Completing the Single Market in Financial services: An Advocacy Coalition Framework

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Abstract

The paper applies a revised version of the 'advocacy coalition framework', modified so as to incorporate the role of material interests as well as ideas, to the empirical record of the policy-making processes of key pieces of legislation dealing with securities trading in the EU and which were necessary to the completion of the single market in financial services. It is argued that in almost all the Lamfalussy directives, the main (but, by no means, the only) line of division was between a 'Northern European' coalition and a 'Southern European' one. This was due to differences in the national regulatory frameworks, the configuration of national financial systems and their competitiveness (hence, 'interests'). However, the tension was also due to different belief systems (hence, 'ideas') about financial services regulation.

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Introduction

The Financial Services Action Plan (FSAP) and the introduction of the Single Currency in 1999 gave new momentum to financial market integration in the European Union (EU). Compared to banking and insurance, securities is the sector of most intense activity in the 2000s, partly because market integration had lagged behind in this field and a catching up was therefore overdue, and partly because technical innovations increased the potential for cross-border securities trading.

Most of the 42 measures proposed in the FSAP for completing the single market in financial services concerned securities trading, and they subsequently found their way into four so-called 'Lamfalussy directives', named after the process through which they were negotiated and implemented (on the Lamfalussy architecture see Quaglia 2007). These directives, which contained market-making and market-shaping measures, were: the Prospectus directive (2003), the Market Abuse directive (2003), the Transparency directive (2004) and the Market in Financial Instruments directive (MiFID) (2004).

Theoretically, the paper uses a revised version of the 'advocacy coalition framework', modified so as to incorporate the role of material interests as well as ideas, as elaborated in Section 2. This approach was chosen to shed light onto the policy process and outcome because it permits to consider the activity and interaction of public and private actors, situated at different levels of governance in the EU (on the

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use of the advocacy coalition framework in EU policy-making see Radaelli 1999, Dudley and Richardson 1999).

Empirically, this paper analyses the policy-making processes of two key pieces of legislation necessary for the completion of the single market in securities: the Prospectus directive (2003) and the Market in Financial Instruments directive (MiFID) (2004). Out of the four Lamfalussy directives, these were those with the greatest economic impact and the most politically controversial. This paper does not examine the so-called level 2 implementing measures of these directives.

The leading research question addressed in this paper is what were the main obstacles in the negotiations of these directives and why? Can any lesson be drawn for the completion of the single market in financial services and, more broadly, in other sectors in the EU?

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

The rules set in place for the completion of the single market in the early 2000s were the result of negotiations between these two coalitions, and were based on a series of compromises, even though the new rules tended to be closer to the preferences of the Northern coalition. This is explained by the bargaining power of its members, which

in turn was affected by the changes in the policy environment and some learning that took place across coalitions.

2. The advocacy coalition framework in theory and practice

An advocacy coalition is formed by 'actors from various governmental and private organizations who both (a) share a set of normative and causal beliefs and (b) engage in a nontrivial degree of co-ordinated activity over time' (Sabatier 1998: 103). One or more coalitions can be present within a policy subsystem, which is composed by a set of policy-makers and stakeholders who are actively concerned with a certain issue, regularly seeking to influence public policy related to it.

As Sabatier (1998: 103) specifies, 'the belief system' of an advocacy coalition is organised into a 'hierarchical, tripartite structure': i) the 'deep core' of the shared belief system includes basic ontological and normative beliefs; ii) the 'policy core' beliefs, which represent the causal perceptions by the coalition (the definition of the problem, its causes and solutions) and are its fundamental 'glue'; and iii) the secondary aspects of the coalition's belief system, comprising instrumental considerations on how to implement the policy core (eg minor decisions concerning budgetary allocations, administrative regulations) (Surel 2000), and which can vary somewhat among different members.

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

In many policy oriented studies and empirically grounded research, especially in the economic field, it is difficult to separate neatly ideas and interests, and it can be somewhat naïve to identify coalitions based purely on values or ideas. At the same time, as this paper argues, to identify coalitions based purely on interests might overlook an important part of the explanation. On the one hand, there are massive and powerful economic interests at stake in financial services. On the other hand, ideas, in the form of technical knowledge and objectives and instruments of regulation, are important in this complex and 'technical' policy area.

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

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

The remainder of this section outlines the two principal advocacy coalitions active in the regulation of financial services in the EU, identify the main members of each coalition, and teasing out the various components of their belief system. The subsequent sections apply this framework to the empirical record, highlighting the interplay of the coalitions in the policy process and their influence on the outcome.

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

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

The 'policy core' beliefs concern:
(i) the definition of the problem: whereas completing the single market is more or less a shared objective for both coalitions (though with a different degree of intensity, being more important for the Northern group), the Northern coalition prioritises market liberalisation, mainly through market-making measures and 'negative integration', and the Southern coalition prioritises re-regulation at the EU level, through market-shaping measures and 'positive integration';
(ii) the content of regulation: light-touch regulation, principle-based, and competition-friendly is endorsed by the Northern group, whereas prescriptive regulation, rule-based, prioritising consumer protection is favoured by the Southern one;
(iii) the relationship between the public authorities and industry: the Northern group believes in private sector governance, based on the involvement of industry through consultation, drafting and implementing soft law; the Southern group believes in the steering action of the public authorities.

The secondary aspects of the coalition's belief system vary somewhat among different members. They partly depend on the specific situation in which the various members of each coalition find themselves, such as the degree of competitiveness, the market share of private actors; the organisational structure and the institutional prerogatives

for public actors. These secondary beliefs are not considered in this paper, given the considerable number of policy-makers and stakeholders involved.

The two coalitions competed for influence in the policy process concerning the main legislative measures underpinning the completion of the single market in financial services in the early 2000s. This paper argues that both coalitions were successful to a certain extent in that the policy outcome was often a compromise solution, even though the Northern coalition was overall more successful in shaping the rules set in place. After all, the re-launch of the single market in financial services was mainly their priority (Mügge 2006, Bieling 2003). In the case of financial services, the main changes of the policy environment that empowered the 'Northern coalition' were the introduction of the single currency, which gave new momentum to financial market integration in the EU and the increasing competition with the US in this sector, as elaborated in the concluding part of the paper.

3. The Prospectuses directive (2003)

The Prospectus directive allowed capital to be raised throughout the EU on the basis of one set of documents – the prospectus - and gave bond issuers a choice of regulator. The directive gave competence to a single authority in the member state to supervise compliance with the provisions. The rationale of the directive was to encourage cross border competition and promote market integration, given the fact that the pre existing rules concerning the mutual recognition of prospectuses were largely ineffective in practice, as different versions of the prospectus had to be prepared for each member state.

The directive was first proposed by the Commission in May 2001 and it was criticised by industry, which lamented that the draft had not be subjected to a consultation procedure before being formally adopted by the Commission. Reportedly, the initial draft produced by the Commission was close to the preferences of the Mediterranean coalition (in particular, the public authorities in Italy and France).

Three main criticisms articulated by the industry and the public authorities of the Northern European member states were subsequently taken on board by the European

Parliament (EP), since the Committee on Economic and Monetary Affairs of the EP traditionally adopts positions that are close to those of the Northern group. The first issue was the scope of the directive, whereby the light-regulation coalition highlighted the insufficient number of exemptions included in the directive, an issue linked to the definition of 'qualified investors', in that this coalition wanted a broader definition of such type of investors, for example including certain private investors. This is because less burdensome provisions for the issuer usually apply whenever the investor is a 'qualified investor', which requires less legal protection, as compared to small non-qualified investors.

The second issue was 'the home country principle' to determine the competent authority for the approval of the prospectus. The Northern coalition wanted the issuers to be given the choice of the authority to which to submit the prospectus for approval. On the one hand, the concern of the Northern coalition was that some regulators – in particular those from the Mediterranean countries with France as part of the coalition - might insist on the use of the national market as a condition of approval (letter of Christopher Huhne, Member of the European Parliament, MEP, and rapporteur of this directive, *Financial Times* 5 November 2002). On the other hand, the concern of Southern regulators and the Commission was that the freedom for issuers to choose the regulator from which to seek approval might trigger a 'race to the bottom', as issuers would shop for easy approvals.

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

The EP, which received intense lobby from industry, and the Northern member states asked for significant amendments concerning the points mentioned above in first

reading in February 2002. In the Parliament, the socialists mostly lined up with the approach preferred by Southern Europe, as elaborated below, whereas the conservatives and liberals mostly took on board the requests put forward by Northern European countries, even though to some extent there was also a split along national lines in the Parliament. The Council was also divided internally between the Northern group and the Southern one. In August 2002, the Commission presented an amended proposal in response to amendments proposed by the EP, some member states and industry (all members of the Northern coalition).

Negotiation resumed in the Council and between the Council and the EP. In the end, exemptions related to qualified investors were extended to certain private investors with relevant expertise and the threshold value for exemptions was lowered, as proposed by the EP. A compromise between the position of the EP and part of the Council, which was also a compromise between the two coalitions, was reached on the duration on of the vetting period, and the competent authorities were enabled to grant exemptions from disclosure requirements for some enterprises. Eventually, an agreement based on a package deal between the EP and the Council was put together, whereby companies that issued bonds (but not shares) above Euros 1,000 would have a choice of regulator, which would de facto give freedom of choice to the vast majority of issuers (Ferran 2004).

The Prospectus directive, as initially drafted, displayed a potentially over prescriptive approach by limiting the choice of issuing market by the issuers and privileging consumer protections regardless of the costs imposed on industry. The European Commission, backed by France, Italy and Spain had initially proposed that all equity and most debt issuers could go for approval only to their national regulator, which would thus enjoy a sort of monopoly, instead of leaving it to the market, giving issuers the possibility of choosing the regulator for approval.

Besides being a clash of national interests - the national governments were keen to set in place rules that were most advantageous for their financial centres - it was also a matter of different belief systems, based on different deep normative beliefs: market trust and market distrust. As for policy core beliefs, the Northern coalition privileged a ‘market-making’ regulatory approach, the other a ‘market-shaping’ one. In Northern

Europe and Anglo Saxon countries, the prospectus is considered as an information tool, not a consumer protection tool: it is 'light' and it is not vetted by regulators. In Southern Europe, including France, the prospectus is seen as a consumer protection tool: the information in it has to be detailed and is vetted by the regulators (interview, London 12 May 2007). This also espoused a different vision about the role of the public authorities vis a vis the market.

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

The MiFID was a core part of the FSAP, being described by financial press as the 'new Big Bang' in financial services (*Financial Times* 26 October 2006). It was proposed in November 2002 to update the existing Investment Services directive (ISD) issued in 1993, which only applied to a specified number of financial instruments and investment services (see Mügge 2006) . All the firms previously covered by the Investment Services directive are subject to the MiFID but new categories of firm fall within the remit of the MiFID, such as investment banks, stock brokers and broker dealers, futures and options firms, commodity firms, and portfolio managers. Moreover, retail banks and building societies are subject to the MiFID for some parts of their business such as the sale of securities, or investment products.

The directive set common rules for securities and derivatives markets, permitting investment firms to operate throughout the EU by using a 'single passport', which allowed financial firms to conduct business across Europe with the approval of their home authorities. Investment firms were enabled to process client orders outside regulated markets (first and foremost, stock exchanges), which previously was impossible in some member states. This was the so called 'concentration rule', which had been one of the main bones of contention in the negotiations of the ISD in 1993, as it was a priority for France and the Southern European countries, which had this rule in place. The public authorities in these countries believed that the market for securities trading should be carefully regulated and monitored, hence their legislation prescribed routing all orders for securities trading through regulated markets (stock exchanges).

This meant that, in many member states (such as France, Italy and Spain), the MiFID exposed stock exchanges to competition from multilateral trading facilities (i.e. broadly non-exchange trading platforms) and 'systematic internalisers' (i.e. banks or investment firms that systematically execute client orders internally on own account, rather than sending them to exchanges). This was already the case in some member states, such as the UK. This approach is competition friendly, in that it creates competition between stock exchanges and big banks. However, it can reduce investor protection if adequate pre-trade and post-trade requirements are not set in place.

The MiFID, because of the lobbying of the Southern coalition, included greater harmonisation as compared to the ISD, setting pre-and post-trade transparency requirements for equity markets; a new regime for 'systematic internalisers' of retail order flow in liquid equities; and more extensive transaction reporting requirements. Multi Trade Facilities and 'systematic internalisers' were subject to similar pre- and post-trade transparency requirements as the exchanges, ensuring a level playing field between the exchanges and their competitors, as explained below.

In November 2002, the Commission proposed the directive, which was subsequently amended by the European Parliament in first reading in September 2003 and the resulting text was further amended by the Council. Once the Council formally adopted a Common Position on the basis of the political agreement in October 2003, the proposal returned to the Parliament for its second reading. Negotiations between the Parliament, the Council and the Commission before second reading in the Parliament ensured that, at that stage, the Parliament was able to approve a compromise text also acceptable to the Council. The directive was finally adopted in April 2004.

The Commission initially presented a draft that was closer to the positions of the Southern coalition, raising the objections of some MEPs and parts of the industry, especially the investment firms in the UK as well as investment banks, several of which are US-owned, but based in London. The Commission's draft was approved by the Council by Qualified Majority Voting (QMV) after the rather unusual decision of the Italian Presidency to call for a vote, rather than continuing negotiations in an attempt to reach a consensus, as it is common practice, despite the fact that the dissent of the Northern coalition, namely the UK, Ireland, Luxembourg and the Nordic

countries was clear. The EP, with the backing of Northern member states, first and foremost the UK, managed to have important amendments included in second reading. In the end, the MiFID ended the 'concentration rule' present in much of continental Europe.

The second controversial issue, which was related to the first one, was ‘pre-trade transparency’ (art 27) that referred to publishing the prices of securities, hence the obligation by which investment firms have to reveal to the markets details of client orders and, if the firms are trading on their own account, some indication of the terms on which they themselves stand ready to buy or sell a specified share. This issue was particularly important for the Southern coalition, which wanted clear rules to be set in place for all the market players, including investment banks and financial companies, which are by definition ‘non regulated markets’. Oversimplifying only slightly, whereas the Northern coalition wanted to keep them by and large ‘unregulated’, opposing pre-trade transparency requirements, the Southern coalition wanted to impose prescriptive rules concerning pre-trade transparency, presented as a tool for investor protection.

Negotiations in the Council and the EP focused intensively on this issue. In the Council, preferences differed widely, ranging from the removal of the relevant articles to extending its provision. Under an earlier position taken by the ECOFIN Council, stockbrokers would have had to publish advance prices for potential trades of over €3 million, which the MEPs claimed was too risky, even though the EP was also divided on this issue. In the end, the principle of pre-trade transparency was maintained for firms that are termed ‘systematic internaliser’ (a firm that on a systematic, organised and frequent basis deals on its own account by executing orders outside a regulated market or multilateral trading facility, Article 20 Implementing Regulation) for ‘liquid shares’ and for transactions up to a certain threshold, defined as ‘standard market size’¸ meaning that very large trading positions will not have to be divulged (Article 27 MiFID). It was also recognised that firms needed some flexibility so that, in certain cases, they could offer their clients better prices than they quoted publicly.

Let us look in more details at the preferences of the main policy actors and their intervention in the policy-making process at various levels. The directive basically

pitted two coalitions against each others. This was evident in the making of level 1 legislation, but it also surfaced in the adoption of some level 2 measures, which are not discussed in this paper. On the one hand, the national governments and economic interests in continental Europe tried to limit the extent of market opening, with a view to protecting small investors and the national stock exchanges, which feared the competition of the large (mainly British-based) investment banks (*Financial Times,* 13 March 2006). Some national stock exchanges in continental Europe, such as Euronext, Borsa Italiana and Bolsa de Madrid were especially vulnerable, because the MiFID removed rules that in effect had eliminated competition in their home markets.

On the other hand, the London Stock Exchange and to some extent the Deutsche Borse actually expected more business as a result of the MiFID, through the extension of single passport rules that allows more investment firms to operate on a pan-European basis (*The Economist* 9 September 2006). Hence, the UK financial services industry and the national authorities preferred light regulation, promoting market liberalisation.

In the policy-making process at level 1, the evidence suggests that the Commission took industry input into account in preparing its final draft of the MiFID proposal, which contained significant improvements over earlier drafts (Treasury Committee 2006: 16). The EP provided a sympathetic hearing for industry and the two coalitions that played out in the Council were also present in the EP, largely lined up along national lines. Overall, the Northern coalition was able to influence the position taken by the EP (Ciani 2007).

Unusually, the Italian presidency of ECOFIN called a vote, adopting a Council position on the proposed directive by QMV in November 2003, despite the opposition of the UK, Ireland, Finland, Luxembourg and Sweden, with Germany switching position towards the Southern coalition, despite the fact that internalisation was practised by many German private banks. The presidency was criticised as it was seen as having a vested interest in pushing through the proposal as it had been formulated (ie limiting internalisation), despite the opposition of countries that have a large financial sector. Moreover, it is relatively unusual to call for a vote in the Council, as

the Presidency most of the time endeavours to reach consensus, rather than isolating member sates, even when they do not have a blocking minority.

The EP proved an important channel for industry to articulate its policy preferences. The main policy actors that lobbied the EP were the big investment banks (often US owned and based in the UK); the Federation of European Stock Exchanges (FESE) and the largest stock exchanges; the European Federation of Assets Management Associations (EFAMA) and some of its most active national associations, such as French association (AGF); the European Banking Federation (EBF) and the largest national banking associations; and the largest national associations of investment firms, such as the French Association of Investment Firms (AFEI), the Italian equivalent, ASSOSIM, whereas in the UK it is the London Investment Banking Association (LIBA). International associations were also active, often coordinating with British-based associations. Towards the end, the EP was increasingly approached by private banks and consultancies lobbying on their behalf. Reportedly, the Parliament, like the Council, was split, largely according to national lines. Indeed, the UK and Finish MEPs (the two rapporteurs of the directive were British and Finish) were very active in promoting a market-making, competition-friendly approach, privileging consumer choice, whereas the MEPs from the Southern countries took a market-shaping, rule-based approach, privileging consumer protection.

Amongst the member states, the positions and the policy preferences of the German and Belgian authorities are the most difficult to characterise. The position of the German government on this issue was unclear and unstable because domestically there were competing policy preferences of policy-makers and stakeholders that were part of the two advocacy coalitions active at the EU level. Whereas the most domestically-oriented part of the banking system (namely the savings banks and the cooperatives) shared the policy preferences of the Southern group, the large private banks shared the policy preferences of the Northern group. The public banks in Germany tend to have better access to policy-makers in the landers, whereas the large private banks tend to have better access to policy-makers at the federal level. The federal state structure, the competition amongst ministers and the role of party political competition compounded the definition of the German position on this directive (interview, Paris, 18 July 2007). Observers reported that the policy position

taken by Germany in the negotiations of the directive very much depended on which authority (and even individual) was representing the country. This also explains why the Germans somewhat switched position, voting against the UK and Luxemburg, when the Italian presidency called a vote on MiFID in 2003.

The position taken by the German savings banks and the public banks on pre-trade transparency and internalisation was in line with the positions expressed by the respective EU level peak associations, where the German component is very important. Hence, they were part of the Southern coalition, which contrasted with the preferences of the British banks and global investment banks, which were part of the Northern coalition. The EBF was internally divided on this issue. Officially, it was closer to the Anglo Saxon approach. However, the French and Italian banking associations put forward a dissenting opinion and they lobbied directly the Commission and the EP.

Why were the banking associations in the Mediterranean countries defending regulation that could be seen as advantageous for stock exchanges? It was a problem of competitive position: these banks were used to operate with the concentration rule. It would have been costly to adopt a different system, where they would have been less competitive, at least initially (interviews, Paris 18 July 2007, Rome 10 December 2007). However, the banks that were part of the Southern coalition also believed that pre-trade transparency requirements were part and parcel of sound regulation. In Italy, for example, as more than one interviewed put it, it was seen as imperative to avoid the return to the 'Far West' (interviews, 11 December 2007), characterised by the almost complete absence of securities trading regulation, as it had been the case before the introduction of financial market legislation in the 1990s.

5. An overall assessment of the policy process and outcome

In an overall assessment, to what extent is the advocacy coalition framework useful to explain the policy process and outcome? Does this shed novel light onto the completion of the single market? To address these questions, it is necessary to ask which were the most important actors and why? How did policy-makers and

stakeholders define their policy preferences? And how were such preferences pursued in the policy process and with what outcome?

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

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

It should be noted that certain national governments approached the MEPs from their own countries, attempting indirect ‘governmental lobbying’ of the EP. For example, on the MiFID, the British government that was seriously unhappy with the first draft proposed by the Commission, approached British MEPs. Hence, sometimes, the member states teamed up in the Parliament and the Council, and this feature can be captured well by the advocacy coalition framework. More often than not, the MEPs voted according to party line. However, in the internal debate leading out to a vote, they also took into account national preferences, whenever the matter was politically sensitive domestically.

The member states (to be precise, the national governments, particularly the Treasury and Finance Ministries) were key players in decision making stage, as the ECOFIN Council had ultimately decision making power, together with the EP. The Council was generally split between in two: the Northern group and the Southern one. In the negotiations, the positions of the national governments reflected the preferences of powerful domestic groups, especially in those countries, such as the UK, where there is traditionally an intense and constructive interaction between the public authorities and industry. In some cases, it also reflected the preferences of the public authorities, even when they differed from those exposed by the national industry, or part if it, in particular in countries, such as Germany, which has a federal structure (viz the MiFID and the large private banks), and France and Italy, where there is traditionally a strong steering action by the state with limited consultation with the private sector.

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

Coalitions of member states varied depending on the directive being negotiated and the specific issues dealt with, even thought the traditional line of friction was between countries, such as the UK, Ireland, the Netherlands, and the Nordic countries embracing a market-making, competition-friendly, principle-based approach; and the market-shaping, rule-based, investor protection approach adopted by France, Italy, and the other Mediterranean countries; with Belgium and Germany switching position and hence coalition depending on the specific content of the legislation being negotiated. However, such line of attrition also ran within member states and national

industries (most notably in Germany), in which case the main juxtaposition was between the beliefs and the interests of the most internationalised and competitive part of the sector, and the domestically-oriented state-owned one. For example, there was a divide between the private banks and the public banks in Germany, and to a more limited extent between some large banks and the small-sized banks that form the rest of the sector in France and Italy.

In lobbying on securities governance in the EU, there was a sort of implicit division of competences. National associations and individual firms mainly interacted with the national authorities, whereas EU level associations interacted with EU level authorities (the Commission, the EP). However, the most active national associations, such as the British Bankers Association or the German private banks association (the latter has a well staffed office in Brussels), and some international companies, which either have offices in Brussels or use the services of lobbying firms based there, also lobbied at the EU level, usually (but by no means only) the MEPs and the Commission's officials of their own nationality. This was less the case for other national associations, which have a very limited experience of lobbying in Brussels and/or prefer to rely on the action of the national public authorities. At times, the presence and the activity of national associations and private companies in Brussels - for example, the French and Italian banking associations have representatives in Brussels - posed difficulties in coordinating the position and actions of EU peak associations, whenever the national associations had very different policy preferences and pursued them publicly. The most active national associations were generally part of the competing advocacy coalitions outlined above.

EU umbrella associations were split on certain issues, as its members (national associations) had different preferences, and, in addition, some of the national associations were split internally. In the negotiations of the MiFID, the EBF had to try to reconcile the different policy preferences of the French and Italian banking associations and those of the British banking association. The positions of EFAMA also resulted diluted by the need to find a compromise between the preferences of its members (national associations). A similar conundrum was sometimes faced by national associations. For example, the French and Italian banking associations

represent large banks (such as BNP Paribas, Unicredito) and small saving and cooperative banks, which might have different policy preferences on certain issues.

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

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

Nonetheless, it is difficult to clearly separate belief systems (hence, ultimately ideas) from the features of the national financial system and regulatory issues related to the competitiveness of industry or specific preferences of market players (hence, interests). British policy-makers have traditionally adopted an internationalised free market approach, but this is also influenced by the large number of foreign owned companies (especially from the US) located in the City. French, Italian, Spanish

policy-makers embrace a market-shaping inward-oriented approach, which is interconnected to the limited competitiveness of their financial sector. German policy-makers also subscribe to a market-shaping policy, but given the competitiveness of part of their financial sector (private investment banks and financial conglomerates) tend to be more market oriented and competition friendly than France, Italy and Spain, even though this also depends on the specific issues being negotiated.

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

As far as changes in the policy environment are concerned, the Northern coalition was empowered by the introduction of single currency, which increased financial market integration in the EU, and by the renewed competition between the EU and US in this field (Mügge 2006). In this environment, the completion of the single market in financial services became a priority for the EU and the market-making, competition-friendly approach was regarded as the most successful, providing a competitive model for the EU. In turn, this had implication for the learning process taking place between the coalitions and their members.

The advocacy coalition framework considers the possibility of learning across belief systems in specific circumstances. Interviews with policy-makers and stakeholders reveal some instances of learning across the two coalitions, whereby members of the Southern coalitions moved closer to the belief system (or parts of it) of the Northern

coalition. As suggested during interviews, generally speaking, stakeholders active in the market and exposed to international competition and regulators of a younger generation and/or educated in Anglo Saxon environment tend to be more receptive to a market-making, competition-friendly approach. Overall, the two belief systems have become more similar because the continental approach has assimilated elements of the Northern one.

Comparing to the past, major progress has been made in the completion of the single market in securities. In turn, securities trading was the main missing piece in the completion of the single market in financial services. In the past, it had proven particularly difficult given the presence of powerful competing advocacy coalitions. The re-launch of the single market in securities has been made possible by the prevalence of one coalition over another (it was the empowerment of the Northern coalition, which however had to compromise with the Southern coalition), which was facilitated by the evolution of the policy environment and a process of learning.

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

Conclusion

The directives passed in the early 2000s and examined in this paper were designed to substantially increase financial market integration in the EU, through de-regulation, re-regulation, convergence of supervisory practices and improved cooperation amongst national supervisors. The MAD and Transparency directives were mainly market-shaping, whereas the Prospectus and MiFID were mainly market-making.

The making of these directives, but especially the Prospectus and the MiFID, was characterised by the presence, the interactions and the influence in the policy process

and eventually in the outcomes (ie the policy measures adopted) of two competing policy coalitions. On the one side, there was a market-making coalition, formed by Northern member states, their public authorities, industry, some MEPs. On the other side, there was the market-shaping coalition, formed by Southern member states, parts of their industry and some MEPs. It should be noted that these two advocacy coalitions and their belief systems are present in other financial services, such as banking (cf Quaglia 2008), payment services and clearing and settlement (Quaglia forthcoming).

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

Besides being slowed down by dissimilar (at times opposite) interests of the main policy-makers and stakeholders, the completion of the single market in securities was also rendered more complex by different (often competing) belief systems exposed by the main actors about securities trading regulation. Paraphrasing the title of the path breaking book of Story and Walters (1997): *Political Economy of Financial Integration in Europe: The Battle of the Systems*, financial market integration in the EU in the 21st century was not only the battle of the systems, it was also the battle of ideas (to be precise belief systems) about the regulation of securities trading.

The main lesson to be drawn for the completion of the single market is that policy-makers and academics need to pay attention to ideas (or belief systems) as well as interests. Policy-makers are aware of this – in the financial services sector there are now several EU initiatives designed to promote the creation of a 'shared supervisory and regulatory culture across the EU'. Academics should endeavour to combine or integrate ideas and interests in their studies in a more systematic way. An adapted

version of the advocacy coalition framework can be instrumental in doing so. It would be interesting to extend this analysis to other sectors of the single market.

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