.237–63, Dietrich Rueschmeyer and Theda Skocpol, eds, *States, Social Knowledge, and the Origins of Modern Social Policies* (Princeton: Princeton University Press, 1996).

HI analyses differ about the ways in which institutions are altered, but share the view that globalization is usually met with gradual change in formal institutions, building on or altering existing institutions, rather than revolutionary reform.²³ (Modification of the effects and logics of institutions is another matter, as several writers underline how these can alter fundamentally without corresponding alterations of formal institutions).²⁴ Streeck and Thelen argue that existing institutions are transformed ‘without disruption’ through five modes of gradual change- displacement, layering, drift, conversion and exhaustion.²⁵ Such processes may lead to major institutional change and indeed the spread of neo-liberal institutions, but are slow and existing formal institutions are preserved. Hall and Soskice (2001) argue that in the face of globalisation, nations become more diverse, reinforcing existing institutional complementarities and maintaining different ‘varieties of capitalism’.²⁶ John Campbell offers a ‘bricolage’ model, arguing that in response to globalization, policy makers reconfigure and re-mix existing institutions. However, the common conclusion across HI analyses is that institutional legacies strongly influence the evolution of formal national institutions.²⁷

A critique of HI analyses of internationalisation and domestic institutional reform

HI approaches dealing with internationalization and institutional change have several strong points. They point to the role of existing arrangements, which is essential since institutional reform debates and decisions do not take place on a ‘blank page’ but from the starting point of existing national institution. They also offer empirically applicable categories and predictions. They set out good reasons why radical modification of national institutions is difficult and bounded. Recent work explicitly integrates change into its analyses.

At the same time, they suffer from important limitations. They take a narrow view of internationalisation of markets.²⁸ Several reduce it to economic globalisation, and even here, the concept is sometimes confined to that adopted by early ‘strong globalisationalists’, namely increased cross-border capital and trade flows.²⁹ The occurrence and extent of economic globalisation remain bitterly contested.³⁰ Moreover, the treatment of globalization provides a

²³ Although Campbell, Institutional change, at the end of his study, does seek to define conditions under which revolutionary reforms take place, but the much of his analysis is about translation and bricolage.

²⁴ See Streeck and Thelen, Beyond Continuity, Richard Deeg, ‘Change from Within: German and Italian Finance in the 1990s’, in Streeck and Thelen, Beyond Continuity pp.169-202.

²⁵ 2005; see also Thelen 2004

²⁶ See also Hall 2007 op cit.; for other ‘varieties of capitalisms’ studies that conclude that in the face of international or global pressures, diversity continues, see for instance -Berger and Dore 1996, Crouch and Streeck 1997.

²⁷ NB Peter Hall and Kathleen Thelen ‘Institutional change in varieties of capitalism’, paper presented to the annual meeting of the American Political Science Association Washington DC, 1 September 2005.

²⁸ For a wider discussion of the concept, see Mark Thatcher, *Internationalisation and Economic Institutions* (Oxford: Oxford University Press 2007)

²⁹ Cf. Susan Strange, *The retreat of the state : the diffusion of power in the world economy* (Cambridge : Cambridge University Press, 1996), David M. Andrews, ‘Capital Mobility and State Autonomy: Toward a Structural Theory of International Monetary Relations’, *International Studies Quarterly*, 38 (1994), pp. 193–218, John B. Goodman, Louis W. Pauly, ‘The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets’, *World Politics*, 46/1 (1993): 50–82 for treatment of globalisation as a multi-dimensional variable see David Held, Anthony McGrew, David Goldblatt and Perraton, *Global transformations: politics, economics and culture* (Cambridge, UK : Polity Press, 1999); a rare exception is Djelic and Quack, *Globalization and institutions, who include EU regulation*.

³⁰ For attacks see Neil Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-First Century Capitalist Societies*. (Princeton, NJ: Princeton University Press, 2001) and Paul Hirst and Grahame Thompson, *Globalization in question : the international economy and the possibilities of governance* (Cambridge: Polity Press 1999).

good illustration of general critiques by Peters, Pierre and King, and by Blyth of the narrowness of HI analyses: the focus on efficiency can mean that the ideational aspects and mechanisms of internationalization are eliminated.³¹ Equally, other international sources of market change outside globalization such as cross-national diffusion, transnationalization and multi-level governance supranational entrepreneurs, are omitted or given insufficient recognition.³²

A second criticism is neglect of domestic public policy processes, which also offers an illustration of the general criticism of neglect of conflicts and political struggles. Several approaches see societal actors as the main bearers of internationalisation, especially firms that respond to altered competitive conditions, in turn leading to action by policy makers.³³ But, the analysis neglects public policy makers as a potential source of institutional change, able to initiate and lead reforms. It is strange to treat public officials as largely passive actors, responding to societal ones, especially given earlier HI work on 'bringing the state back in'.³⁴ Equally, there is too little on how internationalisation operates within the policy process- how internationalisation affects the strategies, coalitions and resources of actors. Yet institutional change is often highly contested and overall 'efficiency' can be secondary to considerations of power and advantages for specific actors.

A third issue concerns the apparently increasing frequency of rapid, comprehensive and cross-nationally similar reform of national market institutions. 'Liberal' economic institutions have replaced long-standing institutions, representing radical changes. Thus for instance, privatization has replaced public ownership across many countries and sectors, ending institutional arrangements dating back decades or even centuries.³⁵ Liberalisation of supply, trade and capital flows has replaced restrictions and rules protecting domestic suppliers.³⁶ Government powers have been delegated to new or independent regulatory agencies.³⁷ Hence the empirical claims of HI analyses face conflicting evidence.

Developing HI analyses of internationalization and reform of domestic market institutions

³¹ Peters, Pierre and King, 'The Politics of Path Dependency', Blyth, 'Any More Bright Ideas'.

³² Deeg and Jackson 2007, pp154-5; for a good discussion of different international sources of change, see Elliot Posner, 'The Supranational Origins of Europe's New Stock Markets', *World Politics* 58 (2005), pp. 1-40; for cross-national diffusion also see below.

³³ Cf. Hall and Soskice, *Varieties of capitalism*, Djelic and Quack, *Globalization and institutions*.

³⁴ Peter B. Evans, Dietrich Rueschmeyer, Theda Skocpol (eds), *Bringing the state back in*, Cambridge : Cambridge University Press, 1985

³⁵ For recent work, see for instance, Judith Clifton; Francisco Comín; Daniel Díaz Fuentes, 'Privatizing public enterprises in the European Union 1960-2002: ideological, pragmatic, inevitable?', *Journal of European Public Policy*, Volume 13(5) (2006), pp. 736 - 756.

³⁶ Beth A. Simmons, Frank Dobbin and Geoffrey Garrett, 'Introduction: The International Diffusion of Liberalism', *International Organization* 60 (2006): 781-810, Beth A. Simmons and Zachery Elkins, 'The Globalization of Liberalization: Policy Diffusion in the International Political Economy', *American Political Science Review* 98(1): 171-89, Mark Thatcher, *Internationalisation and Economic Institutions: Comparing European Experiences* (Oxford: Oxford University Press, 2007), Victoria M. Murillo and Cecilia Martínez-Gallardo, 'Political Competition and Policy Adoption: Market Reforms in Latin American Public Utilities', *American Journal of Political Science* 51 (1) (2007), 120-139.

³⁷ David Levi-Faur; 'The Politics of Liberalisation: Privatisation and Regulation-for-Competition in Europe's and Latin America's Telecoms and Electricity Industries', *European Journal of Political Research*, 42/5 (2003): 705-40, Fabrizio Gilardi, 'The Institutional Foundations of Regulatory Capitalism: The Diffusion of Independent Regulatory Agencies in Western Europe', *The Annals of the American Academy of Political and Social Science*, 598 (2005): 84-101, Mark Thatcher, 'Delegation to Independent Regulatory Agencies: Pressures, Functions and Contextual Mediation', *West European Politics* 25(1) (2002) pp.125-47, Murillo and Martínez-Gallardo, 'Political Competition and Policy Adoption'.

The foregoing analysis suggests that historical institutionalism has given too little attention to public policy and political processes in its consideration of internationalization and domestic institutions. This section seeks to develop HI analyses, notably concerning different forms of internationalization, the mechanisms whereby they may influence institutional change, their carriers and effects on strategies, coalitions and resources of actors in the policy process.

The section draws greatly on literatures on cross-national policy transfer, diffusion and learning.³⁸ They offer a good source of concepts and mechanisms because they combine international and national levels of analysis.³⁹ Indeed, several authors using the policy transfer/diffusion approach have also used different forms of historical institutionalism, suggesting that the two literatures are compatible.⁴⁰ The literatures suggest that external policies can affect the incentives of actors in other nations, including market actors and policy makers. Although policy transfer has often been treated as a dependent variable (eg Bulmer and Padgett 2005), here it is used as an independent or intervening variable to explain how and why different forms of internationalisation affect domestic institutional reform.

Market internationalization can be defined as new or strengthened factors that put pressures on national policy makers to alter domestic markets (taken here as systems of economic exchange for goods and services) but are outside the control of those policy makers.⁴¹ Hence it extends well beyond economic globalization and capital flows. The policy transfer literature points out that the policies of overseas nations and of international organizations can affect national decisions. One prominent source of cross-national policy transfer/diffusion is the policies of powerful overseas nations that are outside the control of domestic policy makers

³⁸ For discussions of policy transfer/diffusion, see David Dolowitz and David Marsh, 'Who Learns What From Whom? A Review of the Policy Transfer Literature', *Political Studies*, 44(2) (1996): 343-57 and 'Learning from Abroad: The Role of Policy Transfer in Contemporary Policy-Making', *Governance*, 13/1 (2000): 5-24, Colin J. Bennett, 'Understanding Ripple Effects: The Cross-National Adoption of Policy Instruments for Bureaucratic Accountability', *Governance*, 10(3) (1997): 213-33, Richard Rose, *Lesson-drawing in Public Policy* (Chatham NJ: Chatham House Publishers, 1993), Simmons and Elkins, 'The Globalization of Liberalization', Simmons, Dobbin and Garrett, 'Introduction: The International Diffusion of Liberalism', Simon Bulmer and Stephen Padgett, 'Policy Transfer in the European Union; an Institutionalist Perspective', *British Journal of Political Science*, 35(1) (2005), pp. 103-26, Simon Bulmer, David Dolowitz, Peter Humphreys and Stephen Padgett, *Policy Transfer in the European Union. Regulating the Utilities*. (London: Routledge, 2007), Edward C. Page, *Future Governance and the Literature on Policy Transfer and Lesson Drawing*. Hull: ESRC Future Governance Programme, www.futuregovernance.ac.uk/Papers, 2000, Mark Evans, Jonathan Davies (1999) Understanding 'Policy Transfer: A Multi-Level, Multi-Disciplinary Perspective' *Public Administration* 77 (2), 361-385; for a critique, see Oliver James and Martin Lodge. (2003) The Limitations of 'Policy Transfer' and 'Lesson Drawing' for Public Policy Research. *Political Studies Review* 1:2, 179-193

³⁹ At the same time, the policy transfer/diffusion/learning literature does not provide a set of substantive hypotheses nor does it suggest that detailed historical studies that are focused on national specificities are particularly useful; hence it is not a rival to HI analyses either substantively or methodologically but rather is a set of concepts and frameworks that can be applied (and indeed integrated) with other approaches.

⁴⁰ For instance, Bulmer and Padgett, 'Policy Transfer in the European Union', Bulmer et al, *Policy Transfer*.

⁴¹ This is derived from the 'second image reversed' tradition- see for instance, Jeffrey Frieden and Ronald Rogowski 'The Impact of the International Political Economy on National Policies', in R. O. Keohane and H. Milner (eds.), *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1996) pp. 25-47 who define internationalisation as "an exogenous decrease in the costs, or an increase in the rewards, of international economic transactions" which then give rise to increased cross-border trade and investment, although they then unfortunately focus almost exclusively on trade; Wolfgang Streeck suggests that "internationalization is 'social relations' that may put pressure on national institutions" and "extend across national borders"- W Streeck, 'Globalization: nothing new under the sun?', *Socio-Economic Review* 5 (2007): 537-47, p538

but which affect the ‘related’ nation through trade, language or culture.⁴² Although linkages can be mutual, the clearest example is when one nation is much more independent than the one(s) that it affects- for instance, due to size, insularity or limited overseas trade. A second source of cross-national transfer can be supranational regulation organizations, such as the EU and the WTO. These organizations take decisions that can influence domestic markets and have a degree of autonomy from their members or at the very least, are unlikely to be controlled by the government of any one nation.⁴³ Thus for instance, the growing literature on ‘Europeanisation’ emphasizes the many ways in which the EU can influence domestic decisions.⁴⁴ Drawing on these policy-related literatures, the scope of internationalization can be broadened to include ‘policy forms’.

HI analyses have been rightly criticized for over-focusing on interests and efficiency in explaining institutional change and omitting ideational aspects of decision making. They need to study a wider range of mechanisms whereby the different forms of internationalization can influence domestic decision making about institutions, which is often about ‘who gets what’ rather than overall efficiency. The policy transfer/diffusion literature offers such a range. Simmons and Elkins (2004) offer a useful division between mechanisms that operate by altering the ‘payoffs’ of decision makers and those that involve ideas.⁴⁵ The former can take the form of direct coercion, through military force or legal requirements, or creating standards so that nations making different choices are classed as ‘deviant’ and face losses. Alteration of payoffs can also be more indirect, through competition, as policies in one country alter the relative competitive advantages of certain market structures. One example is regulatory competition where alteration in one nation’s institutions offers its firms new advantages relative to those elsewhere with implications for inward investment and competition for overseas markets.⁴⁶ The second type, mechanisms involving ideas, include cross-national learning, affecting information and theories about institutional choices.⁴⁷ But they also include emulation, whereby overseas examples are copied because they alter the ‘norms of

⁴² Cf. Simmons and Elkins, ‘The Globalization of Liberalization’, Simmons, Dobbin and Garrett, ‘Introduction: The International Diffusion of Liberalism’.

⁴³ Unlike Simmons and Elkins, international organisations are treated separately from cross-national diffusion, since such organisations are assumed here to have a degree of autonomy from a powerful nation, and hence can offer an independent force for reform; for a principal-agent analysis of the EU discussing its autonomy see Mark Pollack, *The Engines of European Integration* (Oxford: Oxford University Press, 2003); for debates about EU autonomy from national governments, see Andrew Moravcsik, *The Choice for Europe* (Ithaca, N.Y. : Cornell University Press, 1998) and Wayne Sandholtz and Alec Stone Sweet, eds, *European integration and supranational governance* (New York : Oxford University Press, 1998).

⁴⁴ Among the vast literature, see for instance, Kevin Featherstone and Claudio M. Radaelli, eds, *The politics of Europeanization* (Oxford : Oxford University Press, 2003), Maria Green Cowles, James Caporaso, and Thmoas Risse, (eds), *Transforming Europe* (Ithaca: Cornell University Press 2001), Public ‘Policy Change and Discourse in Europe’, Special Issue, *West European Politics*, 27/2 (2004), Vivien A. Schmidt, *Futures of European Capitalism and Democracy in Europe* (Oxford: Oxford University Press 2006).

⁴⁵ See Simmons and Elkins, ‘The Globalization of Liberalization’, Simmons, Dobbin and Garrett, ‘Introduction: The International Diffusion of Liberalism’ and also Bulmer and Padgett, ‘Policy Transfer in the European Union’.

⁴⁶ For a discussion of regulatory competition, see Claudio M. Radaelli, ‘The Puzzle of Regulatory Competition’, *Journal of Public Policy*, 24/1(2004): 1–23.

⁴⁷ Among the vast cross-national policy learning and spread of ideas literature, see for instance Rose, *Lesson-Drawing*, Randall Hansen and Desmond S. King ‘Eugenic Ideas, Political Interests, and Policy Variance,’ *World Politics*, 53 (2001): 237–63., Mark Blyth, *Great transformations : economic ideas and institutional change in the twentieth century*, (New York : Cambridge University Press, 2002), Dolowitz. and Marsh ‘who learns what from whom’, Judith Goldstein and Robert O Keohane, eds, *Ideas and Foreign Policy. Beliefs, Institutions and Political Change* (Cornell University Press, 1993) Peter A. Hall ed, *The Political Power of Economic Ideas* (Princeton: Princeton University Press 1989).

appropriateness' and hence what is legitimate, regardless of whether the new institutions are more efficient.⁴⁸

Analyses of the possible carriers of internationalization need to go beyond firms to include other possible actors such as elected politicians, civil servants, political parties, experts and non-governmental organizations. The policy transfer/diffusion literature points to the need to investigate who are the 'transfer agents' and when, how and why they operate at both the international and domestic levels.⁴⁹ This invites consideration of how internationalization affects strategies and coalitions, for as HI studies accept, greater attention in studying institutional change should be given to coalitions, since they must form and overcome opposition to reform.⁵⁰

Finally, increasing the explanatory power of HI analyses calls for testing in selected cases and development of better specified, more specific and more bounded claims. This is especially true because historical institutionalism is based on explaining empirical phenomena,⁵¹ and hence if 'deviant' cases are found- such as rapid and/or cross-nationally convergent institutional change in the face of internationalization- HI claims need to be altered. This article seeks to do so through a selected case study, namely securities trading in European nations between the mid-1960s and 2007.

In examining the case study, thus the present article examines both economic and policy forms of internationalization, and their operation through effects on domestic policy makers' payoffs and ideational influences. It goes beyond firms to include other possible actors who may be carriers of internationalization.

The case of internationalisation and regulatory institutions for securities trading in Britain, France and Germany 1965-2007

The case of regulatory securities trading is selected to develop HI analyses of market internationalization and domestic institutional change for several reasons. It is economically and politically significant. It is crucially linked to the type of economy a nation has, notably whether it is more 'bank based' or equity based. Hence changes in securities markets can have repercussions throughout the economy and indeed, would be expected to affect wider institutional complementarities. Moreover, in the mid-1960s Britain, France and Germany all had deeply-rooted and diverse sectoral economic institutions that corresponded reasonably well to wider characterizations about the different 'varieties of capitalism'. Over the period from the 1960s until 2007 they have faced several different powerful forms of internationalization. Three forms are notable and studied here: revolutionary transnational technological and economic changes, which represent a form of economic globalisation;

⁴⁸ Cf. Paul J. DiMaggio and Walter W. Powell, 'Institutional Isomorphism and Collective Rationality', in W. W. Powell and P. J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis* (Chicago, IL: University of Chicago Press, 1992), pp. 63–82., Kathleen McNamera, 'Rational Fictions: Central Bank Independence and the Social Logic of Delegation', *West European Politics* 25(1) (2002.), pp.47-76

⁴⁹ Cf. Dolowitz and Marsh; Diane Stone, 'Transfer agents and global networks in the 'transnationalization' of policy', *Journal of European Public Policy*, Volume 11, Issue 3 June 2004, pages 545 – 566, David P Dolowitz, David Marsh (2000) *Learning from Abroad: The Role of Policy Transfer in Contemporary Policy-Making Governance* 13 (1), 5–23.

⁵⁰ Peter A. Hall, 'The Evolution of Varieties of Capitalism in Europe' in B. Hancké, M, Rhodes, and M Thatcher, eds, *Beyond Varieties of Capitalism* (Oxford: Oxford University Press, 2007), Djelic and Quack, , *Globalization and institutions*.

⁵¹ Sven Steinmo, 'Historical Institutionalism', 2007.

policies in the US, a powerful national which can influence European nations through altered payoffs and ideationally; supra-national regulation by the EU regulation which has both coercive legal force and can operate through ideational mechanisms. Moreover, the three forms began at different times, with the first starting from the mid-1960s, the second being more significant from the mid-1970s and EU regulation only becoming prominent in the late 1980s. The case thus allows the effects of different forms of internationalization to be studied and the relative importance of ‘economic globalization’ and policy forms of internationalization to be assessed. Current HI analyses would lead us to expect institutional stability or bounded evolutionary change, thereby maintaining diverse institutions. If these claims are upheld, it would offer powerful support in other domains less exposed to market internationalization, especially as transnational technological and economic developments have been sweeping.

The period from the mid-1960s until 2007 is studied, offering a significant time period to examine HI claims of previous institutions influencing institutional evolution. The article uses a classic historical institutional tool, namely process tracing, to study the effects of the three different forms of internationalization, thereby aiding in identifying carriers of internationalisation, and their strategies, coalitions and opponents.⁵² This empirical part begins by briefly summarizing the three forms of internationalization in the sector before examining their effects on reform of regulatory institutions in the three countries. Regulatory institutions are taken here in the sense of institutions that structure economic transactions. The focus is on three formal institutions that lie at the heart of the organization of markets: the ownership and organization of stock exchanges; rules governing company share trading; the allocation of powers and arrangements for regulation of share trading.

Securities Trading in the Mid-1960s in Europe

In the mid-1960s, securities trading markets were highly national. Cross-border trading was limited.⁵³ The technology of the sector was stable and material- trading took place on the physical floors of national stock exchanges and settlement and clearing were based on paper documents. There was almost no supra-national regulation and hence institutional arrangements were decided at the national level. Those arrangements were usually very long-standing, dating back decades or even centuries. In Britain, France and West Germany stock exchanges had domestic legal or de facto monopolies over the public trading of company shares. They were organised as non-profit making bodies or clubs of individual domestic traders. Moreover, their formal rules were designed to protect small individual investors, their traditional bedrock customer; these rules included fixed commissions and separation of traders from other powerful groups such as banks or investor that might otherwise exploit their size.

At the same time, significant institutional differences also existed among the three countries in terms of the structure and ownership of exchanges, the rules governing competition or the allocation of regulatory powers. In Britain, most trading took place on the London Stock Exchange (LSE), although it did not have a legal monopoly. LSE, founded in the seventeenth

⁵² Cf. James Mahoney and Dietrich Rueschmeyer, eds, *Comparative Historical Analysis in the Social Sciences* (Cambridge: Cambridge University Press 2003).

⁵³ In 1965, total sales and purchases of US and foreign stocks by foreigners on the NYSE were \$9376m (c0.26% of GDP)- adapted from NYSE Factbook Historical Statistics; in 1970, cross-border transactions in bonds and equities combined was only 2.8% of GDP in the US and 3.3% in Germany- Susanne Lütz, *The Revival of the Nation-State? Stock Exchange Regulation in an Era of International Financial Markets*. Cologne: Max Planck Institute, p.16, citing figures from the Bank of International Settlements.

century, was organised as a private gentleman's club consisting of male British members who traded as individuals with personal liability. It operated within a 'self-regulatory' system led by the City of London and the Bank of England, based on shared informal norms.⁵⁴ Indeed, LSE was larger and more internationalized than its counterparts in continental Europe, forming part of the City of London. Commissions for trading were fixed by LSE, avoiding 'ungentlemanly' haggling over fees. Trading was divided between wholesale functions (by 'jobbers') and retail functions dealing with investors (by brokers).

In contrast to Britain, the French state's role in securities trading was direct and overt. The Paris Bourse was state-owned and the brokers (*Agents de Change*) were publicly-appointed 'ministerial officials', who enjoyed a legal monopoly over public share trading dating from an *ordonnance* of Philippe le Bel in 1304 and operated within formal state regulations.⁵⁵ State officials also played a direct role through the Comité des bourses de valeurs, responsible for rules governing share trading, which was chaired by a deputy Governor of the Banque de France and included a *directeur* of the Trésor.

In West Germany, regional fragmentation was much greater than in Britain and France. There were eight regional exchanges owned by the regional chambers of commerce and the regional governments (the *Länder*) were responsible for legal supervision of their respective exchanges and appointment of official brokers (*amtliche Kursmakler*) who had a monopoly over trading and price setting on the exchanges. Investor protection was extremely limited: insider trading was not even a criminal offence and transparency requirements were low. The banks largely controlled securities trading through their members sitting on exchange boards and originating many orders. But, in truth, securities trading was relatively unimportant: the banks accounted for the vast bulk of lending to companies and indeed, the exchanges were only open two hours per day.⁵⁶

Thus in the mid-1960s, although exchanges were national and based on individual traders and indeed consumers, important differences existed across Britain, France and West Germany. These matched general descriptions of the three in the comparative capitalisms literature, notably Britain enjoying 'club government', France with a direct role for the central state and West Germany as a bank-dominated capitalism as well as being highly regionalised.⁵⁷ Thus Britain had a privately-owned stock exchange operating under a self-regulatory system, France had a publicly-owned exchange over which the central state had many formal powers, while West Germany had a regionalized system dominated by banks.

Internationalisation

⁵⁴ See Michael Moran *The Politics of the Financial Services Revolution: The USA, UK, and Japan*. Basingstoke: Macmillan.1991

⁵⁵ For a history see Lehmann 1997.

⁵⁶ See Storey 1997, Lütz 1997 and 2000.

⁵⁷ See for instance, Shonfield, A., *Modern Capitalism* (Oxford: Oxford University Press, 1969), Zysman, J., *Governments, Markets and Growth* (New York: Cornell University Press, 1983), JES Hayward, *Industrial enterprise and European integration : from national to international champions in Western Europe* (Oxford: Oxford University Press 1995), Peter Gourevitch *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca, NY: Cornell University Press, 1986) Peter Katzenstein, *Small states in world markets : industrial policy in Europe* (Ithaca, N.Y. : Cornell University Press, 1985), Moran (2003). *The British regulatory state: high modernism and hyper-innovation*. Oxford: Oxford University Press.

The period between the mid-1960s and 2007 saw different forms of internationalization that revolutionised the sector.⁵⁸ They put pressure on traditional national institutions such as monopolies, individual traders and fixed commissions through the different mechanisms identified by the policy transfer literature, notably by aiding the emergence of new cross-national transfer agents, altering payoffs and offering examples of reform, thereby affecting ideas.

First, transnational technological and economic developments that began in the late 1960s transformed the sector. Widespread computerization made share trading on overseas or new 'alternative exchanges' easier. At the same time, cross-border financial flows rose sharply, representing a lucrative market to be captured. To give one example, purchases and sales of securities abroad by US investors rose from \$5b in 1977 to \$232b in 1989⁵⁹ while cross-exchange trading (i.e. when a firm's shares are purchased on foreign exchanges) grew by an estimated factor of 8 between 1986 and the early 1990s.⁶⁰ Moreover, financial markets also became increasingly dominated by large firms. Verdier (2002: 176-7) calculates that over the period 1980-late 1990s, the share of financial assets held by institutional investors rose in all the industrialised nations he examined and indeed in the US, institutional investors accounted for approximately 25% of public share trading in the 1950s but over 60% after 1969,⁶¹ while in Britain, individual ownership of UK equities dropped from 54% of the total in 1963 to 17.7% in 1993.⁶² Finally, securities trading greatly expanded, both in absolute terms and relative to GDP, greatly increasing incentives for well-functioning stock markets. The changes were dramatic: turnover of equities on the NYSE was 2.06% of GDP in 1965 and 78% in 2003; the figures for London are 0.77% in 1965 and 190% in 2003, and for France, 0.01% in 1965 and 53% by 2003.⁶³

Transnational technological and economic developments altered the potential agents for policy transfer; in particular, they saw the emergence of international financial firms, both as investors and suppliers of services. They also changed the payoffs for national policy makers concerning national institutions governing securities trading. They increased incentives to ensure internationally competitive exchanges and traders in order to capture cross-border investments and firms. Conversely, they put pressure on traditional stock exchanges as domestic non-profit making 'clubs' of individuals, who faced their national monopolies being undermined, increased capital costs of new investment in and international firms who could press for institutional changes to reduce their costs and for better quality services and indeed could switch markets if dissatisfied.

A second form of internationalization came from major reforms in the 1970s and 1980s in the United States, which accounts for 40-50% of the total world securities market.⁶⁴ Alternative electronic exchanges developed such as NASDAQ (National Association of Securities

⁵⁸ For further details, see Thatcher, *Internationalisation and Economic Institutions*, ch 2.

⁵⁹ For figures, see Andrew Sobel *Domestic Choices, International Markets*. (Ann Arbor, MI: University of Michigan Press, 1994), p52, J. A. Grundfest, 'Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences'. *Journal of Financial Services Research* 4 (1990), 349-378, pp.357, 353.

⁶⁰ William Coleman and Geoffrey Underhill, 'Globalization, Regionalism and the Regulation of Securities Markets', *Journal of European Public Policy*, 2/3 (1995), pp.488-513, p.495; cf. Ronald C. Michie, *The London Stock Exchange: A History*. (Oxford: Oxford University Press, 2001), p. 623.

⁶¹ Donald R. Fraser, Peter S. Rose, *Financial Institutions and Markets in a Changing World*. (Dallas, TX: Business Publications.1980), p. 326.

⁶² Michie, *The London Stock Exchange*, p: 631; John Plender, 'The Rise and Rise of the Institutional Investor', *The Banker*, September: 1980, pp.41-48.

⁶³ Thatcher, *Internationalisation and Economic Institutions*, p.42.

⁶⁴ For figures, see statistics produced by the World Federation of Exchanges GIVE REF.

Dealers Automatic Quote) which began in 1971 and by 1985 was the third largest stock exchange in the world.⁶⁵ Within stock exchanges, fixed commissions in the NYSE were abolished in 1975, triggering cuts on brokerage rates, especially for large trades. Meanwhile, large powerful, multi-service US firms developed in the 1980s, such as Merrill Lynch, Shearson Lehman, Salomon, or Drexel Burnham Lambert that began to expand abroad;⁶⁶ their resources greatly surpassed those of European securities traders.

US reforms altered payoffs for European firms and policy makers. They increased international competition for trading, especially by institutional investors in major companies ('blue chips'), the most lucrative parts of the securities market and put pressure on European stock exchanges and traders which lacked capital to invest and become international. But they also offered an example of how institutional reforms could be beneficial. They showed that new stock markets using electronics could be created and compete with incumbents with physical trading floors or the benefits of reforming protective rules such as fixed commissions. Moreover, the creation of conglomerates offered a powerful example for other nations of how the securities industry could be reshaped.

EU regulation was the third form of internationalisation to affect securities trading in Europe. The European Commission proposed an Investment Services Directive (ISD) in 1988, that, after fierce battles among member states, finally became law in 1993.⁶⁷ It offered limited liberalization through opening access to securities exchanges. Thus for instance, it prohibited national rules limiting numbers of persons having access to 'regulated markets' (such as traditional stock exchanges).⁶⁸ To aid cross-border entry, the ISD created a European wide 'passport' and 'home country control': firms authorised in one member state were to have access (including membership) to regulated securities markets in other member states. This included 'remote access' - i.e. trading without a physical presence in the market (for instance by using electronic screens).

Legal coercion on EU member states was limited, especially as the ISD left much scope for national choices to limit competition or over the allocation of regulatory powers.⁶⁹ But EU regulation could also affect domestic decision making through other mechanisms identified by the policy transfer/diffusion literature. First, it introduced new potential EU transfer agents, notably the European Commission. Second, it could influence expected payoffs, by affecting expectations of competition. The influence of EU regulation grew as the ISD was followed by negotiations that gave birth to the MIFID (Markets in financial instruments directive), passed in 2004 which extends the scope for cross-border entry.⁷⁰ Finally, it could operate through

⁶⁵ Hamilton, *The Financial Revolution*. (New York: Free Press 1986) p.43.

⁶⁶ Hamilton, *The Financial Revolution*, pp. 78-110.

⁶⁷ Coleman and Underhill, 'Globalization, Regionalism and the Regulation of Securities Markets', P. Brown, 'The Politics of the EU Single Market for Investment Services', in G. Underhill (ed.), *The New World Order in International Finance*. Houndmills, UK:MacMillan, 1996, pp. 124-43, Benn Steil, *The European Equities Markets. The state of the union and an agenda for the millennium*. London: Royal Institute for International Affairs, 1996, pp. 115-26; for details of the ISD, see Niamh Moloney, *EC Securities Regulation*. (Oxford: Oxford University Press 2002).

⁶⁸ If access were limited due to the legal structure or technical structure of a market, the member state was to ensure that both were to be regularly adjusted.

⁶⁹ For instance, its 'concentration principle' permitted member states to require transactions in investment services covered by the ISD to be carried out on a 'regulated market' such as a stock exchange and it did not require the creation of independent regulatory agencies.

⁷⁰ Notably through 'passporting' - i.e. firms being authorised in one member state to provide financial services in other member states, and greater 'home country control'.

ideas, altering domestic norms about appropriate or 'legitimate' institutional structures, or through encouraging mimetic or normative isomorphism.⁷¹

Thus by 2007, the European securities trading markets had faced three powerful forms of internationalization that threatened traditional institutions such as stock exchanges organized as clubs of national individuals with monopolies over trading. Equally, the three forms consecutively, aiding process tracing of their effects within nations. How did they in fact affect debates and decisions about institutions in Britain, France and Germany?

Internationalisation and institutional reform in Britain 1965-2007⁷²

In the 1960s and 1970s, traditional British institutions were subject to strong pressures from economic internationalization. Large institutional investors became increasingly predominant. But they were unhappy with traditional British institutions, notably the division of trading between wholesale jobbers and retail brokers which meant two sets of charges and fixed commissions that created cross-subsidies to individual investors. To take advantage of this expanding potential market of large investor, in 1975 a group of merchant banks created a new exchange called ARIEL using new electronic technology and offering lower charges. It seemed to threaten LSE's economic foundations, namely large investors. At the same time, LSE members faced increased costs, notably due to introducing new computer technology, but also lower revenues because of difficult market conditions. Meanwhile, LSE continued to lose its position internationally, especially relative to the US.⁷³

Yet despite these pressures, the institutional structure was largely left intact.⁷⁴ One reason is that LSE adopted an alternative strategy of investing in new technology and reducing prices to match ARIEL. Another is that LSE members appeared content to accept graceful decline. Most important of all, neither the government nor the Bank of England appeared to have the desire to overcome resistance by LSE to reform.⁷⁵

However, the 1980s-2007 saw a dramatic reversal of institutional inertia as British policy makers adopted a new strategy of transforming LSE from a club for selected British-based individuals into an association open to companies from all over the world and a force in the international securities market.⁷⁶ Revolutionary change took place with the 1986 'Big Bang': fixed commissions and the division between brokers and jobbers were abolished; a new electronic trading system replaced LSE's floor; LSE was opened to corporate members with limited liability, including foreign firms. Radical changes continued thereafter. Individual membership of LSE was abolished in 1991 and LSE became a listed company in 2000. The

⁷¹ For a discussion of these sociological institutionalist processes, see Claudio Radaelli 'Policy Transfer in the European Union' (2000), *Governance*, 13/1: 25-43 and (2003). 'The Europeanisation of Public Policy', in K. Featherstone and C. M. Radaelli (eds.), *The Politics of Europeanisation*. Oxford: Oxford University Press, pp. 27-56.

⁷² For histories, see Michie, *The London Stock Exchange*, David Kynaston. *The City of London: A Club no More, 1945-2000*. London: Chatto and Windus 2001.

⁷³ For instance, in 1970, turnover on the NYSE was \$103,063m and \$15,310m on LSE; by 1980s the figures were \$397,670m for NYSE and \$53,511m for LSE- NYSE Facts and Figures.

⁷⁴ The most important were that foreigners could become members of LSE in 1971 and women in 1972.

⁷⁵ Thatcher, *Internationalisation and Economic Institutions*, ch 4.

⁷⁶ Kynaston, *The City of London*, pp. 696-8; for figures and examples see Michie, *The London Stock Exchange*, pp. 580-92. For general analyses of 'Thatcherism' and how it led to sweeping reform of economic and regulatory policies, see Moran, *The British Regulatory State* (Oxford: Oxford University Press 2003) and Andrew Gamble, *The Free Economy and the Strong State: The Politics of Thatcherism* (Basingstoke: Macmillan, 2nd ed 1994).

result was an inflow of foreign business and companies,⁷⁷ the takeover of many British firms by overseas ones and a series of attempted takeovers of LSE after 1998 by overseas predators (such as Deutsche Börse, NASDAQ and McQuarry) without resistance by public policy makers. Self-regulation was also ended: a statutory regulator created in 1986 (the Securities and Investment Board- SIB) was succeeded by a more powerful independent regulatory authority, the Financial Services Authority (FSA) in 2000.⁷⁸ These bodies took LSE's remaining regulatory powers and increasingly replaced informal norms with detailed formalised rules. Thus by 2007, traditional sectoral economic institutions had been abolished and replaced with very different ones with great consequences for the sector.

Radical reform was started by national actors from outside the traditional financial policy community. Thus the 1986 'Big Bang' was triggered by the general competition authority, the Office of Fair Trading⁷⁹ while the SIB followed a report on investor protection in 1984 by a retired law professor (Jim Gower).⁸⁰ However, once the process of change began, the Bank of England, the government and eventually LSE's senior management became central participants. They overcame strong opposition by members of LSE, often supported Conservative Party backbench MPs, who feared that their independence would be ended.

Two forms of internationalization became important in the new strategy of making London an internationally attractive financial centre and in overriding resistance to radical change.⁸¹ One was economic internationalization, especially the growth in international trading, the emergence of cross-border firms, and the creation of new electronic markets.⁸² It operated mainly through fears of altered economic payoffs. Reformers argued that these transnational technological and economic changes greatly altered competitive conditions in securities trading. They offered opportunities for the City of London to capture a share of growing markets, but also increased its vulnerability, as large investors and dealers had the capacity to trade securities outside LSE.⁸³ Meeting overseas competitors meant transforming LSE: as the Financial Times put it, the Bank [of England] some time ago lost patience with the clubby, inward-looking Stock Exchange which was opting out of international markets".⁸⁴

Yet such economic internationalization had been ongoing during the 1960s, 1970s and early 1980s without major institutional modifications. The second prominent and newer international factor was the decisions and strategies of US policy makers and firms.⁸⁵ One mechanism for its influence was altered payoffs through fear of competition. The Bank of England and LSE's senior managers were worried about losing international equities trading and for domestic UK securities business to the NYSE.⁸⁶ They were concerned that stock brokers and jobbers had narrow expertise and were under-capitalised relative to overseas

⁷⁷ Reid 1988: 89-102

⁷⁸ See Jonathan Westrup, 'The Politics of Financial Regulatory Reform in Britain and Germany', *West European Politics* 30:5,1096 — 1119

⁷⁹ It used new powers under general competition law (the 1976 Restrictive Practices Act) to refer LSE's fixed commissions to the Restrictive Practices Court.

⁸⁰ Lawrence CB Gower, Review of investor protection: report part 1. Cmnd.9125. London: HMSO, 1984; he also issued an interim report in 1982.

⁸¹ Cf. Lawrence 1996: 325-6.

⁸² Cf. Reid 1988: ch.2, Moran 1991: ch.3; Plender 1987, Gower 1988: 2; The Financial Times 28.1.81, 15.8.83, 15.11.83; interview, Alex Fletcher, The Financial Times 13.12.83; Institute of Contemporary British History 1999: 103-4.

⁸³ The Financial Times 15.8.83, 30.4.84, 1.5.84.

⁸⁴ The Financial Times 30.4.84; cf. Moran 1991: 76.

⁸⁵ Cf. Moran 1991: 57-8, 74, Reid 1988: ch.2.

⁸⁶ The Financial Times 7.10.85, 18.10.85; 21.8.86, 12.11.83, 21.10.83; interview senior LSE official.

financial firms, especially in the US.⁸⁷ Regulatory competition also played a role, through ‘trading up’ in standards,⁸⁸ as reformers sought a modernised and efficient regulatory system, as judged against the US.⁸⁹ However a second mechanism was ideational: reformers were able to use the US example to legitimate their case. Thus for instance, in its case against LSE on fixed commissions, the OFT cited evidence from the ending of such commissions on the NYSE in 1975, while after a visit to the US, the Government minister for corporate affairs declared that he was “unafraid of dual capacity” [ie ending the broker/jobber division] and hoped that it would follow the examples he had seen in North America.⁹⁰ In the 1990s, the US financial regulator, the SEC, was increasingly used as a positive example by those advocating greater powers for regulators, notably the head of the SIB and large institutional investors.⁹¹ The role of the US was an example and resource to legitimate change, rather than a model that was emulated wholesale.

The third form of internationalization, EU regulation, was almost totally absent in British decisions on institutional reform. One important reason was that Britain had already opened its securities market to competition before EU legislation. However, another is that British policy makers were suspicious of EU regulation, fearing that it would raise costs and reduce the UK’s competitive advantage.⁹²

France

Between the mid-1960s and the mid-1980s, there were several serious debates about institutional reform.⁹³ They were led state officials, notably the finance ministry, the sectoral regulator after 1967 (the Commission des Opérations de Bourse -COB) and Government-appointed commissions of senior policy makers.⁹⁴ These policy makers pointed out that almost no foreign shares were traded on French exchanges and the Paris Bourse was much smaller than LSE or NYSE.⁹⁵ They argued that French institutions for securities trading were inadequate, especially given economic internationalization. The Paris Bourse was open two hours a day (12.30-14.30) and prices were written on a blackboard, making it difficult for overseas investors to trade. It lacked liquidity: many stocks were traded rarely; the *Agents de Change* were ill-equipped for large trades because they did business as individuals with personal liability, thereby severely limiting their capital; the *Agents* could only match buy and sell orders during the Bourse’s opening hours and at its prices, and were forbidden to trade on their own account (‘contre-partie’). Investor protection was poor as regulatory organizations were weak.⁹⁶ The Paris Bourse also suffered from complexity; one notable example was the

⁸⁷ The Financial Times 5.2.80, 6.2.80, 15.2.80, 15.9.83, 19.9.83, 21.12.83; Reid 1988: 33-4; interview senior LSE official.

⁸⁸ Cf Vogel

⁸⁹ Alex Fletcher, Minister for Corporate and Consumer Affairs, FT 20.1.84; Gower Report 19.1.84; comments, Norman Tebbit, 25.9.84; 21.8.86.

⁹⁰ Alex Fletcher, interview, The Financial Times 13.12.83.

⁹¹ Interview, Andrew Large Financial Times 3.11.92; Lawrence 2001: 97; interview senior financial regulator 1.

⁹² Goodison 1988; see for instance, Financial Times 12.7.2000, 15.7.2000, 22.7.2000, 15.9.2000, 20.9.2000; interviews senior financial regulator 1, senior financial regulator 4.

⁹³ Decoopman 1979: 149-82.

⁹⁴ Notably the 1971 Caplain report, the 1972 Baumgartner report, and then later the 1980 Pérouse and 1985 Tricot reports.

⁹⁵ In 1971, the capitalisation of French exchanges was 117 billion francs as compared with 390 for Britain and 5500 for the US; for figures see Turot 1973; Pérouse 1980: 43-46.

⁹⁶ Cf. Lehmann 1997: 58-87, Conac: 2002: 24- 25, Le Monde 31.8.67.

coexistence of two prices for the same shares depending on whether settlement was immediate or delayed.

The commissions and COB suggested significant reforms to modernize the Bourse. Proposals included ending dual pricing, introducing continuous computerized trading and allowing trading by the banks, who were much better capitalised than the *Agents*. But all such ideas were blocked by opposition from the *Agents*, who were suspicious of reforms that might reduce their turnover or undermine their position as individual traders.⁹⁷ In addition, trade unions were strong among the *Agents*' employees, and the prospect of redundancies due to changes such as computerisation led to prolonged strikes in 1968, 1974 and 1979 that closed the Paris Bourse.

Only one significant reform was made, namely the creation of a sectoral regulator, the COB, in 1967. The government looked at overseas regulators, notably the SEC in the US. It concluded that bodies separated from the government could combat market abuse and hence offer protection to investors.⁹⁸ Hence it established the COB as 'public regulatory body' with the explicit aim of developing the stock market, including playing "a wider international role".⁹⁹ But although the COB was an innovation for French administration, in the 1960s and 1970s, it had few powers and its independence was limited.¹⁰⁰

Thus by the late 1980s, French institutions remained largely unchanged from previous decades and indeed centuries. They were suited to individual French investors rather than overseas and/or company investors. The sole significant reform, the COB, had occurred twenty years earlier. Faced with strong domestic opposition to institutional reform, French policy makers pursued a strategy of encouraging securities trading through financial incentives¹⁰¹ and accepting the continuing decline of French stock markets relative to those overseas, notably in the US.¹⁰²

Yet from the late 1980s onwards, a series of reforms (notably legislation in 1988, 1989, 1996 and 2003) ended long-standing French institutions that the *Agents de Change* had previously successfully defended. In 1988, legislation abolished the *Agents*' monopoly over trading and their position as ministerial officers.¹⁰³ It permitted the *Agents* to become limited companies open to takeover (including by the *Agents*' traditional enemies, the banks as well as overseas firms). The organization of the Bourse was altered by an electronic system (the *CAC-cotation assistée en continue*), which led to all-day trading. Long-standing French specificities were terminated- for instance, the prohibitions on *Agents* trading on their own account outside Bourse prices and hours were ended in 1986 and 1998, while the dual price system was abolished in 2000. Equally, the Bourse was transformed into a privately-owned limited company in 1989. The independence and powers of the COB were increased in 1989 and 1996, and in 2003, it was merged with two self-regulatory bodies to form the AMF (Autorité des Marchés Financiers) with a wider remit and substantially enhanced powers.¹⁰⁴

⁹⁷ La Vie Française 27.12.76, 24.1.77, 14.2.77, 30.4.79, Le Figaro 31.3.79.

⁹⁸ Decoopman 1979: 1; Le Monde 31.8.67; Le Nouveau Journal 22.2.68; interview senior financial regulator 1.

⁹⁹ Burgard 1972: 861-4, cf. Lascoumes 1985: 6-7.

¹⁰⁰ Cf. Conac 2002: 56-7, 113, 116-17; one example was that a government commissioner sat on its Board.

¹⁰¹ Such as forms of unit trust encouraged under the loi Monory of 1978

¹⁰² For instance, in 1970, turnover on the Paris Bourse was \$4,229m compared to \$103,063m for the NYSE, representing 2.5% and 0.5% of each country's GDP; by 1985, the figures were \$1,023,202m (15% of US GDP) and \$31,613m (2.5% of French GDP)- figures from NYSE Facts and Figures and converted by author.

¹⁰³ Couret 1988, Cerny 1989.

¹⁰⁴ Frison-Roche 2004.

Reforms were led by the government, notably the Finance Ministry.¹⁰⁵ It established high-level commissions that produced reports preparing the ground for changes¹⁰⁶ led discussions with other actors and when the Agents de Change resisted reform, imposed it on them.¹⁰⁷ The government, especially the Trésor, provided key personnel, even to nominally private sector organizations.¹⁰⁸

Internationalisation was crucial to the initiation of reform and to its legitimisation. Transnational technological and economic developments continued to be felt, as in the 1970s. Thus for instance, the *Agents de Change*, who traded as individuals, lacked capital for expansion, liquidity or funding new computer systems for the Paris Bourse.¹⁰⁹ However, two newer and more visible forms of internationalization were reforms in overseas nations (especially Britain), and EU regulation. With respect to the former, policy makers compared French institutional arrangements such as trading rules, settlement systems and regulatory organisations, with overseas exchanges.¹¹⁰ They became particularly concerned about Britain after the 1986 ‘Big Bang’, which was seen as “an English strategy of domination”.¹¹¹ They were worried that the Paris Bourse was much smaller than its rivals and that dealing in French shares was migrating to London: by the late 1980s/early 1990s, an estimated 15-30% of French shares were traded on LSE’s SEAQ-International system.¹¹² They argued that the Paris Bourse had to modernise and expand internationally to match overseas exchanges, particularly LSE.¹¹³ In graphic language, a member of the National Assembly argued that the law of 1988 was essential because of the risks of Paris being “deserted” by investors unless it could offer the same services and degree of investor protection as other exchanges.¹¹⁴ Reforms such as allowing the Agents to become limited companies, open to outside investors, or ending restrictions on the Agents trading on their own account outside Bourse hours and prices, were justified by the need to meet competition from LSE.¹¹⁵

EU regulation was also prominent in reform debates and influenced decisions in several ways. First, it affected expected payoffs through increasing fears of competition among exchanges. Policy makers pointed to the need to prepare French markets and firms for competition arising from the opening of European capital markets as part of the Single Market (‘1992’) and the

¹⁰⁵ Key individuals included: Pierre Bérégovoy as Finance Minister 1988-92, Daniel Lebègue (*directeur du Trésor* 1984-7, Christian Noyer (*directeur du Trésor* 1993-95) and Philippe Jaffré (posts dealing with financial markets throughout the 1980s and early 1990s).

¹⁰⁶ Eg the Tricot Commission 1985, the La Portz report 1988 and the de la Serre report 1991.

¹⁰⁷ La Tribune de l’Expansion 1.6.89, 10.7.91, Libération 10.7.91, Les Echos 3.1.96; interview senior financial practitioner 1.

¹⁰⁸ Eg the head of the Paris Bourse and then Euronext from 1990, Jean-François Théodore, was seconded from the Trésor- Le Figaro 11.12.90.

¹⁰⁹ Lehmann 1997: 111; La Tribune de l’Expansion 23.10.90; interview senior legislator 2.

¹¹⁰ La Tribune de l’Expansion 2.1.90, Le Figaro 27.6.90, De La Serre 1991, Marini 1994, Gourlard 2003; Le Figaro Economique 2.2.95 and Le Monde 29.3.95; La Tribune Desfossés 4.1.96, Libération 23.10.2000, Les Echos 12.9.2002;

¹¹¹ Quote- Dupont, head of the Compagnie des Agents de Change, Le Monde 16.1.86, Le Figaro Economie 20.10.86; cf. Courbis and Dupuy 1989; interviews senior legislator 1 and 2, senior financial practitioner 1.

¹¹² In 1989, the Paris Bourse had a capitalisation of 1.95B francs compared with 4.8b for LSE; cf. La Tribune de l’Expansion 23.10.90, 25.10.90, 5.7.91, 10.7.91, De La Serre 1991; interview senior financial practitioner 2.

¹¹³ Dupont 1986 : 95; Tribune de l’Economie 15.6.87, Le Monde 24-25.3.85, 2.12.87, interview, Régis Rousselle (head of the Société des Bourses Françaises), La Tribune de l’Expansion 20.6.88; La Tribune de l’Expansion 15.1.90, Les Echos 22.2.95; cf. Choinel 1990; interview senior financial regulator 3; see reports by COB, Le Portz 1988; Tricot Commission 1985.

¹¹⁴ Philippe Auberger (RPR), Le Monde 2.12.87; see also Dupont 1986: 89.

¹¹⁵ Dubroeuq and Juvin 1989: 45-47, 56-58; Le Monde 2.12.87; La Croix 12.3.87, Le Figaro-Economie 20.10.86, Humphreys 1986, Courbis and Dupuy 1989; interviews senior financial regulator 1 and 2; de la Serre 1991, La Tribune de l’Expansion 7.2.92 (report by Bacot to CBV), La Tribune Desfossés 29.7.94.

1993 Investment Services Directive.¹¹⁶ They used these arguments to justify reforms such as ending restrictions on brokers in Paris, creating stronger French firms and altering regulatory structures.¹¹⁷ Second, EU law provided a “powerful lever for reconsideration of institutional structure”.¹¹⁸ It led to modifications going well beyond those required legally by the EU but which were justified, in part, by the effects of EU liberalisation.¹¹⁹ Thus for instance, the COB was strengthened in the 1996 law that transposed the 1993 Investment Services Directive (ISD) into French law, while the creation of the AMF in 2003 was also justified in part by meeting the call in the 2003 directive on insider trading and market manipulation for a ‘single administrative body’ and for aiding European cooperation.¹²⁰

The French strategy was to create a strong Paris-based international company through mergers and acquisitions. During the 1990s, this meant attempting a merger with Deutsche Börse, but agreements failed due to differences over technology. Instead, in 2000 the Paris Bourse merged with the Brussels and Amsterdam Bourses to form Euronext, which merged with NYSE in 2007, thereby creating a highly internationalized exchange.

(West) Germany

To strengthen stock markets, attempts at institutional reform were made in the late 1960s and early 1970s.¹²¹ They included rules that trades be executed by brokers rather than banks, increased transparency and investor protection rules and greater independence of the exchanges from the banks. But these ideas failed. The *Länder* resisted increased federal powers, fearing that they would lead to the closure of smaller regional exchanges.¹²² They and the banks were hostile to formalisation of regulation.¹²³ By 1980, securities trading remained a small adjunct of the banking system; few companies were quoted even in the 1980s and the number was declining.¹²⁴

Yet the period from late 1980s saw radical changes and abolition of long-standing institutions.¹²⁵ They were driven by the ‘Frankfurt coalition’, led by large banks (notably Deutsche Bank), the Frankfurt stock exchange and its home *Land*, Hesse. But they met fierce opposition. Many *Länder* and some of the smaller regional exchanges opposed centralization

¹¹⁶ Comments by Eduard Balladur, Finance Minister, National Assembly debates, *Le Monde* 2.12.87; *La Tribune de l’Economie* 15.6.87, Bézard 1989: 934; Viandier 1989: 46-7; Choinel 1990: 48; *La Tribune de l’Expansion* 5.7.91, interview senior legislator 2.

¹¹⁷ Bacot, Dubroeuq and Juvin 1989: 45-47, 56-58, cf. interview, Jean Arthuis, Finance Minister, *Les Echos* 11.7.96; interview senior financial regulator 2; *La Tribune de l’Expansion* 6.7.91, 10.7.91 (report by Barbier de la Serre for CBV), 7.2.92 (report by Bacot to CBV), *La Tribune Desfossés* 29.7.94.

¹¹⁸ Interview senior legislator 1; interview senior financial regulator 2.

¹¹⁹ Notably restructuring regulatory authorities in the law of 2 July 1996- cf. *La Tribune Desfossés* 10.1.94, *Le Figaro Economique* 2.2.95, interview, Jean Arthuis (Finance Minister), *Les Echos* 11.7.96. Interview senior legislator 1, senior financial practitioner 2.

¹²⁰ Frison-Roche 2004: paragraph 19, Goulard 2003: 17; Decoopman 2003; Coquelet 2004: paragraph 1.

¹²¹ They included draft legislation prepared by the government in 1968- Beyer-Fehling and Bock 1975: 17-79; see also Schwarke 1994.

¹²² Interviews senior exchange official 2 and 3; VBW-Wirtschaftsdienst, 14.3.1969, *Handelsblatt*, 20.10.1971.

¹²³ *Handelsblatt*, 23.1.1968, 2.2.71, 6.4.72, FAZ, 21.2.1969, *Zeitschrift Kreditwesen* 1.4.1969. *Die Welt* 19.11.70.

¹²⁴ Story 1997; between 1956 and 1983, the number of stock exchange listed companies fell from 686 to 442 (Pöhl 1992: 323).

¹²⁵ See Deeg 2005 on German financial reform in general, which he argues changed ‘path’; for other analyses, see also Moran 1989, 1992 and Lütz 1998, 2002.

and increases in federal powers;¹²⁶ this was important because federal legislation needed to be passed by the Bundesrat, which was composed of representatives of the *Länder*. Equally, there was general hostility to ‘Anglo-American’ practices, such as juridification of regulation or a strong federal regulator such as the SEC.¹²⁷

Given such resistance, the German reform route involved a series of changes that individually were less sweeping than those in Britain and France, but cumulatively transformed sectoral institutions.¹²⁸ They often involved lengthy negotiations and compromises. The process began with the creation of a new federal futures exchange in 1989, the DTB, based in Frankfurt. This was a major change both because it involving overcoming opposition (futures trading was prohibited under the 1934 banking law and there was much suspicion of ‘speculation’ dating back from the 1920s) and because it was a single national market.¹²⁹ But attempts between 1989 and 1992 to unite all the regional exchanges into one company failed, due to resistance by regional exchanges and the *Länder* governments.¹³⁰ Instead, a privately-owned holding company was established (Deutsche Börse AG). Through subsidiaries Deutsche Börse owned the Frankfurt exchange (which was privatized), the DTB and provided common services such as clearing and settlement and electronic information to all the regional exchanges. Although regional exchanges continued to exist, Deutsche Börse accounted for c90% of the securities business, and then in 2001 it became a publicly-listed company. During the 1990s, DB replaced physical trading floors with an electronic trading and clearing and settlement system. Banks and other financial institutions were allowed to trade directly on the new electronic system and in 2002 public price fixing for transactions was ended, rendering the *Kursmakler* obsolete.

Despite resistance to greater federal powers and to formalization, the regulatory framework was also altered.¹³¹ In 1994, a new Federal Securities Supervisory Office, the Bundesaufsichtsamt für den Wertpapierhandel- BAWe was created. But the BAWe fell within the jurisdiction of the ministry of Finance, limiting its independence. Moreover, it did not regulate the supervision of markets and trading, which remained within the jurisdiction of the *Länder*, who fought strongly to retain powers.¹³² Only in 2002 was a more independent and powerful federal regulatory authority created, Bafin (Bundesanstalt für Finanzdienstleistungsaufsicht). Its President and Vice-President are nominated by the Federal Government and its budget is approved by an ‘administrative council’ that includes several representatives of the Federal Finance Ministry, thus underlining the role of the Federal government rather than the *Länder*. Compared with its predecessor, Bafin’s responsibilities were greatly widened across the financial sector and its powers over market behaviour were increased.¹³³

Policy forms of internationalisation were crucial for the Frankfurt coalition’s strategy and its ability to overcome strong opposition by the *Länder* and smaller exchanges. Two factors were

¹²⁶ Story 1997: 256; DBT 26.4.91, Rheinischer Merkur 14.6.91, Wirtschaftswoche 30.8.91, 28.2.92, Die Zeit 17.10.91, SZ 15.2.92, Handelsblatt 17.1.2002.

¹²⁷ Story 1997: 255-6, 264-5, Lütz 1998: 160.

¹²⁸ Major legislation included the 1989 Stock Market Act, and Financial Promotion Acts in 1990, 1994, 1998, 2002,

¹²⁹ Moran 1992: 147-8.

¹³⁰ Frankfurter Rundschau 28.4.90, FAZ 16.6.90, Die Zeit 24.1.92, Handelsblatt 31.3.95; interviews senior banker 1 and 2, senior exchange official 1 and 4, senior Bundesbank official.

¹³¹ See Westrup, ‘The Politics of Financial Regulatory Reform’.

¹³² Handelsblatt 21.1.93.

¹³³ Handelsblatt 26.5.94, 28.12.94, 7.7.96, 22.3.2000, 18.12.2000, 19.12.2000, 17.1.2002, 13.3.2002, 21.3.2002, FAZ 25.4.2002, 126.4.2002, 16.5.2003.

particularly prominent. One was London's 1986 'Big Bang' and subsequent reforms. They influence policy makers through ideational mechanisms, notably by offering an example of institutional reorganization. Thus for instance, the British FSA was seen as successful in increasing coordination and was important in the establishment of Bafin.¹³⁴ But, more directly, they operated through expected payoffs, namely increased fears of international competition for securities trading.¹³⁵ German policy makers underlined the extent to which Germany was disadvantaged relative to other countries, especially Britain, by its lack of a large, powerful central exchange, trading of overseas stocks and absence of a sector-specific regulator exchanges.¹³⁶ They feared securities trading migrating to London - indeed, one senior member of the Frankfurt exchange coined the term 'Londonfurter' - shares issued in Frankfurt but traded in London.¹³⁷ Such fears were a powerful factor in reform. One prominent example was the creation of the DTB to respond to new futures markets in German shares created in London and Paris.¹³⁸ Equally, the electronic trading and settlements system was designed to match overseas exchanges.¹³⁹ Reformers also pressed for a powerful independent regulator as part of the strategy of making German markets internationally accepted and attractive.¹⁴⁰

EU regulation was the second form of internationalization that was crucial. It operated in several ways. First, the European Single Market and the introduction of the Euro increased fears of competitive pressures, especially on Germany's regionalised system of exchanges.¹⁴¹ The Frankfurt coalition argued that to function effectively in the European market, Germany needed to modify its institutions- in particular, to create a strong national stock exchange and supervisory authority instead of regional markets and fragmented supervision.¹⁴² Second, implementing EU directives provided the occasion for self-criticism, cross-national comparison and major reform legislation.¹⁴³ Indeed, it was used to justify wider changes not required by EU law. Thus for instance, EU directives on insider trading and investment services passed in 1989 and 1993 required member states to specify a securities supervisory body that would undertake coordination with other member states and participate in a network

¹³⁴ Interviews senior banker 2, senior regulator; Handelsblatt, 17.10.01, 8.5.01.

¹³⁵ For its citation by different actors: Frankfurt stock exchange organisation- Handelsblatt 16.4.85; Karl Otto Pöhl, President of the Bundesbank, Handelsblatt 7.5.85, 22.8.85; reforms planned by the eight regional exchanges, Handelsblatt 22.4.86; Presidents of the Düsseldorf and Frankfurt exchanges- Handelsblatt 31.12.86; Deutsche Bank, Handelsblatt 9.6.86, 15.10.87, 24.10.88; Wolfgang Röllner, President of German banking association- Handelsblatt 31.10.85, 16.10.87, SZ 27.9.88; Federal Association of German Banks- FAZ 4.11.87; Bundesbank annual report- FAZ 15.4.88; see also Handelsblatt 7.8.87, 3.9.87.

¹³⁶ VWD Europa 5.6.87; article by W Hirche, Economics Minister Lower Saxony, Handelsblatt 29.10.87; speech by Karl Otto Pöhl, President of the Bundesbank, Wirtschaftswoche 21.7.89; Handelsblatt 31.12.86, 6.3.87, 3.9.87, 29.10.87, 24.3.88, 16.2.89, Wirtschaftswoche 7.8.87, Frankfurter Rundschau 24.3.88, SZ 24.3.88, FAZ 9.6.89; Interviews senior banker 2, senior exchange official 1.

¹³⁷ Hans Messer, President Frankfurt Chamber of Industry and Commerce, Handelsblatt 3.9.87; Story 1997: 257-8, 261, 264; Moran 1992: 146-8.

¹³⁸ Story 1997: 263-4

¹³⁹ Handelsblatt 29.11.89; Lütz 2002: 236; Breuer, Die Welt 27.4.90, Wirtschaftswoche 28.6.91, FAZ 4.7.91, Handelsblatt 23.11.95, 12.10.98.

¹⁴⁰ Der Spiegel 7.1.91, Welt am Sonntag 3.2.91, Wirtschaftswoche 28.6.91, FAZ 4.7.91, Handelsblatt 5.7.91, 14.8.91, 12.9.2001, 10.10.2001, Rheinischer Merkur 12.7.91, Wall Street Journal 21.6.96; interviews senior exchange official 2, senior regulator, senior banker 2.

¹⁴¹ Handelsblatt 15.2.80, SZ 20.8.88, FAZ 7.11.89; cf. Story 1997: 258; interview senior banker 2.

¹⁴² Rolf Breuer, Deutsche Bank, Die Welt 27.4.90, Rüdiger von Rosen, Working group of German stock exchanges, VWD Europa 29.10.90; Banking Association call for major reform- Handelsblatt 12.11.96; Hessen Economics Minister and Deutsche Börse head, Handelsblatt 23.11.95, 11.9.96; CDU/CSU parliamentary financial experts, 7.7.96, Financial Times 10.7.96; Gerhard Eberstadt, Dresder Bank Board, Handelsblatt 3.12.98.

¹⁴³ Handelsblatt 14.8.91, 10.3.93, 28.12.94, 21.6.96, 22.7.96, 10.9.2001, FAZ 4.7.91, 21.6.96, SZ 20.7.96, Wirtschaftswoche 28.6.91, 30.8.91; interview senior exchange official 2.

of regulators. Although EU directives did not specify the form of national agency, reformers claimed that their implementation necessitated a national agency and that EU law outlawing insider trading required modification of German law.¹⁴⁴ This led to the establishment of the BAWe in 1994. Equally, Bafin was in part due to arguments that Germany needed a single strong agency to deal with higher EU demands that the *Länder* found increasingly difficult to deal with.¹⁴⁵

By 2007, Germany had transformed its sectoral institutions. Its strategy was to create one privately-owned dominant company, Deutsche Börse, but weak retain elements of a federal system. Although it sought international expansion, its attempts to merge or take over LSE did not succeed in the early 2000s and it remained a strongly German-based company.

Conclusion

Between the mid-1960s and 2007, securities markets were greatly internationalized. The effects on national regulatory institutions of three forms of internationalization- transnational and technological developments, reforms in the US and EU regulation- have been analysed. The article has shown that long-standing national institutions continued until the mid/late 1980s. Thereafter, radical reform and cross-national convergence took place. What does this pattern of inertia and then change tell us about internationalization and domestic institutional change? What are their broader implications for HI analyses of institutional change and markets?

With respect to the first question, three substantive arguments can be made using the case study, claims that may serve as hypotheses for other domains. The first is that when transnational technological factors operate on their own, HI claims of institutional inertia or limited divergent change are upheld. Thus between the 1960s and the mid-1980s, there was remarkable institutional stability despite sweeping changes such as increased cross-border flows, computerization or the rise of largescale investors. Long-standing institutions that seemed inappropriate for the changing nature of the industry, such as monopolies of national exchanges, trading being reserved to nationals who operated as individuals, formal rules designed to protect individual investors or exchanges open only two hours a day, continued. Equally, the three countries maintained national specificities that had existed in 1965 and matched those suggested by general comparative institutionalist studies, namely club-government in Britain, 'statism' in France and regionalised and bank-dominated capitalism in (West) Germany.¹⁴⁶ The only major reform too place in France (the creation of a weak sectoral regulator, the COB in 1967), which further increased cross-national divergence. The institutional arrangements between 1965 and 1985 are summarized in Table 1

Table 1 Features of regulatory institutions for securities trading in 1965-1985

	Britain	France	Germany
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¹⁴⁴ Lütz 1998: 158-9, 163; VWD Europa 29.10.90, Welt am Sonntag 3.2.91, Wirtschaftswoche 28.6.91, FAZ 4.7.91, Capital 1.9.91, Handelsblatt 29.4.92, 10.9.2001.

¹⁴⁵ Interviews senior banker 2, senior regulator; Lütz 2002: 247 CHECK page; Handelsblatt, 17.10.01, 8.5.01.

¹⁴⁶ See for instance, Hall 1986, Schmidt 2002, Hayward 1986, Zsyman 1983, 1996, Albert 1993.

Organisational position of stock exchanges	London Stock Exchange- private club of individual male British members (foreigners allowed 1971, women 1972)	Paris Bourse - publicly owned	Several exchanges owned by regional chambers of commerce
Rules governing competition	Domination without legal monopoly for members of LSE trading as individuals; trading split between wholesale and retail; fixed commissions	Legal monopoly for publicly-appointed brokers (<i>Agents de change</i>) trading as individuals; dual markets for same securities	Legal monopoly on exchanges for publicly-appointed brokers- (<i>Kursmakler</i>), trading as individuals; domination of trading by banks
Allocation of regulatory powers	Self-regulation led by LSE Council and Bank of England, mostly through informal norms	Most powers in hands of Ministry of Finance and Banque de France, but creation of COB 1967	Regions (Länder) responsible for legal supervision of their exchanges

Detailed historical process tracing helps to explain the institutional inertia. It was not for lack of pressures from internationalization. On the contrary, traditional institutions came under considerable pressure from transnational technological and economic developments in all three countries. There were serious discussions of change, proposals and even attempts at reform. Yet until the mid-1980s, established sectoral interests were able to fend off reform; indeed, process tracing reveals the striking fact that serious reform discussions in France and West Germany peaked in the 1960s and early 1970s, as transnational technological and economic factors strengthened. One reason for institutional survival was that non-institutional responses were found such as financial policies to aid stock exchanges. But the main explanation is that policy makers and exchanges accepted slow decline and institutions that protected existing suppliers but were not suitable for changed technological and economic conditions.

The second central argument however, is that that ‘policy forms’ of internationalization can contribute to rapid, sweeping and convergent reform of regulatory institutions. They do so because they become part of the domestic policy process and affect the ‘regulatory space’ within which decisions are taken¹⁴⁷: they influence the strategies, coalitions and legitimating arguments of national policy makers, including not just socio-economic interests but also governments and officials. They operate through payoffs, or expected payoffs, but also through ideational mechanisms of learning and legitimation. The case examined two policy forms of internationalization: reforms in significant nations (the US); supra-national regulation (by the EU). It showed that in Britain, once actors had decided to attack traditional regulatory institutions for domestic reasons, reforms in the US offered a source of fear of loss of markets as well as an example that domestic British policy makers used to legitimate change. Policy makers were able to ‘learn’ selectively, notably from the US, helping them to legitimate change and counter established veto players. In France and Germany, overseas reforms and supranational regulation by the EU were central in decisions to introduce reform. Fear of competition from London was strong, while British reforms also operated through ideational mechanisms by offering an example of successful change. EU regulation increased fears of regulatory competition. Moreover, its transposition into domestic legislation offered occasions for reform by aiding reconsideration of existing national institutions and provided arguments for reformers to legitimate changes that went well beyond those required legally by EU legislation. Supra-national regulation was used to legitimate and provide occasions for altering long-established regulatory institutions and countering entrenched opponents of reform

Thus in all three countries policy forms of internationalization helped to undermine long-standing and cross-nationally diverse regulatory institutions and their replacement with similar ones. The reforms were not gradual or evolutionary as recent HI analyses suggest,¹⁴⁸ but saw the abolition and replacement of many long-standing institutions. Equally, contrary to much of the literature on ‘varieties of capitalism’, three very different countries adopted similar formal sectoral reforms. Between 1986 and 2007 radical and comprehensive reforms were introduced that abolished very long-standing institutions. They included privatization of exchanges in France and Germany, and their transformation into quoted companies, the end of monopolies over share trading, and the creation of independent sectoral regulatory agencies. National specificities such as dual markets in France, brokers and jobbers in Britain or high

¹⁴⁷ For discussions of regulatory space, see Hancher, L. and Moran, M. (eds.) (1989). *Capitalism, Culture and Economic Regulation* (Oxford: Clarendon Press) and Colin Scott (2001). ‘Analysing Regulatory Space: Fragmented Resources and Institutional Design’, *Public Law*, Summer: 329–53

¹⁴⁸ For instance, Streeck and Thelen 2005 or Campbell 2004

regional fragmentation in Germany were ended. The new institutions are summarized in Table 2.

Table 2 Sectoral regulatory institutions for securities trading in 2007

Institutional feature	Britain	France	West Germany
Organisational position of stock exchanges	London Stock Exchange a listed company	Privately-owned listed company, part of Euronext	One dominant exchange, Deutsche Börse, privately-owned listed company
Rules governing competition	Brokers open to takeover and entry allowed for companies, including banks	Brokers open to takeover and entry allowed for companies, including banks	Brokers open to takeover and entry allowed for companies, including banks
Allocation of regulatory powers	Sectoral regulator with detailed powers of rule-making and enforcement	Strengthened sectoral regulator with detailed powers of rule-making and enforcement	Strengthened Federal sectoral regulator; some powers remain with regional governments (Länder)

The third argument is convergence in institutional outcomes does not mean that international factors operated in the same ways across the three countries. On the contrary, detailed historical research shows diversity in reform routes and in the role of internationalization. In Britain, change was triggered by domestic factors, but thereafter, reforms in the US were important due to fear of competition and use as a legitimating example. The reformers' strategy was to make London an internationally-attractive financial centre, regardless of

nationality. In contrast, in France, reforms in Britain and EU regulation, operating through mechanisms of feared regulatory competition, occasions for reconsidering existing institutions and legitimating new institutions were crucial. The US was not a significant factor except as an example in the late 1960s. The French strategy was to create an international champion, with strong French connections and overseas alliances, namely Euronext. In Germany, reforms in Britain and EU regulation, operating through similar mechanisms as in France were crucial. The German strategy was also to create an international champion, although mergers and takeovers of other exchanges had largely failed by 2007.

The timing and pace of change varied. Britain moved first through one very revolutionary change (the 1986 Big Bang). It was followed by France, which introduced a series of rapid reforms between 1988-1996. Germany brought up the rear, modifying institutions over a longer period (1988-2003) through a series of limited but cumulatively significant steps. Germany is thus the most ‘incremental’ and Britain the least. The leaders of change and their coalitions also varied. In Britain, the Big Bang was triggered by outsiders to the traditional financial community before being taken up by a powerful coalition (the Bank of England, LSE’s senior management and the government) that overcame opponents among Conservative party backbenchers and small members of LSE. In France, state actors led change, notably the Finance Ministry. They met strong opposition from existing state beneficiaries, notably the *Agents de Change* and when necessary, the government imposed reforms. In Germany, reformers had to face smaller regional stock exchanges and most important of all, powerful *Länder* governments. Change took place through negotiations and consensus building, which took time. The overall approaches to reform can be summarised as revolutionary change led by partnership between financial community and government in Britain, a state-led strategy of internationalised champion in France and a bank and state alliance moving via consensus and negotiation in Germany. Table 3 summarises the differences in reform routes and strategies. These also correspond to HI/comparative institutionalist work on reform processes.¹⁴⁹

Table 3 Internationalisation and institutional reform: national patterns

	Britain	France	Germany
Role of internationalisation	Domestic and US	International-regulatory competition from London and EU regulation	International-regulatory competition from London and EU regulation
International Strategy	London as international market open to all	Creation of French-based international champion	Creation of German international champion
Timing	1986	1988-92	1989-2002
Pace	Revolutionary	Rapid	Incremental
Entrepreneurs/leaders of change	Outsiders	State	Frankfurt coalition
Opposition	Small stock brokers and	Agents de Change	Länder, smaller stock exchanges

¹⁴⁹ See for instance, Vivien Schmidt, 2002, Peter Hall 2008.

	Conservative backbenchers		
Mode of change	Initial attack and then overwhelming coalition led by financial community	State imposition	Consensus and negotiation
Overall pattern	Revolutionary change led by partnership between financial community and government	State-led strategy of internationalisation	Frankfurt coalition (bank and state alliance) moving via negotiation

What does the analysis of internationalization and the conclusions of the case study suggest about the value of historical institutionalism as an analytical framework for studying change in regulatory institutions? At least three broader implications can be underlined.

First, it shows that if HI analyses take an over-narrow view of internationalization of markets, focusing on economic globalization, they are confronted with processes and outcomes that contradict their predictions. In particular, they fail to understand the ways in which different forms of internationalization enter domestic policy making and aid rapid reforms that are not incremental or evolutionary but can be revolutionary and involve abolishing and replacing existing institutions, even very long-standing ones. Such reforms may lead to cross-national convergence, even across nations with very different histories and institutions, again contrary to HI analyses. They may operate through mechanisms that involve ideational mechanisms legitimation. These weaknesses of HI analyses of internationalisation mirror more general critiques of their ability to historical institutionalism to explain change and an over-emphasis on inherited structures.¹⁵⁰

Second however, the article has also argued that historical institutionalism can be enriched with concepts and mechanisms taken from policy transfer/diffusion approaches. It can take a broader approach to internationalization beyond economic globalisation, notably by inclusion of include policy forms such as regulatory reforms in other significant nations and supranational regulation. They also permit attention to be paid to a wider range of mechanisms within the policy process whereby those policy forms influence domestic institutional reform, notably fear of regulatory competition and use of overseas and supra-national regulation to legitimate change. They respond to strong criticisms of the conservative bias of historical institutionalism and its exclusion of important factors such as conflict or the power of ideas.

Finally, the article argues that an enriched approach does not remove the explanatory value of the HI approach of studying institutional development within countries over significant

¹⁵⁰ Peters, Pierre and King 2005, Blyth 1997; Crouch and Farrell

periods of time rather than just examining institutional outcomes. On the contrary, even if cross-national institutional convergence takes place, the case shows that an HI approach is valuable. It allows opponents and obstacles to reform that are institutionally-inherited and embedded to be identified. It helps to understand the strategies and coalitions whereby reformers seek to overcome such opposition. It aids in explaining the pace and timing of reforms. Perhaps most important it identifies which forms of internationalization were influential and the mechanisms for their operation, for, as the case shows, countries can take different routes to similar outcomes. These routes and explanations could not be read off institutional outcomes but need a HI analysis, tracing existing institutions and attempts at reform within countries over significant periods of time. When historical institutionalism is developed by adopting concepts and mechanisms from theories of policy making, it can better explain apparently surprising outcomes such as inertia despite strong transnational technological and economic forces for change followed by rapid, comprehensive and convergent change in regulatory institutions.