Abstract:

The paper attempts at contributing to the understanding of the EU external action by identifying the sources of the EU position in the debate for the reform to the international financial architecture (IFA). Specifically, by analyzing the EU agreed position in the international meetings convened to address the long-term consequences of the subprime crisis, the paper investigates the factors that led the EU to campaign for strengthening the role of public authority and for giving priority to financial stability and social protection in the governance of the international financial system. The argument of the paper is that the sources of the EU position in the international reform process lie in one of the European approaches to financial capitalism, namely, the one that seeks to combine free markets with social solidarity and regulation. Indeed, although there is no unique model of European capitalism, the crisis has shifted the EU away from the ‘neoliberal’ towards the ‘regulated’ model, as attested by the content of EU financial sector policies. Illustrating the major changes in those policies, in terms of the location and purpose of regulation, the paper argues that the shift is primarily the result of an intellectual reassessment within the British policy-making elite. The articulation of an alternative model by some of the other largest member states further reinforced these trends.

Keywords: EU; varieties of capitalism; finance; regulation
Introduction

The paper attempts at contributing to the understanding of the EU external action by identifying the sources of the EU position in the debate for the reform to the international financial architecture (IFA). Specifically, by analyzing the EU agreed position in the international meetings convened to address the long-term consequences of the subprime crisis, the paper investigates the factors that led the EU to campaign for strengthening the role of public authority and for giving priority to financial stability and social protection in the governance of the international financial system.

Although the regulatory outcome of the international debate is far from being settled, the EU agreed position, as evidenced in the preparatory documents endorsed by the EU Heads of state and government, is particularly interesting in light of two recent trends. First, in the decade that preceded the subprime crisis, the governance of the international financial system had been increasingly informed on the delegation of regulatory authority to the private sector (Cutler, Haufler, and Porter, 1999; Hall and Biersteker, 2002; Higgott, Underhill, and Bieler, 2000). In particular, international regulatory bodies refrained from recommending direct regulation of market actors and products, focusing instead on strengthening supervisory cooperation, while encouraging private actors to regulate themselves (Sinclair, 2005, Tsingou, 2006). The EU position in the post-subprime debate is thereby interesting because it explicitly acts against the most recent international regulatory trends. Second, understanding the EU position in the international debate is also important in light of the transatlantic relationship. Indeed, before the crisis burst, it is difficult to distinguish between the EU position and that of the United States for the regulation of the financial services industry (Posner and Véron 2010). Indeed, the EU did not dispute the basic principles set under U.S. leadership, including the principle of private sector self-regulation (Helleiner and
Pagliari, 2009). Hence, analyzing the EU position in the current regulatory debate allows gauging whether the EU and the U.S. are still on the same page of the international regulation book.

At the theoretical level, there are at least two explanations that may help account for the EU stance in the post-subprime international financial negotiations. The first explanation builds on normative arguments of EU foreign policy. Specifically, this explanation holds that the EU stance in international financial negotiations can be attributed to a distinct EU identity. Building on the ‘normative power’ argument, according to which the EU acts upon the ‘principles of democracy, rule of law, social justice and respect for human rights’ in its external relations (Manners 2002, p. 241), the explanation here is that the EU is projecting to the international level its distinct values on how financial systems have to be politically organized. The second explanation builds on rationalist accounts of policy-making. Specifically, the argument is that the EU international position reflects the outcome of the negotiations among EU member states and their competing economic and financial preferences (Moravcsik, 1998). In this connection, it is possible to hypothesize that the subprime crisis has empowered the pro-regulation coalition of policy-makers in the EU at the expense of the coalition that had favored light-touch regulation in the recent past (on this point see, for instance, Quaglia, 2009). Such an internal power reshuffle was also probably influenced by public mobilization. Amid polls showing growing taxpayer anger at imprudent investors, politicians across the political spectrum sought policies to acquiesce popular discontent thereby converging around a position favoring strengthened financial regulation.

Although the two explanations are often regarded as alternative ones, this paper argues they are complementary. Indeed, policy-makers’ preferences on financial regulation cannot solely be derived from political economy considerations but also from specific understandings about what should be the type and purpose of regulation. That is to say, the intellectual mindset of what constitutes appropriate and acceptable political organization of financial markets is a crucial factor in shaping actors’ preferences and in forging coalitions around specific regulatory proposals (Blyth, 2002).
Building on these observations, the argument of the paper is that the sources of the EU agreed position in the international financial negotiations lie in the convergence of views of the largest EU member states around a specific approach to financial capitalism, namely, the one that seeks to combine free markets with regulation and social protection. The EU is thereby currently exporting at the international level the values underpinning this ‘regulated’ model of capitalism. Nevertheless, the paper also argues that the regulated model is not simply the straightforward outgrowth of a normative identity. Indeed, the key point here is that there is no a unique model of European capitalism but contending ones (Amable, 2004; Schmidt, 2002). Given such a variety, the result of the competition among different models is crucial to understanding what values the EU is projecting to the outside. In this connection, it is possible to say that the convergence of views around the principles of the regulated model was primarily the result of an intellectual reassessment of the neoliberal approach to financial markets within the British policy-making elite and of the articulation of a tractable alternative by some of the largest EU member states, i.e. Germany and France, which discursively exploited the apparent failure of the neoliberal approach.

In order to gauge the convergence of views around the principles of the regulated model, and their endorsement as a common EU position in the international financial negotiations, the paper analyzes the evolution of the EU financial services policy. Specifically, the paper illustrates the main changes in this policy in terms of the location of regulatory authority (be it the public or the private sector) and in terms of regulatory objectives. The paper then links these developments to the EU agreed position in the first three G20 meetings that followed the subprime crisis, which were held in Washington, London, and Pittsburgh respectively. The negotiations held within the G20, that bring together the Finance Ministers and Central Bank Governors of both developed and developing countries, were chosen as a case-study because of the steering role accorded to this body for the reforms to the institutional architecture of the global financial system. The way in which the EU is represented in this international body is a further justification for the case-selection. Indeed, some EU countries, such as France, Germany, Italy, and the UK, have their national
representatives sitting at the G20 table. On top of that, however, the EU Council rotating Presidency and the head of the European Central Bank also participate to the workings of the G20. Hence, the EU multiple representation in the G20 provides crucial empirical evidence for detecting the signs of the contestation and competition among different models regarding the political organization of financial markets.

Before starting reviewing the EU stance in the G20, some clarifications are in order. To start with, whereas in trade policy the Council delegates negotiating authority to the Commission that speaks with a single voice on behalf of the whole EU (Elsig, 2002; Meunier and Nicolaïdis, 1999), in finance policy, member states have not delegated such extensive policy-making authority to the supranational level. It follows that the international financial negotiations are more members-driven than the trade negotiations are. Since national governments, rather than supranational actors, are the crucial actors in the EU external representation in the issue area of financial services regulation, the analysis thereby solely focuses on national executives, especially those of the largest member states, namely, the UK, France, and Germany, which are also the EU countries directly represented in the G20. Such an analytical focus is also motivated by the fact that the EU position on the regulation of financial services has been usually influenced by the largest financial centres, namely London, Frankfurt and Paris. The position of the UK is particularly important here because it is widely understood that the UK has traditionally played a crucial role in shaping the content of the EU financial policies. Secondly, the paper is not meant to assess the efficiency of the EU in international financial negotiations. That is to say, the paper does not attempt to gauge the influence of the EU in terms of the outcome of the negotiations; it rather aims at explaining the sources of the EU international stance.

The paper develops the argument as follows. In the second section, the paper introduces the international regulatory debate that followed the subprime crisis by focusing on the EU position and placing it in the wider context of the tension between competing understandings on what is the appropriate political organization for financial markets. The following sections empirically analyze
the convergence of views of the EU largest member states around specific approaches to financial
capitalism over time. Specifically, the paper first explores the predominance of the neoliberal model
in the period preceding the subprime crisis, drawing attention to the content of the financial services
policies that were prevalent in Europe at that time. The paper proceeds by showing the contestation
of that model on the heels of the subprime crisis and linking such a contestation to the EU agreed
position in the G20 negotiations. The last section summarizes the findings of the paper and
elaborates on their implications for the EU as a regulatory power and for the study of the EU
external action.

2. The EU and the Financial Markets

Since the summer of 2007, the world scenario has been dominated by the US sub-prime mortgage
crisis and its repercussions on global financial markets and economic growth. Indeed, as banks
around the world wrote down their losses and cut down on financing, financial distress severely hit
the real economy leading to what has been widely defined as the worst recession since the 1930s.
Under these conditions, along with the immediate concern for stemming the effects of the crisis,
policy-makers have been debating the long-term measures that have to be adopted in order to
reduce the likelihood of future crises. The European Union has been one of the most active actors in
the debate that followed the crisis, repeatedly calling for an international regulatory framework that
covers ‘all financial markets, products and participants’ (EU Commission, 2009). In particular, the
EU has put its weight behind regulatory proposals that shift the locus authority away from the
private to the public sector at both the domestic and international level. Furthermore, in terms of
regulatory objectives, the EU has emphasized the need to put financial stability and social
protection at the top of the international regulatory agenda.

Building on normative accounts of EU foreign policy, the substance and the objectives of
the EU-sponsored regulatory measures can be explained as a reflection of the particular values the
EU polity is based on. This argument is well-illustrated by the endorsement of the doctrine of ‘managed globalization’ which shaped the EU Commission stance in international trade negotiations in the early 2000s (Meunier, 2007). Applying this logic to the case under investigation, the EU behavior in international financial negotiations can be explained in light of the normative adherence to a specific set of principles for the organization of financial markets, such as the importance of public intervention in the functioning of the markets.

This paper builds from this normative explanation of the EU external action because it takes as its starting point the principles and values that inform actors’ behavior. However, the paper departs from the normative explanation because of the recognition of the political contestation that characterizes the adoption of a specific set of principles and values. Indeed, the main problem in the normative explanation lies not so much in what it contains, but in what it misses. Specifically, it misses the fact that values, and thereby identities, are always contested and contingent (Katzenstein, 1996, p. 3). Values do not appear in a vacuum but are embedded in a political environment in which they are publicly debated and selected. As a result, they are neither fixed nor fully formed but subject to evolution over time since they are shaped in political battles where different groups of actors support distinct set of values over another.¹ Hence, if we want to understand why a specific set of values is projected to the outside, we should first specify the distinct set of values the EU projects to the outside and how these values came to dominate within the EU itself. Identify what is the set of values that comes to dominate in a polity. In order to do that, we should insert this identity in historical contexts where contending preferences and normative orientations confront each other.

Building on these insights, the paper argues and illustrates that explaining the EU position in international financial negotiations requires an analysis of institutionalization of contending preferences in the EU financial services policies. Preferences, however, cannot solely be derived from an analysis of the domestic political economy of each member; they are also shaped by

¹ For a thorough criticism of the EU normative power argument from a political-economy perspective see Falckner, 2007.
normative orientations. Indeed, as EU integration proceeded, differences began to emerge among members about the principles that should inform the governance of the markets (Hooghe and Marks, 1999).

The literature on the varieties of capitalism (VoC) adds to the understanding of the existence of different principles through which states can govern the economy and the financial markets. Indeed, although this literature has been mainly focused on unveiling the micro-foundations of national political economies by concentrating on the behavior of domestic firms (Hall and Soskice, 2001), several studies have forcefully shown the continuing importance of the state in structuring the domestic economy (Schmidt, 2002). For instance, Whitley (2005) has demonstrated that the state plays a fundamental role in shaping the characteristics of the business system including the manner in which employers behave through their association. In light of the subprime crisis, it has also been shown that the state played a primary crisis management role even in a liberal market economy (LME) such as the UK, where the process of economic adjustment had been guided by governments rather than by the markets (Moschella, forthcoming). In sum, these findings call for a deeper investigation of the role that states perform in the organization of the markets and for the definition of the dimensions along which to discriminate among differing organizational models.

In this connection, I propose to distinguish between two models of the political organization of financial markets: the neoliberal and the regulated model. Whereas it is common practice to distinguish between models of financial capitalism according to whether the financing for enterprises takes place via banks or the equity market (Deeg, 1999; Zysman, 1983), the distinction hereby suggested builds on contending understandings of what is the appropriate role of governments in the markets. In particular, the distinction is based on two dimensions: the intensity of regulation with which public authority intervenes in the functioning of the markets, and the purpose of that regulation. In what follows, I explain each dimension in turn clarifying the contours of the attending models.
As far as concerns the first dimension, the distinction between the neoliberal and the regulated model of financial capitalism revolves not around the question of whether or not to use regulation to govern the markets – in fact, there would be no market absent regulation. Rather, the distinction revolves around the extent to which public regulation should interfere with the basic economic functions that the markets perform. Indeed, the neoliberal model is based on the assumption that direct governments’ interventions should be kept to a minimum because free markets can alone effectively contribute to economic growth and to the maintenance of financial stability. On the one hand, by channeling resources from savers to investors, financial markets help the transfer of capital to its most productive uses thereby boosting investments and economic growth. On the other hand, aggregating information and determining the prices at which funds are allocated and risks are traded, markets display the necessary disciplinary effect on the financial system. In contrast, the regulated model conceives of financial stability as a goal of public policy. Since market actors do not have full information to exercise financial discipline, and since they are often prone to emotions and herding behavior, market discipline can result in an excessive degree of financial instability with negative consequences for the real economy. Seen from this perspective, governments’ intervention is thereby justified to fill in the limitations of market discipline and prevent excessive risk-taking.

The logical corollary of these assumptions are the endorsement of differing governance principles for financial markets. Indeed, the neoliberal model supports the adoption of the principles of self-regulation, according to which the responsibility to regulate falls within the private rather than the public sector. Tangible examples of this approach in the governance of international financial markets include the growing reliance on institutions’ own assessment of risks as enshrined in the Basel II accord, which allows banks to use their own internal measures and models to determine the riskiness of their portfolios (see, for instance, Tarullo 2008). Next to the endorsement of the principle of self-regulation, the faith in market discipline as an effective
mechanism to ensure economic growth and financial stability has also led to increasing efforts to limit the role of public authority when it is not delegated to the private sector. This has crystallized in the principle of light-touch regulation, according to which public regulation and oversight should not excessively interfere with the interplay of market forces. Under these conditions, the primary function of governments is that of ensuring the smooth functioning of markets by presiding over transparency of information and guaranteeing competition. In the regulated model, in contrast, the appropriate model of regulation – the rule-based approach – is the one in which governments and regulatory authorities do not solely aim at enhancing market mechanisms but also fill in their deficiencies by articulating detailed codes of conduct for market actors. In particular, public authorities, be they domestic regulators or international organizations, have the responsibility to intervene in financial markets in order to ensure that the process of funds allocation does not lead to the exclusion of some social actors and in order to make market actors accountable to political power.

The second dimension varies according to the purposes that regulation is meant to pursue. Although the standard view is that the primary objective of regulation is that of reducing the asymmetric information problems that affect financial markets (White, 2009), it is possible to conceive of a wide variety of macroeconomic and microeconomic goals. To start with, financial regulation is meant to pursue financial stability. That is to say, the emphasis is put on preventing excessive risk-taking by financial institutions and dangerous financial linkages among firms and markets. Second, regulation may be introduced to help create a level playing field for financial institutions. That is to say, regulation can be used to heighten competitive conditions in financial markets, by lifting barriers on entry or deciding not to introduce price regulation among others. Finally, some regulatory instruments are introduced primarily in order to defend the counterpart of the regulated entities, that is to say, consumers of financials services. In this connection, regulation

---

2 Specifically, it is up to domestic regulators to allow banks to use their internal risk models.
can also be used to lend to politically or socially attractive projects, social groups or industrial sectors.

Building on these observations, it is possible to say that the neoliberal and the regulated model of financial capitalism varies according to the emphasis put on one set of regulatory objectives over the others. In particular, in the neoliberal model, the emphasis is put on financial integration with the attendant attention to regulatory requirements facilitating competition and liberalization. In the regulated model of financial capitalism, in contrast, governments’ regulatory interventions emphasize the establishment of consumers’ and employees protection schemes within the wider framework of financial stability. Indeed, the regulated model rotates around a notion of financial governance that covers growth, employment, and social cohesion objectives. This approach to capitalism thereby seeks to protect domestic actors from economic disturbances, combining free markets with social solidarity.

The characteristics of the two models are directly relevant to our search for the roots of the EU position in international financial negotiations. Indeed, the expectation here is that the EU will be inclined to support those international measures that are in line with its approach to financial governance and, in particular, with its understanding about what is the appropriate role and purpose of public authority in the regulation of the markets. In other words, the EU will export the characteristics of its domestic model for the governance of financial markets.

When applied to the EU, where more than one model exists, these arguments require specifying what model becomes the dominant EU model. In this connection, it is necessary to analyze the evolution of the EU approach to financial markets as it crystallized in the policies for the single market of financial services. In what follows, I thereby trace the relative weight over the 1990s of the contending conceptions of the political organization of financial markets as enshrined in the neoliberal and the regulated model. Tracing the evolution of the principles guiding EU financial services policies, I am going to show the progressive shift away from the neoliberal to the
regulated model that followed the crisis. This shift, in turn, impacted on the EU agreed position in international financial negotiations.

3. The institutionalization of the neoliberal model in the EU

The creation of a European financial area, based on the removal of restrictions of cross-border capital flows and the creation of a legal framework for a single market of financial services, has been one the major purposes of the EU program to establish a single market since the 1980s (Story and Walter, 1997). The early 1990s Maastricht Treaty further boosted this process by codifying the project of the European Monetary Union (EMU). The 2000 Lisbon strategy, then, with its focus on enhancing structural reforms, put its weight behind the process of European financial integration as put forward by Commission’s Financial Services Action Plan (FSAP). Together with the report by the Lamfalussy Committee (2001), which was appointed by the July 2000 ECOFIN Council in order to adapt EU regulation to the changes in international financial markets, the FSAP provides evidence on the principles that guided the political organization of the financial markets in the EU in the period preceding the subprime crisis.

The Lamfalussy report, released in February 2001, has provided the building block for the creation of financial supervisory authorities at the EU level. In particular, Level 3 of the Lamfalussy framework deals with the cooperation between national regulators to ensure common and uniform implementation of European legislation.3 In this connection, the Committees of supervisors – in the securities, banking and insurance sector – play a crucial role in fostering the creation of a common

3 The Lamfalussy framework initially proposed a four level approach with regard to the legislative process for securities. Level 1 concerns the drafting of the high level objectives that the securities legislation must achieve. At Level 2, the technical requirements necessary to achieve these objectives are specified. The measures adopted at Level 3 are intended to ensure common and uniform implementation across members. Level 4 measures relate to the enforcement of the legislation.
EU approach among national regulators so to facilitate a consistent application of EU legislation. While all regulators and supervisors have objectives around market confidence and investor protection, there are different operational approaches. Indeed, regulators and supervisors have a diversity of powers both in terms of scope and in terms of supervisory and investigative means, and of rule making. For instance, some regulators tend to rely on principles for financial conduct while others adopt more detailed rules.

As far as concerns the principles informing the activities of the EU committees of regulators created on the basis of the Lamfalussy report, the EU regulators and supervisors tend to rely on principles rather than rules in discharging their activities. Indeed, in the attempt to facilitate implementation of EU legislation, the Level 3 Committees produce a number of general recommendations to facilitate coordination among national authorities. The coordinating activities of the Committee of European Securities Regulators (CESR) well illustrates this point. Indeed, the CESR acts as ‘supervisor of national supervisors’ by developing a number of proceedings, such as administrative guidelines, interpretative recommendations, common standards, peer reviews, comparisons of regulatory practice. These coordination tools, however, leave a significant room of maneuver to each national supervisor in deciding the acceptable level of risk in the domestic market. Recognizing the limited regulatory impact of its activities, the CESR (2004, 10) therefore suggested that, should the EU decide to develop more far reaching options to improve the coordination efforts carried out by the Level 3 Committees, ‘the discussions could explore the possibility to provide the Network [of securities regulators and supervisors] with additional legal and supervisory tools.’ Furthermore, the deliberations of the Level 3 committees differ from Level 1 and Level 2 legislation since they are not binding and they are not part of Community law, with the attendant limitations of the committees’ regulatory powers.

Next to the Lamfalussy framework, the dominant EU regulatory approach to financial markets can also be discerned from the measures suggested in the Financial Services Action Plan
(FSAP). The Action Plan, prepared by the EU Commission in 1999, set forth the policy objectives and specific measures to move towards the single market for financial services. In this connection, the FSAP envisaged a number of legislative and regulatory actions. Interestingly, most of these actions were primarily aimed at pursuing the goal of pan-European integration. That is to say, liberalization was the primary regulatory objective of the FSAP proposed measures. For instance, the Commission provided a list of Directives to be adopted or amended, including updating the Directive on reporting requirements, clarification of the Investment Services Directive, and the drafting of a takeover bids Directive. The common denominator of all these legislative proposals is the emphasis put on the removal of outstanding barriers to capital and financial services in the EU market in order to deepen integration and strengthen competition.

The EU internal position was not confined to the domestic level but the pro-liberalization approach also colored its international stance. Indeed, the Communication of the Commission in October 1998 entitled ‘Financial Services: Building a Framework for Action’ made clear that the Commission’s objective was for the EU to take a leading role in the international discussions to maintain a level playing field both within and beyond the EU. Furthermore, in the fall of 2003, after some initial misgivings, the EU lent its support to the revision of the Basel accord, which, as already anticipated introduced the principle of self-regulation in international banking regulation while pursuing the simultaneous goal of creating a level playing field for the industry and ensuring financial stability (Tarullo 2009, p. 34). The Basel II accord was than translated into a new EU capital adequacy directive with no significant change in 2005.

The EU endorsement of the governing principles of the neoliberal model can be traced back to the interaction among member states and, in particular, to the competition among contending understandings about the role and purpose of public authority in the governance of the markets.

---

4 According to Tarullo’s historical account of the negotiations of Basel II, in 2003 the European regulators became intent on producing a final version of the international accord because they were anxious to move forward on a new EU capital adequacy directive.
Specifically, the institutionalization of the neoliberal principles in the EU financial services policies can be understood in light of the British advocacy and the lack of opposition from the advocates of the regulated camp. In other words, the convergence of views around the neoliberal approach to financial market was facilitated by the ‘market-making’ coalition led by the UK (Quaglia, 2008). Furthermore, as Elliott Posner (2009b, p. 185) describes the situation of the time, ‘dissenting voices and potential (often unaware) losers articulated no tractable alternative’.

For instance, it has been widely documented that the UK prevented the emergence of supranational and international policies that could run counter to the domestic interests of the City of London, which was keen on fostering global financial mobility so to enhance its global competitiveness (Augar, 2009, p. 47; Helleiner and Pagliari, 2009). In this connection, the UK mounted a determinate defence against all European and international efforts aimed at strengthening financial regulation (Zimmermann, 2009). Furthermore, next to defending the interests of the City of London, British policy-makers were also acting on a specific mindset regarding the appropriate regulatory and supervisory approach to financial markets. Specifically, a principles-based versus a rules-based approach came to characterize the UK approach to the organization of the markets. In his much quoted November 2005 speech to the annual conference of the Confederation of British Industry in London, the then Chancellor of the Exchequer Gordon Brown (2005) so summarized that approach,

the better, and in my opinion the correct, modern model of regulation – the risk based approach – is based on trust in the responsible company, the engaged employee and the educated consumer, leading government to focus its attention where it should: no inspection without justification, no form filling without justification, and no information requirements without justification, not just a light touch but a limited touch.
With hindsight, the head of the Financial Services Authority (FSA) Lord Turner further clarified the predominant approach to the regulation and supervision of financial markets noting the existence of ‘a political philosophy where all the pressure on the FSA was not to say: “Are you looking more closely at these business models?” but to say: “Why are you being so heavy and intrusive? Can you not make your regulation a bit more light touch?”’ (as reported in Zimmermann, p. 223). As a result, not only did the UK opposed incompatible regulation with its outstanding approach to financial capitalism at the EU level but also at the international level.

Interestingly, however, since the early 2000s, the position supported by the UK for the political organization of financial markets at both the EU and the international level was not seriously challenged by the other largest member states. On the one hand, as already anticipated, the apparent success of the UK model in bringing about economic growth and financial stability put the other countries on the defensive. On the other hand, there was a ‘convergence, or at least the congruence of the preferences of the Member States’ about the regulatory and supervisory framework needed to govern the EU markets’ (Quaglia, 2007, p. 282).

This is not to say that were not differences between the UK and the other large member states about the principles that should guide the regulation and supervision of financial markets. Rather, there are several examples of such a difference. At the EU level, for instance, German sought for guarantees that the Commission would not use its newly gained powers under the reformed regulatory committee procedure to push through legislation that would favour London over Frankfurt as a financial centre (Quaglia, 2007). At the international level, intra-EU contending approaches to the governance of financial markets are well illustrated by the early debate on hedge fund regulation in the Financial Stability Forum, where France and Germany advocated for the use of direct regulation against the UK preferences (Robotti, 2004, p. 18).

In spite of these differences, however, from the early 2000s till the burst of the subprime crisis, the neoliberal model was institutionalized in the EU financial services policy. While serious
contention surrounded the operational implications of the adoption of the neoliberal governing principles, they nonetheless became enshrined in the political organization of the EU market influencing the EU international regulatory stance.

4. Towards the endorsement of the regulated model

In the aftermath of the subprime crisis, the validity of the neoliberal model, as a model able to bring about economic growth and financial stability, had started been questioned among academics and the general public alike (Helleiner, 2009). According to Nouriel Rubini (2009), for instance, the pillars of the financial supervisory system of the past decade have all failed, including the principles of market discipline and light-touch and self-regulation. Interestingly, this kind of rethink of the previously dominant regulatory approach has become common even within the group of policymakers that had supported the institutionalization of the neoliberal model in the EU financial services policies.

Within the UK, for instance, the Chairman of the Financial Services Authority (FSA) Lord Turner well summarizes the growing skepticism towards the principles that have underpinned the governance of financial markets until recently. In his words, ‘the financial crisis has challenged the intellectual assumptions on which previous regulatory approaches were largely built, and in particular the theory of rational and self-correcting markets’. ‘Much financial innovation has proved of little value, and market discipline of individual bank strategies has often proved ineffective.’ (Financial Service Authority, 2009). In a similar vein, the Prime Minister Gordon Brown went public recognizing the importance of the role of governments to regulate the markets. In his words, ‘I have learned from this financial crisis that the disciplines we expect of markets cannot be guaranteed without strengthened supervision.’ Recognizing the need to change, he also concluded that ‘the 1997 supervisory system was right for the circumstances we faced then;’ the crisis,
however, calls for a new regulatory and supervisory framework (Telegraph, 15 March 2009). Reflecting on banking regulation, even the Governor of the Bank of England Mervyn King (2009), called for reducing the discretion accorded to the private sector in assessing risk, while conceding that at all forms of regulation, whether light or heavy touch ‘failed to some degree to prevent the accumulation of risks’. In other words, what these public pronouncements show is that the British policy-making elite is undergoing a process of intellectual reassessment of its thus far preferred approach to financial markets. Interestingly, then, such an intellectual rethink is taking place absent significant changes in the country’s political economy. That is to say, the domestic financial industry continued opposing most of the new proposals to regulate the markets coming from Brussels or from the international bodies.

The mirror image of the British elites’ intellectual rethink has been the debate on financial regulation within the European Union. Indeed, with the UK in a defensive crouch in the background, the EU institutions have developed a number of proposals to centralize supervision of financial firms at the EU level (de Laroisière, 2009) and to tighten controls on hedge funds, tax havens, and credit rating agencies while increasing protection for bank depositors. Whereas it was believed that market actors could look after themselves and contribute to economic growth and international financial stability, the predominant view in Europe today seems to be that markets require strong regulatory mechanisms to function effectively. The French President Nicolas Sarkozy even concluded that ‘a page has been turned’ on an era of post-war ‘Anglo- Saxon’ capitalism (as reported in Parker, et al. 2009). The shift in the regulatory priorities and in the role accorded to regulation in the EU is clearly put in the EU website, where it reads that it was only after ‘the outbreak of the financial crisis in 2008 [that] the stabilization of financial markets became a priority and financial sector reform a crucial instrument to achieve it.’

---

5 European Commission, DG Internal Market, Financial Services - General Policy, Available at http://ec.europa.eu/internal_market/finances/index_en.htm accessed March 1, 2010
revision of the Capital Requirements Directive, the European Council referred to ‘work to strengthen the rules on stability’ (Council of the European Union, 2008, p. 3).

The EU position in favor of strengthened and stability-oriented financial regulation did not remain at the domestic level but has been projected to the international negotiations convened to discuss the reforms to the international financial architecture. This is well evidenced by the EU leaders’ agreed language negotiated before the G20 summits. Indeed, in these documents, EU leaders agreed to support the expansion of the scope of public authority in the governance of international financial markets, and to ensure sustainable growth and development.

For instance, in the preparation to the London G20 summit (Council of the European Union, 2009a, p. 15), the EU Heads of state and government agreed to pursue a G20 agreement based on the recognition of the crucial role of intergovernmental cooperation and thereby of public authority in the governance of financial markets. In this connection, EU leaders agreed to support an international agreement aimed at strengthening and expanding public regulation and public international organizations, including by ‘improv[ing] IMF surveillance instruments in order to strengthen its key role in crisis prevention’. They also agreed to ‘very substantially increase IMF resources’ as the guiding principle in the reform to the international financial architecture.

Furthermore, the EU Heads of state and government (2009a, p. 17) committed to foster a G20 based on ‘rigorous enforcement of financial regulation and transparency, backed by effective, proportionate and dissuasive sanctions, in order to promote integrity in financial markets.’ They also specified that ‘review[ing] conduct of business rules [was meant] to protect markets and investors, as appropriate across different sectors and markets’. In this environment, making markets and market actors accountable to political power has become a keyword among EU policy-makers. For instance, the October 2008 Presidency Conclusions reads that, ‘the European Union must work with its international partners on a genuine, all-encompassing reform of the international financial system based on the principles of transparency, sound banking, responsibility and world governance’ (Presidency Conclusions, 2008, p. 5).
Finally, the importance attached to the measures aimed at sustaining growth while sheltering the most vulnerable social groups in the society also appears on top of the EU leaders’ agenda for international financial negotiations. On the one hand, the international counterpart of the measures aimed at protecting the most vulnerable social groups is represented by the EU leaders’ commitment to keeping open markets and pursuing the Millennium development goals in order to help developing countries achieve sustainable growth in spite of the tensions if the financial markets. On the other hand, the EU leaders have advocated for the endorsement of a ‘Global Charter for Sustainable Economic Activity’ as a first step toward a set of global governance standards (Council of the European Union, 2009a, 2009b). As the EU Heads of state and government put it in the preparatory document to the G20 Pittsburgh summit (Council of the European Union, 2009b, p. 2), the Charter should ‘reaffirm principles of responsibility, sustainability and transparency’.

The convergence of EU member states on the proposals agreed in the preparatory documents to the G20 summits can be explained in light of the UK rethink on its preferred approach to the political organization of financial markets and of the pressures coming from the other largest EU countries acting on the contestation of the neoliberal model. For instance, Germany and France were advocating more strongly than ever a far-reaching shift towards a more regulated financial system. In a programmatic speech in the German parliament on 15 February 2008, Finance Minister Steinbrück drew attention to the role that public authority has to play in the governance of the markets by emphasizing the continental tradition of according the state a central role in ensuring equal opportunities for all market participants (as reported in Zimmermann 2009, p. 218). Furthermore, on the heels of the near-bankruptcy of one of its commercial bank IKB, Germany took position against the self-regulation principle that had been prevalent in the international regulation of the banking industry (Benoit 2008). As the French Finance Minister noted with reference to the banking crisis, ‘what happened 12 months ago was just horrible for our societies, it was horrible for our economies’. She then concluded that ‘if we want to avoid a recurrence of the crisis we need to
change the rules.’ (Financial Times, G20 rift opens on banking reform. September 4, 2009). In other words, the new rules for banks should make sure that financial institutions are at the services of the economy and not the contrary.

Interestingly, however, the UK did not oppose the EU calls in favor of enlarged and strengthened regulation at the EU and the international level. For instance, at the March 2009 EU summit in Brussels, which preceded the London G20 summit, Gordon Brown endorsed the proposals favoring tougher regulation, including the regulation of hedge funds and private equity funds where they might pose a systemic risk (Financial Times, Prime minister gives ground over regulation, 21 March 2009). This is not to say that the UK uncritically accepted the new regulatory proposals for the international financial system or that it experienced a fundamental reordering of the aims of its economic policy (Hodson and Mabbett, 2009). Rather, serious bones of contentions remained as attested by the debate on bank bonuses before the Pittsburgh summit when France pressed for mandatory caps, but the UK distanced itself from the proposal (Barber, 2009). Nevertheless, in spite of some of the British misgivings, the UK ultimately echoed most of the official regulatory goals set out by the European Commission and the other large EU member states.

In sum, on the heels of the subprime crisis, the EU regulatory approach to financial markets at both the domestic and the international level had started shifting away from the set of neoliberal principles towards a set of principles staked on the assumption that public authority has to actively intervene in the regulation of the markets while pursuing the goal of stability and social protection. The content of the new regulatory policies advanced in the EU well reflects the contestation of the previously dominant neoliberal model and the progressive endorsement of the regulated one. France and Germany’s advocacy, on the one hand, and the British intellectual rethink, on the other, combined to make this shift possible. This shift also had implications for the EU international stance. Indeed, EU leaders agreed supporting those initiatives that are compatible with the principles of the regulated model.
Conclusions

Along with the short-term problems associated with managing the crisis, the subprime crisis has also raised several questions related to the long-term governance of financial markets. Indeed, the crisis has showed the inadequacy of most of the existing rules and supervisory practices. In this connection, several proposals have been advanced to make the financial system more resilient to crises. The EU has been one of the most active actors in the debate to reform the international financial architecture. In particular, the EU has suggested the adoption of measures aimed at enlarging the perimeter of regulation and reducing the reliance on market discipline to stimulate growth and ensure financial stability. The EU has thereby envisaged a more direct role for public authorities – be they national or international, such as the international financial institutions.

Investigating the EU position in the international negotiations, the paper has argued and illustrated that the EU position has been shaped by a specific approach to the governance of the financial system, namely, by what has been here defined as the regulated model of financial capitalism. The model is staked on the principle that public authority has a primary role to play in governing the functions of financial markets. Furthermore, the purpose of public intervention has be directed towards ensuring the stability of the financial system as whole while protecting jobs and the most vulnerable groups in the society. Drawing attention to the normative adherence to a specific set principles as a crucial factor that shapes the behaviour of the actors involved in the EU financial governance, the paper has nonetheless argued and illustrated that today’s progressive endorsement of the principles characterizing the regulated model cannot be fully understood but in the context of the political battle through which principles are debated and selected. Indeed, the shift to the regulated model can only be understood as the result of the political contestation of the previously-dominant neoliberal model that had been largely instantiated in the EU financial services policies in the decade that preceded the subprime crisis. In particular, the subprime crisis has
brought about a rethink of previous regulatory models within the UK policy-making elite and has stimulated the activism of the advocates of contending models – such as Germany and France.

Whether the contestation of the neoliberal model that has emerged on the heels of the crisis will lead to the permanent deviation in the international financial system and in the EU financial services policies is probably too soon to be told. As has already noted, the debate on the reforms to the international financial architecture is far from being settled. Hence, it is hard to claim that the case for a more strengthened role for public authority, for instance, has definitely won. Although policy makers of all stripes and countries have announced to bring the financial system under control, few policies have actually been delivered in this respect, raising the question of whether the political resolve to regulate will be maintained in the coming months. At the time of writing, for instance, most of the EU new regulatory proposals have still to be adopted by the European Council and Parliament. Furthermore, although there has been a shift towards the regulation of markets and actors previously left outside the public regulatory oversight, the content and the purpose of that regulation are not significantly different from those of the recent past (Pagliari, 2010).

Identifying the sources of the EU position in international financial negotiations in the adherence to a specific model of capitalism, and in particular, in a specific understanding about the governance of financial markets, the paper attempts to advance both theoretical and policy debate. In particular, tracing the debate about regulatory measures adopted with the aim of ensuring global financial stability, the paper suggests the emergence of important changes in the EU financial governance. In particular, the findings of the paper indicate that the EU has changed its financial regulatory priorities by giving financial stability prominence over the objectives of ensuring competition and a level playing field in the internal market.

Finally, although I did not investigate the extent to which and the mechanisms through which the EU position was endorsed at the international level, the paper also seeks to drawn some insights about the influence of the EU in international financial regulation. In particular, the EU position in international financial negotiations raises the question of whether we are going to
witness growing transatlantic tensions or even to a shift of power between the EU and the U.S. For instance, the debate over the shape of financial regulation and the EU directive on hedge funds has raised significant tensions between the two sides of the Atlantic. The U.S. Treasury Secretary Timothy Geithner, in a letter to Michel Barnier, Europe’s internal market commissioner, voiced concern about ‘various proposals that would discriminate against US firms’ (Financial Times, France and UK seek hedge fund deal, 11 March 2010). Not only does the EU current regulatory stance raises concerns about the transatlantic leadership in forging the rules of global finance. It also raises a question about the relative power of the U.S and the EU in forging those rules. For instance, after having criticized the free market ‘Anglo-American’ financial principles, the German finance minister, Peer Steinbrück, also predicted that a more ‘multipolar’ global financial system would emerge from the crisis. As he put it, ‘America will not be the only power to define which standards and which financial products will be traded all over the world’.6 Analyzing the EU-US financial disputes, Elliot Posner (2009a) has also recently concluded that, because of the centralization of EU financial governance, the EU-US regulatory financial relationship has been redressed in favour of the former. The findings of this paper add to these insights by suggesting that the rapprochement of the UK to the other large member states is likely to increase the EU leverage on the content of international financial rules. Furthermore, if ‘in the past, the endorsement of market discipline and self-regulation in international rules was largely a product of the preferences of the U.S. and Britain’ (Helleiner e Pagliari, 2009), the fact that the crisis has at least called into questions these preferences may lead us to expect an increasing role for the EU in the design of the rules for the international financial system.

References


