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The dual nature of Europeanization: divergent national mechanisms to common monetary and securities markets policy

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1. Introduction

Europeanization has increasingly become a fashionable term. While in the past years the term has been primarily used within the context of EU policy making, in recent literature authors have widened the scope of the term to identify both supranational and national levels of analysis and often have incorporated an interactive component. For example, Börzel labeled Europeanization "a process of adaptation and adjustment by parties to changed conditions within their domestic political systems" (Börzel, 1999). Olsen builds on this concept by exploring different responses to adaptive pressures across member states shaped "by long, strong and varied institutional histories, with different trajectories of state- and nation-building, resources and capabilities" (Olsen, 2002). In addition, Schmidt not only agrees that national institutional patterns matter, he creates a framework of analysis in the form of a cost-benefit approach according to the member states institutional differences (Schmidt, 2004). These definitions recognize the importance of including mediating factors in understanding member states' approach to Europeanization. This thesis intends to further this recognition by evaluating the influences of specific mediating factors on different national mechanisms to Europeanization. It then illuminates potential benefits of these mediating factors within the context of integration of European securities markets.

This thesis aspires to advance analysis of mediating factors by incorporating the impact of European integration on member states in terms of policy and institutional changes. Critical to this examination is the inclusion of the "goodness of fit" concept as well as a cost-benefit analysis. Given the significant role of the fit between member states, EU policy and institutional structures, a broad understanding of the compelling role of mediating factors in state response allows for the most thorough and ultimately credible data. Since loose fit with EU entails lower national sovereignty over financial arenas, these factors are essential for shaping national adjustment mechanisms in order to respond to EU changes. Not only is the understanding and acknowledgement of these factors invaluable in the exploration of how and why national policy and institutional structures are altered but it also proves central in determining the level of policy and institutional convergence which then take place among member states.

It is argued that the most appropriate argument proposed to explain changes in national responses to Europeanization throughout time can no longer be solely given as: *"Member states adjustment to Europeanization is a complex process shaped by the act of dual factors that stream from both national and supranational level."* This thesis proposes that this explanation is too narrow. It does not fully recognize the importance of mediating factors that vary among countries which shape domestic responses to European policies. It needs to be broadened to include the recognition of the significance of these factors and the roles and implications that the varying differences in these internal mechanisms within nations play in the differing levels of national adjustment. A more accurate description would therefore need to include these mechanisms as they are critical in explaining how as well as why shifts in the adjustment of mechanisms to EMU and securities market integration occur. This thesis proposes through in depth analysis how and why changes in governance preferences, institutional differences, economic vulnerability, timing or number of veto points best explain the shifts in national policy preferences to Europeanization. In fact this thesis argues that these differing policy preferences (dependent variable) are in fact explained best through the differing mediating factors (independent variable). Through extensive analysis it is clear that the inclusion of mediating factors are required in order to gain an accurate understanding of the differing consequences of either inertia, transformation, accommodation or retrenchment be fully explained.

These conclusions are the result of a rigorous data analysis contrasting countries that vary in 1) institutional structure (unitary or federal state); 2) empowerment and capacity of political actors to influence final decisions and or 3) degree of economic vulnerability to external pressures. To strengthen the data, different mediating factors and their influence on a country's response to Europeanization should be evaluated through EMU and securities market integration pressures as examples of hard and soft convergence demands respectively. Within this thorough exploration of differences between EU states is a comparative analysis of the economic basis of political power in three member states and its ability to fully implement EU directives. Here the focus is on policy responses of three influential member states: France, Germany and Great Britain. These countries vary not only in national market structure but also in the structure of their decision making processes. In the cases of France and Great Britain these are referred to as unitary as opposed to Germany which is federally organized. Also they are selected as the most different cases in their response to Europeanization, given the significant difference in institutional capacity, economic preferences and politics. These differences, in turn, have implications on varying levels of state capacity to respond to and apply various EU pressures over time. Hence, these countries have not only dominated the EU financial markets and negotiations, but also represent three different approaches to EMU and securities markets liberalization according to the market structure, policy preferences already in place and organization of the state itself, making them interesting cases. In addition, different study designs may be needed in attempting to explain different degrees of Europeanization between the countries, and trying to understand the role and the link between indirect effects and EU pressures on the policy change.

This thesis extensively compares and discusses the centrality of mediating factors in shaping national responses to EMU and securities market integration. By extensive exploration and illumination of the differences between varyingcountries's approaches to EMU and securities market integration, directly addressed will be the main research question:

"What are the factors that express different national preferences to Europeanization and hence, result in distinct adjustment mechanisms to common monetary and securities markets pressures"?

This question reveals intensive debate on specific conditions that lead to particular dynamics of mediating factors and forms of adjustments in order to cut policy accommodationcosts. This debate is clearly shown to require the explicit inclusion of the before mentioned independent variables. The process of Europeanization and its different impact on member states' policies as the result of the institutional fit and loss-gain equilibrium is critical. Consequently it is of great importance to examine mediating factors and their influence on member states adjustment mechanisms as the way to argue that changes in policy preferences are driven and endorsed by the costs and benefits of such adjustments.

To continue the argument, this paper will first recall the explicit definition of Europeanization, emphasizing its boundaries and area of influence which follows Olsen's theoretical framework that addresses specific questions on Europeanization. He addresses *what* is changing and *how* changes take place (Olsen, 2002). In the next chapter, we will present and analyze some of the adjustment mechanisms defined by Radaelli (2000). We continue through research on the mechanisms variations across representative member states (France, Germany, and Great Britain). In our final chapter we will broaden our analysis to include securities markets integration using the same adjustment mechanisms pattern. This approach will help us to compare and discuss changes in dynamics and influence of mediating factors in different stages of Europeanization process as well as shifts in national adjustment mechanisms. We will conclude with differences between country's responses to different Europeanization pressures that are catalyzed through highly defined convergence criteria and loosely given securities market policy and changes in indirect factors that shape divergent policy outcomes. The thesis argues that mediating factors that occur on the national level are the main determinant of national responses to Europeanization. In addition it suggests that they operate differently in different member states at different times.

1.1 Different meanings of Europeanization

The first chapter examines the roots of the Europeanization phenomenon and different labels which are attached to it. It also exposes different definitions of Europeanization and analyzes two main approaches defined in economic literature: 1) the "top down" approach and 2) the "bottom up" approach. In particular, this chapter intends to explain uses of the term Europeanization and different stickers posted in literature. The survey of literature on the Europeanization phenomenon reveals the diversity in notions and statements of what Europeanization really is and how it creates changes in national contexts. It will be interesting to bring together and discuss how different authors apply different meanings to Europeanization. Glancing at the theories on Europeanization will help us distinguish its main purpose: effects and empirical implications on a country's road to EMU and securities markets integration. This discovery will illuminate crucial differences between the terms of Europeanization and European integration as we focus on the uses of the two terms in explaining national policy and institutional change.

In addition, this chapter establishes modes in which Europeanization exerts pressures on member states, making distinctions with the concept of globalization. As will be discussed in this thesis, Europeanization is more than globalization: not only does it craft economic pressures similar to globalization but it also acts as shield against them. Therefore, we will try to explore the Europeanization features in order to distinguish and contrast the concepts of Europeanization and globalization, comparing the notions of within the context of their influence and surrounding discourse in national adjustment mechanisms as response to these pressures. To illustrate this we will give a definition of the two phenomenons and directly illuminate the differences between the concepts of globalization and Europeanization. Given such differences between globalization and Europeanization one can make distinctions between these two phenomena and observe their impact on both national policy and institutional adjustments.

Hence, the main purpose of this chapter is to introduce the reader to the concept of Europeanization. It will orient the reader to its main ideas as well as the ways it influences changes in national policy and institutional structures. It will include the other the two way process in both directions examining a country's adjustment mechanism to Europeanization as well as the possible patterns that arise from it.

In order to avoid too much generalization we will extract a few of the main uses of Europeanization. These will emphasize European integration as the development of institutions of governance at the level of the EU including ways in which national systems of governance converge and penetrate the common monetary framework. These findings will hence be utilized in following chapters as useful tools to utilize for further research on Europeanization of securities markets. In addition, this chapter will incorporate comparisons between national responses to EMU and the Europeanization of securities markets. Subsequently it will create linkages between the most influential mediating factors and specific adjustment mechanisms chosen by the before mentioned countries included in the study.

1.2 National adjustments to convergence criteria

The second chapter is mainly interested in empirical applications of the theories defined in the first chapter. In particular it focuses on adjustment mechanisms and their variations among countries in response to the Maastricht convergence criteria, as an example of highly specified rules. In the EMU flow chart there were three events that lead countries toward monetary union and a single monetary currency. The first event that resulted in the creation of monetary union were global economic shocks. These pressures were neutralized by the creation of monetary unity and introduction of stable but adjustable exchange rates. All countries were committed to adjust their currencies to proposed fixed exchange rates in order to preserve monetary sustainability and price stability. But before all countries started with the process of economic convergence that were introduced by the Maastricht Treaty criteria as final stage, they developed European monetary system as ticket for members states to adjust their monetary policies at the entrance to an EMU. In particular, we want to discuss why member states converged on distinctly different patterns even though the degree of economic and policy convergence introduced by the Maastricht Treaty were very high.

However, at this point thesis differs from previously set Schmidt's theory on different degrees of adjustment pressures and to them responding adjustment mechanisms, where she argues that the case where an EU decision requires member states to follow a highly specified set of rules and comply with it, the adjustment mechanisms potentially involves a high degree of coercion (Schmidt, 2002). The thesis argues that separation of adjustment pressures and mechanisms is warranted in order to examine how changes in political preferences, institutional organization or other mediating factors shape county's response to Europeanization, defining difficulties that member states experience on they road to EMU and tied monetary policies. In particular, changes in mediating factors and their influence on member states preferences towards EMU will be tested. Difficulties on country's rocky road to EMU will hence, become apparent in this chapter. Nevertheless, these findings contrast Schmidt's argument about the predictability of national adjustment mechanism as response to particular pressures from the top. This outcome will subsequently shift the focus of our study from analysis of supranational pressures down to variations in mediating factors as main generator of change at national level.

In addition, this chapter will also cover the concept of optimum currency area that is traditionally used as guide in explaining countries monetary divergence, using cost benefit framework. Therefore, we will give slight survey of this part of the literature seeking to determine weather prospective EU members that created optimal currency zone enjoy more benefits than countries that stayed outside. Some of the findings on link between optimal currency area membership and level of convergence to Europeanization principles are important for research design of this paper because it emphasizes that countries with high levels of convergence and optimal currency area membership display considerably more convergence and are considered as potentially eligible participants for successful liberalization of their securities markets under Europeanization.

In sum, France, Germany and Great Britain had different positions on monetary convergence that reflected their domestic preferences and capacities for change. Nevertheless, it is interesting to observe and analyze changes in mediating factors across countries in the process of monetary convergence. While one country struggled to impose changes within the diffused system of decision making which involves vide range of actors (Germany), other one didn’t have easy time to fully meet the criteria because of its high economic vulnerability to external pressures (France). The third country had limited access to convergence criteria since it opt out form the Maastricht Treaty principles (Great Britain), turning more to domestication that Europeanization of its monetary policy. Within clearly defined the Maastricht Treaty terms it stays to be analyzed why representative member states highly diverged resulting in policy discourse.

1.3 Europeanization and securities markets liberalization

The final chapter exposes member states response to Europeanization of securities markets, with emphasis on mediating factors that determine country’s preferences toward single securities market. This volume especially examines the degree of fit between the mechanism pattern used in country’s response to convergence criteria (presented in the second chapter) and model used for Europeanization of securities markets. It considers changes in mediating factors in both cases of Europeanization, in particular to three selected countries with different institutional arrangements and political preferences, and assumes how these different national settings can contribute to divergent policy outcomes. Hence, this chapter compares and draws conclusions about the fit or misfit between adjustment mechanisms used in different stages of Europeanization and examines influence of mediating factors such as political actors and institutional structure on changes of member states attitudes toward European monetary union and Europeanization of securities markets.

This chapter begins with brief overview of EU securities market regulation and institutionalization that seek to introduce reader with the process of European integration and creation of new set of policies and institutions at European level. The emphasis will be on the most important policy and institutional features of newly created supranational framework that includes creation of Financial Service Action Plan (FSAP), as guide to single securities market, and establishment of Committee of Wise Man.

Second part of the chapter refers to comparison between adjustment mechanisms toward EMU and securities market Europeanization. This comparison will certainly reflect changes in key mediating factors that produce dissimilarity in countries response to EU pressures within given time dimension. Therefore, as member states included in the study did not converge on similar patterns to EMU it will be interesting to analyze and discuss what the implications are of such behaviour on securities market integration? This issue refers to the core element of second research task that examines influence of key mediating factors, especially changes in institutional arrangement within EMU, and on national approach to Europeanization of securities markets.

At this point we will test Schmidt's assumption that more specified EU rules imply higher degree of national policy coercion and vice versa. As it will be discussed later, this assumption goes in the line with county's approach to EMU and highly defined convergence criteria, but it also shows some odd effects in the case of securities markets Europeanization. Therefore, our research on national adjustment mechanism will help us to explain and understand why member states converged more in the case of securities market liberalization. It adds to our understanding of how countries that assumed different mechanisms to EMU shift their preferences in setting rules for securities market regulation, willing to join single market on more converging basis. By illuminating the influence of EMU on changes in monetary systems as central and sensitive element of public finance that subsequently loosened national economic vulnerability to external pressures and shifted political preferences toward Europe, the chosen research design provides advantages for understanding of national responses to Europeanization, that are sometimes contrasting to conventional explanations of policy and institutional change.

The final volume combines insights from research founding with preliminary set proposition on the effects of EU directives on member states throughout Europeanization.

1.4 Theoretical framework

Europeanization is a relatively new term that has recently emerged as a key topic in the studies of the European Union. One of the major debates in this research field centres of the question as to where are the boundaries of Europeanization and how it differs to rather similar concepts of globalization and European integration. At the same time, an expanding subfield of Europeanization (Radaelli 2000, Börzel and Risse 2001, Scharpf and Schmidt 2001, Hall and Soskic 2001, Schmidt 2002) has generated the insight that member states use different national mechanisms in response to common European challenges.

Therefore, the best way to address the question how Europeanization influence changes at national level is to get to grips with different definitions of Europeanization that emphasize different uses of the concept that mostly overlap (Olsen 2002, Lawton 1994, Cowles and Caporaso 2001). Yet we also want to dismantle the concept of Europeanization as interactive two-way relationship emphasizing the influence of European institutions on member states level or embodying of national preferences into the EU structures. The first approach refers to studying of top down approach and it is very important in illustrating how European integration matters (Börzel 2002, Ladrech 1994, Schmidt 2002, Dyson 2002) while latter one adopts bottom up approach analyzing impact of national mediating factor on Europeanization process (Radaelli 2000, Heritier 1999, Wallace and Wallace 1999, Risse 2002, Olsen 2002). Although, both concepts can be applied to further analysis we will focus on the latter in order to get more comprehensive picture how changes at national level occur under common EU pressures.

The literature about success and controversies of EMU and comparative analysis of changes in monetary systems across member states abound. One of the major debates in why countries with similar institutional structures and political preferences use different adjustment mechanism to monetary union (Donnelly 2004, Steinher 1989, Schmidt 2002, Dyson 2000). There are numerous studies that emphasise differences in countries response to EMU and degree of policy convergence. In addition, authors have sought to concentrate on particular country trying to give more precise meaning underlining changes in mediating factors that resulted in different patterns to Europeanization. For example, authors like Dyson and Featherstone (1999), Eichengreen and Frieden (1994), Maes (2004), Marcussen (1999), and Moravcsik (1998) were mostly interested in French case of Europeanization. Other authors like McNamara (1994), Gilpin (1982), Donnelly (2004), and Lohman (1994) emphasized obstacles and dilemmas that Germany faced on it way to EMU. Finally Great Britain, as the only country that opted out of the Maastricht convergence criteria and stayed inert in the face of pressures from the top, has become the key theme in studies of Mulhearn and Vane (2003), Dyson (2002), Risse (1999), Schmidt (2002), and Howell (2003).

While European monetary integration became a key issue of an EU studies, Europeanization of securities markets has just recently started to emerge. Most of the studies that tackle this issue refer either to the origins of European securities market integration and creation of policy and institutional structure Licht (1997), Ferran (2004), Moloney (2002), Ásgeirsson (2004) or implications of securities market integration on national policy and institutional changes (Lütz 2000, Story and Walter 1997).

Both of these bodies of literature are of the recent nature, leaving the room for further analysis and contributions. Hence, it can be enhanced significantly by examining the concrete effects of Europeanization on changes in monetary systems and securities markets at national level. Therefore, we found interesting to clearly identify the challenges entailed in increasing European integration and its effects on national monetary arrangements and securities markets liberalization. The main aim of thesis is to bridge emerging literature on European monetary union and securities market integration and engage both in order to critically examine some of its concepts, like goodness of fit and loss-gain equilibrium in analyzing response strategies in three member states- France, Germany and Great Britain. In doing so, we can argue that differences in national response to Europeanization and variations of adjustment mechanisms across countries are critically shaped throughout time by national characteristics of mediating factors, such as policy actors, existing institutional structure, economic vulnerability and number of veto points.

2. Europeanization

This chapter initially looks at the concept of Europeanization as it has been explained by various economists in the recent past. After providing a glimpse into the literature available on Europeanization and its effects on member states, the chapter will begin to clarify more specific components of the concept offering a fresh set of tools for analysis. Variables will be assigned to generators of change in order to help understand varying patterns of adjustment. Ultimately this chapter will contribute to a more comprehensive understanding of the notion of Europeanization.

After a deepening explanation and understanding of the term Europeanization, national variables is important before we identify different national variables as key factor to be considered when explaining different national responses to common EU challenges. In later stage we will elaborate more on the implications of different national responses that lead to policy divergence, and that can fit in selected monetary and securities policy field equally well.

2.1 Meanings of Europeanization

Recently a lot has been said about Europeanization. The term has been defined loosely defined by economists and has a variety of connotations among laypeople.In order to attach more concrete meanings to the term, this chapter will both gather and analyze predominant economist's explanations of it. Attempts to establish a more precise definition is crucial as it is so often employed by economists. Only with a concrete definition can its influences be accurately analyzed. While the concepts may over-lap at points, Europeanization is not simply a synonym for institutionalization on the supranational level or changes in national policies under EU pressures. It is rather a more interactive concept incorporating the two-way influences by all actors and policies on both the European and member states level.

Hence, to better understand what Europeanization really is, how it matters for member states and what is changing under its influence we will enclose a classification of some of the representative theories that consider this issue. Therefore, proposed course of action towards Europeanization is to separate phenomena into three dimensions referring to appropriate theoretical framework defined by Olsen (2002). Henceforth, each part will address specific question on Europeanization that is *what* is changing under EU influence and *how* changes take place.

Also, I would like to make a short remark about the fact that different authors assigned different meanings to Europeanization it's not a problem *per se*. Better understanding of those theories and emergence of relation between them may help us to give better explanation of the development, impacts and effects of Europeanization. Therefore, the first part of this chapter will present two different approaches to Europeanization in order to link subsequently these two bodies of Europeanization phenomena.

What does Europeanization mean? Use of the term Europeanization is really broad and can be found in work of sociologists, economists, social anthropologists, and political scientists. Since we are interested how Europeanization creates policy and institutional changes on national level the focus of our research task will be narrowed on the latter case emphasizing political dimension of Europeanization. Our concerns here will be Europeanization as two way process under which changes on both national and supranational level occur. In particular we will include theories that emphasize creation of supranational institutions, rules and policies and their effects on changes at national level. The former approach emphasize Europeanization as the process of institutionalization on the supranational level and evolution of European rules and policies (European integration) while latter refers to influence of these new institutional structures on policy changes at national level. Nevertheless, the first approach overlaps with the concept of European integration, and therefore, it is important outline differences between concepts of Europeanization and European integration. This issue will be addressed in the second part of this chapter.

Both top down and bottom up approach encompasses transformation component weather national response as result of signals from the top, or changes in European policies and institutions themselves. But still they remain uncompleted suggesting only one dimension of Europeanization where interactivity and relation between actors and institutions at both levels remain vague. Attempts to include all dynamic elements of the process, later studies highlighted Europeanization as interactive two way relationship between EU and member states.

For the long time, theories of Europeanization have been mostly concerned by changes in national policies and institutions analyzing the impact and dynamics of European rules and policies on domestic structures. Significant U turn in Europeanization theory is made by seminal article of Robert Ladrech on Europeanization and political parties (Landrech, 2002). He made a step forth to more precise meaning of Europeanization defining it as *process*: "Europeanization is an incremental process re-orienting the direction and shape of politics to the degree that EU political and economic dynamics become part of the organizational logic of national politics and policy-making"[1]. To put in other words, Europeanization produces changes in domestic policies and institutions as adaptive response to European challenges. Yet, while Ladrech observed Europeanization as the process by which member states alter their policies and institutions in response to EU pressures, it cannot be considered as linear or single line approach. Not to create confusion of Europeanization as convergence process where national responses to EU influence are harmonized, even though this might be one of the possibilities, Ladrech (2002) upgraded its definition emphasizing variables that shape the process referring to when and how EU influence has been penetrated into national policies and institutions. As he emphasized "there would be national specific adaptation to cross national inputs" explaining that type of change differs according to the type of challenge coming from the top and national pattern designs as mix of political, cultural and economic variables. All these conditions shape countries response to the penetration of EU rules into domestic policies. This Landrech's observation on variables that shape Europeanization effects on domestic policies and hence, result in different reform outcomes is useful input for

[1] Dr Robert Ladrech: **Europeanization and Political Parties: Towards a Framework for Analysis,** Queen's Papers on Europeanisation, Number 2, 2001, pp. 3

our research work. His definition of Europeanization as process also implies responsive patterns on national response to common EU challenges.

Following the same approach to Europeanization, we may define Europeanization as dynamic process conducting changes at national level through development of institutions at European level or as Cowles and Caporaso (2001) put it: “The emergence and development at the European level of distinct structures of governance”[2]. Power and influence of these newly formed institutions on the EU level are realized through “development of formal and informal rules, procedures, norms, and practices governing politics at European, national and subnational level” (Cowles and Caporaso 2001). In this sense, Europeanization straits pressures through boost of institutional centralization that creates rules and determines extend up to which domestic policies and institutions has to change in order to comply with supranational policies. But if we want to give more precise meaning of Europeanization, then its notion of process that includes EU policies creation or European institutionalization has to be different including variables that shape national policy responses to European influence. According to this remark, Cowles and Caporaso (2001) noted that the change would not occur if there is no “misfit” or “mismatch” between supranational and national policies that is “the lower the compatibility between European and domestic processes, policies, and institutions, the higher the adaptation pressure “. These new dimensions embrace when and how changes occur and hence, are very important input for further case study design on national adjustment mechanisms to Europeanization.

Similarly, Lawton (1999) suggests that Europeanization is *de jure* transfer of sovereignty to the EU level not getting involved in further explanation how and in what way member states agree to cede part of their sovereignty to the supranational level. Therefore, he forgets to mention under which circumstances changes occur and the way member states respond to changes in EU policies and institutional arena. Even though, Börzel(1999) followed the same pattern putting Europeanization in the frame of national dependence to European policy decision making, her approach specifies what happens next when domestic policies transfer part of their sovereignty to European level. She defines Europeanization as “a process by which domestic policy areas become increasingly subject to European policy-making” (Börzel, 1999). Even though this approach needs further specification it shows that European actors and institutions have profound impact on domestic policies in which they shape EU impacts as much as they adopt them. In these definitions Europeanization is illustrated as independent variable which influences changes in national policies and institutions (dependent variable).

Wallace following the same path of Europeanization as process defines it as: ”embedded feature which frames politics and policy within the European states” (Wallace, 2000). To put it in different words, framing in this context has dual meaning. Fist of all, Europeanization creates a frame around national context leading to convergence or harmonization of national policies. But as institutionalization andchanges on the supranational level are not sufficient incentives per se for changes on domestic level analysis of Europeanization has to include other dimension of framing where national response to changes in European policies has been shaped in order to fit into existing national pattern.

[2] Maria Green Cowles, James A. Caporaso: **Transforming Europe: Europeanization and domestic change**, Cornell University Press, 2001, pp. 1

Drawing upon this definition, Liebert (2002) argues that convergence embodied within shared frameworks does not necessarily promote uniformity rather "frame convergence is conceived as compatible with domestic diversity, and, depending on it must be expected to come in multiple forms of outcomes".

This line of thought corresponds to Radaelli's definition where he adds that "Europeanization is not convergence, although may be one dimension of Europeanization, as it may also produce divergence"(Radaelli 2000). Therefore, his concept of Europeanization refers to "a set of processes through which the EU political, social and economic dynamics become part of the logic of domestic discourse, identities, political structures and public policies"(Radaelli 2000). The central element of Radaelli's definition is dynamic component of Europeanization where EU rules and policies have been transformed by the adaptive response of domestic actors and institutions. His definition emphasizes importance of domestic structures in accommodation to European rules and policies, but does not mention importance of institutionalization at the supranational level.

To wrap up, by putting different concepts of Europeanization we may argue that they complement rather than they exclude each other. They all refer to the same phenomena giving different meanings and concepts. Also, some theoretical work has just begun to call for ways to combine bottom-up theories of integration with the top-down theories of Europeanization (Haverland and Holzhacker, 2006). Therefore, comprehensive understanding of the modes of Europeanization and their relation is significant for explanation of domestic policy change.

With discussed Europeanization theories we are able to expose why different members states respond differently to common European challenges. Nevertheless, as the concept has become over stretched and employed to different scenarios of national change, the research concept will be restricted to the top down approach of Europeanization. Using this mode of research we will try to move the Europeanization debate further to the state impact and mediating factors in shaping the different response to EU pressures.

2.2 Europeanization and institutional change

Although, understanding of the term Europeanization is good starting point for further in depth analysis of national policy and institutional change, too many theories can create confusion about the exact nature of the process. Therefore, analysis of how Europeanization creates change and its outcomes is more determined by empirical studies than by precise definitions or as Morisi and Morlino put it: "there are different forms of Europeanization operating at different levels at different times"(Morisi and Morlino, 1999).

As we can notice, Morisi and Morlino emphasized *time dimension* as really important factor of national response to Europeanization. Therefore, the way Europeanization creates a change is not only determined by supranational pressures and national mechanisms responding to changes at EU level, but also by time when those changes occur. At this point, challenge is to define Europeanization dynamics on changes at national level throughout the time followed by growth in its size and influence. Hence, time dimension of Europeanization should be determined in more precise outlook in order to be handy tool for our empirical analysis. Here we may refer to influential contribution of Ulrike Liebert's (2002) study of Europeanization and domestic policy where she illustrates time dimension of Europeanization: "Reflecting the dynamics of the integration process after Maastricht, the term (Europeanization, prim. aut.) has been successful in directing attention to an always larger range of Europeanization impacts and for analyzing change in practically all sectors and dimensions of state polities, domestic politics and public policies". [3] Still, time as factors for policy change is vague, since it does not expose how changes in policy and institutions arrangements across countries happen within given increments of time. We argue that it is possible to solve the problem by dissecting Europeanization chronologically, emphasizing its two cornerstone periods in building of the single financial market - European monetary union and securities markets liberalization.

Hence, we look forward to determine European financial integration and cooperation as interactive two way process. As mediating factors (independent variables) are changing over time, we seek to isolate their influence and explain how (in different increments of time) they move the Europeanization of member states forward policy divergence.

2.3 Uses of Europeanization at a glance

Even though we defined Europeanization as the process of convergence toward common policy, it stayed vague why member states respond differently to common EU pressures. Therefore, to take a step forth in explanation of different adjustment mechanisms we can dismantle definition of Europeanization on two basic questions, and that is *what* is changing and *how*.

To address these questions we will employ Olsen's (2002) definition of five possible uses of Europeanization that perfectly fits here[4]. Unfortunately, this concept of Europeanization is too broad and employs to use different scenarios of Europeanization including those applicable outside EU borders[5]. Since these models are not relevant for our study, we will concentrate only on two concepts of Europeanization that emphasize institutional centralization and penetration of national policy preferences into European framework. Hence, we will use first theoretical model that emphasize "development of institutions at the European level" (Olsen, 2002) or the European integration and creation of new institutional structure at supranational level, and second model of Europeanization that concentrate on the central penetration of national systems of governance (Olsen, 2002) or the top down approach. Hence, latter process that explains adjustment of national policy and institutional structures to European pressures, since 'Europeanization is a shaped process, not a passively encountered process' (Wallace, 2000) perfectly responds to our query on divergent national adjustment mechanisms and factors that shape this response.

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[3] Ulrike Liebert: **Causal Complexities: Explaining Europeanisation,** Jean Monnet Centre for European Studies (CEuS), CEuS Working Paper Number 1, 2002, pp. 6

[4] Johan P. Olsen: **The Many Faces of Europaenization,** JCMS, Volume 40, Number, 5, 2002, pp. 923

[5] Other three possible uses of the term Europanization are: changes in external territorial boundaries, exporting forms of political organizations beyond EU borders, and political unification project (Olsen, 2002).

In useful summary of the fist approach that concentrates on *development of institutions at the European level*, Olsen's (2002) assumes that changes occur as result of institutionalization at the supranational level and creation of new set of policies and rules *per se*. Europeanization, in this sense, is more focused on European integration that draws attention to upraising trend of institutionalization. I argue that changes under Europeanization may be triggered by institutionalization at the EU level, especially when common regulatory framework has been established to boost convergence among national policies and institutions. But Europeanization can be understood more as dynamic interaction between two levels of influence, emphasizing key role of national response to EU change. Hence, we assume that the policy discourse problem can be circumvented by separating Europeanization and European integration chronologically (Haverland and Holzhacker, 2006). We will try to expose and move this debate firther in the next volume.

We are also seeking to use and expand Olsen's notion on *central penetration of national systems of governance*, explaining how different models of politico-economical governance respond to EU challenges. Here, Europeanization gets greater dimension referring to the adaptation of national policy and institutional structures in response to changes on the supranational level enhancing convergence to common EU regulatory framework. In addition, this notion implies divergent national responses within different institutional arrangements. Therefore, we may suggest that penetration of EU rules into national structures is conditioned by differences in their territorial design (unitary or federal), longstanding political cultural traditions, patterns of policy decision making, etc. Using these key elements as independent variable we may identify influence of mediating factors on country's response to Europeanization. Therefore, effort to comply with common regulatory network will inevitably collide with national policy and institutional arrangements of these domains. This notion is essential element for our empirical research on national adjustment mechanisms to EMU and Europeanization of securities markets in three selected case studies (France, Germany and Great Britain).

To sum, without denying Europeanization as interactive, two way process most of the studies concentrate on one side of its dimension. I suggest that this study maintain and discuss both top down and bottom up approaches on the equal basis. Therefore, next volume will analyze the process of Europeanization, with emphasis on European integration as its key element.

2.4 Europeanization vs. European integration

One way of explaining Europeanization phenomena is to clarify the process of European integration "as creation of common institutions empowered to create and enforce implementation of single regulatory framework at national level" (Schmidt, 2002). Making distinction between two different, intertwined phenomena is important step in understanding Europeanization process as a whole. Still, sometimes seems difficult to separate and encounter their specific influence, as some definitions portray Europeanization and European integration as twin phenomena. One of illustrations of this notions that put equality between two processes knotting them under one hat is Risse (2001) view on Europeanization as: "emergence and the development at the European level of distinct structures of governance, that is, of political, legal, and social institutions associated with political problem solving that formalizes interactions among the actors, and of policy networks specializing in the creation of authoritative European rules“. Hence, apart from Europeanization *per se*, and variables that influence changes in the process of national rules and institutional harmonization, it is important to distinguish differences between Europeanization and European integration. Then, as we will demonstrate in following volume Europeanization is more extensive term than European integration.

As noted above, Europeanization is round way process that encompass mechanisms of change uploaded from domestic level, influencing changes or adjustments in European institutions and policies with boomerang effect when it comes to downloading of policies at national level. Hence, Europeanization determine interactive process of change where member states ability to upload preferred policies will have positive implications on policy downloading, with respect to mediating factors that carve country's response to European impetus. In this sense, Europeanization can be understood as compact process that includes both increasing institutionalization at European level and its impact on changes in national policies and institutions. Henceforth, understanding of European integration process and its influence on changes at national level cannot be completed without clear picture about Europeanization as interactive, two way process that mediate and transfer signals between two levels affecting changes in national policy and institutional arrangements. This approach goes in line with Howell's (2002) reveal on Europeanization as "concept based on downloading from a top down perspective or EU effects on domestic policies"[6]. Similarly, Hix and Goetz (2000) identified "European integration as an independent variable and change in domestic systems or Europeanization as the dependent variable" (Hix and Goetz, 2000).

Using those arguments and Schmidt's (2002) framework on Europeanization-European integration interaction and its effects on liberalization of securities markets, as our special area of interest, we may suggest following (Figure 1). Globalization and changes in European politics had significant effect on evolution of the common securities regulation. Still, member states experienced long and rocky road to European securities market. Successful launch of single market and European Monetary Union did not lead to significant restrictions of mediating factors in countries response to common securities policy. Nevertheless, enhancing European integration followed by establishment of new regulatory and advisory framework (European Securities Committee, Committee of European Securities Regulators, Committee of Wise Man) and strengthening of their role through new common regulatory framework proposed by Lamfalussy shifted the distribution of power to European level limiting the possibilities for member states to pursue specific regulatory policies according to their preferences and domestic market situation. Even though, new four level regulatory framework "propose a 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" (Mügge, 2006), its implementation results were highly shaped by national mediating factors showing strong path dependence of political culture,

[6] Kerry E. Howell: **Up-loading, Downloading and European Integration: Assessing the Europeanization of UK Financial Services Regulation,** Queen's Papers on Europeanisation No 11, 2002, pg. 3

existing institutions, number of veto points, political actors and time of change in countries institutional change to EU pressures.

With the introduction of new, effective decision making at supranational level EU introduced game rules that are the same for all member states. Proposed European securities market rules, even though clearly defined, have leaved certain leeway to member states to interpret them. Since there is no prediction as to "how the new equilibrium must look" (Knill and Lehmkuhl, 1999) different mediating factors will through designing national regulatory responses also produce different policy outcomes. The nature and power of these mediating factors differs among members states and hinge on institutional configuration of respective model of politico-economic change (Menze, 2003). Thus, varieties of policy and institutional arrangements generate different responses to a common European impetus.

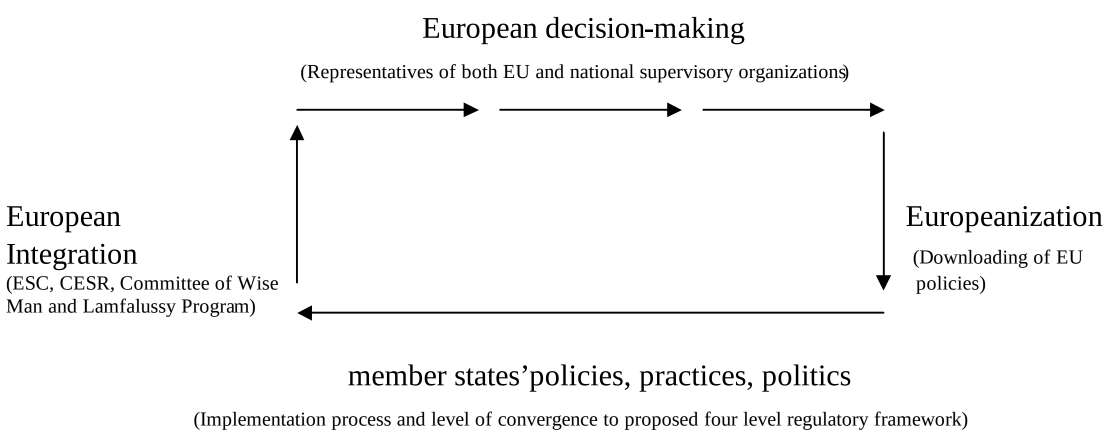

Figure 1. Europeanization and European Integration within single securities market

In the case of securities markets, Europeanization has been launched by institutionalization process at the supranational level, restricting state impact on securities market and bringing new incentives for market liberalization. Member states, even though with limited policy power and market control lost their influence on allocation of resources and subsidies for less developed regions. This new regulatory outlook was supposed to raise market mechanisms effectiveness and improve investors and private actors participation in market functioning and development, primary lead by profit incentives. But still, common regulatory framework created as dynamic and flexible single market approach to external pressures went far beyond traditional centrality of state law and government role in market regulations. What matters, then, is weather private investors and interest groups are organizationally powerful to push their interests and influence national re-regulation on EU induced changes, triggering the come back of securities market de-liberalization.

To wrap up, in contrast to the Maastricht convergence criteria, new regulatory structure of European securities market leaves certain leeway for member states to adopt leaving room for national mediating factors to act. Hence, European integration or development of institutions at supranational level is not self-sufficient reason to fully explain how changes at national level occur. The contribution of this finding goes far beyond the

European integration, down to the national level by focusing on the mediating factors and their influence on divergent adjustment mechanisms throughout time. Before we elaborate on these mediating factors, we will refer to the Europeanization impact straight through the processes of uploading and downloading.

2.5 Uploading or …

In order to respond to Olsen's (2002) query on "what determines the responses, adaptability and robustness of domestic institutions, including their ability to ignore, buffer, redefine or exploit external European-level pressures" first we have to clarify and understand two main approaches to Europeanization.

The bulk of the literature defines Europeanization as process of policy and institutional change at national level through either a "top down" or "bottom up" approach. These approaches have been recently developed and enhanced to embrace more fashionable terms of downloading or uploading which mirror the concepts of "top down' and "bottom up" process, with the spotlight on the behavior of political actors involved in Europeanization[7]. Hence, "top down" approach emphasize evolution of institutions at European level and new set of norms, rules and policies that are downloaded by member states within a process of "domestic adaptation with national colors" (Risse, 2001). Therefore, "top down" process as downloading of rules and ideas refers to the process of adaptation of national policies and institutional structures to changes at EU level with different levels of congruence. These variations in correspondence toward common EU rules and policies can be explained by *goodness of fit* (Cowles and Caporaso, 2001) that is, the level of compatibility between existing and EU-induced regulations (Heritier, 1996).

The "goodness of fit" (Risse, 2001) between the European and the domestic level determines level of domestic congruence to common policies. Pressures for domestic change rise with the level of misfit. Hence, lower levels of adjustment will lead to higher adaptation pressures from the top. Nevertheless, misfit is necessary factor that trigger the need for domestic transformation but still not the only condition for (any) domestic change caused by the EU (Haverland and Holzhacker, 2006).

Whether misfit will result in substantial domestic changes depends on presence of mediating factors that shape and facilitate national adjustment mechanisms and are considered as catalysts for modification of domestic policies.Change will take place therefore if such interplay of mediating factors embraces the impetus from the EU (Menz, 2003). These factors include domestic veto points that can "effectively empower political actors with diverse interests to resist adaptation pressures emanating from Europeanization and formal institutions providing actors with "material and ideational resources to exploit new opportunities leading to an increased likelihood of change"(Börzel and Risse, 2001)[8]. Higher

[7] Nathaniel W. Lalone: **An Awkward Partner: Explaining France's Troubled Relationship to the Single Market in Financial Services,** Centre of International Studies, University of Cambridge,2005, pp. 213

[8] Tanja A. Börzel and Thomas Risse: **Conceptualizing the Domestic Impact of Europe,** Oxford University Press, 2001, pp. 2

number of veto points implies lower political capacity and hence, it is more difficult to introduce the legal and political changes necessary for compliance (Börzel and Panke, 2005). Hence, the question of Europeanization and its impact on national change thus does not concern goodness of fit, but rather the domestic distribution of power amongst relevant interest groups, which *can* be predicted (Menz, 2003). Hence, the fate of European policies depends on government preferences rather then the goodness of fit (Haverland and Holzhacker, 2006). Still, interwined political systems make it difficult to ditect what causes what (Vink and Graziano, 2007). Hence measuring of Europeanization calls for more systematic work that will include all mediating factors and they interrelation.

2.6 … Downloading

In contrast to previously explained "top down" approach, "bottom up" concept highlights influence of pre-existing national structures that receive and modulate pressures from EU. These factors imply differences in adaptation by member states and diverse levels of convergence to common impetus of EU introduced changes. Since the better fit implies lower costs of accommodation, member states are competing which one will upload more policy preferences to supranational level, and hence increase the fit with European institutional arrangements. This penetration of national institutional and policy features into European level is mostly reserved for representative member states with strong economies that, by uploading of policy preferences, can evade any adjustments or modification in specific policy sector and hence, reduce costs of policy accommodation. For example, Germany played major role in shaping currency provision criteria of the Maastricht Treaty, especially in making certain that stable European currency will protect domestic Deutsch Mark from possible open market inaccuracy.

"Top down" or "bottom up" approach are not exclusive concepts, and should be considered and analyzed as mutually interdependent phenomena that shape national adjustment mechanisms in response to EU challenges. As we already mentioned above, European integration is not sufficient element per se in explaining national change under EU challenges. Henceforth, we have to include other key variables that occur at national level and generate different national response to common impetus of EU induced monetary or securities liberalization. We put forward Europeanization as a process shaped by the national response to a type of EU challenge, weather rules are highly specified as in the case of the Maastricht criteria in the run up to European monetary union or given in the form of suggestion or proposition, as in the case of securities market policy.

2.7 Dimensions of change

By illustrating Europeanization as a process of institutional building at the EU level we seek to respond to Olsen's (2002) query as to *how* Europeanization influence changes in national structures and different adjustment mechanisms. But still, it remains vague how institutionalization at European level has actually succeeded to persuade governments for synchronized collective action? In a useful summary of research, Olsen suggests that "institutional change is the outcome of voluntary agreements among the relevant actors" [9]. Therefore, in this mutual game actors or member states are trying to discover and design forms of institutions that will help them to come out with better off than they could do on they own. Following this hint, member states are trying to develop adequate institutional outlook at the supranational level that will lead their policies to achievement of mutual objectives of economic efficiency and effectiveness. Of course in their strategic approach member states are primary driven by financial incentives and reduction of accommodation costs (Börzel and Risse 2000, Schmidt 2002). Then, European integration can be understand as moving forward better fit (to create home like institutions and increase fit to the EU structures) with positive effects on domestic economies.

But while there is general agreement over importance of institutionalization and common regulatory framework, less consensuses is achieved about the nature of the policies and ways they should be designed and implemented. In this dispute, as Börzel (2002) suggests, political actors are trying to increase the *fit* between national and EU policies in order to "minimize the costs which the implementation of European norms and rules may impose on their home constituencies"[10]. This line of thought is similar to Cowles and Caporaso concept of goodness of fit, where countries seek to increase the level of compatibility between existing and EU-induced regulations (Heritier, 1996).

Henceforth, Börzel puts *costs* of EU policies implementation as main incentive for member states that strives to minimize expenses by implying different adjustment mechanism designs. In this sense, as member states have distinct institutional settings they will compete for supremacy at the EU level for policies that better *fit* to their interests and hence, minimizing costs of implementation. Member states are not only seeking to minimize costs of ad hock EU pressures, but also to upload preferred policy model up to EU level increasing the level of *fit* and hence, reducing possible implementation costs in the future. Except this cost benefit issue, it has been argued that forecasting power of goodness of fit is rather weak. Hence, explanation of Europeanization dynamics and outcomes goes far beyond the goodness of fit concept by focusing on the strength of EU pressures and domestic mediating factors.

We now turn from our attention on incentives for change to different uploading mechanisms that drive the change. To explain what effects Europanization has on member states it is also important to discuss weather and to what extend member states have an effect on EU policies. One implication of this approach is that understanding of variations in member states influence on the EU policies and institutions will mirror in their different responses to Europeanization. In seminal work on EU environmental policy making, Börzel (2002) draws three types of national uploading strategies: pace setting, foot dragging, and fence lifting[11]. *Pace setting*, defined as "actively pushing policies at the Europan level, which reflect a member states policy preference" (Börzel, 2002) is reserved for countries with high economic development particularly in the area of regulatory policies. As we will show later Germany with strong economy, stable monetary system and highly influential central

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[9] Johan P. Olsen: **The Many Faces of Europaenization,** JCMS, Volume 40, Number, 5, 2002, pp. 929
[10] Tanja A. Börzel: **Pace Setting, Food Dragging, and Fence Sitting: Member States Responses to Europeanization,** JCMS 2002 Volume 40. Number 2. pp. 194
[11] Tanja A. Börzel: **Pace Setting, Food Dragging, and Fence Sitting: Member States Responses to Europeanization,** JCMS 2002 Volume 40. Number 2

financial institution was pace-setter in the monetary convergence process, shaping some of the Maastricht criteria preaches according to its preferences. In most of the cases successfully applied pace-setting strategy leads to less costly national adjustment mechanisms to EU challenges, preferably accommodation or retrenchment. In contrast, foot-dragging strategy or "blocking or delaying costly policies", aims to stop or at least reduce the attempts of some member states to upload, for them preferable policy models at EU level. Since, some of the member states have poor level of compliance with the EU rules, and hence, bigger misfit, they pay more for implementation of the EU policies. Therefore, these countries hope to prevent uploading or achieve at least some compensation for implementation costs. The latter constitutes transformation. Finally, the fence-lifting strategy is the most neutral one, which aims neither at initiating or promoting preferred policies at European level. In monetary policy, France sits on the fence between Germany and other member states, since it was interested in formation of EMU and reaching consensus about most preferable monetary model that fits all.

It is true that at least some pressure from the top is necessary for any change at the national level, but it still remains vague what conditions shape country's response to EU. Following Knill and Lenschow (1998) notion "that national regulatory environments may or may not be affected by top down Europeanization" we argue that Börzel's concept cannot adequately explain changes at national level with limited use in market making fields like monetary and securities policy. Therefore, in order to explain how member states accommodate to the Europeanization, we need to look beyond the EU adjustment pressures by focusing on the national mediating factors. Also, as is important to test national mediating factors within given time dimension as " member states in heightening the cost and benefits of various alternatives of cooperation and integration might learn from past experiences of unexpected (Haverland and Holzhacker, 2006).

Taking adjustment pressures hypothesis on the member states cooperation and development of the EU does not necessary explain a particular causal mechanism and possible reform outcomes. Even if there is obvious misfit with introduced EU changes, national re-regulatory efforts may not reply to those changes. Therefore, concepts of goodness of fit (Börzel and Risse 2000, Cowles and Caporaso 2001, Heritier 1996) and cost management (Börzel 2001, Schmidt 2002) are not enough reasons per se to explain different national adjustment strategies. Hence, the next section moves beyond the narrow goodness of fit concept by focusing on mediating factors and their impact on national adjustment mechanisms. The focus is now on the turning point from the narrow Börzel`s concept toward more comprehensive Schmidt's (2002) notion. This implies that "only by putting (the EU, prim. aut.) decision constraints together with the mediating factors we can adequately explain countries' differential policy outcomes, whether inertia, absorption, or transformation" (Schmidt, 2002).

Therefore, next chapter will put forward and analyze role of key mediating factors that occur on national level and shape national specific response to EU adjustment pressures leading to the national policy divergence. In later stage, some of the national response patterns arising from the interplay of key mediating factors will be discussed.

2.7.1 Mediating factors

In this volume we seek to explain how mediating factors shape divergent national response to common EU impetus since Europeanization besides policy convergence also "denotes the consequences which may have a variable impact at the national level" (Buller and Gamble, 2002)[12]. Hence, this part contributes to the concept of Europeanization by dealing with the effects of the mediating factors and thus has a primary focus on the domestic level.

A bulk of literature on Europeanization is mostly concerned with whether and how Europe impacts domestic policies in highly differential ways. In attempt to explain the variability of Europeanization and discourse of action at the national level (Schmidt and Radaelli 2002), some of the academics referred to use of general goodness of fit concept assuming that "the lower the goodness of fit between the EU and national levels, the greater the imposition on actors" (Tacher, 2004). Lower fit will hence, impose grater influence of mediating factors that determine to what extend countries are likely to converge and take up new policies. Hence, the goodness of fit formula that assumes linear correlation between the level of fit and adaptation pressures, has to be interceded by mediating factors that arise at national level such as: economic vulnerability, number of veto points, political actors, existing formal institutions, and timing, in order to explain how policy changes occur. Then, analysis and understanding of mediating factors that occur at domestic level is crucial for further debate on Europeanization and its various impacts on domestic monetary and securities market policies in France, Germany, and Great Britain. Nevertheless, focusing on the variables that shape Europeanization impact and result in domestic discourse allows us to move beyond narrow concept of the EU adjustment pressure to more influential work of mediating factors. This volume bridges these two emerging concepts of goodness of fit that trigger the need for change and mediating factor as catalyst of EU pressures at national level.

We argue that organizational characteristics of mediating factors critically shape domestic response strategy to Europeanization. Hence, they act as a link between Europeanization pressures and specific modes of integration and cooperation. In addition to the four main variables defined by Börzel and Risse (2001) we will include time as important catalyst for change because it brings dynamic component into slightly static concept of institutional mediating factors. Lenschow, Liefferink and Veenman (2005) point out that "institutions are the main independent variable to explain political outcomes in periods of stability".[13] But in the period of globalization and dramatic changes in both political and economic arena, especially within securities market as our specific area of interest, this factor has been influenced by other intervening variables becoming dependent variable itself. Hence, weather or not a country responds in adjustment of its institutional structure to EU changes, will depend on absence or presence of mediating factors throughout time.

We present five mediating factors at glance. *Economic vulnerability* is one of the conditions that actually explain straightforward weather and to what degree countries economic capacity strengths or loosens its sovereignty to the pressures of Europeanization.

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[12] Jim Buller and Andrew Gamble: **Conceptualising Europeanisation,** Public Policy and Administration, SAGE Publications and PAC 2002, pg. 11

[13] Andrea Lenschow, Duncan Liefferink and Sietske Veenman: **When the birds sing. A framework for analysing domestic factors behind policy convergence,** Journal of European Public Policy 12, 2005, pg. 802

This approach is similar to Maes and Qualglia (2003) concept of *strong* and *weak* states that refers to countries *capacity* to intervene in economy as well as the degree of its autonomy from supranational influence[14]. According to this notion weak states with porous policy structure and dispersed and poorly coordinated set of institutions are more vulnerable to Europeanization, while strong states with generally high degree of coherence in economic policies are more inert in response to the EU changes. In contrast, Scharpf (2000) shifts his view from institutional structure to economic capacity suggesting that countries vulnerability to external, either globalization or Europeanization pressures, depends upon the strength of their currencies, the size of their financial markets and the scope of their businesses. In our specific case, all selected member states- France, Germany, and Great Britain have had traditionally portrayed as *strong* countries. But in order to understand discourse in their adjustment mechanisms we need to consider other variables that determined weather the strong country is more (or less) aware of the need for change.

Second mediating factor that mirrors countries political capacity to respond to the external pressures, and hence, influence the pace and extend of policy change is number of *veto points.* Every political system includes a certain number of institutional or partisan actors whose agreement is necessary for a change of policy (Tsebelis, 1995). The basic idea of his veto players' concept is that institutional and policy changes can be understood in terms of number of actors who can block a policy change and restrict download of new policies from European level. Hence, the more veto points are, and the more their preference and interests diverge, the harder is to reach consensus and introduce changes as response to EU directives[15]. The more decision making power is dispersed in political system with more actors who have to rubber stamp decision, the more is difficult to reach political consensus over policy change in response to the Europeanization pressures. In this sense, existence of large number of veto points will hold back domestic adaptation to EU changes even though consensus is reached within government. In our particular case, unitary states like France and Great Britain, with highly centralized decision making structure and lower number of veto points make easier job for their executives. Hence, in France state actors have formulated policies without significant input from societal actors even though certain level of accommodation in their preferences (through lobbing) is present. In opposite, Britain government has always tended to keep high autonomy in policy formulation and implementation process, holding those preferences after expansion of policy networks as self-regulation concept. Therefore, with this policy design and decision making culture we may expect more inert role of British policy actors towards European directives.

Finally, in Germany, with exceptionally large number of institutional and partisan veto players (Schmidt, 2002) substantial policy changes as response to the EU pressures are less likely. This institutional structure includes highly integrated policy and social actors within the federal network. Their decision making power is driven by the culture of consensus, as

[14] Ivo Maes and Lucia Quaglia: **France's and Italy's Policies on European Monetary Integration: a comparison of "strong" and "weak" states,** Robert Schuman Center for Advanced Studies, RSC No. 10, 2003, pg. 3

[15] George Tsebelis: **Veto Players and Law Production in Parliamentary Democracies,** Journal of Common Market Studies, 2002, pg. 102

federal state and Länder have to compromise in order to ensure the appropriate application[16]. But even though Germany is federal, multi-actor system, with large number of veto points and dispersed decision making structure, the existence of high policy discipline and high level of consensus among Bundestag parties affect Länder majorities to policy change (Bawn, 1999). This process will include negotiations with a wide range of political and social actors (like private interest groups who want to secure their interests on securities market) in order to reach win-win position and imply policy changes as response to the EU directives. This system has been highly effective when actors agree, with exposition to "joint decision-trap" when they disagree (Scharpf, 1988). To wrap up, Germany's decision-making culture, as typical example of multi level governance, is very similar to that of the EU. Therefore, EU did not affect in a large manner changes in German policies. This makes easier for political actors to go for accommodation or uploading of national policy desires through open and frequent negotiations with the EU level. This process leads national adjustment to the EU policies resulting in the higher level of fit.

The next mediating factor- *existing institutional structure* is necessary to understand the nature of puzzling in the countries responsive mechanisms. Still, its ability to predict country's capacity to generate policy change (Schmidt, 2002) is limited. This variable is one of the goodness of fit varieties where better fit between existing national policy and institutional structures with those of EU leads to loosen Europeanization pressure for domestic change. Also, institutions are important element of resources allocation. They provide actors with material and ideological stocks, increasing the likelihood for change. For example, while in France commitment to the European monetary integration required a major change in policy regime during the mid l980s, along with a new discourse of legitimacy, in Germany the goodness of fit with introduced EU structures ensured that the existing policy regime, ideas, and discourse remained largely unchallenged (Schmidt and Radaelli, 2002).

Compliance with the EU rules highly varied among member states, depending not only on institutional structure and capacity to bring the change but also on willingness of *political actors* to implement those changes. As Risse, Cowles and Caporaso (2001) noted that "institutions do not change institutions; actors do"[17]. Börzel and Risse (2003) term these actors as "change agents" or "norm entrepreneurs". Weather EU rules will be implemented depend mostly on policy actors' preferences and interests. These preferences may be primarily determined by political *interests* (Sharpf, 2000) and strongly influenced by political *culture* and ways decisions have been made (Börzel and Risse, 2001). Different constellations among the actors led to different re-regulatory outcome. The response strategy reflects the preference of the strongest actor (Menz, 2003). Hence, policy change in response to Europeanization will emerge if supported by ideas on necessity of particular policies, beliefs and appropriateness of policy implementation (*logic of appropriateness*, Risse, 2001). Also need for change can be triggered by interest and identities of involved actors (Hansen, Scholl 2002). In addition, some of the authors emphasize the importance of leadership as generator for policy change. For example, President Mitterrand's decision was crucial for France to stay in European monetary system and to cede part of their monetary sovereignty to supranational

[16] Vivien A. Schmidt: **Procedural democracy in the EU: the Europeanization of national and sectoral policy-making processes,** Journal of European Public Policy Volume 13, Number 5, pg. 685
[17] Thomas Risse, Maria Green Cowles, James A. Caporaso: **Transforming Europe: Europeanization and domestic change**, Cornell University Press, 2001, pg.11

institutions (European Central Bank). At the same time, German Bundestag during Kohl government cumbered with budgetary constraints and external pressures had decided to restrict Länders influence over decision making process and launch policy reform in response to the EU directives. This resulted in dramatic increase of the institutional capacity for change. Therefore, it can be expected that strong political culture and presence of positive public attitude towards Europeanization, will play significant role in enhancing policychange under the EU directives.

To sum, even though Europeanization pressure is important trigger for change still it does not confirm that these pressures will result in policy change. Therefore, understanding of five mediating factors and their influence on domestic policy revision and changeare essential elements that shape countries adjustment mechanisms in response to EU pressures, often leading to policy discourse. This notion stress the dominance of economic vulnerability, existing institutional structure, national reform capacity, political actors and timing in curving out the domestic policy change under the Europeanization guidelines. In short, understanding of adjustment pressures and mediating factors are necessary precondition for explaining whether and how member states respond to Europeanization demands in different policy arenas and different increments of time.

2.7.2 Divergent national mechanisms to common EU impetus

There is no country that is similar to another. Countries differ in levels of their economic development, ways their governments have been organized, made decisions, and cultural tradition embedded strongly within each institutional and policy system. Therefore, even with the similar adjustment pressures from above these embedded differences make evident that policy changes always retain strong national traits shaped by the play of different mediating factors.

In this volume we seek to respond to Olsen's (2002) query as to *how* and *when* member states alter their policies in response to EU changes. Therefore, previous discussion on variables that shape Europeanization impact and result in domestic discourse allows us to move forward to analysis of divergent national responses to common EU pressures. We argue that besides differences in national mechanism shaped byplay of these factors it is possible to outline some adjustment patterns and hence, predict country response to the EU pressures.

Although each policy sector is different in adjustment mechanisms to EU changes, Radaelli (2000) distilled four adjustment mechanisms from the literature (Cowles and Risse 2001). These adjsutment patterns emerge as product of dynamics and variety of mediating factors across different countries and policy areas. They run from accommodation as system maintenance that relates to number of responses to EU changes maintaining different levels of system and policy integrity to extreme that includes absence of change either as product of high fit between domestic and EU policies or as resistance to EU changes. This extreme is known as *inertia*.

Accommodation occurs when domestic structures are compatible with the EU rules and policies, and hence result in slight adjustment of national policies. Such mechanisms include partial policy change which does not fundamentally change the corepolicy preferences (Radaelli, 2000). Accommodation strategy can be applied when there is good fit between national and EU policies assisted involving entrepreneurial skills of political actors and their persuasiveness to introduce new policies (Dyson, 2000). Also, accommodation mechanism is very popular in political systems with political interest and capacity to launch reforms. For example, it was relatively easy for Britain to adjust its securities policy and institutional structure to those required by EU with the enhancing liberalization of domestic security market, provided freedom of capital movements and strong investors' protection guaranteed by the national regulations.

Next, *transformation* implies higher level of policy changes that can sometimes go against traditional policy preferences. Hence, it involves not only change of policy instruments but also it reinforces changes in policy preferences. Transformation is typical adjustment mechanism of "top down" approach with non restricted downloading of the European principles into the national institutional structures and polities. This mechanism often assume significant economic vulnerability, lower fit with the EU preferences and loose political institutional capacity to accept EU challenge andtake transformative discourse (Schmidt, 2002). Only with this strategic approach member states take high price of policy adjustment that mostly encompasses shifts in their policy legacies and preferences, leading to the institutional renewal.

Inertia is defined as "the slowest resistance to change or no change at all" (Radaelli, 2000). The lack of political will to commit to European policies and little economic pressure to impose changes lead to inertia. This approach is very close to the scenario selected by members with strong economies, high financial autonomy, labor and capital mobility and flexibility (e.g. Great Britain). Inertia will occur when political actors see little or no benefits of policy change in terms of long-standing policies sustainability. Also, this strategy might be appropriate solution when member states face scarcity of political and intellectual resources capable to persuade others about necessity for change. When member state face strong mismatch with EU preferences, inertia can be introduced as response to system protection from external pressures. These pressures might entail radical turn in domestic policies and institutions, and hence high implementation costs.

Finally, *retrenchment* as fourth adjustment mechanism reflects national policy preferences in the face of EU policies and institutions. It explains other side of Europeanization process where strong member states with political capacity to introduce and lead reforms are capable enough to upload its policy preferences and role back some of its progress up to the European level. We can tag this process as *boomerang effect* (prim. aut.) as it brings new ideas and concepts down to national level that are received, processed, modified, and rolled back up to the supranational level. Retrenchment is privilege of strong economies that can reduce the level of misfit, and therefore reduce costs of downloading sometimes costly EU rules. These upload incentives can improve level of convergence to EU policies by leading member states, but at the same time increasing expenses for other countries, with high economic sensibility and limited political capacity for change.

Before we elaborate on the link between adjustment pressures and mechanisms, we refer first to the globalization, as important external drive for change. Therefore, we seek to discuss weather Europeanization is globalization by another name? The contribution of this section implies explanation of the relationship between two phenomena, their boundaries and influence on changes in national monetary and securities market policies.

2.8 Europeanization and globalization

After all economic and political changes that hit the Europe in the last decades of the 20th Century it still remains unclear weather those changes reflect global trends, referred to as globalization, or they are directly attributable to arising institutionalization at EU level known as Europeanization. Hence, after glanced Europeanization concept basic understanding of globalization phenomenon is important to distinguish these two phenomena and their area of influence.

Although, changes in Europe had specific objectives and forms under the label of Europeanization, they cannot be insulated from the overall trend of globalization. Mostly globalization is portrayed thought the line of evolutionary changes in economic structures and opening up of securities markets under the influence of deregulation, technical innovation and rising international competition. Consistent with this line of argument is Bache and George (2006) notion of globalization as: "a particular regional expression of changing nature of global capitalism"[18]. In this sense, globalization can be understand as raising trend of deregulation of financial services flows putting control beyond centralized regulatory authorities where "markets are becoming more important, governments are becoming less so" (Verdier and Breen, 2001). Hence, these changes influence countries to alter their institutional structures and accommodate conditions of their monetary policy to those changes. Even though, globalization effects may be much broader including cultural and social aspects, its pressures on changes in economic structures are the most influential one.

Following global changes, the European Union has promoted exclusively form of economic integration and national deregulation through raising trend of European integration and creation of representative system of institutions at the supranational level. Still, dilemma weather Europeanization was really necessary factor for member states to address those changes and accommodate their institutional structures to globalization pressures, remain unsolved. Some authors emphasize that: "European economies would have reached a qualitatively similar state of market deregulation by simply exposing themselves to the global winds without engaging in the costly and painstaking construction of Europe" (Verdier and Breen, 2001). Others, in contrast, stress the role of Europeanization as synonym for globalization, keeping European interest within globalization outlook and implying that through the process of European integration member states "aggregate national welfare maximization" (Mügge, 2006).

Europeanization is indeed the case of market regulation through deregulation loosing national supervisory control over the securities markets. This process of securities market Europeanization follows the red line of upraising liberalization where enlargement of national markets, in order to follow global trends, require no more governmental action other that

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[18] Ian Basche and Stephen George: **Politics in the European Union,** Second edition, Oxford University Press, New York, 2006, pp. 47

deregulation and opening of markets. But still, effects of Europeanization aredueling creating trade offs for member states. This argument asserts that deregulation of national actions, on one side, lead to better adjustment of national policies to common regulatory framework loosening impact of external shocks on national economies and financial markets volatility, but on the other assume ceding of the national sovereignty over financial policies and institutions to EU level.

Instead of conclusion, Europeanization of national markets through deregulation and raising liberalization is indeed similar to globalization, working as its regional agent. In opposite, European integration assume new institutional and regulatory structure asking member states to give up part of their policy sovereignty over securities markets triggering the come back of de-liberalization.

2.9 Further use of the first chapter key disclosures

Notion that globalization and Europeanization pressures influence changes in national institutional and policy structures producing different levels of convergence has to be analyzed within specific national set up. These features reflect differences in national approach to these phenomena shaped by existence and different intensity of mediating factors throughout time. Understanding of mediating factors, their dynamics and influence on divergent national response to common EU pressures are important element in discussion over divergent adjustment mechanisms towards EMU and securities market integration. Even though some patterns can be identified, play of the five mediating factors as independent variables give final tough to divergent national adjustment scenarios to Europeanization.

Therefore, five mediating factors defined in this chapter (economic vulnerability, number of veto points, political actors, existing institutional structure, and time) will be applied and tested within EMU and Europeanization of securities markets. In order to discuss the query weather and how mediating factors influence different national preferences throughout Europeanization, it is important to use certain patter of work. Hence, we will use comprehensive theoretical founding on four response patterns defined by Radaelli (2000). Apart from this issue, we will follow the Radaelli's (2000) flowchart on the most suitable action for analysis of Europeanization in order to forward overall analysis outlook. He suggested that would be the most appropriate to unpack the concept of Europeanization and distinguish between related concepts like monetary convergence, harmonization and political integration[19]. Based on this revelation our study identifies two milestones of financial market development- monetary convergence and securities market integration. Therefore, our founding on five mediating factors (Börzel and Risse, 2001, Cowles and Caporaso, 2001) and respectable four responsive patterns (Radaelli, 2000) in the case of the France, Germany, and Great Britain goes beyond the goodness of fit and cost management explanation to by emphasizing the five mediating factors and testing their effects on the policy divergence.

[19]Kerry E. Howell: **Up-loading, Downloading and European Integration: Assessing Europeanization of UK Financial Services Regulation,** Queen's Papers on Europeanisation, Number 11, 2002, pg. 3

3. EMU as Europeanization

It is now prudent to turn to the measurable potency of mediating factors in a particular event. This chapter discusses the influence of mediating factors on the divergent national responses to the European Monetary Union. It will examine the impact of economic vulnerability, number of veto points, political actors, existing institutionalstructure and time respectively. Their impacts on national mechanisms (expressed as inertia, accommodation, transformation or retrenchment) are examined in the cases of France, Germany, and Great Britain. In addition to illustrating the potency of mediating factors through these countries' EMU experience, this chapter will go on to further a theoretical founding.

This chapter explores the influence of mediating factors on a country's commitment to the Maastricht convergence criteria. It argues primarily that each country's degree of subscription to EMU principles is dependent on the nation's policy priorities and institutional structure. In fact, it is shown that the degree and number of difficulties in each respective country's convergence toward monetary union reflects policy priorities that might be altered throughout time and under different EU pressures. After this concept has been comprehensively delineated, the next chapter will in turn examine the mediating factors which modify a country's response to EMU within the context of securities markets. This examination will lead to the drawing of conclusions about shifts in national preferences over time.

3.1 How it all started?

The formal establishment of the European Monetary Union (EMU) was a defining moment for both European integration and for further securities markets liberalization. It will be shown that initial financial adjustments were triggered by strong globalization pressures. In addition to the rapidly changing global economy, Europewas faced with a lagging financial sector creating a need for changes. Fixed exchange rates had been designed to assure price stability and full employment during periods of high economic vulnerability while the gold standard aimed to limit growth in world economy (Krugman and Obstfeld, 2003). The collapse of the Bretton Woods regime of fixed monetary rates and oil crises heated waned drove the European economies pushing them toward monetary reform.

Parallel with changes on the global scene, European countries were faced with the new Europeanization phenomena, representing strong institutionalization as part of globalization as well as apart of it. This phenomenon stems from wish for convergence in monetary policy area that will produce more competitive and less risky environment suitable to response to external pressures. After all, the particular feature of liberalized securities markets is money (Steinherr, 1989). The period of monetary integration beginning with the monetary snake that manage fluctuations of the national currencies inside narrow limits against the dollar (Baldwin and Wyplosz, 2004)[20] and culminating with the creation of fixed exchange rates set

[20] Even though a promising project, snake collapsed soon hit by the oil crises, policy divergence and dollar weaknesses, allowing national currencies to float freely against the dollar.

up the basis for creation of the European monetary system. This process of European integration in monetary sector will have profound effects on the national decision making process, also influencing the development of the future single securities market.

Still, the process of integration and Europeanization has not continued uniformly over the past decades (Haverland and Holzhacker, 2006). Therefore, we seek to look beyond the European institutionalization in monetary and securities areas by analyzing mediating factors and their impact on policy divergence and change in EU-member states relationship over time.

3.1.1 The rocky road to European monetary union

Creation of European Monetary System has brought the new array of benefits for member states combining the elements of fixed exchange rates and single currency unit ECU within monetary union. This notion is opposite to work of Emerson on monetary union conception emphasizing that "monetary union can consist of either a fixed exchange rate regime or single currency" (Emerson, 1992). As we can confirm EMS managed both. Elimination of exchange rate uncertainty and further intentions toward single market merged to secure monetary stability across Europe. EMS also brought valuable gains in long term macroeconomic sustainability, through reduction in inflation rates and price stability.

But, first milestone to monetary union will be soon put on the test. High inflation rates that diverged markedly in Europe seriously threatened to jeopardize EMS sustainability. The most obvious solution for this burden was naturally to find model that will lead member states toward monetary convergence. This is the time when Germany, the largest and stabile economy with the lowest interest rates, with strong and influential Bundesbank gradually emerged as the most influential in Europe (Donnelly, 2004) Even though, member states were trying to anchor their currencies to Deutsche Mark, EMS as monetary watershed failed to secure extensive integration and enhanced institutionalization at EU level.

Even though it didn't succeed to keep countries joined in monetary union, EMS lay some of the basic principles of the future European monetary union (Baldwin and Wyplosz, 2004). Fist of all, it justified the need for adoption of single currency as natural step toward internal market. Second, it showed that monetary union is much more that fixed exchange rates. Adoption of monetary union involves trade-off between benefits of reducing exchange rate risks and the cost of reducing number of assets in the national economy (Neumeyer,1998), including giving up of significant amount of national monetary autonomy. Finally, EMS fruitful outlook provides useful guidelines for creation of monetary union, including elements like fixed rate regime, single monetary currency and strong central authority. These elements will be subsequently brought together by the Maastricht Treaty manual creating the European monetary union (EMU), currency area that brought a new dimension of monetary unification schemes.

Through creation of EMU countries sacrificed even more sovereignty over their monetary policies than a fixed rate regime normally requires (Krugman and Obstfeld, 2003). But what actually EMU principles apply and why countries agree to cede part of their monetary sovereignty in ever lasting game of gains and losses? At first, we might refer to illustration of economic costs and benefits of fixed rate regimes and shared single currency, usually set up and clarified within the optimum currency area (OCA) principles, before we continue with explanation of the national adjustment mechanisms to EMU.

3.1.2 Estimating benefits of EMU- what's in it for member states?

As noted above, costs of EU policies implementation is the main incentive for member states seeking to minimize expenses mostly through changes in their adjustment mechanisms (Börzel, 2002). Hence, costs and benefits of European monetary union tends to underplay the complexity of trade-offs involved in countries response to EMU and application of convergence criteria. In this sense trade offs that member states face can be best differentiated through the loss and gain terms, weather giving up of sovereignty is experienced as absolute loss of national power over monetary area ceding authority to supranational level, or as a gain in power because national authority is now better able to achieve its (microeconomic) goals[21]. Often, these trade offs are at the heart of member states dilemma weather and up to which level state should penetrate into common currency area so that losses of national sovereignty offset gains of achieved economic goals and enhanced trade and securities market liberalization (Schmidt, 2002). Importance of this dilemma is also highlighted as one of the main determinants in country's response to EU changes that will be addressed into more details in the chapter on Europeanization and securities markets.

Although, effects of EMU are different in each policy sector, we will narrow our analysis of single currency area and its aims for securities market liberalization. Money is essential element for every financial transaction, making it easier and less expensive. But when more currencies are involved investors face multiply fundamental risks like exchange rate risk, credit risk, interest rate risk and country or sovereign risk. These risks have also significant impact on countries policies and market development hoping to find and apply good risk management tools and systems (Saunders, 2000). In that sense, we may argue that world will benefit of having just one currency that would successfully manage risky and costly transactions by diminishing country or risk of exchange rates. But, opening of domestic markets also brings some risks *per se*. First of all, spill of national risks over national border can spread across whole area raising the costs of sharing the same currency. Second, single currency areas are not always optimum, and asymmetric shocks from one country can have bigger and more costly effects in other countries within the area. Therefore, to tackle loss-gain equilibrium of monetary integration and its subsequent impact on securities market liberalization, we will use open currency area approach (OCA) that identifies monetary convergence trade offs straightforward.

By large view, creation of European monetary union and hence, process of Europeanization has positive advantages for boost of trade and investments across member states. According to Mundell (2000) introduction of single currency avoids both the volatility and inflationary bias of floating rates, and the vulnerability to speculative crises of fixed exchange rates that are not irrevocably fixed. Hence, member states will, by joining EMU

[21] Vivien Ann Schmidt: **The Futures of European Capitalism**, Oxford University Press, 2002, pp. 59

benefit from lower exchange rate uncertainty. In other words, national markets and companies will benefit from doing business within optimal currency area where cumbersome exchange rate changes are reduced, lowering transaction costs and increasing companies' ability to expand financial asset portfolio to include foreign securities determined in the same currency as domestic ones[22]. Even so, companies will benefit from trading abroad with securities denominated in the same currency, profiting from dispersed securities portfolio denominated in same currency and hence, lower exchange rate uncertainty. Still, introduction of the single currency may also have some negative effects on resource allocation and trading within securities market. First of all, exchange rate risks is what makes speculative trading profitable for investors, who hope to achieve high profit gains on diversified and unpredictable changes in exchange rates. Without exchange rate risk market volatility with turbulence associated with floating exchange rates will be reduced and hence, return on investment rates on foreign assets and securities will be limited. Irrevocably fixed rates do not encourage speculation, and therefore impeding investments and capital inflows within optimal currency area (Nuti, 2000).

Besides reduction of national currencies exchange rates, EMU will also dismantle other barriers, fist of all commercial and sovereign risk, laying thebasis for greater securities markets integration. Introduction of single currency area will eliminate commercial risk in long term contracts between member states, and hence, lower costs of uncertainty of trade with business entities within the optimum currency area. Also, companies within EMU will no longer suffer from country or sovereign risk, the risk that repayments from foreign borrowers may be interrupted because of the interference from foreign government (Saunders, 2000). Lowering investment uncertainty as one of the foreign investment risks, state can also benefits from improved country rating. In this sense, the use of a common currency has been suggested as potentially increasing significantly the amount of trade among the geographical regions using the same currency. This increased economic efficiency is likely to reduce risk across the board and thus reduce sovereign risk (Powell, 2000).

Still, EMU is a lot more than benefits gained from implementation of single currency and erosion of national market risks including, exchange, commercial and sovereign risks as representative ones. Countries integration within EMU should be, therefore furthered with costs of policy and institutional change, as well as consequences of budgetary adjustments, reduction of inflation rates and public spending that can result in microeconomic instability of some regions. Nevertheless, as well as member states are gaining benefits from diminished national market risks, there are new risks that arise within internal market. Giving up exchange rate instrument and national sovereignty can bring benefits (loss of domestic market risks and easier achievement of economic goals), but still query on when and up to which conditions such a step is relatively painless remains.

When analyzing EMU costs and benefits and monetary convergence trade offs for member states, it is always good to tackle basic findings of optimal currency area (OCA) approach. This approach is useful tool for member states to decide weather it makes sense to abandon its national currency and give up sovereignty, and under what conditions this process might be beneficial.

[22] Anthony Saunders: **Financial Institutiona Management: A Modern Perspective,** Third Edition, The Irwin McGraw Hill Publishing, 2000, pp. 111

Actually through application of OCA principles they weight gains of diminished national market risks and losses of asymmetrical shocks and costs that occur within internal market. Therefore, states are measuring gains of monetary union and costs of shared single currency and dependence upon supranational financial authority. This concept of losses and gains is essential for better understanding of countries response to Europeanization and policy divergence, primarily lead by the cost incentives.

Seminal work of Mundell (1968) as OCA theory bible, preach that optimum currency area comprised from more than one currency involves adjustment among national currencies in order to correct regional economic shocks. According to this concept if a monetary union or other regime with fixed exchange rates were to succeed, the criteria of labor and capital mobility within the standard optimal currency area has to be realized. In other words, countries that form optimum currency area will benefit from fixed exchange rates only if their economies are closely linked by trade in goods and services and by factor mobility[23]. Combining this theoretical approach with actual performance on creation of integrated market with free circulation of persons, goods, capital and services set by the *White Paper on the Completion of the Internal Market* (1985), we can argue that European Union is close to the OCA concept. Therefore, the first stage of EMU as an optimal currency area involves completion of internal market, starting with harmonization of economic polities and laying out the basis for further financial integration.

Still, labor and capital mobility is not only precondition for OCA to work. However, if currency area grows larger, it becomes more diversified, and diversity subsequently brings costs (Baldwin and Wyplosz, 2004). These costs, from economic point of view, are related to institutionalization at EU level, as well as expenses of national policies and institutional structures adjustments to those changes. Even though, central financial authority is essential for securing stability and long turn market sustainability through policy adjustments, still it is unable to reach and manage all asymmetric shocks that are locally produced. Asymmetric shocks, those which affect some countries (or regions) and not others, or produce different effects in different countries, raise the costs of sharing the same currency[24].

Besides Mundell's seminal approach to optimal currency area that emphasizes labour and capital mobility as essential criterion for minimizing costs of an asymmetric shocks within monetary union, we can also distinguished other two concepts in order to test weather EU is an optimum currency area. First, McKinnon's (2001) "openness" concept links economic development with changes in exchange rates and actually extend Mundell's approach. He suggests that countries which are very open and depend heavily on each other will not suffer from changes in exchange rates and hence, will benefit from creation of optimum currency area[25].

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[23] Paul R. Krugman, Maurice Obstfeld: **International Economics: Theory and Policy,** Sixth Edition, Addison Wesley, 2003, pp. 624

[24] Richard Baldwin and Charles Wyplosz: **The Economics of European Integration,** The McGraw-Hill Companies, 2004, pp. 331

[25] Ronald McKinnon: **Optimum Currency Areas and the European Experience,** Stanford University, 2001, pp. 3

Second, Kenen (2000) gave very interesting scenario under which asymmetric shocks and costs of operating within optimum currency area will be less likely for countries whose production and exports are widely diversified and of similar structure. In that case, these countries will have less need for any exchange rate adjustment in order to enter optimal currency area. Still, less developed countries, being less equipped with the policy instruments, should make more frequent, and hence, more costly changes or perhaps resort to full transformation of their policies. Therefore, gain of achieved economic goals, boost trade and competitiveness will offset loss of exchange rate instrument and national financial sovereignty, and very likely result in countries accommodation mechanism to EMU.

In short, analysis of EMU costs and benefits show that countries do recognize loss gain equilibrium as essential incentive for change. But, our interest goes far beyond eroding of national sovereignty and loss of exchange rate instrument. We want to analyze which other factors, besides costs, shape national adjustment mechanisms to EMU and result in divergent national response across Europe. Therefore, in next volume we will examine key mediating factors performances on national response to the Maastricht Treaty criteria. Then, we will outline each factor impact on national response strategy and how they foster or constrain EMU convergence pressures to be more or less transmitted into the national policy reform.

3.2 National commitment and EMU: dueling swords?

Even though, member states have distinctive structure of public policies, introduction of the Maastricht convergence criteria imposed highly defined rules and constraints to national monetary policies in order to reshape and fit into the EU framework (Schmidt, 2002). According to this theoretical device we would expect member states to highly converge on the single monetary pattern using accommodation or transformation strategies to EMU. Still, the reality could not have been more different, as member states converged in different levels resulting in policy discourse. Nevertheless, divergence remains even though the Maastricht criteria embodied extraordinary powerful policy agenda because public policies are so central, so fundamental to modern state (Cowles and Caporaso, 2001).

Therefore, we seek to clarify and understand which variables critically produced divergent national adjustment mechanisms in response to common convergence criteria. Only with analysis of changes in mediating factors dynamics and influence over member states in response to highly specified EU monetary directives we hope to explain how and why domestic adjustment mechanisms change resulting in policy discourse. Hence, we will test theoretical explanation of mediating factors for analyzing policy change within EMU. Later, these results will be discussed against their explanation on securities markets policies. This will help us to explain our speculations as why national mechanisms and the forms of integration change over time.

3.2.1 France: sitting on monetary fence

In France, economic vulnerability to globalization pressures was very high. This in turn had implications for national economy to change as it became more sensitive to the EU requirements. The oil shocks and economic stagflation were crucial for economic reform to start. But although France faced high economic constraints imposed by globalization, the country's response to those changes was highly influenced by a long tradition of state intervention in economic life and role of political elites (Maes, 2004).Therefore, political commitment to push the reforms toward monetary principles was crucial factor that brought France into the EMU family. Also, France used Europeanization as a guide to macroeconomic changes that will overcome rising vulnerability of national economy. Hence, we may argue that economic vulnerability acted as enhancing factor on the French journey to EMU, since French government has justified monetary reforms as part of the Europeanization process.

Furthermore, economic vulnerability was important impetus that triggered the need for change. Still, besides its advantages economic vulnerability was not the crucial factorthat shaped French response to EMU. In this sense, we claim that party elites in France were the mayor actors in country's policy discourse where the disagreement about preservation of national sovereignty or integration into European area has been mayor vehicle for transformation of EMU principles into national framework. Donnelly's (2002) assumption that French government promote monetary union in order to push reforms forward explains the French positive attitude toward EMU even though the potential economic gains were too low to offset loss of national sovereignty. Therefore, French road to EMU is certainly drawn by motivation of key decision makers that had used Europeanization principles as the guidelines toward more successful national reform.

But as countries response is shaped by the mix of mediating factors that change over time we may argue that at first French way to EMU does not seem so smooth. France had delay in moving toward European monetary integration which can be explained by the government reluctance to give up part of sovereignty over national policies. At beginning, France approach to EMU has been restricted, reflecting difficulties that country had in meeting convergence criteria domestically (Donnell, 200). Still, political elites were willing to secure stability of national currency deciding to remain in monetary union, however, hoping to stimulate economic growth even at the cost of higher rate of inflation (Maes, 2004). The exchange rates were crucial element of reform strategy that will subsequently respond in price stability and decline of inflation rates. This reorientation of French monetary policy will secure strong institutional capacity and improve French positions in negotiations toward EMU. Also, France was motivated to promote domestically EMU issue in order to loosen restrictive German monetary policy and provide sustainability without severe Bundesbank directives. This fence lifting strategy promoted French interest for stability in the region, sharing German preferences for monetary sustainability and economic growth.

This fashion dominated French policy during the Gaulle and Mitterrand presidency, securing stable microeconomic surrounding and good starting position for less costly accommodation adjustment strategy. Therefore, we may suggest that Europeanization in the French case had perfect timing coinciding with the start of economic reforms introduced at the end of 1980s. The political debates surrounding the referendum on the Maastricht Treaty in 1992 can be seen as breaking point for creation of the future French identity within Europe. Supporters of convergence criteria and EMU, particularly on the French right, have argued in favor of a *binding* strategy, while opponents supported a return to traditional balance of power (Marcussen, 1999). Hence, fit with EU institutions did not account for the positive attitude towards EMU, rather decision makers that utilizes adjustment mechanism according to their own political preferences.

Nevertheless, preservation of national identity will be soon put on test bythe two critical events- the failure of Mitterrand economic policies in the early 1980 and political unification of Europe at the beginning of 1990 (Schmidt, 1996) creating additional pressures on the French political stance. Also, failure of Mitterrand's economic policy was considered as the last gasp of the traditional French interventionist policies[26]. Reform of economic policies has been hence, seen as the breaking point in the French response to EMU that will also back up the country's ability to struggle against the external pressures.

It was only a matter of time when France will be more Europeanized shifting its approach from the monetary inertia to proactive outlook towards EMU that included accommodation of national policies and institutions with supranational principles. Therefore, we may argue that the role of political elites was vital forcreation of the Europeanized France and changes in its preferences toward EMU. It is not to say that French political elites did not use economic reasons to gain public support for EMU, because they were certainly backed up with economic goals, where the economic merits of single currency were highly placed on their agendas. But we also suggest that, preferences and interests of elites in France, as unitary state without veto points could jeopardize governmental decision making process, were the crucial mediating factor that strongly influenced country's approach to EU. In this sense, shape of the national adjustment mechanism to EMU mirrored the changes in political preferences rather than real economic needs. In the table, we illustrate interplay of mediating factors in France that enhance or constrain its way to EMU therefore, resulting in policy discourse. As we discussed above factors took different roles in shaping the country's response to EMU, since different national set up and level of fit determine different (enhancing or constraining) features of each factor. We will apply these results against the outcome of the next chapter to discuss as to why the role and effects of the mediating factors change over time creating different forms of integration.

	Economic vulnerability	Veto points	Political elites	Institutional structure	Timing
Enhance	v	v		v	v
Constrain			v		

Table 1. Influence of the mediating factors in France

In sum, French response to EMU has been heavily contested by changes in the political preferences. But even though, French polities were contested with the preservation of national sovereignty on one side, and Europeanized France on the other, national identity and strong economic features prevailed over rival visions of Europeanization. France, hence,

[26] Ivo Maes: **On the Origins of the Franco-German EMU Controversies,** European Journal of Law and Economics, Number, 2004, pp. 30

experienced accommodation in monetary policy in response to the pressures from the top that at the same time act as globalization catalyst. However, French absorbed most of the EMU model features, which gradually embraced modern, European monetary concept, yet in French colors.

3.2.2 Germany: Trading stability commitment for reunification permission

In Germany, economic vulnerability was not that much of an issue until beginning of the 1990s, mainly because of the strong and successful Bundesbank that made early U turn to monetarism in response to global economic pressures. Nevertheless, central banks led strict monetary policy in order to secure sustainability of national currency, low inflation rates and price stability. Therefore, Bundesbank traditional preferences for stability and policies focused on combating inflation (Schmidt, 2002) with good monetary performances helped in promoting the German model with strong independent central bank as pattern for European institutionalization. Hence, Germany has presented not just the leading and the largest economy in Europe, but also the preferred pattern for monetary integration that will magnify its supremacy.

Although, the Maastricht convergence criteria symbolized German monetary power, it is interesting to analyze how Germany became the role model and what factors enhanced the reform leading to slight accommodation of its monetary policy. At this point we may argue that political actors played an important role in underpinning and shaping German response to EMU. At that time, strong German economy had little to gain economically by entering monetary union. In this case, strong economic performances gave Germany prerogative attitude over EU pressures. Hence, we seek to answer who determined German destiny within EMU? We assume that German response was shaped outside its borders, since Germany accepted monetary union as a means of binding for political reunification (Donnelly, 2002). It is complex case shaped by interaction of economic developments, political preferences and high power of inherited institutional organization.

The restrictive approach to convergence criteria reflected political preferences during Gerhard Schröder government, who was primarily driven by the interest for stable monetary policy. Although, political actors as an important factor in domestic response to EMU, they were less influential catalyst for change than, for example in France or Britain. This can be explained by different institutional settings in those countries with different levels of empowerment delegated to the central government. Such settings include multi-actor system in federally organized Germany with number of veto points and hence, restricted power of executives to impose changes. In opposite, single-actor system that is on the scene in the unitary organized France and Great Britain has higher capacity to impose governmental decisions with less veto points[27]. In this sense, we may argue that veto points in federally organized systems act as constraining factor that limits national institutional capacity to impose changes determining certain mode of integration in favor of majority.

[27] Vivien A. Schmidt and Claudio Radaelli: **Opening the Black Box: Europeanization, Discourse, and Policy Change,** Introduction for a Symposium Issue of West European Politics, 2002, pp. 12

Even though political actors matter in federally organized systems like Germany, they would not be able to push country toward implementation of preferred policies in case where national policy and institutional structures are highly reversed to supranational structures. Hence, this switch in factors shape domestic change under the EMU pressures will work only under the strong inherited institutional capacity as strong generator of change. In this case German political actors could successfully negotiate with existing level fit and strong economic fundamentals controlling the mode and level of integration. These strong economic fundamentals are based on the strong central bank and superior performances of national currency as hard currency with fixed exchange rates[28].

Therefore, we may argue that strong negotiating positions toward EMU were mainly driven by goodness of fit and national political preferences that were at the same time deeply institutionally embodied (Dyson, 2002). Even though, German's gain merits from EU integration with high level of fit, its explanation power of used adjustment mechanism is weak. Rather, we can emphasize preferences of political majority and institutional heritage as the crucial factors for change.

Difficulties in German case of Europeanization appeared when the loss of national sovereignty fairly overweight benefits of Europeanized domestic monetary system. This meant that German politicians needed good reason to transfer responsibility for monetary policy up to the European level and sacrifice strong national currency that was at the same time one of the symbols of national sovereignty (Schmidt,2002). Nevertheless, in explanation of German discourse to EMU it is important to address not only five mediating factors that were common for all member states, but also to address one- political unification, specific to German case of Europeanization. Germany, at the beginning of the 1990, expressed strong will for political reunification that had to be blessed by other EU member states. Faced with possible French veto on reunification, Germany confirms its European way reflected in its readiness to apply institutional design for monetary integration. Hence, to gain political goals, Germany shared its strong monetary fundamentals with other EU states by scattering strong monetary know how over the Europe. It was a silent swap of strong monetary positions for political reunification. Hence, German unification acted as a new catalyst for domestic change (Dyson, 2002). We may also add that the timing of unification and German Europeanization was perfect, even though the influence of this factor spill over the economic area.

At this point we may refer to different interactive influence of German mediating factors which enhance or constrain country's ability to impose changes and hence, results in policy discourse. German response to European monetary union has been shaped by different dynamics and influence of the five mediating factors illustrated in the table below. Specific reform discourse account for strong existing institutional structures and veto points as reform generators and loosen effects of economic vulnerability and political elites limited by the decision making power within federal system (Table 2).

[28] Kenneth Dyson, **Germany and the Euro: Redefining EMU, Handling Paradox, and Managing Uncertainty and Contingency,** Queen's Papers on Europeanization No. 6, 2000, pg. 8

	Economic vulnerability	Veto points	Political elites	Institutional structure	Timing
Enhance	v			v	v
Constrain		v	v		

Table 2. Influence of the mediating factors in Germany

To sum up, with strong economic fundamentals embodied in the stable national currency and authoritative central bank, Germany had slight problems on its way to EMU. This conclusion goes in the line with the Olsen's theory of the different patterns of European integration where countries with centralized financial institutions that enjoy great financial authority the EU policy are more likely to have an impact on domestic arena[29]. Hence, the Maastricht Treaty symbolized German monetary power and successful financial integration lead by independent, powerful central bank. The result of perfect fit between German and EU monetary system meant that German policy makers had an easy job in accommodating to the EMU requirements. Also, these factors created a buffer that shifted the cumbersome federal structure into more decision friendly. Still, it remains to be discussed if these factors maintained the same mode of integration with the EU securities market.

3.2.3. Britain: Gatekeeper of national interest

In sharp contrast to both France and German stance to Europeanization, the British attitudes toward European monetary integration illustrated high inertia since the adoption of the Maastricht Treaty, when Britain choose to opt out from the single currency area. Therefore, I found interesting to analyze and discuss British domestication of monetary system and its implications on further liberalization of securities market.

Although, British economic vulnerability was even higher than in Germany, it responded quite late to the globalization pressures. In this regard, economic vulnerability did not act as essential mediating factor that will adjust British policy preferences to EMU principles. Instead, Britain responded with high inertia to European integration that stem from divided stance of political actors over Europeanization and strong economic fundamentals embodied in the sound money and financial stability. These two factors were the main generators of change. We could say that Britain was more Euro skeptical over how European integration will influence national economies making them more or less vulnerable of globalization pressures. Nevertheless, in Britain as unitary state where central government had enough capacity to impose decisions, political actors remained vital mediating factor that shaped response to EMU and determined its (narrow) place under the Euro sky. Also, key decision makers gathered under Tacher's presidency were not willing to persuade public for necessity of change toward EMU, but even more important about its merits for Britain, giving concerns about the loss of financial sovereignty. Hence, political actors were not just the crucial but also hindering factor that shaped the British skeptical and distant attitude to EMU.

[29] Ian Bache, Stephen George: **Politics in the European Union,** Second edition, Oxford University Press, New York, 2006, pp. 62

The lack of political will to Europeanization principles and no to euro as single currency show strong signs of inertia and retrenchment (Radaelli, 2000). This was especially the case during the Conservative government of John Major, who negotiated opt out form the Maastricht Treaty. The same scenario was applied later by the Blair's Liberals who opt out from the single currency area (Gamble and Kelly, 2002). Although, Britain had strong currency and authoritative central back, which at the same time empirically supported it's off from the EMU and single currency, it also enjoyed high fit with the European structures. Therefore, it would be expected that British no to EMU and single currency was not erroneous decision that could endanger further Europeanization, in particular toward securities market integration. British commitment to sound money, an anonymous central bank and freedom of capital movements were policies adopted independently in the past acting as milestones of its further integration into the European artifacts.

British domestication that emphasizes the essential role of institutional structure and political preferences shaped its mode of Europeanization, of course in a British way. Hence, with the high level of fit and lack of political will to impose and conduct reforms Britain has utilized Europeanization requirements to its own preferences.

	Economic vulnerability	Veto points	Political elites	Institutional structure	Timing
Enhance	v	v		v	
Constrain			v		v

Table 3. Influence of the mediating factors in Great Britain

To wrap up, British decision not to join EMU and single currency area will not determine or even produce negative attitude towards Europeanization. Even though it remained outside the euro area, Britain, as EU member state, is still affected by decisions made at the supranational level. Also, according to Leuffen and Luitwieler reveal on the length of membership that impacts state preferences for further integration, we can expect stronger links between Britain and EU in the future. How this will impact securties market integration stays to be analyzed and discissed in the following chapter on Europanization of securities markets.

3.3 Further use of the first chapter key disclosures

As discussed in this chapter monetary union is dynamic process guided by national political and economic interests. Even though, according to the Schmidt's (2002) reveal on types of adjustment pressures, was expected that the member states will take the same trajectory towards EMU they took various modes of integration. France, as spokesman of the EMU, had a tough choice between devaluing national currency in order to adjust to the convergence criteria or higher control over the economy so it could please business community. Germany has also faced trade offs on its way to EMU. As the monetary strongest European country it had a fear that opening of the market and inflow of economic shocks from the less develop countries, would have negative impact on economy and might cause more severe damages.

Also, Germany was under the strong external pressures that feared to jeopardize political reunification if it refused to contribute to the monetary unification. Finally, Britain with strong and highly influential key decision makers stayed outside the monetary unification, even though presence of economic vulnerability and good timing suggested different scenario. In the next volume we will continue with our debate on national mechanisms to Europeanization, where the same mediating factors will be tested in securities markets area as example of looser type of European integration, and set against the EMU results.

4. Europeanization and securities markets

As discussed in prior chapters on the European Monetary Union (EMU), national response mechanisms to the convergence criteria varied greatly with different mediating factor arrangements. The result of this mix is the dominance of existing institutional structure and political preferences that were able to shape domestic response to their own advantages. This ended in different modes of integration and hence, monetary policy divergence across Europe. While the discourse of the mediating factor's impacts on monetary policy is extremely productive and valuable, exploration of its impact within the ever-changing field of securities market is also of critical significance. It is imperative to ask the question: Will mediating factors assume the same role towards EU induced securities policies? This chapter will address this vital question at length.

The case of securities market Europeanization is particularly interesting because we can examine whether intense efforts aimed at strengthening the EU monetary integration have also resulted in a higher degree of securities markets integration. To comprehend the complex relation between the EMU and Europeanization of securities markets and, in turn, its influence on changes in countries' response strategies, we have to look at conditions beyond EMU and factors that curved the uprising trend of securitization in Europe. In particular, mediating factors need to be examined as a critical element in understanding European securities integration and policy divergence.

4.1 *EMU: key to more integrated securities markets?*

In order to begin exploring the role which the creation of the EMU has played in the development of the European securities market, it is it is essential to examine the market prior to the adoption of a single currency. Negotiating a single securities market at the beginning of 1990s was a challenging and highly ambitious mission due to "heart of the state" economic regulations (Mügge, 2004). In this vastly divergent financial environment, with its labyrinth of different nationally embedded regulations, governments were narrowly able to come to an agreement on a lowest common denominator (Steil, 1993). In this climate, securities markets remained relatively closed as national level institutions asserted control over their regulation.

Over a decade and a half later, the European securities market looks strikingly different. National markets have been liberalized, securities market regulation is based on harmonized EU laws and integrated supranational governance is in place (Mügge, 2004). In order to fully understand this dramatic transformation on the securities landscape, many issues need to be examined in depth. It is crucial to address the degree to which the creation of the single securities market was driven by progressively rising benefits of European integration. This chapter will illuminate this process. In particular, it will emphasize the critical growing trend of European integration (including the introduction of the euro) in the process. In fact the integration was pivotal in laying the groundwork for securities market development in that it fostered a more friendly and progressively secure financial environment. Indeed this environment made it possible for national securities markets to operate within and realize economic benefits from the single currency arena.

It is clear that the main driving forces that triggered and continued the development of the European securities market were a combination of significant globalization changes, the wave of financial liberalization and the information technology revolution (Hartmann, Madeleine and Manganelli, 2003). Even Schmidt (2002) considered the internationalization of financial markets (facilitated by globalization pressures and rapidly changing technology) as by far the most critical shifts influencing the changes of member states in this arena. World Bank statistics (2000) also show a distinct correlation between European securities market reforms and globalization. Specifically between 1993 and 1998, international bonds issued by foreign residents in addition to the Eurobonds) increased from just over $1.3 trillion to more than $2.6 trillion. This increased doubling (from 8 percent to 16 percent) the share of international bonds to total bonds outstanding in world markets. Still, numbers do not reveal the factors primarily influencing the steadily increasing trend of securitization in Europe as well as the econometric graphs which show the specific different securities markets forms. Therefore, this thesis will continue with an analysis of the various effects that EMU had on development of the securities market across Europe.

In articles tackling the vast issue of Europeanization, analysts consistently agree on the basic premise that the EMU matters (Yang, Min and Qi Li, 2003). Analysts writing on the issue, such as Dickinson (2000) agree that the integration of major securities markets in Europe increased greatly after the creation of the European Monetary Union. To support this argument it is important to begin with the most basic and most persuasive effects of monetary union: introduction of a single currency. As previous chapters discussed, the single currency area created numerous economic benefits for member states' economies. The list of benefits comprises the shrinking or elimination of exchange and currency risks, the elimination of currency related investment regulations as well as improvement of the country's credit rating. These direct effects are easily measured, and much data on them is readily available. Yet, the more suitable, but arguably more important, indirect effects of EMU on securities markets are more challenging to evaluate statistically. For example, it is clear that the vast increase in market breath and depth are at least correlated with reduced transaction costs stemming from the single currency area.

Moreover, Pozen (2001) emphasized that the introduction of the euro has already accelerated the growth of the region's financial markets. Liberated from the foreign-exchange transaction costs as well as risks of currency fluctuations, growing cross border investments have fueled the rise of larger, more liquid European stock and bond markets, including the recent emergence of a substantial junk bond market. These more dynamic capital markets, in turn, have placed increasing competitive pressure on both government and market players by giving corporations new financing options and thus lowering the cost of capital. In addition, since the euro's introduction the number of European companies whose securities have been rated by the Standard and Poor's has climbed 38 percent (Foreign Affairs, 2001.)

As a result, European stock listings and trading volumes have soared. In addition new stock exchanges such as the pan-European Easdaq and the German Neuer Markt have soared. In the past generation the value of European stock markets has grown at a compound rate of 20 percent per year (from barely $200 billion in 1979 to $7.4 trillion in early 1999). Among the Eurozone nations, stock markets are now worth nearly 90 percent of GDP. These burgeoning stock markets, in turn, are spurring the growth of hedge funds and venture capital, as well as initial public offerings, which raised a record $47.1 billion in Europe last year (Foreign Affairs, 2001). In sum, the euro has catalyzed a transformation in European finance. In turn the boom in national securities markets (based on the euro as the single currency) has translated into growing political support (at the EU level) for a single, open market in financial services (Pozen, 2001).

Danthine, Guavas and von Thadden (2000) similarly emphasize the benefits of the EMU. They assert that the EMU opened the "possibility for the creation of the world's largest domestic financial market in Europe." They underscore the importance of a single currency as a necessary condition for the emergence of pan-European capital markets, emphasizing that it is just one among numerous benefits of EMU on EU securitization. Therefore, they expanded Dickinson's (2000) concept with deepening effects of EMU on creation of centralized securities markets institutions.

As discussed, Europeanization starts with European integration or creation of institutions at the supranational level. Still, as can be seen in the EMU example, European integration and Europeanization are parallel processes that do not continue in the same trajectory (Haverland and Holzhacker, 2006). High adjustment pressures do not automatically produce higher levels of policy converge. As time progresses, Europe shifts to more liberal forms of cooperation that will leave member states a greater freedom to shape, monitor and control their policies in accordance with Europeanization propositions. Hence, it is to be expected that Europeanization of securities markets with their different adjustment pressures on member states will utilize different institutional models according to the national preferences. Subsequently this will encourage policy discourse. Therefore, sources of transformation and policy divergence must be sought within member states (Mügge, 2006).

It is a common belief that distinction between two Europeanization milestones lies in the competition politics (Mügge, 2006). As international outlooks began to shift, the innovations forced changes within the deeply entrenched field ofsecurities markets, thus increasing the competition between the markets as who will be able to attract more investments. Therefore, let us begin with the process of European integration and its impacts onto the member states securities markets. This analysis put forth by EMU state mechanism reveals that goodness of fit and adjustment pressures are important, but not the essential factors for change. Following the same path as in the case of EMU we will look beyond European integration and fit concept by focusing on the effects of mediating factors.

Thus, following lines will challenge national response with divergent mediating factor arrangements within completely different surrounding than that in the EMU. It is implied that institutional and policy building at the supranational level emphasize rising globalization pressures (Laurence, 2001) or increase the continuum of the Europeanization trend (Moravcsik, 1991) as primary driving forces. Therefore five mediating factors remain central in our analysis but now are applied to and tested in a different political and economic environment, which may imply divergence per se.

4.2 Fast forward European securities market

European securities markets are of major importance in performing the function of promoting the raising of capital that generates economic growth and development (Alexander, 2006). Hence, building the EU securities market has attracted global attention among field experts and analysts and has sparked much dialogue and discussion around the varying impacts of different factors on securities markets integration. Therefore, the literature on European integration of securities markets cuts across debates on globalization, European integration, and national securities markets liberalization. Analysis of securities market institution building and its impact on national markets need to include these varieties of influence. This account will encompass all elements of divergent national responses to EU imposed securities liberalization, and help in the clarification of the process of Europeanization of securities markets as a whole.

It is known that the EMU outpaced the development of securities markets' integration. Indeed, experts writing on this issue have consistently iterated that the monetary union has gone "far toward quickening the pace of overall financial integration" (Simmons, 2001). The second dimension refers to the growing linkages between domestic securities markets involved in single currency area. While useful, these components do not fully explain the forces driving or limiting securities market integration and divergent national responses to common EU pressures. External pressures and influences such as the rising Europeanization trends as well as the creation of the EMU still need to be translated into change by domestic mediating factors.

It can be argued that along with the influence of monetary convergence on the integration of European securities markets, national responses to EU challenges will be colored by domestic factors keeping prerogative in regulation and control over domestic markets. Hence, this volume will emphasize influence of European integration in securities sector (Mügge, 2004) as well as state-centric understanding of these EU challenges (Kastner and Rector 2003, Li and Smith 2002) propelled by interplay of mediating factors.

Hence, we may suggest that national decision makers were faced with dual impetus of securities markets liberalization created under national preferences and European integration. To explain the first challenge we may refer to Sobel's notion (1994) on political arguments emphasizing that securities markets liberalization has been triggered by either international pressures (outside-in explanations) or internal impulses playing a primary role (inside-out explanation). Even though, Sobel emphasized obvious effects of globalization and technological progress on securities markets reform, these external factors were too disparate to account for observable variations in national strategies. In opposite, his *inside-out* explanation of securities market changes is very close to our concept as they highlight domestic factors in institutional and regulatory reform, emphasizing bottom up approach in Europeanization of securities markets (Sobel 1994, Coleman 1996).

Before tackling variations in countries response to Europeanization of securities markets, focusing especially on adjustment mechanisms, we seek to explain the process of policy and institutional building at supranational level or Europeanintegration in the case of securities markets. After in depth analysis of rules and policies and strength of adjustment pressures they create it will be possible to address the query on weather harmonization of securities policies is likely at all or weather it is moving *up* toward more strict rules or *down*, leaving room for member states to adjust.

4.3 Building the new EU securities infrastructure

The European securities markets are rapidly developing from the high degree of segmentation and state influence to more integrated form based on national deregulation. Henceforth, liberalization of securities markets was central to 1992 single market program. Initial effort toward European securities market conducted from national institutions produced central documents: the Investment Services Directive (ISD) and Capital Adequacy Directive (CAD) in 1993. Even though these documents presented brave steps toward a single securities market, they fail in attempt to bring national policies together. The problem was that supranational regulation did not follow liberalization of national securities markets. Kern Alexander's (2002) concept on securities markets liberalization and integration can be useful here, emphasizing that EU institutional design and scope of regulation should be based in part, on the level of integration in securities markets. At the same time he argues that liberalization of securities markets does not necessary have to lead to integration of securities markets. Therefore, we may suggest that leaving the enforcement of initial documents to national structures EU institutions failed in attempt to create integrated securities market. Hence, EU securities markets stay highly fragmented and segmented.

At this point, we may draw the line between the process of market integration and monetary snake as initial process of monetary convergence. Even though it was a promising project snake failed soon as no single strong party could take the role of monetary union gatekeeper. Similar happened in securities market field. With no strong party to dominate others, mutual recognition rather that harmonization became the sneaky road to market building (Mügge, 2004). Hence, ISD and CAD, inefficient to enforce compliance among national policies, left leeway to member states to express national interest and encourage divergence. Although, securities markets liberalization in wake of ISD and CAD did not show unilateral adjustment to globalization pressures, they were part of coordinated shifts in national agendas and a positive project of the European securities building.

External pressures and dashing Europeanization trends highlighted strategic role of securities markets pressing governments to cooperate more closely toward integration. Since every member state wanted to upload some of its preferences and interests into the new EU regulatory framework, legislation is based on a result of legally binding, harmonization of national regulations funded as mutual recognition of national regulators. This combination of *national interests* creates single market in which financial institutions are supervised by national, *home country* supervisory authorities (Alexander 2002). EU rules set by the mix of national preferences had loosely impact on financial actors deepening cross-border barriers. Hence, remaining market fragmentation and segmentation encouraged member states to freely choose how to implement decisions will emerge in less convergence within Euro area (Schmidt, 2002). In this sense, we may suggest that securities market integration was initiated and conducted from the bottom, influenced by interests of key decision makers and extend to which these policy objectives have already been achieved domestically.

Still, we cannot judge securities market integration based on theoretical assumption emphasizing that less regulatory convergence will necessary lead to loosen integration (Schmidt 2002, Cowles and Caporaso 2002, Börzel 2001). As securities markets are dynamic and institutionally embodied business areas highly depended upon globalization pressures and technology progress there is a pragmatic need for more streamed, flexible and expedited legislative approach to respond to these changes and risks arising from them. Hence, we may suggest that home based regulation within clearly defined EU framework will increase national securities market performances through minimum standards incorporated in their legislative framework.

Soon EU decision entrepreneurs admitted that until European securities market became more integrated, a single EU securities regulator would not be an efficient or effective model for EU securities market[30]. Therefore, the pattern used in creation of European monetary union with ECB as authoritative single regulator and highly coercive convergence rules cannot be successfully applied in the case of securities market. Therefore, EU is not optimal area for single securities regulator (Alexander 2002). However, after the competition of the monetary union, many of the new forms of cooperation and integration appeared. In this new outlook Europeanized countries will reach for more Europeanization, no matter what directions they take.

4.3.1 FSAP: Setting up basis for new EU regulatory structure

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). Even though the home control regulatory principle seemed as good ad hock solution for effective functioning of single securities markets, it will become less effective in the future when securities markets overgrow narrow domestic regulatory structures. This assumption required establishment of more centralized regulatory framework. In 1999 European Commission will introduce the Financial Services Action Plan, a financial market to-do-list (Mügge, 2004). With FSAP European actors for the first time took the lead in setting the securities market agenda. Beyond a move toward more national markets harmonization, FSAP had aimed to secure financial stability as well as keep EU regulatory standards of prudential supervision up-to-date. This would manage systematic risks of enlarged securities market. It was a gain battle of EU actors seeking to create more unified framework and enhance regulatory integrity at supranational level. Hence, FSAP set forth new, effective regulators framework tailored to current securities market needs that will enhance supranational influence in promoting the cross border investments and trading under the common rules. The FSAP was ambitious program that narrowed home interest principle and introduced new EU regulatory framework that by requiring more liberalized and harmonized markets will lead to true integration of EU securities markets.

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[30] Alexander, Kern Alexander: **Establishing a European Securities Regulator: Is the European Union an Optimal Economic Area for a Single Securities Regulator,** ESRC Center for Business Research Cambridge University, 2002, pp. 2

These dramatic changes in securities market institutionalization are responses to an increasing integration of EU financial markets, as well as growing globalization pressures and impeding technology progress in this field. This all, within new FSAP plan, created more tension between member states supervisor seeking to assume more regularity and supervisory responsibilities in the new EU institutional set up. France authorities requesting that the new EU regulatory authority should be based in Paris, with European Central Bank in Frankfurt,as the UK is not the Eurozone member (Mügge, 2004). Therefore, in such a sensitive environment the role of the EU decision makers has to be carefully shaped.

4.3.2 Can Lamfalussy save the idea of EU securities market?

Aware of the fact that establishing an one-size-fits-all rule, as in the case of the EMU, is doomed to failure, EU regulators tried employing a more flexible approach. The European Council decided in Lisbon in March 2000 to set up an independent Committee of Wise Men in order to reduce the backlog in the EU securities market regulation (Lamfalussy, 2006). Despite its primarily concern with regulation and not necessary with harmonization of the national policies, Committee of Wise Man with its chairman Baron A. Lamfalussy will play determining role in speeding up the regulatory concept of securities markets making it more flexible and efficient.

The proposed remedy to improve harmonization and penetration of national securities markets was to introduce a four-level regulatory approach for proposing, adopting and implementing an EU securities legislation set up by Lamfalussy[31]. This four-level system is not composed of strict rules but rather suggestions and consultations with national regulatory authorities and end-users in order to achieve better efficiency and effectiveness of integrated securities market. Even though it faced opposite opinions about effectiveness toward creation of integrated EU securities markets, it cannot be denied its significant influence on better cooperation among supervisory authorities and better enforcement of the EU regulations. Not only that, Lamfalussy succeed in triggering the further securities market institutionalization process, where two core supervisory institutions the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR) will be established. These events will have a profound influence on further Europeanization of securities markets, leading to more harmonized national regulative within EU bounds. This development and broaden institutionalization will certainly have positive impact on the quality of European securities markets and on leveling the regulatory appliance across member states[32]. Well

[31] Accordingly to the Lamfalussy scheme, Level 1, an initial phase, referes to EU framework leigslation and essential measures that Committee adoptes after full consultations; Level 2, an implemenation phase, referes to adoption of measures decieded at level one in cooperation with two committees (ESC and CESR); Level 3, the transposition phase, CESR works to ensure consistent implementation and application of EU legislation in all member states. This stage involves close cooperation between the CESR and member states. Finally, at level 4, the monitoring phase, the Commission fulfils its function as a guardian of the treaty by checking compliance with EU legislation in member states. Hence, it referes to enforcement and involves Cimmission and member states.

[32] 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 (Gottwald, 2005).

structured EU policy and institutional structures, tailored to specific nature of securities markets and divergence of national policy structures, will certainly increase degree of regulatory harmonization and reduce the possibility for host-country restriction (Lannoo, Casey and Sutton, 2005). In addition, important convergence has taken place in policy goals, policy content and policy outcomes (Coleman, 1996).

It is suggested that besides the FSAP and Lamfalussy program induced important EU securities institutionalization, they did not evolve substantial harmonization of national legislation. It has been also argued that Lamfalussy's program "does not provide institutional safeguard of political accountability to EC council and Parliament and will also create legislative delay and inflexibility in promulgating and implementing securities regulation in member states" (Alexander, 2006). Consequently, these less specified EU securities rules will create less adjustment pressures and hence, result in policy divergence among member states. In implications of these less structured rules is that member states have an option to add whatever regulatory structure they believe appropriate, above and beyond the minimum levels that have been harmonized (Heritier, 2003). These circumstances will only strengthen the effects of mediating factors.

Taking this fact into consideration, it is critical to seek to clarify and understand the role of mediating factors and changes in their preferences on country's response to EU induced securities liberalization. Effects of change in mediating factors straighten by globalization pressures, technology progress and specific nature of securities markets, lead to radical shifts in countries response to Europeanization of securities markets, comparing to those applied in monetary unification. These new competitive conditions will influence different role of domestic mediating factors resulting in shift of adjustment mechanisms in response to Europeanization requirements. Like in the case of EMU, focus lies on France, Germany and Great Britain. These countries have not only dominated financial markets and the negotiations, but also represent three distinct financial system traditions, making them an interesting story to tell (Mügge, 2006).

4.4 France: Back in the game

As the preceding chapter on French approach to EMU made clear, the French economy is adapting remarkably well to globalization and Europeanization pressures. Also, French decision makers on the way to EMU gave up part of financial sovereignty as price worth paying for economic growth and increased prosperity (Gordon and Meunier, 2001). Hence, there is to assume that French integration into the EU securities markets is expected to follow a path of steadily increasing convergence as a result of the monetary integration. But as we noted above the degree of EU securities integration is determinate by role of national specific set of mediating factors. Therefore, high levels of French monetary convergence will be challenged by new securities environment that shuffle mediating factors resulting in turn of adjustment mechanism. It is not any more a question whether financial sovereignty can be traded, but what securities market integration brings for competitiveness and prosperity of domestic economy.

France started quite early with the liberalization of its securities markets. The transformation begins with the Little Bang in 1988, followed by increased privatization and rise of private capital that additionally boost stock market growth. During this period French financial services had undergone a dramatic change, opening up French markets. What is more, early securitization will actually encourage France to sit up from monetary fence and take lead in the EU securities markets integration. Early domestic securities market liberalization, uploading of national structures and preferences at supranational level and strong incentives for further growth within single market curved out French role as securities market pace setter. Later, this will apply lower costs of adjustment to EU policies.

Although, it is assumed that securities markets reform is primarily facilitated by strong globalization pressures and rapidly changing technology, these pressures still had to be transferred into change by mediating factors (Kastner and Rector, 2003). In France, securities integration mirrored the state domination of financial system (Mügge, 2006). French regulation combined political discretion over credit allocation with a role of leading firms in government debt markets and monetary policy (Story and Walter, 1997). This role of political actors in conducting securities market liberalization can be seen as strong nationally embedded regulation of the market but also as weakness of private capital to manage market operation and a free allocation of resources. In creation of the new institutional structures France will follow British example with supervisory power delegated to the Commission des operations de bourse (COB) that will actually gain sufficient independence to counter state interest in market control and supervision (Mügge, 2006). This securities model with strong central regulator will be later uploaded at supranational level ensuring strong French representation at the EU level. While this development seems to underline the trend toward a shift in the roll of state in finance in France, they cannot be considered as a wholesale rejection of state impact (Coleman, 1996) where state still has the role to play (Schmidt, 2002).

Soon, this home regulation in France (Mügge, 2006) will be challenged by increasing global markets growth, where securities market deregulation and loosen state impact would be necessary precondition for global competition. By the early 1990s, cross border flows of capital had reached enormous volumes, and the issuance and trading of securities on French market burgeoned. From 1993 through 1998, international bonds (bonds issued by foreign residents plus eurobond issues) increased from a little over $1.3 trillion to more than $2.6 trillion, which doubled from 8 to 16 percent the share of international bonds to total bonds outstanding in world markets. International equity issues have also increased substantially, from less than $50 billion in 1996 to more than $70 billion in 1998 in real terms (Bank for International Settlements, 1999). These events will somehow converge with changed aims of French political decision makers, as the found those economic costs of capital controls overweight their benefits in the new world economy. Also, the nature of securities markets placed a large pressure on political actors to loosen their control and restriction over financial structures and operation as it was the case in monetary system. Nevertheless, the impact of other mediating factors is an important issue in explaining the French efforts towards single European market.

Not just political actors change their aims and attitudes under globalization and Europeanization pressures but also shifts in other mediating factors are also obvious. This time-to-time accommodation to external pressures will result in changes of adjustment mechanisms to EU induced securities liberalization, now lead by increasing role of private investors and interest groups empowered to negotiate with political actors. Therefore, this case in very interesting because as unitary state France did not face hinder effects of veto points, but instead had to reach consensus with investors' lobby groups together with other securities market associations for more efficient, market based securities operations. Under these pressures, political actors deregulated securities market establishing new, efficient trading borrowed from management capitalism but still with the great role of state or state related actors (Schmidt, 2002). Hence, veto points even though did not have direct effects on final political decisions indirectly, in the case of securities markets reform, it produces constraining effects towards more Europeanization.

	Economic vulnerability	Veto points	Political elites	Institutional structure	Timing
Enhance	v		v	v	v
Constrain		v			

Table 4. Influence of the mediating factors on the France securities market reform

Early launch of securities market reform will show as decisive point in strengthening the French role in the EU securitization. Also, as we noticed all crucial factors in financial reform (economic vulnerability, political elites and veto points) shift their roles from monetary integration hinders to promoters of securities market Europeanization. Therefore, it is not suppressing that France had much more success in Europeanization of its securities market reaching higher level of policy and institutional convergence throughout domestic friendly mechanism implying only slight adjustments of national structures.

Is it because France picked perfect timing for securities reform, or great supervisory power of single regulator that will be later uploaded at European level, or close cooperation with interest groups and securities associations that highlighted French role as pace setter in EU securities market will remain vague. Furthermore, we may argue that all these mediating factors worked in perfect harmony, shifting French role from monetary transformation to securities retrenchment and slight accommodation (Radaelli, 2000), placing the country on global securities markets map. Nevertheless, neither the globalization pressures nor EMU had lead to significant penetration of France into EU securities markets, as its market still remains under the control of national regulators triggering the come back of de-liberalization. In this sense we cannot argue that de-liberalization was a triumph of markets over governments (Vogel, 1996), but more vice versa.

4.5 Germany: From monetary leader to follower of the EU securitization trend

By the end of 1992s many countries, including France and Great Britain began with liberalization of their securities markets through new regulatory framework, while establishing and expanding governmental supervision of the organized securities market (Lütz, 2000). At the same time they took initial steps in setting up the pace for

Europeanization of securities markets. Germany, by contrast to both France and Great Britain, started later with its securities market reform. As the pace setter of monetary Europeanization and the strongest economy in Europe Germany hold that prerogative attitude toward the Europeanization of securities markets. Its inertia as response mechanism to EMU can be explained in terms of high economic performances and strong political and institutional capacity to change (Schmidt, 2002), but certainly remain vague why the same concept has been applied to the EU securitization. We argue that German policy entrepreneurs were able to formulate effective monetary policy, but when it comes to securities markets, the path used was not so successful. The reason for market reform failure can be traced back at the nature of securities markets, where stability, strong central control and future monetary predictability certainly do not fit into the ideal securities market pattern. Nevertheless, besides internal obstacles external pressures such as increasing globalization, risks of political unification and integration of European securities markets threatened to impede considerably the competitiveness of the German economy[33].

Although Germany did not completely miss the trend towards securities market deregulation and innovation, for many years did not change much compared with dynamic development in other countries. Besides political unification, structure of other mediating factors did not fit well with the global liberalization of financial markets, threatening to impede German securities market reform. This led to question about German approach to financial services regulation and supervision that had emphasized self regulation as much as possible (Coleman, 1996). Moreover, German institutional set up encompasses much higher level of state intervention than other market based systems[34]. I may argue that German model of financial market Europeanization is the best example why successful monetary policy ideas suddenly become obsolete in dynamic securities markets environment. This effort to apply the same monetary policy supervision through centralized system of control continues to rob German securities markets of that "breath and depth which investors are used at competing securities centers" (Walter, 1995).

Largely in reaction to ongoing reforms in other countries, German securities market started opening and growing more responsive to the EU pressures knowing that it would be left out if did not (Pozen, 2001). Even though institutional heritage hinder the reform start up, later market opening known as Financplatz Deutschland's initiative in the early 1990s has been pushed by big market players (Lütz, 2002) strengthening country's financial position. Meanwhile, a federal supervisory authority for securities markets Bundesaufsichtsamt fürt den Wertpapierhandel (BFW), was established in 1995 coping single regulator pattern already applied in British and French model of securitization.

Due to somewhat belated start and continuous progress of other EU countries, Germany had to make double efforts if it is to catch up with the leading EU securities markets and to keep top positions in the European finance. Governments are making reforms to encourage the growth of their financial markets mostly throughout market-friendly tax

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[33] Susanne Lütz: **From Managed to Market Capitalism? German Finance in Transition,** Max-Planck-Institut für Gesellschaftsforschung, MPIfG Discussion Paper 00/2, 2000, pp. 13

[34] All north western economies with highly developed industries share similar roots (Mayers, 1994).

reforms. By cutting corporate capital gains taxes and taxes on corporate dividends in half[35], Germany lowered transactions costs and increased the amount of stock holdings in new investments, attracting business back to Germany (Pozen, 2001). Although, German securities reform package succeeded, bad timing loosens country's economic potential to upload some of its national preferences up to the EU level. This resulted in radical shift from monetary leader and pace setter to hanger-on of the EU securities suit that resulted in the increased costs of policy transformation.

Besides time as key mediating factor, political actors also played important role in curving out German model of securities markets Europeanization. Before the reforms German securities markets relied heavily on centralized institutional structure highly dependent upon Ministry of Finance and Bundesbank. In addition, until the 1990,the issuing of securities required the consent of the Federal Treasury and Länder governments (Lütz, 2000). Policy makers, corporate leaders, and investors across the region all recognize loss of economic potential caused by a fragmented financial market (Pozen, 2001) as typical for federally organized state. This cumbersome structure with divergent regional economic issues and interest conflicts hinders the pace of securities market liberalization and penetration into the EU structures. Hence, Germany as federal state had to at first solve the problem of insider trading (Mügge, 2006) and emerge nationally (Coleman, 1996) that can catch up with intensified globalization process.

With the changes on political scene in 1980s by new liberal-Christian democrat coalition, Chancellor Kohl's new government embarked on a new pro-European platform to shift financial resources back from the government sector to the private sector[36]. But little had been achieved in the way of securities market reform by the end of the decade, as German politicians remained averse by any big bang experiment across EU countries. Essential to this hesitancy was the financial market stability and long shadow cast over the institutional and decision making structures in Germany, as federal state (Walters and Story, 1997).

Furthermore, German central government played wisely against Länders veto points. First, they new that upgrading and developing of national stock market will *per se* lead to establishment of the new regulatory framework at the central level. Furthermore, central government expresses initiative to upgrade Frankfurt as financial center harming regional bourses that hitherto enjoyed the support of the whole financial community (Lütz, 2000). In this sense, strong national bourse would provide federal political entrepreneurs possibility to defeat the resistance of Länder authorities who protected their regional bourses and pursue with securities market reform supervised by central regulator. This smart play of political actors cancelled influence of veto points and created clear road toward new, European oriented regulatory structure (Table 5). Even Germany partly implemented all the EU induced

[35] Gerhard Schroder, Germany's Social Democratic chancellor, pass market-friendly tax reforms by cutting corporate capital gains taxes in half, effectively liberating $300 billion in appreciated stock holdings for investment in promising new enterprises. It has also lowered taxes on the earnings that companies do not distribute to shareholders, from more than 42 percent to less than 27 percent. And it has cut taxes on corporate dividends to half the current personal income tax rate, the highest bracket of which is slated to drop from 51 percent to 42 percent by 2005 (Pozen, Fidelity Management and Research Company, 2001).
[36] Ingo Walters and Jonathan Story: **Political Economy of Financial Integration in Europe: The Battle of the Systems**, MIT Press, 1997, pp. 162

measures, it fall far short of fulfilling all European commitments for deregulation, illustrating strong national control over the process (Mügge, 2006).

	Economic vulnerability	Veto points	Political elites	Institutional structure	Timing
Enhance		v	v		
Constrain	v			v	v

Table 5. Influence of the mediating factors on the German securities market reform

Nevertheless, functioning of the German securities market rooted on the principles of the federally organized state increase countries prosperity to create a particular securities market network with the central regulatory authority as nucleus. Along with other member states Germany has also moved toward a single regulator, a model that seems to provide best fit for the EU legislation regarding financial services in general (Howell, 2002). In particular, this organizational scheme draws a line between similar organization of German and EU institutions where downloading of European features can be easily, and hence less costly implemented into existing institutional matrix[37]. This argument goes in the line with Davis and Useem (2000) notion that "stock markets embedded in matching institutions can create a virtuous cycle of economic growth". But given the wrong institutional infrastructure, securitization can be an economic disaster[38]. We may argue that similar organizational structure to EU and close cooperation with Länders, Germany actually succeed to catch up the time delay with other European securities markets increasing the chances to become one of the leading securities market centers in the European Union.

To wrap up, while other member states started with reform of their securities markets at the end of the 1980s, political unification came to dominate German economy fail to spot the trend towards securities marker liberation. Hence, Germany missed the perfect timing for securitization that will later increase its expenditures in downloading of EU policies and institutional structure. Late and less dynamic policy adaptation will result in lower stock market capitalization in comparison to France and Great Britain and thus, loosen market growth and competitiveness[39]. Furthermore, in dynamic securities markets time is one of the most important mediating factors that can easily shift leaders to followers. But even though Germany started late with its securities market reform, strong economy, decisiveness of political actors and harmonized decision making process within federally organized state made possible for country to catch up with on going Europeanization. Therefore, strength of key mediating factors in Germany, including political entrepreneurs and number of veto points as especially influenced factors in federally organized states, actually canceled consequences of bad timing.

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[37] Initially, there was minimal change to the German structure but in 2002 a major overhaul was completed. The Federal Financial Supervisory Authority (BaFIN), an institution similar to the FSA, was established in April 2002 and took over supervision of banking, insurance and security markets (Howell, 2004).

[38] Klaus Weber and Gerald F. Davis: **The Global Spread of Stock Exchange 1980/1998,** William Davidson Institute Working Paper 341, 2000, pp.21

[39] Stock market capitalization in Germany increased only for one percent (from 28 to 28 per cent of GDP) in 1986-1994 period while France and Britain doubled their stock exchange value in the same period (OECD, 1995).

4.6 Great Britain: EMU really does (not) matter

London has long been a financial capital of Europe, and this strength was leveraged by early and leading position in securities market liberalization. With early launch of securitization Britain will enjoy the role of reform pace setter, setting up the pattern for other member states and uploading most of its policy preferences at the European level. This case is especially interesting as early transformation of financial market in Britain known as Big Bang (1986) that was mainly influenced by globalization pressures and rapidly changing technology, above any EU decision. Therefore, the British securities market institutionalization with single authority was uploaded to the EU level by retrenchment mechanism, strengthening its goodness of fit, and hence loosening costs of policy adjustment.

British case provides useful insight into the process of Europeanization, helping us to clarify and understand who leads the change in national securities markets liberalization. Hence, we may suggest that dynamic securities markets globalization pressures are the main impetus for change, subsequently shaped by mediating factors and uploaded at the EU level. In this sense, EU securitization started with uploading of domestic preferences and the process of European integration, while EMU basis remain on the creation of EU policy and institutional structures that will be downloaded by member states in more unified form.

Early securitization simply reflects the fact that Britain wanted to secure its role as financial center. Looking back into the past, Britain always held important role in international finance. Hence, aspirations of the British stock market players to keep an important role on international market and gain high profit margins have certainly met with more success than similar aspiration of British government to play a bigger role in domestic securities market. Spurred by the 1979 US stock market deregulation and political willingness to impose reforms in order to secure more business at domestic market, Britain will soon start with deregulation of its securities market. Unlike other European countries, Britain has a good infrastructure capacity for securitization. Different from the civil law, which is prevalent on the European continent, the legal system of Great Britain was based on the common law, which is similar to the system in United States. So a lot of experience in US can be exported directly to UK. That's why UK took the leading position in the European securitization[40]. Hence, present institutional framework has pushed British securitization forward ideal EU model, based on single regulatory authority.

Reform launched with the financial Big Bang encountered numerous benefits, including elimination of fixed commission, market increase in number of market participants and maybe the most importantly rapidly movement of stock trading[41]. Not to forget, perfect timing was one more in the line of benefits that will bring Britain closer to the EU securities

[40] In 1999, UK contributed transactions worth about $26 billion. And it kept the leading position throughout 2000 to 2002, the percentage of value of securitization in Europe are 44% in 2000, 35% in 2001 and 35% in 2002 (OECD, 2005).

[41] In 1986 just three months after the Big Bang avergae daily turnover nearly doubled to £1.161 million (Clemons, 1989).

market model and boost domestic growth. By the same year stock market capitalization reached, as a ratio to GDP, 95 percent in Britain which is at least three times bigger than any other country in Europe (OECD, 1987). Nevertheless, Britain will soon become the center of Euro securities market, even though it opt out form EMU and single currency area. Therefore, even though some are arguing that the euro catalyzed a transformation in European financial market (Frankel and Rose 1997, Pozen 2001, Yang, Min and Qi Li 2003, McAndrews and Stefanadis 2002, Howell 2002) we may add that besides its beneficial features single currency did not have radical impact on boost of securities market trading. The best example is Britain, whose market is still leader in the European securities trading even though it is not a member of single currency area[42]. Hence, we may suggest that some other national factors shape country's power in international financial markets, weather existing institutional structure, political actors' ideology or just right timing that shift reform pioneers to reform leaders.

	Economic vulnerability	Veto points	Political elites	Institutional structure	Timing
Enhance	v	v	v	v	v
Constrain					

Table 6. Influence of the mediating factors on the British securities market reform

Strong institutional structure with the capacity to start securities market liberalization in response to global market challenges was certainly an important factor that fosters British reform. Also, in the later stage of securitization existing institutional structure will became milestone of the British securities market features absorbed by EU.

Furthermore, even though securities markets have been regarded as too important for political actors to be left to private actors alone (Underhill 1997, Lütz 2002, Heilmann 2001), British politicians were ready to tolerate minimum regulation in securities markets[43]. The British government understands the importance of liberalized financial market but also tends to swing from more to less regulation and back again. The thing is that Teacher's government knew how important securities markets are for sustainability of monetary policy and that free market can soon show some of its imperfections, including allocation and system risk that can be administered to the whole economy as waning confidence in financial intermediaries, and perhaps also in the currency, causes interest rates to rise (Plender, 1987). To bridge trade offs in accelerating process of securities market liberalization Thatcher government decided to scrap control on securities market operations under establishment of semi-independent Financial Service Authority (FSA). This new institutional set up preserved the features of single-actor systems characterized by unitary states, but it moved away from self regulation and problems of statutory independent authority based on dialog with interest groups (Howell, 2003). This new institutional structure will not only neutralize interest group influence (as

[42] Today Britain is still the largest securties market in Europe with largest share of 41 percent inEU securtiezation market (J.P. Morgan Securities Inc., 2003).
[43] John Plender: **London's Big Bang in International Context,** International Affairs (Royal Institute of International Affairs 1944-), Volume 63, Number 1, 1987, pp. 42

potential veto points) on securities market reform but also demonstrate close link with the idea of European integration. Hence, creation of central authority to carry out supervision of market players will improve British goodness of fit ensuring that the existing policy regime, ideas, and discourse remained largely unchallenged (Schmidt and Radaelli, 2002). This model of single regulatory authority provides platform for uploading as FSA was identified as model for future EU market and supervisory structures. This model will be later used in Europeanization of French and German securities markets. Even though uploading of globalization artifacts was successful downloading of EU agreements necessitated institutional change. Hence, early securitization has been beneficial for Britain to play inert role with regard to Europeanization of securities markets, it still has as an EU member maintained its policy preferences at the price of adjustment.

To wrap up, British case shows that membership in single currency area does not have much impact on further process of securities market Europeanization. The focus is placed more on good timing as factors that easily turn reform winners to losers. Of course, presence of this variable does not neglect importance of other mediating factors, at first political actors' preferences and existing institutional structure having had the capacity to impose and conduct securitization in response to globalization and Europeanization pressures.

4.7 Key disclosures of the fourth chapter

Following upraising globalization trend, and raising influence of globalization pressures and technology progress, EU member states are rapidly evolving from highly segmented to more deregulated and liberalized securities market. The creation of the EU securities market must be assessed in this perspective, and should be seen as fundamental part of the process. Therefore, we may argue that creation of single securities market has been triggered both directly- through national securitization and indirectly- through globalization pressures.

This perspective involves some changes in national response to globalization and Europeanization pressures. Member states are not any more directed under one-hat-fits-all rules previously applied in EMU. Even though states converge on certain level after joining the EMU, the very nature of securities markets puts markets competition as the main generators of profit gains in the cross-border investments. Hence, intensified market game in contestable securities markets will promote efficiency and deregulation, while implementation of the new set of regulation will respond more to market (and less to state) principles. However, it is to assume that member states will shift their adjustment mechanisms to more flexible and dynamic forms such as accommodation or retrenchment. In this situation inertia to globalization pressures can be fatal for market efficiency and increase in investments, even though country has strong, market based economy like Germany.

We can suggest that countries in the case of EMU have had relatively easy job to do. But, when it comes to loosely given securities market rules (more in the form of suggestions and propositions) the complex search for the best response mechanism will imply potentially painful adjustment phase and lost of time. And as we showed above, time is the most precious factors that distinguish reform losers from reform winners. Good timing and high reform pace pushed France to sit up from monetary fence and shift rather static approach to proactive search for the best securities market model, which will be uploaded to the EU level. The same case has been applied in Britain- securities reform pioneer that, besides monetary inertia, succeed to keep leading position on both global and EU market. The complex process of deregulation and securities markets re-regulation which is advocated in this part implies not only good timing but also harmony of other key mediating factors that work together toward successful liberalization and penetration into EU market. Consistent institutional capacity, political interests and consensus like decision making process are also a fundamental elements in countries response to securities markets Europeanization- they can (or cannot) push country closer to the EU model making it more attractive for foreign investors.

On their way to the EU securities market member states have to be really careful in choosing the most suitable response mechanism according to the nature and dynamic of change. Hence, previous EMU, promoting monetary policy sustainability on the long run, are inapplicable in securities market reform that require paramount importance of competition, deregulation and more contestable environment. Application of the same mechanism, like in the case of Germany, can even in the short-run produce consequences of loosening competitive forces on global market and increase level of risk. To some extend, this time factor can be however, canceled by reshuffle of mediating factors driving country towards EU. Still, along this move to the single EU market, country that missed to upload some of its preferences will certainly loosen its goodness of fit that consequently implies higher costs of adjustment, no matter if we are talking about the monetary reform pace setter or fence builder. The general trend toward more integration will at the end respond in dual nature of financial markets Europeanization, with different playing grounds, rules of the game and mediating factors that crisscross in previously unforeseen ways.

5. Conclusion

Globalization pressures and increasing financial markets Europeanization trends have been the major items in explaining creation of monetary union and increased liberalization of securities markets. The notion that “globalization and Europeanization pressures influence changes in national institutional and policy structures producing different levels of convergence” has to be extended by analyzing the variables that translate these pressures into change. Therefore, after in depth analysis of Europeanization, EMU and securities markets we would like to draw the line and summarize the main results of our research. First, we seek to address how has Europeanization moved member states forward more financial integration? Second, by focusing on the mediating factors we will discuss how and why response and modes of integration change over time.

Hence, understanding of mediating factors within specific time dimension will help us take critical notion on preliminary set proposition weather *member states adjustment to Europeanization is complex process shaped (only) by the act of dual factors.* Hence, this part attempts to shed a light on this issue looking beyond the general concepts of goodness of fit and adjustment pressures by focusing on the relation between mediating factors and divergent forms of integration and cooperation in three selected cases (France, Germany, and Great Britain).

5.1 EMU: strong institutional capacity as impetus for change

The fist contribution of this thesis is to analyze one side of the Europeanization process, curved by the European integration and creation of the new institutional structure at the EU level. Hence, our analysis starts with the introduction of Europeanization, covering the aspects of this phenomenon, its interrelation with globalization pressures and impact on national policies and institutional structures. This debate wrapped up different EU adjustment pressures that are mainly shaped by the specific nature of financial sector, influence and capacity of the strong countries to upload some of its policy preferences, and power of newly formed EU institutions to affect changes at national level. With analysis of three selected cases and differences in their responses to Europeanization, we have been able to portray in more detail the process of Europeanization, with emphasis on adjustment pressures. After comprehensive analysis on Europeanization we may argue that goodness of fit between national stance and EU requirements and adjustment pressures are important, still not essential factors that explain the final form of policy change. Our result suggests that the mediating factors that are national specific are the variables that account for variations in responses and modes of integration across Europe.

As we indicated that Europeanization cannot cause change per se we will use our research results to answer as to who drives the changes in national adjustment mechanism throughout Europeanization? As Schmidt (2002) argues “European integration has exerted differing degrees of adjustment pressure on member states with different adjustment mechanisms depending upon how constraining the decisions taken at the EU level are in their implementation at the national level“. Although true, this assumption is not complete. Our research on EMU, as example of highly specified rules, shows that selected member states did not achieve high level of convergence in their run up to European monetary union. In opposite, countries showed different patterns of adjustment to the Maastricht convergence criteria. Nevertheless, potential adjustment pressure is actually different from actual pressures, since they are shaped by the interplay of different mediating factors that occur at national level. This suggests that certain effects of Europeanization on domestic policy reform do account, but there were other more essential factors that mediate these effects and result in particular mode of integration and cooperation.

We have showed that in the case of EMU and monetary policies reform (so essential to every economy) economic vulnerability, political actors and institutional capacity took the key role in creating the country's response to EU requirements. Country will be ready to reform its monetary policy according to the EU pressures upon extend to which they find themselves vulnerable from increasing global competition. Hence loss of financial sovereignty and national currency offset gains of economic growth and doing business in the risk free optimal currency area. Hence, the final mode of integration will be the result both EMU requirements and national preferences to preserve stable economy. Thus important factors for change, economic vulnerability is not sufficient to explain country's final response to Europeanization, weather inertia, accommodation, transformation or retrenchments occur. Level of convergence to EU structures depends primarily upon interests and preferences of political actors that are capable of controlling the degree and type of Europeanization and are aware of future Europeanization effects when favoring certain EU decision modes over others (Haverland and Holzhacker, 2006). This factor is also facilitated by institutional capacity that affects political actors' ability to impose reforms and achieve higher goodness of fit with the EU institutions, as well as organization of the national political system (federal or unitary). This is consistent with our assumption that monetary sector reform is more pronounced in unitary organized countries with strong central authority than in federally organized states, due to less veto points that delimit the scope of the decision making and hence contribute to the reform efforts.

These finding suggest that institutional capacity and organization of political system has to be emphasized early in Europeanization process; in countries where institutional capacity is weak and with large number of veto points, achieving congruence with the EU rules will be loosen even though there is strong impact of political actors and economic vulnerability. We have also showed that well functioning economies like Germany with good institutional and policy fit is much an issue in curving the country's repose to Europeanization pressures. Moreover, even though strong influence of mediating factors towards EMU and high level of fit with EU institutions were not enough reason for Germany to start the reform. This goes in the line with our assumption that even though political unification of Germany pushed country toward EMU it caused problems in its response to Europeanization securities market, perhaps due to more prerogative attitude over further reforms. This indicates that Europeanized country will be impacted by prior integration trying to apply similar mechanism and modes of cooperation.

Similarly, in British case, political actors, economic vulnerability and strong institutional capacity present the main variables that shaped country's response to monetary

Europeanization. British inertia toward EMU stems from the fact that strong institutional heritage and lack of political will to impose reforms. In France, political actors under the strong pressures from Europe had decided to transform its monetary policy, aided by its political institutional capacity to impose change. Still, the effects of three key mediating factors in monetary reform are not the same. We found that strong political will and economic vulnerability is important in transformation of the domestic monetary policies in response to the EU pressures, but other variable predicts whether the country can act as a pace setter. We do find that in the case of highly specified EU rules, institutional capacity is the key factor that distinguishes leaders from followers. These findings suggest that institutional capacity is the key variable when markets are regulated and EU rules are highly specified, as if economic vulnerability and political interests towards Europeanization are in place. The above findings about EMU and mediating factors lead us to two important issues for further research. The first one is weather country's response to monetary Europeanization can be successfully applied in the case of securities market integration. The second and related question is weather Europeanization of securities market with less specified rules shifts the role of key mediating factors that in turn affects change in adjustment mechanisms.

5.2 Securities markets: picking the right moment

Third contribution of thesis is to use founding on EMU for comparative analysis with the Europeanization of securities markets, in order to find out why and how changes in the national mediating factors occur. Preliminary analysis of country's membership in EMU is very important issue because it is argued that it is very risky to open securities markets that are not prepared to cope with free capital movement. Even though we emphasized numerous benefits of EMU for securities market liberalization, it is important to note that EMU is not the only impetus behind the change in European securities markets. Actually, the process of Europeanization is mainly triggered by globalization and technology progress influencing parallel process of European integration and national institutional building. Hence, national institutional capacity lost its power as main catalyst of change in the case of EMU, creating a room for other mediating factors to act. While shifts in mediating factors impetus for change became obvious over time we argue that use of the monetary adjustment mechanisms in securities market liberalization can be doomed to failure.

Also, changes occur at the supranational level. Highly specialized EMU rules have been shifted to less specialized EU decisions in the case of securities markets liberalization. This mode of integration avoids sovereignty loss and promotes governments monitoring and control over the securities market. As we discussed this modification in rules influence to induce the change deteriorate in presence of high divergence in national policy and institutional reform. This is because governments are freer to choose how to implement decision. Moreover, the amount of coercion countries respond to EU pressures will be loosen not just by less specified rules, but also, by high globalization pressures and specific nature of securities markets. Therefore, rather static monetary policy framework with proposed one-hat-fits-all rules can not be applicable in the case of financial reform where market segmentation and differentiation are the main generators of profit gains in the cross-border investments.

Thesis takes the track that as along EU securities markets should stay segmented in order to preserve its main function in rising and promoting capital gains, securities regulation remain nationally based relying on the newly introduced institutional structure at the EU level. Unfortunately, strong European institutions cannot be created overnight, thus this path to financial liberalization should be gradual one. Hence, underdeveloped EU institutional structure and more dynamic nature of securities markets will influence the shift in mediating factors, where institutional capacity to impose reforms will not be anymore the key determinant for success. Shift of power goes from factors that promote stability (institutional capacity) to those that emphasize flexibility to cope with external pressures (political actors).

Therefore, with more gradual approach in institutional building and loosely given EU rules, supranational institutions failed in time management as the essential factor in achieving the supremacy over securities markets control. We conclude that time dimension reveals that longer state waits to start the reform the less are the chances to become a reform leader. Hence, the explanation on Europeanized states and mechanisms similar to prior integration, as discussed earlier, cannot be successfully applied in the case of securities market integration. Rather it is more important to include a time dimension as crucial factor. Hence, for Britain, the pattern of securities market reform has been shaped by early response to globalization. By good sense for time, Britain will manage to keep the securities markets leading position even though it opt out form the European monetary union. The same pattern has been applied by France, that managed to shift its role from EMU follower to securities markets pace setter, only by picking the right moment for reforms. In Germany, by contrast, running late to response to the globalization pressures and European decisions will cancel its achievements as EMU leader, shifting its mechanisms to high EU directives absorption. One way of reading this is that, once financial sector reforms are carried out (for example monetary policy reform), steps towards further liberalization may not necessary yield gains of successful monetary start up. Loosely given EU rules, specific nature of securities markets and increasing globalization and technology progress pressures will shift the role of the mediating factors that in turn create winners or losers in Europeanization of securities markets.

To conclude, these findings suggest that there is no such a thing as perfect adjustment mechanism to Europeanization. Even though, the basic mechanics of member states' adjustment to Europeanization are shaped by the interplay of dual (national and subnational factors) the final form will be curved by nature of financial sector, empowering different mediating factors to lead the change. In more regulated financial sector with strong and stable institutional structure, like in the monetary sector, we suggest that besides its economic vulnerability to external pressures and political preferences to impose reforms, institutional capacity is the key variable that shapes country's response to Europeanization. In contrast, in highly dynamic financial sectors like securities markets where institutional building is still under construction, EU rules are loosely given and decision making outcomes are shaped by the state-market interaction, early start of the reform shift pioneers to Europeanization leaders and cherry pickers. In addition, as Europeanization of financial sectors encompass challenges not only of a new EU order, but also of a different kind we may conclude that *member states' adjustment to Europeanization is a complex process shaped by the act of dual factors in which sweeping changes in EU rules and rumbling shifts in mediating factors can be relevant for understanding the changes only if they are used within time and sector specific framework.*

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