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The Regulatory State and Financial Services:

An Appraisal of Recent Developments in the European Union

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Abstract

Since 1998 the regulation of financial services in the European Union has experienced dramatic changes. Following an initiative by representatives of the European Commission and some financial services enterprises the EU shaped and implemented a Financial Services Action Plan. Following the recommendations of a Committee of Wise Men chaired by Alexandrre de Lamfalussy the EU established a new regulatory framework with serious consequences for the distribution of power among major actors, the legitimacy of EU decision-making and the possibilities for member states to pursue their own regulatory policies.

Based on a qualitative public choice interpretation of Giandomenico Majone's regulatory state approach this paper analyses the new regulatory state and its impacts. It argues that as a result of a private initiative the Commission established herself and new comitology committees as major regulators. While national governments succeeded in safeguarding their position, the EP and especially the national legislative bodies suffered a loss of control and influence. Especially the organisations of statutory regulation have gained importance in the new regulatory state. While the Lamfalussy process brought a new level of transparency and new opportunities for the participation of non-state organisations in the arcane world of financial market regulation, its overall legitimacy remains questionable.

1 Introduction

"The Rise of the Regulatory State" (Glaeser/ Shelifer 2002; Scott 2003) has been one of the most distinguished and most disputed aspects of recent political and economic analysis. The perspective of a state that abandons the traditional tools of direct intervention and redistribution and turns to technocratic guidance by statutory regulation (Majone 1994; 1996; 1999; Grande 2004) has proved an excellent tool to foster a better understanding of the European integration and the European welfare states. Besides, it has stimulated a rich and insightful academic debate (see Levi-Faur/Jolanda 2005 for a detailed overview).

Changes in European politics have had a tremendous effect on the regulation of European financial markets. The EU ambitious single market program seemed well on its way, when by the end of the 1990s members of the Commission suffered a rather discomforting experience: while touring the European capitals enthusiastically praising what they misunderstood as a new unified trading environment for financial services in the EU, market participants reacted with astonishment or outright rejection. From their point of view, neither the single market program nor the European Monetary Union (EMU) had led to a significant reduction of national barriers. Financial markets were still under the control of national regulators with only a marginal European macrostructure. Thus, by the end of the 1990s, there was little reason to talk of the existence of a regulatory state in EU financial markets.

Today, the situation has changed dramatically. Creating and implementing a Financial Services Action Plan (FSAP) in 1998/1999 (Commission 1998, 1999) the EU has initiated a comprehensive series of 42 reform measures 39 of them being put into practice within the assumed timeframe of six years. When the Barroso Commission took office, the overall sentiment had changed from an urgent desire to kick-start an integrated financial services market to a perceived need of consolidation (see Commission 2005; EPFSF 2005). One of the major factors instruments to achieve this astonishing increase in EU legislative effectiveness was the introduction of a special rule-making process, the Lamfalussy process. Establishing new regulatory and advisory committees and strengthening the role of technocratic experts at the costs of elected representatives this new procedure shifted the distribution of power among the EU institutions, state actors and private actors and limited the possibilities for the member states to pursue specific regulatory policies. The new fast track decision-making was supposed to raise effectiveness and improve public participation and thus provide legitimacy.

Since Giandomenico Majone coined the term of the European Union as a "regulatory state" researchers from a wide variety of disciplines have added to its core understanding. Although recent efforts to clarify the various interpretations of "regulation" and the "regulatory state" in sociology, economics and politics definitely merit appreciation (see Grande/Eberlein 2004; Levi-Faur/Jolanda 2005; Moran 2002; Joerges 2002), it is beyond the interest of this paper to contribute to the macro-scientific debate of the regulatory state as a theoretical model. The regulatory state is interpreted as a specific form of market creation and market correction, a political act in reshaping the relationship between state actors and private actors. Following the positive theory of regulation as introduced by Stigler and Peltzman (see Stigler 1971a; 1971b; Peltzman 1976; Baldwin/Cave 1999; Baldwin 2000; Lütz 2002; Moran 1986) and combining it with an actor centred institutionalism (Scharpf/Mayntz 1995) it interprets regulation as the formulation, implementation and revision of specific rules concerning a specific policy and as the outcome of interactions between individual or collective actors trying to realize their preferences within a dynamic institutional framework (see Gottwald 2006). Following Douglas C. North in distinguishing between actors as "players of the game" and institutions as "rules of the game", the social groups – and sometimes individual actors, too – simultaneously strive for realizing their preferences and for modifying the institutional framework to their advantage (North 1991).

Thus, regulation by definition is dynamic and characterized by a flexible approach towards problem-solving including and combining various norms and mechanisms of governance. Regulation in this understanding goes beyond the traditional centrality of state law as it combines state law with other forms of formal and informal contracts (see Lodge 2003; Scott 2003). Especially in the area of financial markets institutional change is fast and competition between interest groups vying for profits is sharp, often leading to a race between market intervention, business crisis and re-regulation (see Clark 2004: 160-161). This is especially true for a dynamic multi-level polity like the European Union (see d'Hooghe/Marks 2001; 2003; Grande 2000), where neither a stable constitution nor a benevolent hegemon guarantees a reliable and stable set of rules. The emergence of the regulatory state in EU financial markets thus brings together actors who are socialised in different regulatory cultures (D. Vogel 1995) and who are used to competing path dependencies of institutional change (Deeg 1998).

Starting with an analysis of the political push for a European regulation EU financial markets (part 2) the paper then asks for the impacts of the regulatory reforms in terms of distribution of power (part 3.1), the national regulatory states (part 3.2) and legitimacy (part 3.2). Drawing a tentative conclusion, the regulatory state in EU financial markets has brought important progress in terms of effectiveness, transparency and participation, but has shifted competences away from elected representatives to regulatory organisations, enterprises and technocratic experts. In practice, it's not only governments who are kept out of the traditionally arcane world of financial market regulation (Underhill 1995) but the European public in general.

2 The Political Push for Reforms of the EU Financial Markets

Historically, financial markets have been regarded as too important to be left to private actors alone (see Underhill 1997, Lütz 2002, Heilmann 2001). The degree of the governmental control of banking, investment and exchange services varied from direct provision by state actors to state sponsored self-regulation, hardly ever leaving financial markets completely to the pure mechanism of supply and demand (see Lütz 2002; 2003; Laurence 2001; S.K. Vogel 1996). Ongoing globalization of financial market activities led to a dialectic between the growing need of political co-operation to safeguard a minimum degree of government control and the wish to keep external players off the home turf in order to protect so called national champions (see Vogel 1996; Laurence 2001). Early attempts in establishing a single market for financial services in the EU often were blocked by the member states' desire to keep a firm control of this important economic sector although already the Treaties of Rome had called for a liberalization of financial services (see Avgerinos 2002; Brown 1997; Underhill 1997; Moloney 2002). Central legislative initiatives like the first Investment Services Directive or the First Banking Directive encountered heavy political arm-wrestling and succeeded only partially in Europeanizing financial market regulation.

The situation desperately needed to change after the governments had agreed on the European Union and the introduction of a single currency. While interest and expertise in financial markets were rather limited within the Commission as a whole, it is to the merit of some members in the outgoing Santer commission to have stipulated the ambitions reform program by the end of the 1990s. They started to meet with leading representatives of a few European financial services companies in private and under the strict Chatham House rules. Their aim was to define a set of most urgent measures to promote the creation of single market in financial services (Mijs/Puebla 2002:259). After they had agreed on a working program and having secured the backing of Commissioner Mario Monti, the Commission officially drafted a communication calling for an Action Plan for Financial Services (Commission 1998). In the end, the blueprint for regulatory reform of the EU financial markets was worked out first by a private group of managers and Commission staff before in a second step a special Financial Services Policy Group (FSPG) was set up, consisting of representatives from the national financial ministries supported by Commission staff. These documents "Financial Services: Building a framework for action. Communication of the Commission" (Commission 1998) and "Financial services: building the framework for financial markets: action plan" (Commission 1999; see below; Annex 1) called for the implementation of a series of reform measures including the introduction of a new fast-track procedure to improve effectiveness, transparency and legitimacy of EU financial markets regulation.

The task to draft a proposal for a better regulatory decision-makingin the field of securities regulation was handed over to seven experts chaired by an experienced Belgium central banker, Alexandre de Lamfalussy. This Committee of Wise Men was called to "assess the current conditions for implementation of the securities markets in the European Union … assess how the mechanisms for regulating the securities markets in the European union can best respond to developments under way on the securities markets, … propose as a result scenarios for adapting current practices in order to ensure greater convergence and co-operation in day-to-day implementation and take into account new developments on the markets" (Committee of Wise Men 2000:30). The experts proposed a four-level fast-track procedure (see chart p8) based on a differentiation between core principles to be decided upon by Parliament and Council, and technical implementation measures to be defined by new comitology committees. After serious conflicts, the Stockholm Council on Council on 23/24 March 2001 (Stockholm Declaration 2001) adopted the proposals.

The proposals of the Committee of Wise Men hit the sensitive point of the distribution of power among the EU institutions: while the Commission could easily agree on a new comitology procedure, EP and member states alike were concerned with an impending loss of control (Avgerinos 2003; Ferran 2004; McKee 2002;2003; Hertig/Lee 2003). Heavy arm-wrestling between the EP and the Commission led to a delayed formal agreement on the Lamfalussy process and to an unstable compromise The Commission first declared not to take any measure against the vital interests of key member states (Stockholm Council Declaration (2001): Annex 1). Then, after months of negotiations with MEPs, Prodi held a speech in parliament ensuring the EP to have it participate as much as possible at all levels of decision-making plus to support the EP's quest for more supervisory powers in the field of comitology in the future (Prodi 2002:1-2) thus paving the way for an "uneasy settlement" (Ferran 2004:4) of the inter-institutional conflict.

Having been introduced in the area of securities regulation, the Lamfalussy process was adopted for banking and insurance supervision in 2004, too. Today the comitology structure consisting of three pairs of advisory and regulatory committees for each sector of the financial markets lies at the heart of the regulatory state in EU financial markets: the European Securities Committee ESC and the Committee of European Securities Regulators CESR for securities, the European Banking Committee EBC and the Committee of European Banking Supervisors CEBS for banking, and the European Insurance and Occupational Pensions Committee EIOPC plus the Committee of European Insurance and Occupational Pensions Supervisors CEIOPS for insurance, respectively (see Annex 2 for securities regulation).

The Lamfalussy process

The new fast tack decision-making procedure with its new committees forms the core of the regulatory state for EU financial markets. At the first level, the European Parliament and the Council decide in the co-decision procedure (art. 251 ECT) the basic principles of a new regulation or directive and the extent of competences transferred to the new Committees at level 2. Here, the European Securities Committee (see below), consisting of representatives of the national financial ministries, can decide on new regulation after consultation with the Committee of European Securities Regulators (CESR), consisting of representatives of the national supervisory organisations (see below). On the third on the forth level, CESR and the Commission are supposed to ensure consisting and comprehensive implementation of the EU regulations, supervise the member states and sanction misbehaviour.

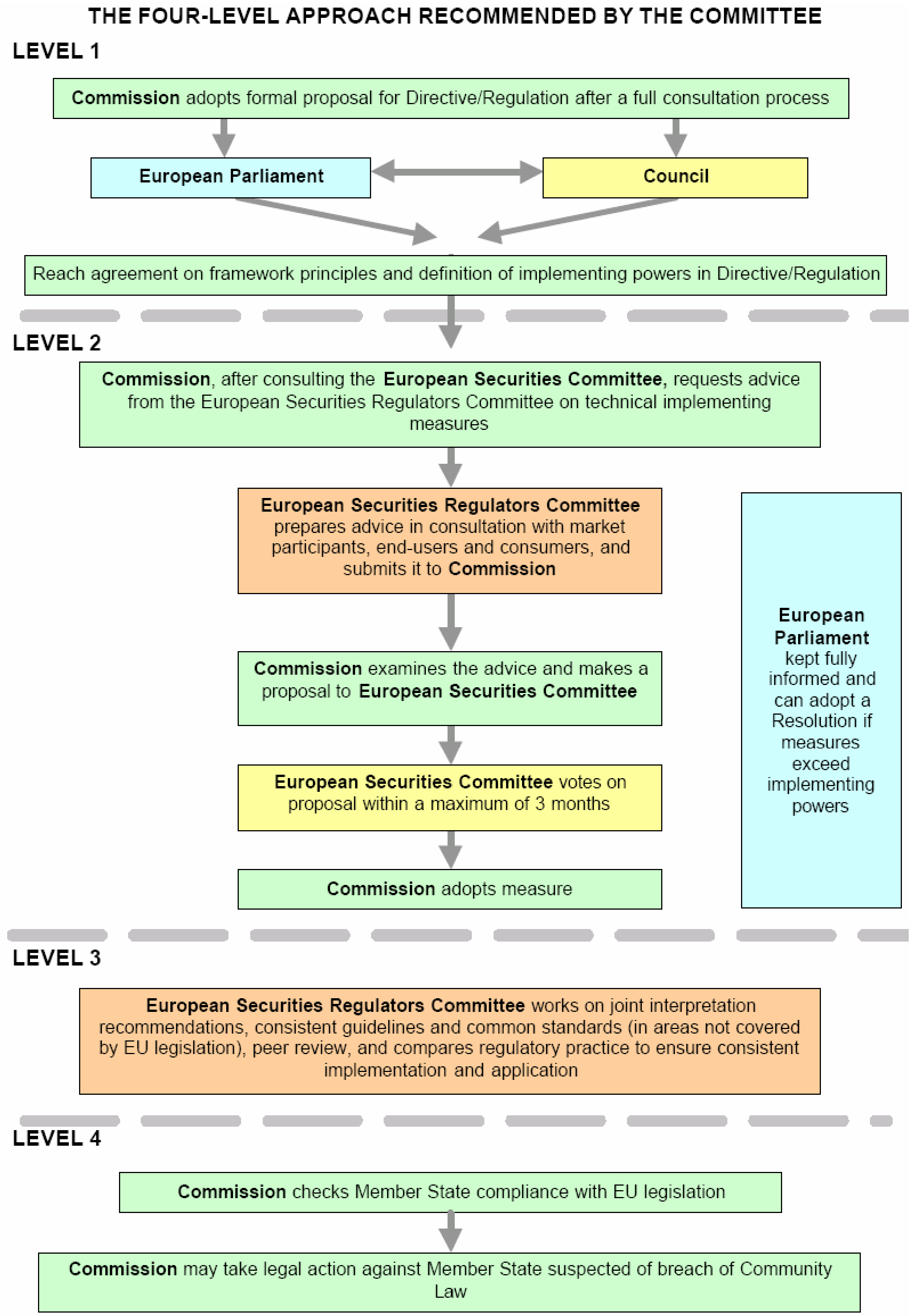
The European Security Committee (ESC)

The ESC was established to "function as a regulatory committee in accordance with the 1999 Decision on comitology to assist the Commission when it takes decisions on implementing measures under Article 202 of the EC Treaty" (Stockholm Resolution 2001:2). Within a fixed period the ESC has to decide on proposals initiated by the Commission on the second level of the Lamfalussy process. As an advisory committee it supports the Commission on all questions concerning securities markets (level one, level two and level three), especially when the Commission puts CESR in charge of working out a technical proposal (Wise Men 2001:29). Having received a proposal from the Commission, the ESC has to vote with a simple majority to endorse it and with a qualified majority to block the proposal within a prefixed timeframe (Ferran 2004; McKee 2003). If the ESC rejects the proposal or does not vote on it in time, the proposal is transferred to the ECOFIN. If ECOFIN rejects the proposal, too, the Commission can decide whether to revise the proposal or to drop the initiative and start a formal decision-making in the co-decision procedure. The EP has to be kept informed on all stages of the comitology procedure, although the parliament has little leverage on the actual decisions of level 2. The members of the ESC are high-level representatives from the national ministries of finance. To prevent the Committee from turning into an organ of the Council, the commission provides president and secretariat. The competences of the ESC have to be defined on a case by case basis each time EP and Council instruct the Commission for the decision-making at level 2 (Wise Men 2001:30/31).

The Committee of European Security Regulators (CESR)

While the ESC was established as a formal regulatory body that at the same time has advisory functions, too, the tasks of the Committee of European Securities Regulators are purely advisory (Moloney 2002; Levin/Lannoo 2005) CESR consists of the representatives from the national supervisors who elect a chairman and set out their operational arrangements without the Commission. “It will act as an advisory group to assist the Commission in particular in its preparation of draft implementing measures (level 2)” (Resolution of the Stockholm Council 2001:2/3). CESR‘s key function is to establish a strong linkage between European decision-making and market participants. Furthermore, its extensive consultation procedures are supposed to provide the new fast track procedure with adequate transparency and thus legitimacy in spite of the diminished role of the EP.

CESR inherited its organizational structure plus secretariat from the Federation of European Securities Commissions, established in Paris in 1997. After some arguing, the national supervisors managed to keep their seat in the French capital, refusing to bow in to pressures to move closer to the EU institutions. CESR work is crucial for the functioning of the whole Lamfalussy process.



Source: Committee of Wise Men 2001

CESR is not required to take decisions unanimously. As in the case of the ESC, this shall prevent agreements on the smallest common denominator (Wise Men 2001:25). When settling issues with a qualified majority, minority positions have to be published. CESR has to consult market participants, experts and consumers in a formalized, extensive and transparent way (see below), as early as possible and throughout the whole consultation process (CESR 2003). Although the Commission triggers the consultation process with the granting of a corresponding mandate CESR is yet entitled to start hearings and ask for comments on its own right.

Officially, CESR has no role to play at level 1 of the Lamfalussy process. But consisting of the representatives of the national supervisors, a certain influence on the Council is impossible to ignore. CESR's primary aim to promote regulatory convergence on the levels 2 and four works through group pressure, the definition of common implementation standards and a close cooperation. Recently CESR has started to publish national implementation reports pointing the finger at those member states, which show deficiencies in implementing the European regulations (CESR 2005). In addition to increasing the pressure on national governments to keep up with European legislation, these reports are supposed to promulgate best practices in European securities regulation and thus provide a soft mechanism of legal convergence.

3. Consequences of the Regulatory Reforms

As foreseen by the Wise Men, ESC and CESR have emerged as a central knot in the dense network of European securities regulation consisting of a wide range of new organizations founded to fulfil various tasks in providing technical advice and public representation (see chart). The spread of formalized consultations and committees like CESR-POL, CESR-Fin or various monitoring groups and steering committees has led to the formal inclusion of market participants, experts and lobbyists. Thus, the introduction of the Lamfalussy framework profoundly changed the distribution of relative power among the actors concerned in Brussels as well as at the national level. It improved the transparency, participation and effectiveness of European decision-making strengthening the legitimacy of securities regulation and increased the pressure on national regulation to converge to some extent in spite of persisting national path dependencies.

3.1 Redistribution of Power among Major Actors

The creation of the new regulatory state for EU financial markets strengthened the Commission, national supervisors and governments and – arguably – big enterprises at the cost of the EP and European lobbying organizations among others. Main beneficiary are the member states, which can impose their interests most effectively in a combined effort by national regulator and financial ministry. While observers had feared that CESR would turn out to be a new committee prone to regulatory capture by the powerful banking and investment associations, it has earned a reputation for being rather too seclusive and not responsive to market interests so far.

Concerning the relationship between state and private actors, the creation of ESC and CESR has formalized and institutionalized the lobbying process in EU securities markets (see Levin/Lannoo 2005; Hertig/Lee 2003; McKee 2003). The introduction of the Lamfalussy has definitely brought a higher degree of transparency and a sharp increase in paperwork for all participants. All important information is published online. Thus, the outstanding importance of informal contacts with members of the various DG concerned with securities markets has somewhat declined as all consultation procedures are openly announced and conducted. CESR even published detailed guidelines for the consultation procedures (CESR 2001; CESR 2003: Annex 1) and is subject to an extensive monitoring by the Commission and market participants (IIMG 2003; 2004; CESR 2004).

Since the ESC consists of representatives from the national governments and CESR defines itself as a network of securities regulators, national administrations have secured themselves key positions in the EU regulatory regime. While this result of intensive inter-institutional bargaining within the EU is of little surprise to the political economist, the actual shift of power within the national administrations was less obvious to expect. With the creation of CESR national supervisors have found a new forum that offered them ample opportunity to distance themselves from the respective governments. Combinations of formal and informal pressure led to a strengthening of the regulatory organizations and increased the costs of direct government interference in their supervisory work. Anecdotal evidence from the Netherlands, Germany and France suggest that the cooperation in CESR works as a strong incentive to lobby national governments for more competences. Taking the British FSA as a benchmark, AFM, AMF and BaFin all have successfully lobbied their governments for more independence and competences (see below).

At first glance, the governments in spite of all integrationist rhetoric and in spite of the transfer of competences to the Commission have skilfully preserved their dominant position in securities regulation. While the co-decision procedure at level 1 did not touch the inter-institutional balance of power, at level 2 the representatives of the national ministries of finance dominate the formal decision-making. While national vetoes are impossible in the ESC, two further mechanisms safeguard national interests: first, the possibility to block legislation in the Council if the ESC fails to agree, and secondly, the "aerosol clause"[1] of the Commission, i.e. her assurance not to take any measure against predominant interests in the Council when drafting level 2 measures. The separation of defining broad principles at level 2 and leaving the technical details to level 2, the governments opened the door to reduce the EPs influence in trying to limit the scope of the level 1 regulation. While some important questions that could not be solved at level 1 thus could be transferred to the comitology, in practice the supposed framework directives have turn out to be extremely detailed, leaving little scope for level 2 decision-making.

Legally, CESR's main tasks are to draft proposals, to give advice and to help supervise the implementation of regulation either decided in the co-decision procedure or by comitology. But by intensifying the cooperation among national regulators CESR helps limit the scope of direct government control. National governments and their regulators seem to lose their capacity to act as unitary actor. Playing multi-level games with European pressure groups and their respective governments, the regulators seem to have reaped the biggest benefits from the introduction of the Lamfalussy process.

Looking at the Commission and the Council, it is far more difficult to take stock of shifts in power. The genesis of the FSAP and the Lamfalussy process obviously underlines the potential role of the Commission as a political entrepreneur. In drafting the new regulatory state, the Commission exercised strong but often disguised leadership and managed to carry through her original requests, first by integrating market participants, then by imbedding the representatives of the Secretaries of the Treasury in the FSPG, always taking advantage of Commission staff acting as secretariat. But within the Lamfalussy process the influence of the Commission depends on the co-operation with the ESC and with CESR. Not following CESR's advice on certain level 2 legislation in some instances, the Commission encountered harsh criticism. The inter-institutional monitoring group recommended the Commission to

[1] This agreement is referred to as the "aerosol clause" (see IIMG 2003:fn17).

openly justify all cases of refusal to follow CESR’s advice (IIMG 2003; 2004). The pressure from market participants and governments alike curtails her influence on level 2 decision-making. On the contrary, it seems that CESR partially takes over the Commission privilege of initiating regulation by being able to force the Commission to follow certain sets of rules (McKee 2002; Ferran 2004). Judging on the prevailing complaints concerning the committee’s secretive style, a new power centre has emerged in the EU regulatory state in finance.

As for the EP, it clearly lost out in the regulatory reforms although some MEPs bravely try to dismiss this notion. After months of negotiations with the Commission and the Council, the EP secured the right to call back the transferred competences as a whole. In addition, the whole Lamfalussy process should be revised thoroughly within six years. Hence the EP’s position is getting stronger once the new decision-making has become too important to be put at risk by alienating the MEPs. But the threat of calling back the competences lacks any sophistication: either the EP “goes nuclear” and completely stops Lamfalussy or it has to accept to be merely informed and its objections just being considered. A clear indicator for the EPs diminished role are changing strategies by business lobbyists to concentrate on different avenues and using MEPs rather for public statements then real influence brokers at level 2.

CESR’s consultations became one of the most important addressees for European lobbying. As the committee is allowed to start consultation procedures without prior permission by the Commission lobbyists still have a strong incentive to ensure smooth national contacts in order to gain access to information on developments in the ESC as early as possible (FT, 22.08.2002). As lobbyists have to manage a two-level approach towards the national governments and administrations and towards the new EU committees the Europeanization of securities regulation has not led to an overall decrease in national lobbying. Lobby groups have to keep in touch with a broad variety of European and national institutions at the same time. But CESR and the Commission push increasingly for a more active role of market participants, i.e. representatives from European banking and insurance companies. This weakens the position of the traditional European associations as the commission increasingly turns directly to enterprises. In CESR’s steering groups providing technical support in drafting implementation proposals for various aspects of new regulations and directives, representatives of enterprises outnumber those from associations and societal groups by far.[2]

3.2 Impact on national regulation

The emergence of an EU regulatory state for financial markets thus has a deep impact on national regulation and the rise on national regulatory states. One of the basic concerns of the Committee of Wise Men was to push for the development of a common basic philosophy of regulation within the EU and for the convergence of regulation and supervision within the member states (Committee of Wise Men 2001). They acknowledged the strong influence of different regulatory styles and path-dependencies especially in the major financial centres. The differences between market-oriented states – called the "Old Boys Club" – assembling behind the formidable British regulatory network and the explicitly state oriented southern states – dubbed the "Club Med" – had not only blocked the negotiations for central directives in the early 1990s (Brown 1997; Underhill 1997), but also shown the high degree of capitalistic variety within the EU. These differing orientations pose a major challenge to convergence and efficiency as the member states still prefer the legal instrument of directives to regulations as recommended by the Committee of Wise Men. As directives have to be implemented by the member states, they still leave considerable discretion to national parliaments, governments and supervisory organisations (see Avgerinos 2003).

The first choice to restrict national divergence had been blocked right from the beginning: The ECOFIN had called for the Committee of Wise Men to develop a new procedure within the existing legal framework. This excluded the establishment of an integrated European regulatory body comparable with the US Securities and Exchange Commission putting regulatory, supervisory and enforcement powers into one single pair of hands. With the establishment of CESR, the concept of CESR bears some remarkable mechanisms to promote the convergence of European financial market regulation. Instead, the Lamfalussy group was supposed to develop other mechanisms in order to promote convergence. The most obvious one was to stimulate closer co-operation among regulatory organizations creating European benchmarks for best practices, organisational structures and the amount of competences transferred to the national regulatory bodies.

Looking at recent developments in national regulatory reforms, one can observe a clear trend towards concentration and integration of regulatory powers within one organisation (Lumpkin

[2] For the composition of all steering committees see www.eu-cesr.org.

2002; Avgerinos 2003). Within few years Germany, the Netherlands, France or Austria among others all followed the Scandinavian[3] and British[4] example in creating cross-sectoral regulatory agencies or "one-shop" regulatory organizations (Schoenmaker 2003). While this development seems to underline the trend toward convergence, even at the organizational level remain serious differences concerning the degree of independence from ministries and parliaments as well as in regulatory competences (see Gottwald/Heilmann/Kremer 2006).

To promote convergence CESR has some well disguised mechanisms beyond the mere increase in regulatory output. Among the most important is the rule that only those representatives of the supervisory authorities are supposed to participate in the CESR meetings who are actually in charge of the discussed drafts in their home countries. Peer pressure is supposed to set a concealed incentive to promote regulatory convergence among the member states (Börsen-Zeitung, 12.03.2004). In trying to agree on technical details CESR not only stimulates the integration of differing national orientations and but also increases the pressure on national governments to provide their securities regulators with the required competences. Day-to-day co-operation of securities regulators provides an excellent benchmark of adequate legal and personal resources for the national organizations. In addition, CESR is developing standards for the implementation of the EU regulation in each member country (Financial Times, 22.03.2004). Representatives of the French AMF as well as of the Dutch AFM explicitly referred to the British FSA for instance while trying to improve their standing vis-à-vis their national governments (Financial Times 7.9.2004; Grundmann-van den Krool 2002; AFM 2002a).

In addition to persisting organisational differences, the major directives like the new Investment Services Directive[5] (see Levin 2002; Lannoo 2003a) or the new Take-over Directive (McCahery et al. 2003; Rossi 2002) still reveal the above mentioned division between rather market oriented and rather state oriented principles for financial market regulation (Gottwald 2005). The Wise Men's call for the formulation of general regulatory principles has fallen to deaf ears so far and is itinerated in various comments evaluating the Lamfalussy process. The question remains how much "diversity in convergence" (Lütz 2003)

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[3] Norway 1986, Denmark 1988, Sweden 1991

[4] Concentration of powers in the hands of the State Investment Board 1997 and establishment of the Financial Services Authority in 2000.

[5] The Second Investment Services Directive has been renamed Markets in Financial Instruments Directive, MIFID (Directive 2004/39/EC).

the EU regulatory state can afford without falling victim to inconsistent and often conflicting regulations.

3.3 Impact on Legitimacy

The establishment of ESC and CESR has shifted the balance of power between the major actors in EU financial market regulation. Judging on the intensive bargaining between member states governments and their supervisors concerning the details of regulation, the work of the EU regulators is definitely more than just simple market-making: like every regulation it contains a momentum of re-distribution of relative gains and losses (see Laurence 2001; Eberlein 2000). The political targets for regulators are often contradictory (Caporaso 1996). Thus it is problematic to have regulatory bodies to decide on questions of public good versus particular interests, especially as the construction of independent agencies bears evident risks of a lack of democratic control and accountability (Eberlein 2000:97). In general, there are three major mechanisms for establishing legitimacy: the provision of outcomes accepted by the public, adequate possibilities to hold decision-makers responsible by voting and the participation in the decision-making process (see Scharpf 1996; 2004; Moravcsik 2002).

As securities regulation usually qualifies as a rather arcane field of high complexity, it is seldom object of an intensive public debate and hardly ever a major argument in national elections. Only very prominent cases like the recent scandals in the United States – ENRON, Worldcom et al. – sometimes lead to a public outcry loud enough to be relevant for elections. But public debate is a prerequisite for providing legitimacy through accountability. As securities markets usually are too complex to find attention outside small circles of experts, assuming only a small demand for legitimacy in policy fields that are not in the core interest of the people (Scharpf 1996) stands in sharp contrast with the overwhelming individual and collective risks arising from market or regulatory failure.

Defining legitimacy not normatively as a certain belief what a good government should be but functionally as a diffuse trust in institutional arrangements (Scharpf 2003) there are two complementary venues for democratic legitimacy: input legitimacy through participation and output legitimacy through participation. The efficiency of decision-making by technocrats within a clearly defined area providing an effectiveness appreciated by the people was supposed to add legitimacy to the EU in fields beyond the direct reach of the nation-state (Majone 1994). In the eyes of the Committee of Wise Men, the introduction of the

Lamfalussy process should improve both: input legitimacy through broader participation and a higher degree of transparency plus a more effective regulation to the benefit of all citizens of the EU (Committee of Wise Men 2001). Judging on the decision-making within the FSAP, the aim of a higher effectiveness seems beyond question (IIMG 2004). More interesting from a political science point of view are the claims of a broader participation and the creation of a level playing field for non-state actors through transparent and formalized consultation procedures.

Overcoming initial problems, the Lamfalussy process has resulted in a flood of public consultations. The Commission now seems to pay much attention to openly contact lobbyists and external experts as soon as possible (FT 4.12.2002). The formalization of the consultations and the consequent publication of all relevant steps and commentaries on the official homepages of CESR have definitely increased the transparency and opened up the lobbying for all persons concerned. In addition, various groups and committees have been established to supervise the comitology work. These groups consist of external experts and are supposed to draft their public reports in close co-operation with all groups concerned. The most important one is the Inter-Institutional monitoring Group set up to review the progress of the Lamfalussy process on a regular basis. One of the IIMG's targets is to ensure that the integration of market-participants and the interested public is working well (IIMG 2003). Judging from the answers of those concerned, the new procedure lives up to the more positive expectations (IIMG 2003:5), although a few aspects of CESR's work are supposed to be further improved (CESR 2005). The number of lobbying organisations, consultancies, research institutes and other groupings taking stock of securities regulation is constantly increasing. The integration of business associations in the law-making seem to add further proof to Stigler's and Peltzman's dictum of industry interests prevailing over consumer interests leading to a regulatory capture (Stigler 1971; Peltzman 1976). Judging on the consultations concerning the prospectus directive or the takeover directive consumer organisations had shown themselves poorly organised (FT 12.03.2002). Therefore it is still the EP – and up to certain degree the Commission – to act as a defender of consumer interests (Schwaiger 2003).[6] The EP even installed a new forum for the regular informal exchange of views concerning financial market issues. But as lobbying in Brussels in general, the heterogeneity of the various industry groups and the complexity of the multi-level lobbying of

[6] The European Parliament Financial Services Forum EPFSF .

the EU seem to work as a certain safeguard against corruption and capture of the regulators by a single group (Moravcsik 2001).

By further opening up EU decision-making to competitive interest groups, the regulatory state resembles a pluralistic polity. Non-governmental organisations function as a further representative of the citizens in addition to the EP (Töller 1999; Schmidt 2001). They are an "early warning system" (Alexander Radwan) for parliamentarians too short of resources to monitor all relevant developments themselves. The Lamfalussy process thus improves the opportunities for social organisations to participate in the regulation of financial markets. But the original idea of creating a level playing field for all groups concerned still awaits realization: although the high degree of transparency and the strict procedural rules have drawn the lobbying business to a certain degree out of the clandestine realm of backroom activities, the distribution of resources and bargaining power still varies considerably among industry and consumer representations (see Frach 2005). Differences in expertise and closeness to influential Commission and Council staff still draws a distinctive line between the general lobbyists and a small regulatory network, sometimes estimated to consist of less than two dozen people.[7] As most of the EU business organisations consist of national organisations, the internal decision-making processes often are cumbersome and result in undifferentiated compromises weakening the impact on the EU decision-making. Only a few associations have installed a business like governance with a managing director entitled to act without intensive prior consultations of his members. Thus the interests of the individual enterprises are filtered through various layers of compromise before reaching the CESR or the Commission as a statement of an EU business association. Hence, CESR tends to push for a stronger role of market participants defined as representatives from enterprises, thus limiting the influence of associations and lobbying groups.[8]

Taken together, the rise of the regulatory state in EU financial markets has improved the opportunities for participation and thus bears the capacity of improving the input-legitimacy of EU regulation, too. But judging on the small numbers of MEPs active in securities regulation and their serious problems in selling this part of their parliamentary work to their local constituencies, the EP simply lacks the resources to deal with the growing number of

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[7] Interviews with various representatives of financial markets lobbying groups in Brussels in September / October 2004.

[8] See for example the membership on the influential CESR steering groups, where representatives from European enterprises outnumber the delegates form associations by far. The membership of all CESR Steering Groups can be found at www.cesr-eu.org.

consultations especially on level 2. Having failed to obtain the right to revise all level 2 decisions when negotiating the introduction of the Lamfalussy process, the parliamentary tools to influence the implementation measures are severely limited. Left with the choice of accepting level 2 decisions or "going nuclear" in calling back the whole comitology, the EP can only try to add as much detail as possible into the level 1 decision-making.[9] Therefore the EP is hardly in a position to provide accountability and legitimacy to the Lamfalussy process. This task rests with the governments who similarly fought to keep control of level 2 (see above). But the construction of level 2 prevents a single government from vetoing the whole process. In the end the Lamfalussy process only slightly improved the possibilities for public participation and control through an enhanced role for market participants and experts, but at the cost of a further restriction of national governments, national parliaments and the EP.

4 The Rise of the Regulatory State for EU Financial Markets

In 1998/1999, members of the European Commission embarked on an ambitious reform project to build a single market for financial services. It was initiated by a small group of Commission staff and representatives or European enterprises that privately developed a reform agenda that was then taken over by the EU institutions. Analyzing the emergence of the regulatory state for EU financial markets, it is remarkable that some of the key actors in European policy-making were left out completely or were rather late to join in: neither representatives of European political parties or European lobbying groups nor members of European regulatory bodies were at first asked to participate; even the governments started to work on the reform agenda only after the main points had been identified and informally agreed upon. The Commission cleverly managed to govern the reform process that in the end enhanced competences.

While changing the distribution of power among European and national actors, the introduction the introduction of the Lamfalussy process has definitely led to an increased output in new regulation. The integration of the EU financial markets is moving ahead fast. Form an economic point of view, this contributes to the well-being of the whole population, as an integrated financial market leads to higher growth rates (Heinemann 2002; Heinemann

[9] Thus, the Lamfalussy process has established an adverse incentive not to restrict level 1 to general principles and the definition of the extent of competences transferred to level 2 which is contradictory to the whole idea of a fast-track procedure.

et al. 2003). Form a political scientist's point of view, the regulatory reforms have improved the transparency of the decision-making process and increased the participation of market participants in general and representatives of the most important European financial services enterprises in particular. Hence the interested public is in a better position to control the new regulation than before the FSAP. Therefore, the new regulatory state adds some legitimacy to EU decision-making by improving efficiency, procedural transparency and participation.

Resting on the involvement of market-participants in consultation procedures, however, those who have been elected to represent the public and define the public good, i.e. the members of the European Parliament and the members of the national legislatives, have little influence especially at level 2. Important competences are increasingly transferred from the hands of the *elected* into the hands of the *selected* - at the European level as well as within the member states. Mistaking level 2 decision-making as the professional solution of technical issues underestimates the (re-)distributive impact of those rules. Without commonly shared values and a clear line of responsibility, the democratic legitimacy of the new regulatory state for EU financial markets rests on procedural transparency that is easily lost in the amounts of documents being published by the new committees. Hoping for governments and MEPs to keep track of these developments and to assure a basic line of accountability seems rather optimistic.

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Annex 1: Original Measures included in the FSAP

1	Directive on prospectuses	24	Report on substantive differences between national arrangements relating to consumer business transactions
2	Directive on transparency obligations for security issuers	25	Interpretative Communication on the freedom to provide services and the good in insurance
3	Communication on the Application of Conduct of Business Rules under Article 11 of ISD	26	Directive on insurance mediation
4	Directive on insider dealing and market manipulation	27	Communication on a single market for payments
5	Directive on Financial Instruments Markets (former ISD)	28	Action Plan to prevent fraud and counterfeiting in payment systems
6	Amendments to 4th and 7th Company Law Directive to allow fair value accounting	29	Communication on an e-commerce policy for financial services
7	Communication updating the EU accounting strategy	30	Directive on the reorganisation and winding-up of insurance undertakings
8	Regulation on the application of international accounting standards	31	Directive on the reorganisation and winding-up of credit institutions
9	Modernisation of the accounting provisions of the 4th and 7th Company Law Directive	32	Directive on the taking up, pursuit and prudential supervision of the businesses of electronic money institutions
10	Communication reinforcing the statutory audit in the EU	33	Amendment to the Money Laundering Directive
11	Recommendation on the statutory auditor's independence in the EU	34	Recommendation on disclosure of financial instruments
12	Implementation of the Settlement Finality Directive	35	Amendments to the solvency margin requirements in the Insurance Directive
13	Directive on financial collateral arrangements	36	Amendment of the Insurance Directive and the ISD to permit information exchange with third countries
14	Directive on Take Over Bids	37	Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate
15	Directive and Regulation on the European Company Statute	38	Creation of ESC and CESR
16	Communication modernising Company Law and enhancing Corporate Governance in the EU	39	Directive on the taxation of savings income in the form of interest payments
17	Communication on Funded Pension Schemes		Not yet completed
18	Directives on UCITS	40	Proposal for a 10th Company Law Directive on cross-border mergers
19	Directive on the activities and supervision of institutions for occupational retirement provision	41	Proposal for a 14th Company Law Directive on cross-border transfer of a seat
20	Communication on Clearing and Settlement	42	Implementation of Basle II Capital Adequacy Guidelines (CAD III)
21	Directive on the distance marketing of consumer financial services		
22	Communication on clear and comprehensible information for purchasers		
23	Recommendation to support best practice in respect of information provision		

Source: Tenth Progress Report (http://europa.eu.int/comm/internal_market/en/finances/actionplan/progress10_en.pdf)

Tenth Progress Report Annex (http://europa.eu.int/comm/internal_market/en/finances/actionplan/progress10-%20annex_en.pdf)

Annex 2: The ESC/CESR-Network