The dynamics of regulatory norms in the EU: a political perspective

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Abstract

The paper examines how policy forms of internationalisation affect the development of regulatory rules. The central argument is that transnational technological and economic factors, even if revolutionary, are often in sufficient to lead regulatory change. Indeed, nations can maintain inherited 'inefficient' regulatory institutions for lengthy periods. Instead, political impetus is required for reform. Policy forms of internationalisation- for instance by reforms in powerful overseas countries such as the US or EU regulation- can provide such impetus through increasing the fear of regulatory competition, offering examples and providing occasions and legitimation for reform.

The paper examines how international factors affect changes in regulatory norms, notably sectoral rules that structure markets. The effects of international forces on national institutions lie at the heart of several debates in comparative political economy over the extent to which markets institutions change and/or converge and the degree of national autonomy in an internationalized world.

'Strong globalisationalists' have put forward a simple but powerful model of changes in market institutions. They argue that increased cross-border capital and trade flows are leading to cross-national convergence as nations adopt 'liberal' economic institutions due to international competition and the need to attract footloose capital.[1] The key actors driving change are economic actors, notably firms and investors, who seek higher economic rewards. The key mechanism for change is economic efficiency, as nations with 'inefficient' institutions lose capital to those with more efficient ones.

In sharp opposition to strong globalisationalists, 'historical institutionalist' (HI) analyses argue that nations maintain stable and different economic institutions. Early HI studies

[1] Cf. Susan Strange, *Casino Capitalism*. *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', *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*, 46/1 (1993): 50–82.

claimed that institutional change is difficult and rare and hence nations maintain inherited and different market institutions despite common international pressures.[2] More recent HI-inspired work on 'varieties' or 'models' of capitalism has suggested that institutions evolve but that changes are strongly influenced by existing national institutions.[3] The most influential model, put forward by Hall and Soskice, argues that it is more efficient and politically feasible for nations to meet globalization (defined in economic terms as "developments that have made it easier for companies to locate operations abroad", including trade liberalization, deregulation and expansion of international financial markets, and declining transport and communication costs) 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'. Hence change is limited and bounded. In the face of globalization, they suggest that liberal market economies introduce more 'deregulation' than coordinated market ones, and indeed nations may become more diverse, because "nations often prosper, not by becoming more similar, but by building on their institutional differences".[4] Thus they maintain a focus on economic globalization, economic efficiency and also identify companies as key actors, but reach opposite conclusions to the strong globalisationists.

Both strong globalisationist and HI analyses have been subjected to strong criticisms. The extent, novelty and even the existence of economic globalization have been strongly questioned.[5] Equally, the explanatory capacity and empirical observations of HI analyses have been attacked.[6] For our purposes of looking at regulatory norms, however, three

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[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] Examples include: Peter A. Hall and David Soskice eds, *Varieties of capitalism : the institutional foundations of comparative advantage* (New York: Oxford University Press, 2001), 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) .

[4] Peter A. Hall and David Soskice, 'An Introduction to Varieties of Capitalism', in P. A. Hall and D. Soskice (eds.), *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001), pp. 1–68, p.60.

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

[6] B. Guy Peters, Jon Pierre, Desmond S. King, 'The Politics of Path Dependency: Political Conflict in Historical Institutionalism', *The Journal of Politics* 67 (4) (2005), 1275–1300, Mark Blyth, '"Any More Bright Ideas?" The Ideational Turn of Comparative Political Economy', *Comparative Politics*, 29(2) (1997), 229-250, Mark Thatcher, -'Varieties of capitalism in an internationalized world', *Comparative Political Studies*, 37(7) (2004): 1-30, Richard Deeg and Gregory Jackson, 'Towards a more dynamic theory of capitalist variety', *Socio-Economic Review* 5 (2007) 149-79, Colin Crouch, Capitalist Diversity and Change (Oxford: Oxford University Press 2005), Chris Howell, 'Varieties of capitalism: And then there

criticisms can be made. First, both sets of approaches adopt a narrow view of international pressures, focusing almost entirely on economic globalization, and giving insufficient attention to policy and political factors. Second, they neglect the role of state officials in both creating internationalization and in utilizing it within domestic policy making in order to reform national economic institutions. Third, the focus on efficiency as a mechanism for change is insufficient and other mechanisms also need consideration.

This article therefore presents a third approach that develops a more political view of internationalization and its effects on market structures. It builds both on HI work and studies of cross-national policy transfer/diffusion. It sets out a 'policy model' to analyse internationalization and regulatory institutions. This involves a broader treatment of internationalization of markets, which can take 'policy forms' as well as economic and technological forms. These policy forms can, for instance, be the decisions of overseas or supranational policy makers that create pressures to alter domestic market institutions. The model sets out a wider range of actors and mechanisms for the operation of these policy forms of internationalisation, that go beyond firms and economic efficiency. In particular, it brings in state actors and coalitions. It looks at sociological mechanisms such as coercion and mimetism, as well as economic efficiency.

Empirically, the article 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). Using historical process tracing it provides two findings that can serve as general hypotheses for other cases. One is that even revolutionary technological and economic developments fail to lead to major institutional reforms. It links this to the policy process, notably because conservative coalitions are able to defend institutions widely seen as economically 'inefficient' through political processes and/or find non-institutional responses to pressures arising from economic internationalization.

In contrast, the second finding is that policy forms of internationalization such as reforms in the US and EU regulation, can significantly contribute to sweeping and convergent reforms of regulatory institutions. They do so by offering opportunities within national policy-making processes for state actors to reshape market institutions. Thus public policy makers can 'learn' selectively from reforms in overseas nations in order to establish reform programmes and legitimate them. They can use EU regulation to circumvent domestic veto players, create occasions for changes not required by the EU and justify reforms.

The article begins by setting out the policy model of internationalization. It then applies it to the case study before drawing broader conclusions.

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was one', *Comparative Politics* 36(1): 103-24; for an appraisal and response, see Bob Hancké, Martin Rhodes and Mark Thatcher (eds), *Beyond Varieties of Capitalism* (Oxford: Oxford University Press, 2007).

I A policy model of internationalization[7]

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.[8] Hence it extends well beyond economic globalization and capital flows.

A framework for studying marklet internationalization can draw both on HI analyses and the literature on cross-national policy transfer/diffusion literature.[9] The latter suggests that there are at least two policy forms of internationalization that can affect national decisions. One is the policies of powerful overseas nations that are outside the control of domestic policy makers (for instance, due to size, insularity or limited overseas trade) but which affect the 'related' nation through trade, language or culture.[10] The most important nation in many markets is the US, accounting for 40-50% of many world markets. The decisions of its policy makers have effects on other countries which are often unable to enjoy reciprocal influence over US policy makers.

A second form of policy internationalization can be regulation by supranational 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. Thus for instance, the growing literature on 'Europeanisation' emphasizes the many ways in which the EU can influence domestic decisions.[11]

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[7] The model is further developed in Mark Thatcher, *Internationalisation and Economic Institutions* (Oxford: Oxford University Press, 2007).

[8] Cf. 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"- Wolfgang Streeck, 'Globalization: nothing new under the sun?', *Socio-Economic Review* 5 (2007): 537-47, p538

[9] 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, 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).

[10] Cf. Simmons and Elkins, 'The Globalization of Liberalization', Simmons, Dobbin and Garrett, 'Introduction: The International Diffusion of Liberalism'.

[11] 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 Thomas Risse, (eds), *Transforming Europe* (Ithaca: Cornell University Press 2001), Public 'Policy Change and Discourse in Europe', Special Issue, *West European Politics*, 27/2 (2004), Schmidt, *Futures of European Capitalism*.

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 who can influence policy forms of internationalisation. Indeed, 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.[12] This invites consideration of how internationalization affects strategies and coalitions, which must form and act to overcome opposition to reform, appoint recognised by recent HI work.[13]

Finally, mechanisms need to go beyond economic efficiency. One can distinguish between those driven by efficiency and those driven by other mechanisms such as coercion and mimetism, or to use the terms coined by DiMaggio and Powell the distinction between competitive and institutional forms of isomorphism.[14] The former, they suggest, involves market competition, niche change, and fitness measures. It is driven by efficiency. internationalisation can alter material payoffs from domestic institutions, changing the most efficient institutional framework for domestic actors.[15] Policy makers may thus compare possible institutions and alter existing ones to maximise payoffs in the light of the altered international environment. However, internationalisation can also operate through regulatory competition among countries: if a nation alters its regulatory institutions, this can also change its advantages relative to other nations, whose suppliers and users are therefore affected if competing for markets.[16] In more concrete terms, if one country adopts advantageous institutions (such as standards or forms of ownership), this may help its firms and hence put pressure on other nations to respond to maintain their competitiveness. Regulatory ‘races to the top’ or to the bottom may take place, as countries compete by establishing high or low domestic standards.[17]

Following DiMaggio and Powell, non-economic mechanisms for internationalization can be coercive, normative or mimetic. Coercion can be economic and financial, but can also take political and legal forms, through binding rules and decisions by international organisations, in this case the EU, on unwilling domestic policy makers; examples could include requiring liberalisation, alteration of ownership of suppliers or modification of

[12] Cf. Dolowitz and Marsh; Diane Stone, ‘Transfer agents and global networks in the 'transnationalization' of policy’, *Journal of European Public Policy*, 11(3) 2004, 545 – 566, David and Marsh (2000) ‘Learning from Abroad’.
[13] Hall, ‘The Evolution of Varieties of Capitalism in Europe’ in Bob Hancké, Martin Rhodes and Mark Thatcher (eds), *Beyond Varieties of Capitalism* (Oxford: Oxford University Press, 2007).
[14] 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.
[15] See Beth A. Simmons and Zachery Elkins, ‘The Globalization of Liberalization: Policy Diffusion in the International Political Economy’, *American Political Science Review* 98(1) (2004): 171-89.
[16] For a good discussion, see Claudio Radaelli (2004). ‘The Puzzle of Regulatory Competition’, *Journal of Public Policy*, 24/1: 1–23.
[17] Cf. Vogel, D. (1995). *Trading Up: Consumer and Environmental Regulation in a Global Economy*. Cambridge, MA: Harvard University Press.

regulatory systems. Equally, powerful overseas nations or companies may oblige weaker countries to alter market institutions through lobbying or threats.[18]

Normative mechanisms involve the diffusion of professional norms. Transnational epistemic communities of policy networks can be important vehicles for transmitting norms across nations, whilst being beyond the control of policy makers in specific countries.[19] The EU offers not just a source of imposition but also of norms and formal and informal trans-European networks. Moreover, if European regulatory norms develop, these may influence domestic policy makers as to what 'appropriate' market institutions should be.[20]

Mimetic mechanisms involves policy makers copying each other, through cross-national 'policy learning' or policy bandwaggoning.[21] It can take the form of attempts at rational analyses of overseas experiences and their applicability domestically. However, it can also be part of political struggles, for as Mark Blyth argues,[22] ideas are 'weapons' in institutional reform, and work on framing and 'discourse' shows that 'learning' is often used to shape debates and legitimate decisions. Nor does 'mimetism' require straightforward copying, as examples can be translated and interpreted.[23] Thus reform in one country may offer examples (positive or negative) for overseas policy makers. Equally, EU decisions may provide a model for national institutions but also be used as part of discourse to justify change.[24]

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[18] Simmons, B. (2001). 'The International Politics of Harmonization: The Case of Capital Market Regulation', *International Organization*, 55/3: 589–620, Simons and Elkins , 'The Globalization of Liberalization', Ohmae, K. (1990). *The Borderless World: Power and Strategy in the Interlinked Economy*. London: Collins.

[19] See Haas, P. (1992). 'Introduction: Epistemic Communities and International Policy Coordination', *International Organization*, 46/1: 1–35; for transnational networks see for instance Stone, D. (2004). 'Transfer Agents and Global Networks in the "Transnationalization" of Policy', *Journal of European Public Policy*, 11/3: 545–66.

[20] Claudio Radaelli, 'The Europeanisation of Public Policy', in K. Featherstone and C. M. Radaelli (eds.), *The Politics of Europeanisation*. Oxford: Oxford University Press, pp. 27–56, Knill, C. and Lemkuhl, D. (2002). 'The National Impact of European Union Regulatory Policy: Three Europeanization Mechanisms', *European Journal of Political Research*, 41: 255–80, R Eising and Jabko, N. (2001). 'Moving Targets: National Interests and Electricity Liberalization in the European Union', *Comparative Political Studies*, 34/7: 742–67.

[21] Different authors use slightly different concepts- for instance, Colin Bennett (Bennett, C. J. (1991). 'How States Utilize Foreign Evidence', *Journal of Public Policy*, 11/1: 31–54) refers to 'emulation', while Richard Rose (Rose, R. (1993). *Lesson-Drawing in Public Policy: A Guide to Learning Across Time and Space.* Chatham, NJ: Chatham House 1993) discusses cross-national learning and Braithwaite and Drahos (Braithwaite, J. and Drahos, P. *Global Business Regulation*. Cambridge: Cambridge University Press 2000) refer to 'modelling'.

[22] Mark Blyth, *Great transformations : economic ideas and institutional change in the twentieth century*, (New York : Cambridge University Press, 2002).

[23] Indeed, Bennett 1991 refers to 'emulation' while Braithwaite and Drahos (2000: 25) talk of 'modelling' in which globalization of regulation occurs through "observational learning with symbolic content".

[24] Vivien Schmidt and Claudio 'Policy Change and Discourse in Europe: Conceptual and Methodological Issues'. *West European Politics* 27/2 (2004) : 183–210, Vivien Schmidt, *The Futures of European Capitalism*. Oxford: Oxford University Press, 2002.

The policy model of internationalization set out (briefly) here therefore offers a more political framework to study regulatory change. It includes policy forms of internationalization, state actors and mechanisms beyond economic efficiency. The next section applies it to a selected case study and argues that it offers a powerful explanation of changes in key sectoral rules that govern markets.

II The case of internationalisation and regulatory institutions for securities trading in Britain, France and Germany 1965-2008

The case of securities trading in Britain, France and Germany 1965-2008 is selected for several reasons. The sector is economically and politically significant. It is 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 different 'varieties of capitalism'.

Most importantly, over the period between the mid-1960s and 2008, three different powerful forms of internationalization transformed the sector: revolutionary transnational technological and economic changes, which represent a form of economic globalisation; 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. Strong globalisationists would anticipate that as transnational technological and economic factors strengthened, so too would reform towards more economically efficient regulatory institutions in order to attract increasingly large international capital flows. Current HI analyses would lead us to expect institutional stability or bounded evolutionary change, thereby maintaining diverse institutions. Given the strength of internationalization, securities trading offers a form of 'hard case' for HI claims- if these claims are upheld, it would offer we would expect them to hold in other domains less exposed to market internationalization.

The article uses a classic historical institutional tool, namely process tracing, over a significant time period to study the effects of the three different forms of internationalization, thereby aiding in identifying carriers of internationalisation, and their strategies, coalitions and opponents. It focuses 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. If these institutions change, the operation of markets can also be expected to alter.[25] After briefly outlining the nature of securities trading in the mid-1960s, this section looks at internationalization and then its effects on institutional reform.

Securities Trading in the Mid-1960s in Europe

In the mid-1960s, securities trading markets were highly national. Cross-border trading was very limited. 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 national 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 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 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.[26] 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.[27] State officials also played a direct regulatory role through membership of the Comité des bourses de valeurs, responsible for rules governing share trading.

West Germany's institutions for securities trading were largely regional. There were eight exchanges owned by the regional chambers of commerce. 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

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[25] This does not of course mean that there is a rigid relationship between market institutions and behaviour, merely that if those formal institutions alter, there will be impacts on behaviour.

[26] See Michael Moran *The Politics of the Financial Services Revolution: The USA, UK, and Japan.* (Basingstoke: Macmillan, 1991).

[27] For a history see Paul-Jacques Lehmann, *Histoire de la Bourse de Paris*. (Paris: Presses Universitaires de France 1997).

and price setting on the exchanges. 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.[28]

Thus in the mid-1960s, important institutional differences existed across Britain, France and West Germany that matched general descriptions of the three in the comparative capitalisms literature. [29] Britain enjoyed 'club government', with a privately-owned stock exchange operating under a self-regulatory system. France had a publicly-owned exchange over which the central state had many direct powers. West Germany had a regionalized system dominated by banks.

Internationalisation

The period between the mid-1960s and 2007 saw different forms of internationalization that revolutionalised the sector.[30] 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.

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 1989[31] 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.[32]

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[28] See Jonathan Storey, 'Globalisation, the European Union and German financial reform: The political economy of Finanzplatz Deutschland' in Underhill, GRD (ed.), *The new world order in international finance. (*Basingstoke: Macmillan, 1997) and Susanne Lütz 'Die Rückkehr des Nationalstaates? Kapitalmarktregulierung im Zeichen der Internationalisierung von Finanzmärkten'. *Politische Vierteljahresschrift*, 38/3 (1997), 475-98 and Vom koordinierten zum marktorientierten Kapitalismus?' in R.Czada, (ed.). *Von der Bonner zur Berliner Republik: 10 Jahre Deutsche Einheit.* (Wiesbaden, Westdeutscher Verlag, 2000), 651-70.

[29] See for instance, Andrew Shonfield, *Modern Capitalism* (Oxford: Oxford University Press, 1969), John Zysman, *Governments, Markets and Growth* (New York: Cornell University Press, 1983), Jack ES Hayward, *Industrial enterprise and European integration : from national to international champions in Western Europe* (Oxford: Oxford University Press 1995), Gourevitch *Politics in Hard Times*, Katzenstein, *Small states in world markets*, Michael Moran, *The British regulatory state: high modernism and hyper-innovation*. (Oxford:
Oxford University Press, 2003).

[30] For further details, see Thatcher, *Internationalisation and Economic Institutions*, ch 2.

[31] For figures, see Andrew Sobel *Domestic Choices, International Markets*. (Ann Arbor, MI: University of Michigan Press, 1994), p52, Joseph A. Grundfest, Internationalization of the World's Securities Markets', *Journal of Financial Services Research* 4 (1990), 349–378, pp.357, 353.

[32] 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. Mitchie, *The London Stock Exchange: A History*. (Oxford: Oxford University Press, 2001), p. 623.

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,[33] while in Britain, individual ownership of UK equities dropped from 54% of the total in 1963 to 17.7% in 1993.[34] 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.[35]

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 in institutional reform by increasing incentives to ensure internationally competitive exchanges and traders in order to capture cross-border investments and firms. Conversely, they threatened the position of traditional stock exchanges as domestic non-profit making ‘clubs’ of individuals: their monopolies risked being undermined, they faced increased capital costs of new technology and the increasingly dominant international firms 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.[36] Alternative electronic exchanges developed such as NASDAQ (National Association of Securities Dealers Automatic Quote) which began in 1971 and by 1985 was the third largest stock exchange in the world.[37] 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 Merill Lynch, Shearson Lehman, Salomon, or Drexel Burnham Lambert that began to expand abroad;[38] their resources greatly surpassed those of European securities traders.

US reforms altered payoffs for European firms and policy makers by increasing 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 firms. But they also offered an example of how institutional reforms could be beneficial. They showed that new stock markets using electronics could succeed

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

[34] Michie, *The London Stock Exchange*, p: 631; John Plender, ‘The Rise and Rise of the Institutional Investor’, *The Banker*, September: 1980, pp.41–48.

[35] Thatcher, *Internationalisation and Economic Institutions*, p.42.

[36] For figures, see World Federation of Exchanges, *Annual statistics*, http://www.world-exchanges.org/statistics/annual.

[37] Adrian Hamilton, *The Financial Revolution. (*New York: Free Press 1986) p.43.

[38] Hamilton, *The Financial Revolution*, *pp.* 78-110.

and compete with incumbents, together with the benefits of reforming rules that protected existing suppliers 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 finally became law in 1993.[39] 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). To aid cross-border entry, the ISD created a European wide 'passport' and allowed firms authorised in one member state were to have access (including membership and 'remote access'- i.e. electronic trading without a physical presence in the market) to regulated securities markets in other member states.

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.[40] 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.[41] Finally, it could operate through ideas, altering domestic norms about appropriate or 'legitimate' institutional structures, or through encouraging mimetic or normative isomorphism.[42]

Thus by 2008, the European securities trading markets had faced three powerful forms of internationalization that had developed successively and threatened traditional institutions such as stock exchanges organized as clubs of national individuals with monopolies over trading.

[39] 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; for details of the ISD, see Niamh Moloney, *EC Securities Regulation*. (Oxford: Oxford University Press 2002).

[40] 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.

[41] 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'.

[42] For a discussion of these sociological institutionalist processes, see Claudio Radaelli 'Policy Transfer in the European Union', *Governance*, 13/1 (2000): 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.

Internationalisation and institutional reform in Britain 1965-2007[43]

In the 1960s and 1970s, traditional British institutions became subject to strong pressures from economic and technological internationalization. Large institutional investors became increasingly predominant. But they were unhappy with traditional British institutions, notably paying two sets of charges because of the division of trading between wholesale jobbers and retail brokers and fixed commissions that meant they cross-subsidised individual investors. In response, a group of merchant banks created a new exchange called ARIEL in 1975 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.[44]

Yet despite these pressures, the institutional structure was largely left intact. 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.[45]

However, the period from the mid-1980s saw a dramatic reversal of institutional inertia. British policy makers adopted a new strategy of transforming LSE from a club for selected British-based individuals into an international market open to companies from all over the world.[46] 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. 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.[47] These bodies took LSE's remaining regulatory powers and increasingly replaced informal norms with detailed formalised rules. Thus by 2008, traditional sectoral economic institutions had been abolished and replaced with very different ones. The result was an inflow of foreign

[43] For histories, see Mitchie, *The London Stock Exchange*, David Kynaston . *The City of London: A Club no More, 1945–2000* (London: Chatto and Windus 2001).
[44] 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*.
[45] Thatcher, *Internationalisation and Economic Institutions*, ch 4.
[46] 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 sweeping reforms of regulatory policies in the 1980s, see Moran, *The British Regulatory State*.
[47] See Jonathan Westrup, 'The Politics of Financial Regulatory Reform in Britain and Germany', *West European Politics* 30:5 (2007/8 CHECK), 1096 — 1119.

business and companies,[48] the takeover of many British firms by overseas ones and a series of attempted takeovers of LSE after 1998 by overseas predators (such as Deustche Bőrse, NASDAQ and McQarry).

Radical reform was far from easy. It was started by national actors from outside the traditional financial policy community. Thus the 1986 'Big Bang' was triggered by legal action by the general competition authority, the Office of Fair Trading[49] while the SIB followed a report on investor protection in 1984 by a retired law professor (Jim Gower).[50] However, once the process of change began, the Bank of England, the government and eventually LSE's senior management became central participants. They had to overcome strong opposition by members of LSE who feared that their independence would be ended and had support among Conservative Party backbench MPs.

Two forms of internationalization became important in radical change.[51] One was economic internationalization, especially the growth in international trading, the emergence of cross-border firms, and the creation of new electronic markets.[52] It operated mainly through fears of altered economic payoffs. Reformers argued that these transnational technological and economic changes 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.[53]

Yet such economic internationalization had been ongoing since the 1960s without major institutional modifications. However, the decisions and strategies of US policy makers and firms offered a second prominent and newer international factor.[54] 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.[55] They were concerned that stock brokers and jobbers had narrow expertise and were under-capitalised relative to overseas financial firms, especially in the US.[56] Regulatory competition also played a role, through 'trading up' in standards,[57] as reformers sought a modernised and efficient regulatory

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[48] Margaret Reid, *All Change in the City: The Revolution in Britain's Financial Sector.* (Basingstoke: Macmillan, 1988), 89-102.
[49] Using the 1976 Restrictive Practices Act.
[50] Jim (CB) Gower, *Review of investor protection: report part 1*. Cmnd.9125 (London: HMSO, 1984).
[51]Cf. Henry Lawrence, 'regulatory competition and the politics of financial market reform in Britain and Japan', *Governance* 9/3 (1996), 311-41, pp.325-6.
[52] Cf. Reid, *All Change in the City,* ch.2, Michael Moran, *The Politics of the Financial Services Revolution: the USA, the UK and Japan* (Basingstoke: Macmillan 1991), ch.3; John Plender, 'London's Big Bang in International Context', International Affairs 63/1 (1986), *The Financial Times* 28.1.81, 15.8.83, 15.11.83; interview, Alex Fletcher, *The Financial Times* 13.12.83.
[53] *The Financial Times* 15.8.83, 30.4.84, 1.5.84.
[54] Cf. Moran, *The Politics of the Financial Services Revolution,* pp57-8, 74, Reid, *All Change in the City,* ch.2.
[55] *The Financial Times* 7.10.85, 18.10.85; 21.8.86, 12.11.83, 21.10.83; interview senior LSE official.
[56] *The Financial Times* 5.2.80, 6.2.80, 15.2.80, 15.9.83, 19.9.83, 21.12.83; Reid, *All Change in the City,* pp.33-4; interview senior LSE official.
[57] Cf. Steven Vogel, *Freer Markets, More Rules* (Ithaca: Cornell University Press 1996).

system, as judged against the US.[58] 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".[59] However a second mechanism was ideational: reformers used the US was an example and resource to legitimate change (although not as a model to be was emulated wholesale). Thus for instance, in its legal case against LSE on fixed commissions, the OFT cited evidence from the ending of such commissions on the NYSE in 1975. After a visit to the US, the Government minister for corporate affairs declared that he was "unafraid of dual capacity" (i.e. ending the broker/jobber division) and hoped LSE would follow the examples he had seen in North America.[60] 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.[61]

The third form of internationalization, EU regulation, was largely absent: Britain had already opened its securities market to competition before EU legislation. Instead, policy makers were suspicious of EU regulation, fearing that it would raise costs and reduce the UK's competitive advantage.[62]

France

Between the mid-1960s and the mid-1980s, there were several serious debates in France about institutional reform, led state officials, notably the finance ministry, the sectoral regulator after 1967 (the Commission des Opérations de Bourse -COB) and Government-appointed commissions. [63] 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.[64] 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: the *Agents de Change* were ill-equipped for large trades because they did business as individuals with personal liability; the *Agents* could only match buy and sell orders during the Bourse's opening hours and at its

[58] Alex Fletcher, Minister for Corporate and Consumer Affairs, *The Financial Times* 20.1.84; Gower Report 19.1.84; comments, Norman Tebbit, 25.9.84; 21.8.86.
[59] The Financial Times 30.4.84; cf. Moran 1991: 76.
[60] Alex Fletcher, interview, The Financial Times 13.12.83.
[61] Interview, Andrew Large Financial Times 3.11.92; Lawrence 2001: 97; interview senior financial regulator 1.
[62] 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.
[63] Decoopman 1979: 149-82; key commissions and reports were: the 1971 Caplain report, the 1972 Baumgartner report, and then later the 1980 Pérouse and 1985 Tricot reports.
[64] 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.

prices, and were forbidden to trade on their own account ('contre-partie'). Investor protection was poor as regulatory organizations were weak.[65]

The commissions and COB suggested significant reforms to modernize the Bourse, such as 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 undermine their position and by prolonged strikes in 1968, 1974 and 1979 that closed the Paris Bourse by the *Agents*' employees who feared redundancies due to changes such as computerisation.[66]

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 increase investor protection.[67] Hence it established the COB with the explicit aim of developing the stock market, including playing "a wider international role". [68] But although the COB was an innovation for French administration in the 1960s, it had few powers and its independence was limited.[69]

Thus by the 1980s, French institutions remained largely unchanged from previous centuries. They were suited to individual French investors rather than overseas and/or company investors. The most important reform, the COB, dated back almost two decades.

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.[70] It permitted the *Agents* to become limited companies open to takeover (including by their traditional enemies, the banks, as well as overseas firms). The organization of the Bourse was altered by an all-day electronic trading system (the CAC- *cotation assistée en continue*). 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. 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 substantially enhanced powers. [71]

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[65] Cf. Lehmann 1997: 58-87, Conac: 2002: 24- 25, Le Monde 31.8.67.
[66] La Vie Française 27.12.76, 24.1.77, 14.2.77, 30.4.79, Le Figaro 31.3.79.
[67] Decoopman 1979: 1; Le Monde 31.8.67; Le Nouveau Journal 22.2.68; interview senior financial regulator 1.
[68] Burgard 1972: 861-4, cf. Lascoumes 1985: 6-7.
[69] Cf. Conac 2002: 56-7, 113, 116-17; one example was that a government commissioner sat on its Board.
[70] Couret 1988, Cerny 1989.
[71] Frison-Roche 2004.

Reforms were led by the government, notably the Finance Ministry.[72] It established high-level commissions that produced reports preparing the ground for changes,[73] led discussions and when the *Agents de Change* resisted reform, imposed it on them.[74] It provided key personnel, even to nominally private sector organizations.[75]

Internationalisation was crucial to the initiation and legitimation of reform. Transnational technological and economic developments continued to be felt, as in the 1970s. Thus for instance, the *Agents*, who traded as individuals, lacked capital for expansion, liquidity or funding new computer systems for the Paris Bourse.[76] However, reforms in overseas nations became prominent. Policy makers compared French institutional arrangements such as trading rules, settlement systems and regulatory organisations, with overseas exchanges.[77] They became particularly concerned about Britain after the 1986 'Big Bang', which was seen as "an English strategy of domination".[78] 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.[79] 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.[80] In graphic language, a member of the National Assembly argued that the law of 1988 was essential because Paris risked being "deserted" by investors unless it could offer the same services and degree of investor protection as other exchanges.[81]

EU regulation was also prominent in reform debates. It affected expected payoffs through increasing fears of competition among exchanges due to the opening of European capital

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[72] Key individuals included: Pierre Bérégovoy as Finance Minister 1988-92, Daniel Lebèque (*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).

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

[74] 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.

[75] Eg the head of the Paris Bourse and then Euronext from 1990, Jean-François Théodore, was seconded from the Trésor.

[76] Lehmann 1997: 111; La Tribune de l'Expansion 23.10.90; interview senior legislator 2.

[77] 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;

[78] 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.

[79]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.

[80] Dubroeucq 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 ; 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 Bourse 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.

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

markets as part of the Single Market ('1992') and the 1993 Investment Services Directive.[82] They used these arguments to justify reforms such as ending restrictions on brokers, creating larger French firms and strengthening regulatory organisations.[83] Second, EU law provided a "powerful lever for reconsideration of institutional structure".[84] 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.[85] Thus for instance, the COB was strengthened in the 1996 law that transposed the 1993 Investment Services Directive (ISD) into French law. Similarly, the creation of the AMF in 2003 was justified in part by meeting the call in the 2003 EU directive on insider trading for a 'single administrative body'.[86]

The French strategy was to create a strong Paris-based international company. During the 1990s, the Bourse attempted to merge with Deutsche Börse, but two failed to reach agreement. Instead, in 2000 it merged with the Brussels and Amsterdam Bourses to form Euronext, which then merged with NYSE in 2007, thereby creating a highly internationalized exchange.

(West) Germany

To strengthen its small stock markets, West German policies makers examined several institutional reforms in the late 1960s and early 1970s.[87] They included rules that trades be executed by brokers rather than banks, increased transparency and investor protection 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.[88] They and the banks were hostile to formalisation of regulation.[89] By 1980, securities trading remained a small adjunct of the banking system; few companies were quoted and the number was declining. [90]

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[82] 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.

[83] Bacot, Dubroeucq 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.

[84] Interview senior legislator 1; interview senior financial regulator 2.

[85] 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.

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

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

[88] Interviews senior exchange official 2 and 3; VBW-Wirtschaftsdienst, 14.3.1969, Handelsblatt, 20.10.1971.

[89] Handelsblatt, 23.1.1968, 2.2.71, 6.4.72, FAZ, 21.2.1969, Zeitschrift Kreditwesen 1.4.1969. Die Welt 19.11.70.

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

Yet the period from late 1980s saw radical changes and abolition of long-standing institutions.[91] They were driven by the 'Frankfurt coalition', led by large banks (notably Deutsche Bank), the Frankfurt stock exchange and its home *Land*, Hesse. They met fierce opposition. Many *Länder* and some of the smaller regional exchanges opposed centralization and increases in federal powers;[92] 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.[93]

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.[94] 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 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.[95] 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.[96] Instead, a privately-owned holding company was established (Deutsche Börse AG). Through subsidiaries Deutsche Börse owned the Frankfurt exchange (which was privatized) and the DTB. It also 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. 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.[97] 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, the supervision of markets and trading remained within the jurisdiction of the *Länder*, who fought strongly to retain powers.[98] Only in 2002 was a more independent and

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[91] 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.
[92] 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.
[93] Story 1997: 255-6, 264-5, Lütz 1998: 160.
[94] Major legislation included the 1989 Stock Market Act, and Financial Promotion Acts in 1990, 1994, 1998, 2002,
[95] Moran 1992: 147-8.
[96] 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.
[97] See Westrup, 'The Politics of Financial Regulatory Reform'.
[98] Handelsblatt 21.1.93.

powerful federal regulatory authority created, Bafin (Bundesanstalt für Finanzdienstleistungsaufsicht). Its President and Vice-President are nominated by the Federal Government. Compared with its predecessor, Bafin's responsibilities were greatly widened across the financial sector and its powers were increased.[99]

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 particularly prominent. One was London's 1986 'Big Bang' ands subsequent reforms. They influenced 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.[100] But, more directly, they operated through expected payoffs, namely increased fears of international competition for securities trading.[101] 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, limited trading of overseas stocks and absence of a sector-specific regulator exchanges.[102] 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.[103] 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.[104] Equally, the electronic trading and settlements system was designed to match overseas exchanges.[105] Reformers also pressed for a powerful independent regulator to make German markets internationally accepted and attractive.[106]

EU regulation for the European Single Market and the introduction of the Euro increased fears of competitive pressures, especially on Germany's regionalised system of exchanges and supervision.[107] The Frankfurt coalition argued that to function effectively

[99] 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.
[100] Interviews senior banker 2, senior regulator; Handelsblatt, 17.10.01, 8.5.01.
[101] 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 Röller, 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.
[102] 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.
[103] Hans Messer, President Frankfurt Chamber of Industry and Commerce, Handelsblatt 3.9.87; Story 1997: 257-8, 261, 264; Moran 1992: 146-8.
[104] Story 1997: 263-4
[105] 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.
[106] 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.
[107] Handelsblatt 15.2.80, SZ 20.8.88, FAZ 7.11.89; cf. Story 1997: 258; interview senior banker 2.

in the European market, Germany needed to modify its institutions- in particular, to create a strong national stock exchange and supervisory authority.[108] In addition, implementing EU directives provided the occasion for self-criticism, cross-national comparison and major reform legislation.[109] 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 cross-national coordination without specifying the form of national agency, but reformers claimed that their implementation necessitated a national agency and modification of German law.[110] 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 respond to EU demands that the *Länder* found increasingly difficult to deal with. [111]

By 2008, Germany had transformed its sectoral institutions. Its strategy was to create one privately-owned dominant company, Deutsche Bőrse, but retain weak elements of a regionalised 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.

III Conclusion

Between the mid-1960s and 2008, three forms of internationalization transformed securities markets- transnational and technological developments, reforms in the US and EU regulation. Yet long-standing national institutions endured 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 analyses of internationalization and regulatory institutions?

With respect to the first question, two substantive arguments can be made that may serve as hypotheses for other domains. The first is that when transnational technological factors operate on their own, institutional inertia occurs. Thus between the 1960s and the mid-1980s, there were serious discussions of change in all three countries and recognition that long-standing institutions seemed inappropriate for the changing nature of the industry. Indeed, process tracing reveals the striking fact that serious reform discussions in France

[108] 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.

[109] Handlesblatt 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.

[110] 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.

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

and West Germany peaked in the 1960s and early 1970s. Yet institutions 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 despite sweeping changes such as increased cross-border flows, computerization or the rise of largescale investors. Moreover, the three countries maintained national specificities that had existed in 1965 which 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.[112] 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
Organisational position of stock exchanges	London Stock Exchange- private club of individual male British members	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	Legal monopoly for publicly-appointed brokers (*Agents de change)* trading as individuals	Legal monopoly on exchanges for publicly-appointed brokers- (*Kursmakler*), trading as individuals;

[112] See for instance, Hall 1986, Schmidt 2002, Hayward 1986, Zsyman 1983, 1996, Albert 1993.

	retail; fixed commissions		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

The second central argument however, is that that 'policy forms' of internationalization can contribute to rapid and sweeping reform of long-standing regulatory institutions. They do so because they become part of the domestic policy process, influencing the strategies, coalitions and legitimating arguments of national policy makers, including not just socio-economic interests but also public officials. They operate both through payoffs, or expected payoffs, but also through ideational mechanisms of learning and legitimation. Thus in Britain, reforms in the US both increased fears of loss of markets and offered an example that domestic policy makers selected and used to legitimate change. In France and Germany, British reforms both created fear of competition and offered an example of successful change. Moreover, EU regulation increased fears of regulatory competition and its transposition into domestic legislation offered occasions and arguments to legitimate changes that went well beyond those required legally by EU legislation. In all three countries, the reforms were not gradual or evolutionary as recent HI analyses suggest,[113] but saw the rapid abolition and replacement of many long-standing institutions. Reforms included privatization of exchanges in France and Germany, the transformation of exchanges into quoted companies, the end of monopolies over share trading, and the creation of independent sectoral regulatory agencies. National specificities such as brokers and jobbers in Britain or high regional fragmentation in Germany were ended. Hence, contrary to much of the HI literature, the three countries adopted similar formal sectoral reforms, summarized in Table 2.

Table 2 Sectoral regulatory institutions for securities trading in 2007

[113] For instance, Streeck and Thelen 2005 or Campbell 2004

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)

What are the broader implications for studying internationalization and reform of regulatory norms? The empirical evidence indicates the value of the policy model of internationalization. It shows that if 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. Thus strong globalisationists would fail to explain why ‘inefficient’ institutions endured, despite powerful transnational technological and economic developments. Equally, HI analyses are confronted with rapid reforms that are not incremental or evolutionary but can be revolutionary and involve abolishing and replacing existing institutions, even very long-standing ones and lead to cross-national convergence, even across nations with very different histories and institutions.

The policy model of internationalization allows analysis of the ways in which different forms of internationalization enter domestic policy making and aid reform. It has highlighted the surprising result that transnational technological and economic factors on their own can be met with institutional inertia and indeed, that reform attempts can diminish even as those factors become stronger. The model includes state actors who are often crucial in reforming regulatory norms, and more generally in forming and leading reform coalitions. It allows consideration of mechanisms beyond economic efficiency, for not only are inefficient norms possible but change can be driven by factors such as coercion or mimetism. More generally, reforms of regulatory norms often involves dealing with powerful sectoral interests who benefit from existing regulation, and hence imposition and/or legitimation are crucial in change. As Fligstein points out, markets are social constructions.[114] As such, changing their rules involves political action, and hence state actors as well as firms, mechanisms such as coercion, learning and mimetism, and processes that require coalitions and legitimation.

[114] Neil Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-First Century Capitalist Societies*. (Princeton, NJ: Princeton University Press, 2001).