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The 'Old' and 'New' Politics of Financial Services Regulation in the European Union

LUCIA QUAGLIA

This research examines the regulatory response of the European Union to the global financial crisis, addressing the questions of whether, how and why the global financial crisis has changed the 'old' politics of financial services regulation in the EU and resulted in the emergence of a 'new' politics. It is argued that, with a good dose of political opportunism and 'anti-free market' rhetoric, a continental advocacy coalition sponsoring a 'market-shaping' regulatory approach has capitalised on the crisis, tipping the balance of regulatory power in the EU in its favour, as compared to the pre-crisis situation.

Keywords: financial regulation, financial crisis, European Union, financial markets, regulatory response

1. Introduction

The global financial crisis that began in 2007 delivered a major shock to the existing architecture for financial services regulation and supervision. The European Union (EU) was one of the jurisdictions most severely hit by the turmoil, prompting an intense regulatory debate on the revision of existing rules and the adoption of new regulatory measures in the EU. This research examines the regulatory response of the EU to the global financial crisis, addressing the questions of whether, how and why the global financial crisis has changed the 'old' (pre-crisis) politics of financial services regulation in the EU and fostered the emergence of a 'new' politics.

In order to do so, it sketches out the EU's regulatory response, evaluating whether it represents a major break from the past, a policy shift, as could be expected following the most severe financial crisis since the 1930s, or whether it is an incremental adjustment. It first analyses the regulatory changes undertaken. It then investigates what has shaped the EU response by paying particular attention to the ideational dimension, asking whether the reforms enacted in the EU

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following the global financial crisis have been underpinned by a change to the prevailing regulatory paradigm in the EU (and possibly elsewhere).

The focus on the ideational dimension is warranted because a considerable body of scholarly work on public policy and political economy considers crises as drivers of ideational change or paradigm shift (Blyth 2002, 1997; Hall 1993, 1989; Jacobsen 1995; McNamara 1998; Marcussen 2000; Mattli and Woods 2009; Widmaier, Blyth and Seabrooke 2007). Crises trigger ideational contestation and undermine the legitimacy of existing regulatory models. For example, Helleiner (2010: 629) has argued that the global financial crisis has generated a 'legitimacy crisis for the neo-liberal globalised financial regime' (see also Helleiner and Pagliari 2010). Nesvetailova and Palan (2010) have predicted, with some important qualifications, the end of the 'neoliberal' paradigm that had gained ground in the regulation of finance globally over the previous decades.

The EU's response to the global financial crisis is an important research topic for three main reasons. First, in the aftermath of the global financial crisis, the EU has made a series of regulatory changes. Second, EU rules to a large extent provide the framework for national regulatory changes in the member states. Third, the EU is one of the largest jurisdictions worldwide, it is increasingly active in shaping global financial rules in international fora, and it is one of the main interlocutors of the US in the policy debate on this subject (Posner 2009, 2010).

Whereas the first and second aspects represent the 'internal' regulatory response of the EU to the crisis, which is the main subject of this piece of research, the third aspect represents the 'external' regulatory response of the EU, which, due to space constraints, is elaborated only very briefly in this article. The research does not attempt to evaluate the effectiveness (or otherwise) of the EU's regulatory response; rather, it sets out to explain the political dynamics underpinning it. However, the conclusions offer some thoughts on this.

This research is operationalised as follows. It begins with a review of the literature of the old politics of financial services regulation in the EU prior to the global financial crisis. This section also outlines the analytical framework of the article, which feeds into the broader 'ideational' literature and builds on previous research on financial services regulation in the EU in the 2000s, pointing out the interplay of two competing advocacy coalitions: the 'market-making' coalition and the 'market-shaping' coalition.

The third section provides an overview of the regulatory changes enacted or set in motion by the EU in the aftermath of the financial crisis. The focus is on the medium to long-term response, hence primarily the legislative measures proposed or adopted by the EU, rather than the short-term crisis management measures taken by the EU. This section classifies the vast majority of the EU regulatory measures and institutional reforms undertaken by the EU as 'market-shaping', that is regulating previously unregulated financial activities, tightening up existing regulation of regulated entities, and strengthening the institutional framework for financial oversight in the EU. In terms of outcome, the new rules tend to embody several regulatory preferences of the market-shaping coalition.

The fourth section explores the new politics of financial regulation in the EU, teasing out the main drivers of and the opponents to the EU regulatory reforms and process-tracing the causal mechanisms at work. It is argued that through the 'window of opportunity' opened by the crisis for both genuine learning and the strategic use of ideas for political purposes, the market-shaping regulatory approach has gained ground at least temporarily in the EU regulatory space. In terms of process, the global financial crisis has served to empower the coalition sponsoring that approach, notably France, Germany, Italy and Spain, and to silence the market-making regulatory approach advocated first and foremost by the UK, Ireland and the Nordic countries.

2. The state of play of the politics of financial services regulation in the EU

The public policy and political economy literature on financial services regulation in the EU has developed somewhat different takes on the subject. Story and Walter (1997) stressed the intergovernmental character of the negotiations on financial market regulation in the EU in the 1970s, 1980s and early 1990s. As the title of their book suggests, their work regarded financial market integration as the 'battle of the systems', whereby the member states were keen to set EU rules that were in line with their domestic regulatory approach and did not create comparative disadvantages or adjustment costs to national industry and the public authorities. However, they also stressed the importance of 'ideas' about regulation, the state and financial services (for a similar argument, see also Grossman 2004).

Underhill (1997), like Story and Walter, highlighted how the 'triangle' of the three main financial systems in the EU – the British, the French and the German – played out and shaped EU financial regulation in the 1980s and early 1990s. These accounts tend to be intergovernmental, overlooking the role of other important actors, such as the European Commission and industry. Moreover, these two pieces of research end their analysis in the mid 1990s, leaving open the question of whether the battle of the system continued (or not) afterwards, perhaps in a different shape.

A second explanation has viewed the Commission as the core supranational actor driving financial market integration (Posner 2005; Jabko 2006). Posner (2005: 20) stressed the 'intended and unintended bureaucratic actions' of the Commission in the creation of new stock markets in Europe in the 1990s. By contrast, Jabko (2006) showed how the Commission was able to 'construct' the single market by emphasising different meanings of the word 'market' to different audiences, forming a coalition that pushed through financial market reform in the late 1990s and early 2000s. These accounts somewhat overemphasise the role of the Commission in the making of financial regulation, a policy area that is still jealously guarded by the member states. Moreover, the Commission has seen its influence reduced in the EU policy process since the time of the charismatic Presidency of Jacques Delors.

A third explanation has focused on the role of the private sector in promoting European financial market integration (Bieling 2003; Mügge 2006, 2010; Macartney 2009; Van Apeldoorn 2002; Underhill, Blom and Mügge 2010). These works emphasise either the structural power of transnational capital or the lobbying activities of financial institutions which 'captured' the public authorities in various ways. Amongst the most prominent were the 'economic' or 'material' capture, given the size and importance of the financial sector in certain countries and the economic resources available to industry for lobbying, and the 'intellectual' capture, based on the high level of expertise and technical knowledge at the disposal of the private sector and often tapped into by the regulators themselves (Baker 2010b).[1] This literature tends to underplay the fact that the financial industry, even the main transnational players, often have competing interests, articulated through national governments, which remain the main port of call for lobbying on EU financial regulation (Grossman 2004).

Other scholars have focused on networks of supervisors in the EU (Coen and Thatcher 2008; De Visscher *et al.* 2008; Quaglia 2008), an approach which, however, has limited explanatory power in the making of level 1 legislation (or framework legislation), because the 'technical' authorities (ie financial supervisors) are only consulted during the legislative process, whereby legislation is proposed by the Commission and co decided by the Council of Ministers and the European Parliament. The network based approach is more successful when applied to level 2 legislation in which the so-called 'committees of supervisors', recently transformed into EU agencies, are the main players.

What all these explanations have in common is that they tend to focus on one set of actors – the member states (to be precise, the three main member states), the Commission and transnational industry – and primarily stress the importance of material economic interests and institutions in shaping the political conflicts concerning financial market regulation in the EU. Two exceptions are Story and Walter's discussion of the role of national regulatory approaches in shaping member states positions concerning financial market integration in Europe and Jabko's (2006) 'strategic constructivism', which highlights the Commission's purposeful usage of ideas with a view to further the completion of the internal market. Nonetheless, the few works that considered the importance of ideas in the making of EU financial regulation did not explore in a systematic way the 'belief systems' (Sabatier 1998) of policy makers and how this influences policy-making.

'Economic constructivism' offers an interesting take on financial services regulation in the EU (and elsewhere) for a variety of reasons (for a review of constructivist research in international political economy, see Abdelal *et al.* 2010; Widmaier, Blyth and Seabrooke 2007). First, previous research has demonstrated that ideas in the form of 'technical knowledge' (Radaelli 1995) and 'policy paradigms' (Hall 1993)[2] are important in complex and 'technical' policy area, such as financial services (Busch 2004, Grossman 2004). Second, with specific reference to market regulation, Vogel (1996: 20) highlights the importance of ideas or 'regimes orientation', defined as 'state actors' beliefs about the proper scope, goals, and methods of government intervention in the economy, and about how this intervention affects economic performance'. Hancher and Moran (1989: 4) use the broader expression of regulatory 'culture' about 'the rules of the regulatory game': that is the 'purpose of regulation', 'legitimate participants and their relations with each other'. Such culture tends to be context specific, as it varies across time, countries and sector (Hancher and Moran 1989). EU regulation is an arena where different regulatory approaches come to the fore and confront each other, which is why EU regulation is often a 'patchwork' of national regulatory styles (Heritier 1996: 149). Third, an economic constructivist take is particularly relevant in the context of the present research, which asks whether the global financial crisis has shifted the regulatory paradigm in the EU, shaping the European response to the global financial crisis.

Some authors have pointed out that in the 1980s and 1990s a dominating paradigm for financial services regulation emerged internationally and in the main jurisdictions, including Europe. They have referred to it as the 'neoliberal' paradigm (Best 2003; Gamble 2009; Helleiner 2010; Nesvetailova and Palan 2010) or as a 'governance light' approach, which favoured 'market-based governance', based on a benign view of financial markets and grounded in efficient market theories (Underhill *et al.* 2010: 10). This regulatory paradigm was sponsored by the US and the UK, which prior to the crisis exercised considerable influence in international regulatory fora (Baker 2010a, 2010b; Helleiner and Pagliari 2010; Wood 2005). In the EU, regulatory liberalism came to dominate EU financial regulation from the mid-1990s onwards until the outbreak of the global financial crisis (Mügge 2011).

Other authors have been somewhat less sanguine about the dominance of this paradigm in the EU and the ironing out of national regulatory approaches in the completion of the single financial market from the late 1990s onwards. Donnelly (2010) has argued that EU regulative norms have to be built on the shoulders of national ones. National policy-makers in the member states have deeply internalised beliefs about the relationship between the state and the market and the legitimate objectives of public policy. Over time, according to Donnelly, there was a gradual convergence, which he refers to as 'collusion', amongst member states' norms of financial market regulation, paving the way to an agreement to delegate functions at the supranational level in the early 2000s.

In a similar vein, but with more emphasis on persisting differences of regulatory approaches, Quaglia (2010a, 2010b) has adopted a revised version of Sabatier's advocacy coalition framework (Sabatier 1998; Sabatier and Jenkins-Smith 1993). An advocacy coalition is formed by 'actors from various governmental and private organisations 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. The advocacy coalition approach adopts a pluralistic view of the policy process that fits well with the multi-level governance of the EU. In fact, advocacy coalitions consist of public and private actors, situated at different levels of governance: national, EU and international.

Quaglia (2010a, 2010b) pointed out two main competing coalitions of interests and ideas struggling to shape financial regulation in the EU in the 2000s: the 'market-making' coalition and the 'market-shaping' coalition. The mapping of these coalitions and their belief systems was carried out through a substantial amount of semi-structured interviews with policy makers and stakeholders located in several member states and EU institutions. Epistemologically a considerable weight was given to interview material, cross-checked with systematic press coverage and a review of publicly available documents.

The market-making coalition, led by the UK, also included Ireland and the Nordic countries. The market-shaping coalition, led by France, also included

Italy, other Mediterranean countries and, in several instances, Germany. The new member states had not yet joined or had only recently joined the EU when the new set of rules designed to complete the single financial market were agreed in the first half of the 2000s. The Commission tended to side with one coalition or another depending on the timing. For instance, the change to the College of the Commission in 2004 and the appointment of the Irishman Charles McCreevy as Commissioner for the Internal Market moved the Commission closer to the market-making coalition.

The two coalitions were divided by different, and at times, competing 'belief systems' (Sabatier 1993, 1998) or 'policy paradigms' (Hall 1993) concerning financial services regulation, in particular its objectives and instruments. To put it crudely, the market-making approach emphasised the objectives of competition and market efficiency, whereas the market-shaping approach privileged the objectives of financial stability and consumer protection, as well forms of veiled protectionism. As for instruments, the market-making approach relied on light-touch, principle-based regulation and private sector governance. The market-shaping approach favoured prescriptive, rule-based regulation, with a strong steering action from the public authorities. These competing regulatory approaches were informed by different attitudes to risk and ontological outlooks about the functioning of the market: respectively, market trust and market distrust (Quaglia 2010a, 2010b). The distinction between market-making and market-shaping is a useful heuristic device, which is however rather blurred in practice. This is because regulatory innovation is always market-making by forcing financial market actors to come up with new products that relate to or partly circumvent new regulation.

Although both coalitions managed to influence the EU regulatory process throughout the last decade, the very completion of the single market in financial services was a clear success of the market-making coalition (Bieling 2003; Mügge 2006; Posner and Véron 2010). Moreover, the EU rules adopted prior to the global financial crisis were to a considerable extent based on the belief system of this coalition (interviews, Brussels, March and June 2007; Rome, December 2007; Madrid, March 2009; Lisbon, November 2008; London May 2007, July 2008).

In the competition between these two coalitions, the UK-led coalition prevailed by and large for three interconnected reasons. First, there was the evolution of the policy environment over the late 1990s and early 2000s. The introduction of the single currency increased financial market integration in the EU, a process that was actively advocated by an increasingly powerful transnational financial industry (Mügge 2010). This also heightened the competition between the EU and US in this field (Posner 2009).

Second, the UK and the US hosted the main global financial centres and had a large financial industry, in particular when compared to the rest of the economy (especially the UK). Their policy-makers therefore had a widely recognised expertise in the financial field and were regarded as providing state-of-the-art regulation, prior to the crisis. Since they also hosted large banks that had the resources to lobby policy-makers domestically and internationally, they were able to shape international regulatory debates (Baker 2010a, 2010b; Helleiner 2010; Wood 2005).

Third, in light of these developments, 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. Hence, a process of learning across coalitions took place, leading to the predominance of the market-making regulatory approach and empowerment of the market-making coalition in the EU.

Since it is widely acknowledged that crises trigger moments of ideational contestation and that ideas generally do not come out of nowhere (Blyth 2002, 1997; Hall 1993, 1989; Jacobsen 1995; McNamara 1998; Marcussen 2000; Widmaier, Blyth and Seabrooke 2007), it is reasonable to ask whether the global financial crisis impinged upon existing regulatory paradigms, shifting the balance of regulatory power across coalitions. The global financial crisis impinged upon the conditions that gave momentum to the market-making approach in the EU prior to 2007. One would expect the crisis to challenge the market-making approach favoured by the EU prior to the crisis, giving momentum to the market-shaping regulatory approach, which advocated the need to 'rein in' the market. Was this really the case? If this explanation has any purchasing power, the new or revised rules should be congruent with the beliefs system (or regulatory paradigm) of the market-shaping coalition. Moreover, through process-tracing one should be able to observe a revision of the existing regulatory paradigms and shifting policy positions across coalitions.

3. The outcomes of the reform of financial services regulation in the EU

A host of new regulatory initiatives were undertaken by the EU in the aftermath of the global financial crisis, besides the short-term crisis management measures adopted in the midst of the turmoil. These changes are summarised in Table 1, which outlines the list of new rules introduced or substantially amended and their content. The EU's actions that did not result in 'hard' legislative measures, such as recommendations on managers' remuneration and the communication regarding a new EU framework for crisis management in the financial sector, are not examined here due to space constraints.

Three general features of the *regulatory outcome* stand out. First, the reforms enacted should be seen as incremental changes tinkering with the existing regulatory framework, rather than path-breaking reforms changing the fundamentals of the system. Several key controversial issues, such as the problem of financial institutions too big to fail[3] and the management of cross-border banking crisis, were not addressed, even though the Commission is likely to come forward with proposed legislation on an EU framework for crisis management in the financial sector later in 2011 (Commission 2011).

The regulatory changes enacted in the EU primarily concerned securities markets rather than the banking sector, which was the epicentre of the crisis. The main regulatory measures that focused on banks, the so-called Basel III Accord (2010), negotiated by the Basel Committee on Banking Supervision (BCBS) and eventually endorsed by the G20, build on an existing set of rules, the Basel II Accord, rather than reinventing them altogether. The new rules that set in place capital and liquidity requirements for banks are due to be incorporated into EU legislation, the so-called Capital Requirements Directive (CRD) IV, which is also a revision of existing legislation.

TABLE 1. Overview of the EU's regulatory response to the global financial crisis

Regulatory change in the EU	Content of new or amended rules
• new rules introduced • existing rules amended • institutions established or reformed	
Banking	
Deposit Guarantee Scheme (DGS) directive amended (October 2008)	Minimum level of coverage for deposits increased; payment time reduced
Proposal for new DGS directive (July 2010)	Harmonisation of coverage and simplification of payout
Securities and investment funds	
Regulation on Credit Rating Agencies (CRAs) (May 2009)	CRAs compulsory registration and compliance with rules concerning conflict of interest and quality of rating
Directive on Alternative Investment Funds Managers (AIFMs) (October 2010)	Legally binding authorisation and supervisory regime for all AIFM, European passport for AIFMs
Proposed regulation on OTC derivatives, central counterparties and trade repositories (September 2010)	Reporting obligation for OTC derivatives to trade repositories, clearing obligation for standardised OTC derivatives through CCPs, common rules for CCPs and trade repositories
Accounting	
Commission Regulation adopting amended International Accounting Standards (October 2008); see also IASB revisions (October 2008)	Fair value not applied to certain banks' assets
IASB standards revisions in progress	
Institutional framework for regulation and supervision	
Directives on ESRB and ESFS (December 2010), following the de Larosière report (February 2009)	Transformation of level-3 Lamfalussy committees into European Authorities; creation of a European System of Financial Supervisors at micro-prudential level and of the European Systemic Risk Board dealing with macro-prudential oversight

Source: Author.

On the one hand, the new rules almost triplicate the regulatory capital for banks, provide a rather restrictive definition of what counts as capital, increase the risk weight of several assets (e.g. the trading book) and for the first time set in place international rules on liquidity management (BCBS 2010a, 2010b). On the other hand, some commentators, such as the *Financial Times* writer Martin Wolf (2010), have argued that the increase of capital requirements for banks is inadequate and that the implementation of the new rules is to be phased in over time until 2019. Be that as it may, what is important for the argument of this article is that, as Baker (2010c) notes, the Basel III Accord was informed by a new, yet incomplete, consensus on macro-prudential supervision that challenged the view of efficient markets and the (over)reliance on the internal models of banks and other forms of self-regulation. John Gieve (2009a), Deputy Governor for Financial Stability of the Bank of England, acknowledged that '... one lesson we have learned from this crisis is that we cannot leave risk management to the banks'. Andy Haldane, Executive Director of the Bank of England, pointed out the need for an 'intellectual overhaul' of the approach to risk management (Tett 2009).

Second, several proposed changes were politically controversial, and the main line of division tended to fall between the market-shaping coalition on one side and the market-making coalition and the industry affected on the other, as elaborated in the following section. The vast majority of the measures adopted can be regarded, by and large, as market-shaping because they are regulated activities or financial institutions that were previously unregulated in the EU and its member states (CRAs), or at the EU level (AIFMs), or at the national, EU and international level (OTCDs). In other instances, they imposed heavier, more prescriptive and more burdensome requirements on financial entities that were already regulated prior to the crisis, as in the case of higher capital requirements for banks and new liquidity management rules (Basel III), or they set in place more substantial protection for depositors (the Deposit Guarantee Scheme Directive, DGSD). The reform of the financial services architecture following the de Larosière Report was designed to strengthen financial supervision at the EU level and to foster macro-prudential supervision in the EU. As in the case of the Basel III Accord, the macro-prudential approach challenged the view of efficient markets and market-based discipline (Baker 2010c).

The distinctive features of some of the new EU rules, such as their prescriptive content, the reduced scope for self-regulation by industry and the potential protectionist effects of the contentious provisions concerning third-country jurisdictions, were in line with the regulatory preferences of the market-shaping coalition (interviews, London, August 2008). Moreover, prior to the crisis, the regulation of CRAs and AIFMs had been a long-standing goal of the market-shaping coalition, first and foremost France, Germany and Italy (interviews, London, May 2007; Paris, July 2007; Berlin, April 2008; Rome, December 2007), as the activities of these financial institutions were seen as clashing with national varieties of capitalism on the Continent (Fioretos 2010; Zimmerman 2010; Moschella 2011). By contrast, the UK and the US had opposed any regulation of CRAs, hedge funds and derivatives markets prior to the crisis (Helleiner and Pagliari 2010).

As far as accounting standards are concerned, the crisis re-opened the never settled divide between the (mainly Anglo-Saxon) supporters of mark to market accounting, and those criticising it, primarily in Continental Europe (Donnelly 2010, 2007; Nölke 2010; Posner 2009). Policy-makers in France and Germany called for limiting the use of fair value accounting in the financial sector during the crisis and were partly successful in doing so. Even the regulatory adjustments that were less controversial, such as the revision of the DGSD, set the new intermediate and final minimum amount guaranteed closer to the levels already in place in France, Italy and Germany prior to the crisis and higher than the existing minimum limit in the UK and several new member states, which, incidentally, were the most reluctant to agree to the new threshold (interview, Paris, May 2009).

In the aftermath of the crisis, the EU and its member states attempted to shape the international regulatory debate. The most prominent regulatory forum was the BCBS, which brings together the central banks and the banking regulators of the G20 countries, as well as the European Commission and the ECB as observers. The main political forum was the G20 summits, where the EU is represented by the President of the Commission and the President of the Council of the EU. The heads of state and government of the main EU countries also attend the G20 summits. In the BCBS, there was not such an ex-ante explicit coordination in the EU. By contrast, prior to the main G20 summits that discussed financial regulation, the EU attempted to coordinate its positions internally. For example, prior to the G20 summits in Washington and Pittsburgh the Council issued an 'agreed language' (Council 2008, 2009b). The EU also agreed on a (rather general) set of priorities prior to the G20 summit in London (Council 2009a).

These meetings at the EU level were often preceded by bilateral or multilateral meetings of the main member states, in which the Franco-German alliance was prominent. Prior to the G20 summit in London, the French President and the German Chancellor sent a joint letter to the presidency of the EU, outlining their priorities for the G20 in London (Sarkozy and Merkel 2009). At that summit, several EU priorities were achieved. The decision to enhance the oversight of systemically-important hedge funds and credit rating agencies met European demands. The most overt success for France and Germany was the G20 stance on tax havens, even though the issue had not been included in the EU agreed language. French President Sarkozy was very vocal on this matter. There was no commitment to additional fiscal stimulus, which was vetoed by Germany, but supported by the UK and the US. The UK however supported and achieve an increase IMF's financial resources. At the G20 in Pittsburgh the EU, France and Germany in particular, called for and partly achieved rules on banker bonuses and exit strategies from fiscal stimuli (Hodson 2011).

4. The politics of the reform of financial services regulation in the EU

The regulatory and institutional reforms adopted or proposed by the EU between 2008 and 2010 share three main features as far as the *regulatory process* is concerned. First, the new rules cannot be regarded as market-friendly. Thus, the market players primarily affected by the new or revised rules, such as CRAs and AIFMs, initially resisted the proposed rules and subsequently engaged in intense lobbying activity to have them amended on the grounds that they would be over-prescriptive and costly to implement. This argument was also used by banks that lobbied on certain aspects of the Basel III Accord and the CRD revisions. During the negotiations on the new rules, the main body representing the financial industry painted a doomsday scenario of the detrimental effects that higher capital requirements could have on the real economy, reducing the amount of credit available for lending to business, as well as increasing costs for banks (IIF 2010). This defensive stance was echoed by comments of the chief executives of several banks.

Second, although with some notable exceptions, the new or amended rules were generally resisted by the UK, Ireland, Luxemburg and a variable mix of Nordic countries, depending on the specific legislative measures under discussion, as demonstrated by the responses to the Commission's consultation, newspaper accounts and interviews with policy-makers. The main argument used by the coalition eager to tone down the EU's regulatory response was that the proposed rules were over-prescriptive, intrusive and potentially protectionist (Tait 2009). They would impose unnecessary costs to industry, damaging the competitiveness of the financial industry in Europe and reducing the attractiveness of European financial centres as a result of regulatory arbitrage. The concern about international 'regulatory arbitrage' has traditionally been at the forefront of policy-makers' minds in Britain,[4] given the fact that London is a leading financial centre that hosts many non-British-owned financial institutions and successfully competes with other financial centres worldwide to attract business (interviews, London, May 2007; July 2008).

In the case of the proposed institutional reforms, there were (mainly British) concerns about giving the new authorities powers over national regulators and the possibility of supervising individual financial cross-border institutions. Besides the UK, Ireland and Luxemburg were also reluctant to transfer powers away from national supervisors to bodies outside their borders (*Financial Times*, 20 March 2009). The UK government was reluctant to grant decision-making powers to EU-level bodies, while public funds to tackle banking crises came from national budgets. To this effect, Gordon Brown, the British Prime Minister, secured a guarantee that the new supervisory system would not include powers to force national governments to bail out banks. The UK also stressed that the EU's supervisory architecture should fit in with global arrangements and should support the development of 'open, global markets' (Darling 2009). That said, the other member states with large financial centres, namely France and Germany, were also hesitant about transferring substantive power to the EU level (Buckley and Howarth 2010).

The new or revised rules as well as the reshaped institutional framework were actively sponsored, or at least strongly supported, by France, Germany, Italy, Spain and other members of the market-shaping coalition, as illustrated by their responses to the consultation, newspaper accounts and interviews with policy-makers. The proposed EU measures were seen as necessary to safeguard financial stability and protect investors. Some of the proposed rules, such as those concerning AIFMs, CRAs and OTCDs, also embodied the deeply ingrained Continental dislike of 'casino capitalism' (Strange 1997), which was seen as serving the fortunes of the City of London (interviews, Berlin, April 2008; Paris, July 2007; Rome, December 2007; Madrid, March 2009; Lisbon, November 2008). France, Germany, Italy, Spain and many East European countries gave their backing to the de Larosière proposals (see, for example, Sarkozy and Merkel's joint letter in March 2009), of which France was the main sponsor. Unlike in the UK, there was limited concern over potential international regulatory arbitrage. In their response to the Commission's consultation on the proposed measures, many respondents, most notably France and Germany, argued that 'Europe should play an instrumental role in shaping a global regulatory regime' and that 'an EU framework could serve as a reference for global regulation' (Commission 2009b: 8).

At the international level, the EU appeared less divided than in the pre-crisis period, not least because it agreed a 'common language', before the main G20 summits (Hodson 2011). Before the crisis, the competition between the market-making and the market-shaping camps also played out internationally. Indeed, two different approaches could be detected in international fora: one in favour of extending the perimeter of regulation to hedge funds, rating agencies, tax havens etc, sponsored by the Germany and France, and one resisting regulation, championed by the US and the UK (Helleiner and Pagliari 2010). At the most important G20 summits in the wake of the crisis, the Anglo-Saxon countries switched their positions in favour of extending the scope of regulation. France and Germany were able to project some of their long-standing regulatory goals to the international level. This was done with a good dose of political opportunism, as suggested by their populist move to limit banker bonuses, which was not a priority for financial stability, but played out well with their domestic electorate.

The negotiations of the Basel III accord were also characterised by a division between, on the one side, the US, the UK and Switzerland, which were keen to impose a stricter definition of capital as well as higher capital requirements; on the other side, continental European countries, first and foremost, Japan, Germany, France and Italy, were reluctant to accept tighter rules. So the division between the Anglo-Saxon countries and the continental European countries played out in the BCBS, even though the contours of the 'battle' were somewhat inverted in the making of the Basel III accord.[5]

Why did the UK and the US push for higher capital requirements, reversing their past position on this matter (cf. Basel II negotiations, Wood 2005; Underhill and Zhang 2008)? First, in part as a result of the state-led recapitalisation in the wake of the crisis, the main British banks were relatively well capitalised when the Accord was negotiated. By contrast, the banks in many continental European countries were under-capitalised. Second, the impact of stricter capital requirements on lending to small and medium enterprises was a major concern for continental European countries, which have a bank-based financial system, where banks provide funding to the real economy. This was less of a concern for the Anglo-Saxon countries that rely more on financial markets for corporate finance. Third, the UK and the US had been badly hit by the crisis, more than other continental countries. Hence, policy-makers in these countries were particularly worried about the capital position of their banks and wanted to be seen as dealing with past regulatory failures. Moreover, higher capital requirements were regarded by policy-makers in these countries as a substitute for more hands on supervision. After the Basel III accord was agreed internationally, the process of incorporating it into the CRD IV began in earnest and some of the compromises controversially reached in the BCBS unravelled, even though the Commission has not yet published the official legislative proposal.

This account suffers somewhat from methodological nationalism in that it presents an oversimplified version of countries positions, whereas states are not monolithic actors, as evidenced below with reference to different views amongst British policy-makers. Industry was also divided on several issues. For example, whereas hedge funds and fund managers (mainly located in the UK) resisted regulation, collective investment funds (mainly located in France), which were already subject to EU regulation and competed with hedge funds in certain segments of the market, supported EU rules on hedge funds (Woll forthcoming). As to be expected, hedge fund managers in France and Germany resisted EU rules.

Regulators gathered in the (former) Committee of European Securities Regulators, including those from continental countries, were worried about the EU setting in place too detailed rules on CRAs, which they would then be responsible for enforcing (interviews, Madrid, April 2009). German financial institutions that engaged in short-selling opposed the idea of an EU (or for that matter, German) ban on this activity and the list of examples could continue. Thus, a more detailed analysis dissecting the national positions would reveal a finer-grained picture. However, upon the whole, the contours of the battle for the reform of EU regulation were those between the coalitions identified above.

Table 2 concisely outlines the main supporters of and opponents to the regulatory changes undertaken by the EU in the aftermath of the global financial crisis.

TABLE 2. Overview of member states and industry's positions on regulatory changes

Regulatory change in the EU	Member states and industry's positions
Banking	
Deposit Guarantee Scheme amendment	Fairly uncontroversial, but new EU level of depositors protection close to the one in place in France, Germany and Italy
Basel III Capital Requirements Directive	Anglo-Saxon in favour of higher capital requirements and liquidity rules; Continental Europe reluctant to accept it
Securities and investment funds	
Regulation on CRAs	France, Germany, Italy: main sponsors UK, some Northern countries and CRAs: reluctant to regulate CRAs in the EU
Directive on AIFMs	France, Germany, Italy: main sponsors UK, some Northern countries and AIFMs: reluctant to regulate AIFM in the EU
Proposed regulation on OTC derivatives, central counterparties and trade repositories	In the past, US and UK: opposed regulating derivatives
Accounting standards	
Commission Regulation (EC) adopting Certain International Accounting Standards, endorsing IASB's Revisions of Fair Value Measurement Revised IASB standards	France, Germany, Italy: main sponsors of change, as they opposed the use of fair value; UK: in favour of fair value
Institutional framework for regulation and supervision	
Commission's Proposed Directives (September 2009, voted by EP and Council in Autumn 2010); see also de Larosière report (February 2009)	France and Germany: main sponsors; Italy, Spain and many central and east European countries: gave their full backing; Britain, Ireland and Luxembourg: reticent

Source: Author.

The content of the new rules was significantly influenced by the market-shaping coalition. Although, in the end, those resisting the new rules or parts of their content did manage to have the original legislative proposals amended, the very fact that the rules were proposed in the first place suggests that the balance of regulatory power has shifted in favour of the market-shaping coalition and that a less market-friendly regulatory approach has at least temporarily gained ground in the EU (for a similar argument, see also Posner 2010; Posner and Véron 2010). Why and how did this happen?

As noted in most of the post-crisis literature, this dramatic event undermined some of the key assumptions of the market-making regulatory approach in the EU (as elsewhere, see Helleiner and Pagliari 2010). It was policy learning that largely contradicted the policy learning of the late 1990s and early 2000s, which had heralded the British model as a successful one for the EU in the struggle over the global competition for financial services (Mügge 2010; Posner and Véron 2010). Prior to the global financial crisis, British policy-makers and their regulatory philosophy had been very influential in shaping the EU's regulation of financial services (interviews, Brussels, March and June 2007; Rome, December 2007; Madrid, March 2009; Lisbon, November 2008). Their model was, however, perceived as discredited by the global financial crisis (Baker 2010a, 2010b; Helleiner 2010; Helleiner and Pagliari 2010; interviews, London, August 2009).

After the crisis, even in the UK, the stronghold of the market-making coalition, alternative views about financial services regulation began to emerge, at least in some quarters (Hodson and Mabbett 2009). As the Turner Review acknowledged (FSA 2009: 38–39), the global financial crisis robustly challenged on 'both theoretical and empirical grounds' the existing 'regulatory philosophy' and the 'intellectual assumptions' of 'efficient', 'rational' and 'self correcting markets' on which it was based. In his oral evidence before the Treasury Committee, Lord Turner spoke of 'an intellectual failure' of the international regulatory community in respect of the global set of rules in place (House of Commons 2010). Andy Haldane, Executive Director at the Bank of England, authored some imaginative papers, demonstrating the very limited contribution of the financial sector to the real economy in the UK (a similar view being echoed by Lord Turner)[6] and arguing that over time the banks have come to 'bank on' the state, with the state providing financial assistance to the banks in case of trouble (Haldane and Alessandri 2009).

The main supporters of the market-making regulatory approach, notably UK policy-makers, did not completely abandon it, but advocated it less forcefully, and some policy-makers began to question it within the market-making coalition. One of the most notable 'conversions' was that of the Commission, which switched to a market-shaping approach. In 2009, the appointment of a new (French) Commissioner for the Internal Market, Michel Barnier, was seen as a victory for the French government. He was seen by some (mainly British) policy-makers as 'suspicious of the free market' (*The Economist* 2009). With reference to the proposed revision of the Markets in Financial Instruments directive, the Commissioner argued that the 'objective is to ensure ... a stronger regulatory framework ... greater market transparency ... as well as more protection for investors'.[7] On the OTC regulation, the Commissioner argued that there had been 'a paradigm shift away from the traditional view that derivatives are financial instruments for professional use and thus require only light-handed regulation.[8] At the same time, the new member states somewhat distanced themselves from the market-making approach that they had previously indirectly endorsed (interviews, Brussels, April 2008, March 2007, June 2007).

In the wake of the crisis and with plenty of political opportunism, policy-makers of the market-shaping coalition forcefully reiterated their 'anti-free market' and 'anti-Anglo American' rhetoric, feeling at least partly vindicated by the global financial crisis. The French President Nicholas Sarkozy remarked that: 'The idea of the all-powerful market that must not be constrained by any rules, by any political intervention, was mad. [….] Self-regulation as a way of solving all problems is finished. Laissez-faire is finished. The all-powerful market that always knows best is finished' (Sarkozy 2008).

Similarly, the German Finance Minister Peer Steinbruck argued that 'the free-market-above-all attitude and the argument used by "laissez-faire" purveyors was as simple as it was dangerous and [German recommendations for more regulation] elicited mockery at best or were seen as a typical example of Germans' penchant for over-regulation'.[9] The Italian Finance Minister, Giulio Tremonti, before the crisis erupted in full force, called for more regulation and state interference, in his book *Hope and Fear*, arguing against 'the dictatorship of the market' (*The Financial Times*, 23 June 2008).

Although these grandiose statements represent political posturing, they illustrate the attempt of the market-shaping coalition to capitalise on the crisis, tipping the balance of regulatory power in the EU in their favour. This is the politics of market-shaping, informed by the need to be seen as doing something (Buckley and Howarth 2010 refer to it as 'gesture politics'), such as the populist move of chastening the banks, while at the same time pursuing other long-term regulatory goals. It is noteworthy that several Continental countries, including the two largest member states, had also been severely affected by the crisis (see Hardie and Howarth 2009). Hence, their regulatory model was not immune from criticism. Moreover, the regulatory reforms introduced in France and Germany after the crisis were rather limited (see Hardie and Howarth 2010; Zimmermann 2010), even though policy-makers in both countries pointed to the need to pursue reforms at the EU level, rather than nationally.

It is unwarranted to speak of a paradigm shift because the (neoliberal) fundamentals of the regulatory system were not questioned in the EU (and elsewhere), even though the financial crisis raised serious doubts about the legitimacy of the previous 'market-making' approach to financial regulation. It also challenged the belief in efficient, self regulating financial markets, as argued by Lord Turner. Ideas and regulatory approaches are instrumental in explaining the changes undertaken by the EU following the 'window of opportunity' opened by the crisis. They also explain why one set of policy actors prevailed over another in the new politics of financial services regulation in the EU.

There were two pathways by which ideas affected the EU's regulatory response. To begin with, there was a 'blame game' being played regarding the Anglo-Saxon model of financial capitalism and market-friendly financial services regulation. This points to a form of 'strategic constructivism' (Jabko 2006), that is, the political use of ideas by the market-shaping coalition to advance its regulatory preferences – it is the politics of market-shaping. At the same time, there was, at least to some extent, some soul-searching amongst the supporters of the market-making approach challenged by the crisis, which weakened their resolve to defend the Anglo-Saxon approach to financial regulation. This suggests a form of genuine 'learning', which Sabatier (1998; see also Sabatier and Jenkins-Smith 1993) singles out as a source of policy change in the politics of advocacy coalitions.

Conclusions

In the aftermath of the worst financial crisis since the 1930s, the EU embarked on a significant revision of financial services regulation, which, however, fell short of a full-blown regulatory overhaul. It failed to address key regulatory issues concerning banking, focusing instead on the regulation of financial activities mainly in the securities markets that were not at the centre of the crisis. The EU regulatory changes were primarily shaped by the regulatory approach of a coalition of actors 'empowered' (or at least not 'silenced') by the crisis – the 'new' politics of financial services regulation in the EU.

What is 'new' about the new politics? The new politics is not altogether new because the two main coalitions were active well before the crisis erupted and their leaders remained unchanged. However, the composition of the coalitions changed partially after the crisis, when some policy-makers, such as the Commission, the new member states and some policy-makers in the UK, moved closer to the market-shaping coalition. The regulatory approach of the market-shaping coalition gained influence after the crisis, contributing to a shift in the balance of regulatory power in the EU. The new politics was primarily a discursive shift that resulted in a limited substantive change, extending the scope and intensity of regulation. It played out within the existing neoliberal paradigm highlighted by previous constructivist research on financial regulation, discussed in Section 2, which explains why the changes enacted were overall rather limited.

The crisis acted as an external shock that triggered policy learning across existing coalitions, partially reversing what had happened in the 1990s and early 2000s. It was seen as validating the market-shaping regulatory approach despite its potential protectionist implications. Consequently, this approach and the coalition sponsoring it have become more prominent in influencing financial services regulation in the EU, at least temporarily. This mechanism of ideational politics was exploited by policy-makers pursuing their political goals, though there was also some genuine reflection on the main shortcomings of the old EU approach to financial regulation.

As for the 'so what?' question, previous research on the role of ideas or policy paradigms reviewed in Section 2 has underlined the importance of crises in bringing about policy changes through learning. This research detects a process of embryonic policy learning and piecemeal ideational shift with reference to EU financial regulation following the crisis – though to a more limited extent, as compared to previous work, for example, on central banking (McNamara 1998, Marcussen 2000). Unlike these works, the present research also stresses the strategic use of ideas by policy-makers to achieve certain political objectives. Amongst the two effects, namely genuine ideational change and strategic constructivism, the latter seems to be the prevalent one in re-regulating EU finance, which accounts for the somewhat distinctive features of EU reforms.

It is important to stress that regulatory reform in the financial sector are still in progress in the EU as elsewhere (eg the implementation of the Dodd-Frank act in the US). Hence, this assessment is necessarily provisional. It might be too early to tell whether this trend will continue in the future or whether the market-making approach and the coalition sponsoring it will regain influence as the memories of the crisis fade away and concerns about competition with the US and third jurisdictions re-emerge. Yet, three years after the outbreak of the crisis, the EU is still setting in place market-shaping rules, such as the recently proposed regulation on OTCD and the revision of the Markets in Financial Instruments directive, designed to improve transparency, for example extending it to non equities markets, including OTCD.

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1. Policy-makers refer to it as 'groupthink', whereby 'banks and regulators are in constant discussion and negotiation and tend to develop shared views and shared misjudgments, as they did on structured credit and wholesale funding' (Gieve 2009b: 11).
2. A policy paradigm can be defined as a shared body of causal ideas concerning a certain policy area. A useful distinction can be made between the most normative part of the paradigm, and ideas about the main policy objectives, instruments and strategies (Hall 1993). To a large extent this resembles the tripartite division of beliefs used in the advocacy coalition framework, examined below.
3. Shortly before the Bank of England took over banking supervision, Governor Mervyn King controversially called for the breaking up of the big banks (*The Economist*, 30 October 2010). He also remarked that '... if a bank is too big to fail ... it is simply too big' (*The Guardian*, 17 June 2009).
4. This expression is used very frequently in the policy documents produced by the British Treasury, the FSA and the Bank of England.
5. This paragraph and the following paragraph are based on interviews carried out in Frankfurt, Paris, and Brussels in July 2011.
6. Lord Turner in an interview for *Prospect Magazine* in August 2009 warned that a 'swollen' financial sector paying excessive salaries had grown too big for society (*Financial Times*, 27 August 2009).
7. http://ec.europa.eu/unitedkingdom/press/press_releases/2010/10123_en.htm accessed in February 2011.
8. http://ec.europa.eu/internal_market/smn/smn56/docs/derivatives_en.pdf.
9. *EUobserver*, 26 September 2008, http://euobserver.com/9/26814.

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