

# SOURCES OF INSTITUTIONAL CHANGE

## The Supranational Origins of Europe's New Stock Markets

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FOR thirty years smaller companies—especially entrepreneurial firms in high-technology sectors—have stood at the center of public debates in Europe about how to revitalize national economies.<sup>1</sup> Identifying such firms as the seedbeds of future innovation, wealth, jobs, and international competitiveness in the post-Bretton Woods era, policy-makers saw limited financing options as an obstacle to their development. Multiple efforts in the 1970s and 1980s to borrow the American solution of opening stock markets to small and untested companies (allowing them to sell publicly traded ownership shares in exchange for capital) never generated much support from the financial gatekeepers. As a result, smaller enterprises remained largely shut out of corporate capital markets.

This article explains a curious turn by which, beginning in 1995, the very same financial elites suddenly became avid proponents of improved financing alternatives for entrepreneurial companies. Between

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<sup>1</sup> Harold Wilson, *Report of the Committee to Review the Functioning of Financial Institutions* (London: Her Majesty's Stationery Office, June 1980); Robert Chabbal, *Le Système financier français face à l'investissement innovation: rapport à ministre des entreprises et du développement économique chargé des PME, du commerce et de l'artisanat* (Paris: La Documentation française, 1995); M. David Dautresme, *Le développement et la protection de l'épargne: rapport au ministre de l'Economie et des Finances et au ministre délégué, chargé du Budget de la Commission* (Paris: La Documentation française, 1982); Karen E. Adelberger, "Semi-Sovereign Leadership? The State's Role in German Biotechnology and Venture Capital Growth," *German Politics* 9 (April 2000).

1995 and 2005 national stock exchanges in twelve countries in Western Europe created nearly twenty competing new markets. Nearly all were modeled on the iconic U.S.-based Nasdaq Stock Market. The most successful survivor of the ongoing competition thus far is London's Alternative Investment Market (AIM). With fourteen hundred companies listed and a market capitalization of sixty billion pounds, it has reversed decades of failure to become a core mechanism for allocating financial resources to local and international smaller firms and a centerpiece of the United Kingdom's thriving global biotechnology sector.<sup>2</sup> After becoming household names during the turn-of-the-millennium boom and bust in international corporate share prices, several of the other new markets—like Paris's Nouveau Marché and Frankfurt's Neuer Markt—eventually failed and have been replaced with yet another round of competing markets.

For a region supposedly averse to risk and U.S.-style capitalism, the ongoing competition over stock markets has had surprising effects, exposing formerly sheltered households to the gyrations of global finance and triggering an inflow of footloose international capital into Europe's smaller companies. Nearly three thousand newly listed firms raised approximately eighty billion euros between 1996 and 2005.<sup>3</sup> These figures start from a very low base, representing a significant reallocation of financial resources. The new markets, moreover, introduced shares in chancy untested companies (novel assets in Europe), which look like ones long available in the U.S. and are attractive to global asset managers. These institutional investors are neither the only buyers nor the most voracious. Households in the United Kingdom, France, and Germany, once given the opportunity, have poured their savings into these stocks, countering the conventional wisdom that Europeans are risk averse because they lack a so-called equity culture. Largely protected from the extremes of global finance in the postwar decades, European households were among the biggest beneficiaries when valuations reached frothy levels at the end of the 1990s. In the aftermath of the March 2000 international market crash, they bore the costs.<sup>4</sup>

<sup>2</sup> "London the Laboratory for Biotechnology Launches," *Financial Times*, January 6, 2005, 18; "Aim High: London's Junior Stock Market Has Outlasted European Rivals," *Financial Times*, October 6, 2004, 16.

<sup>3</sup> These calculations are based on publicly available statistics on the Web sites of the exchanges. See also Laura Bottazzi and Marco Da Rin, "Europe's 'New' Stock Markets," Discussion Paper 3521 (London, CEPR, 2002).

<sup>4</sup> Based on percentages of institutional versus household buyers, German households lost approximately sixty-five billion euros, as share prices on the Neuer Markt fell between April 2000 and May 2001, and French households lost approximately twenty billion euros on the Nouveau Marché during the same period.

The new markets also made Europe more attractive to venture capitalists who began to believe that investing in startup and early-stage companies would reap profits (through initial public offerings) commensurate with those made by their U.S. counterparts. (See Figure 1.) Until the introduction of these markets, venture capitalism, at least in its U.S. variety, hardly existed on the Continent or in Britain. These financial intermediaries are not merely local investors of mobile capital but, like the managers of other forms of private equity, people who challenge the very essence of European managed capitalism.<sup>5</sup> Their business plan is built on a calculation that 70–90 percent of young companies will fail. No one should expect a replication of U.S. entrepreneurial capitalism in Europe,<sup>6</sup> and a decade after the launch of the first new market the ultimate implications of all this fleet-footed capital slushing around the old continent remain largely unknown. Still, it is hard to imagine a scenario without an increase in firm openings and closures, frequent firings and hirings, and the accompanying social effects—the very types of reforms that many Europeans have resisted because they consider them anathema to their values.

Questions about cross-border convergence of domestic institutions<sup>7</sup> have long engaged political scientists and are part of a broader literature about why and how forms of governance originate and change.<sup>8</sup> I focus on explaining three puzzling aspects of Europe's new markets. First, why did the national stock exchanges create new markets? Second, why did most exchanges adopt the Nasdaq organizational form?<sup>9</sup> Finally, why did dissemination to Europe occur in the mid-1990s and take only a few short years?

<sup>5</sup> “Germany Bristles at Capitalist ‘Locusts,’” *International Herald Tribune*, May 5, 2005, 1. Venture capital has thus far escaped the public attacks that have been directed toward other forms of private equity.

<sup>6</sup> See Sigurt Vitols, “Frankfurt’s Neuer Markt and the IPO Explosion: Is Germany on the Road to Silicon Valley?” *Economy and Society* 30, no. 4 (2001).

<sup>7</sup> Institutional convergence in this article is an outcome to be explained and refers to a narrowing of difference between domestic institutions across borders. See Suzanne Berger, “Introduction,” in Suzanne Berger and Ronald Dore, eds., *National Diversity and Global Capitalism* (Ithaca, N.Y.: Cornell University Press, 1996); Helen V. Milner, “Internationalization and Domestic Politics: An Introduction,” in Robert O. Keohane and Helen V. Milner, eds., *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1996).

<sup>8</sup> Berger and Dore (fn. 7); Miles Kahler and David A. Lake, eds., *Governance in a Global Economy: Political Authority in Transition* (Princeton: Princeton University Press, 2003); Kathleen Thelen, *How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States and Japan* (Cambridge: Cambridge University Press, 2004).

<sup>9</sup> By “copying the Nasdaq,” I mean that the exchanges borrowed an underlying bargain for determining which firms receive access to investment capital: untested companies may sell ownership shares through an established exchange in return for providing investors with high levels of information about internal finances.

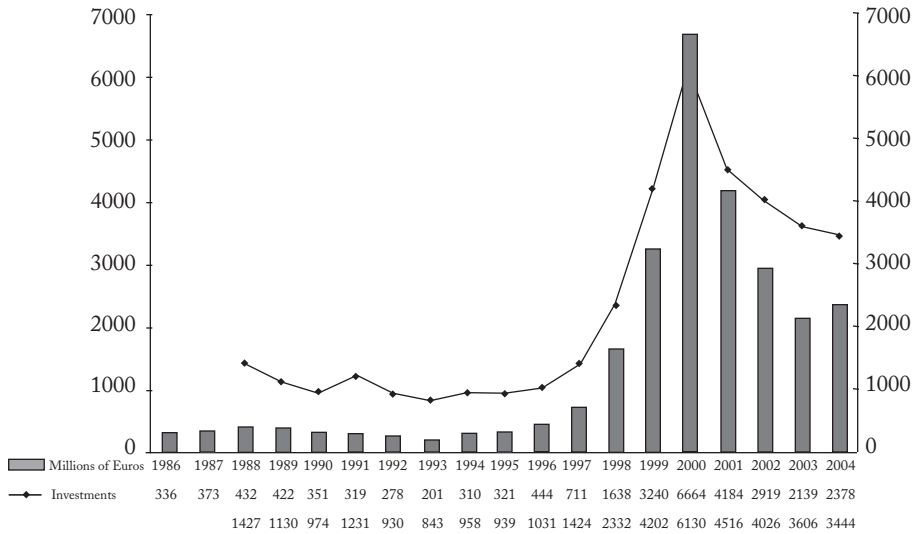


FIGURE 1

VENTURE CAPITAL INVESTMENTS IN EARLY-STAGE COMPANIES, EUROPE<sup>a</sup>

SOURCE: EVCA

<sup>a</sup>“Early Stage” includes EVCA’s seed and start-up categories.

My structured comparisons of the new markets to one another, to previous ones, and to proposals that never saw the light of day reveal that the primary causes behind their creation, form, and timing lie in the political skills, motivations, and actions of supranational European Union bureaucrats, relatively low-level officials working for the European Commission (see Table 1).<sup>10</sup> Seemingly small and unremarkable bureaucratic interventions accumulated over a fifteen-year period to forge new interests, catalyze coalitions, stretch interpretations of EC laws, and frame debates. The bureaucrats’ meddling had the unintended consequence of drawing domestic financial elites into a competition that gave rise to multiple national stock markets, even though the Brussels civil servants intended a single, elegant pan-European rival to the Nasdaq. The net effect of their autonomous actions was to improve the likelihood of innovation in a sector characterized throughout advanced industrialized societies by powerful vested interests and resilience to change.

<sup>10</sup> The European Commission is the EU’s main bureaucracy. It is organized both horizontally in fairly autonomous directorates-general that specialize in policy domains and vertically between the college of appointed commissioners and the main body of administrative officials and other staff.

TABLE 1  
PROPOSALS FOR SMALLER COMPANY STOCK MARKETS IN EUROPE<sup>a</sup>  
(1977–2005)

<i>Year</i>	<i>Name of Market and Owner</i>	<i>Principle</i>
1977	Compartiment Spécial, Fr Exchange	French Feeder
1978	Mercato Ristretto/Expandi, It Exchange	Italian Feeder
1980	Unlisted Securities Market, Br Exchange	British Feeder
1982	Bors 3, De Exchange	Danish Feeder
1982	Officiele Parallel Markt, Ne Exchange	Dutch Feeder
1982	Segundo Mercado, Barcelona Exchange	Spanish Feeder
1982	Swedish OTC Market, Swe Exchange	Swedish Feeder
1983	Second Marché I, Fr Exchange	French Feeder
1984	Stock Exchange II, Bors II, Nor Exchange	Norwegian Feeder
1984	Second Marché, Be Exchange	Belgian Feeder
1985	<i>ECU-EASD, Private Actors</i>	<i>Pan-European Nasdaq</i>
1986	Segundo Mercado, Bilbao Exchange	Spanish Feeder
1986	Segundo Mercado, Madrid Exchange	Spanish Feeder
1986	<i>Segundo Mercado, Valencia Exchange</i>	<i>Spanish Feeder</i>
1987	Geregelter Markt, Ge Exchange	German Feeder
1987	Third Market, Br Exchange	British Feeder
1989	<i>EASDAQ I, UK (Scotland), Private Actors</i>	<i>National Nasdaq</i>
1989	<i>European OTC Market, Private Actors</i>	<i>Pan-European Nasdaq</i>
1989	<i>Eur. Securities Market, Private Actors</i>	<i>Pan-European Nasdaq</i>
1992	Dutch Participation Exchange, Ne Exchange	Dutch Alternative
1992	<i>Eur. Priv. Equity Exchange, Br Private Actors</i>	<i>British Alternative</i>
1992	<i>Mercato Locale Del Nord Ovest, Turin Exch.</i>	<i>Italian Alternative</i>
1993	<i>EASDAQ-UK, Private Actors</i>	<i>National Nasdaq</i>
1993	<i>ECASE, Br Private Actors</i>	<i>National Nasdaq</i>
1993	<i>The Enterprise Market, Br Exchange/Private</i>	<i>National Nasdaq</i>
1993	<i>The National Market, Br Exchange/Private</i>	<i>British Alternative</i>
1993	Second Marché II, Fr Exchange	French Feeder
1994	<i>MESEC, Fr Exchange</i>	<i>Pan-European Nasdaq</i>
1994	<i>Mercato Telematico delle Imprese, It Exchange</i>	<i>Italian Feeder</i>
1995	Alternative Investment Market (AIM), Br Exch.	British Alternative
1995	<i>Electronic Share Interchange, Private Actors</i>	<i>British Alternative</i>
1995	<i>Mittelstandmarkt Bremen, Ge Exchange</i>	<i>National Nasdaq</i>
1996	EASDAQ, Private Actors	Pan-European Nasdaq
1996	Nouveau Marché, Fr Exchange	National Nasdaq
1997	Euro.NM Belgium, Be Exchange	National Nasdaq
1997	Euro.NM Amsterdam, Ne Exchange	National Nasdaq
1997	Neuer Markt, Ge Exchange	National Nasdaq
1999	SWX New Market, Swz Exchange	National Nasdaq
1999	NM-List, Fi Exchange	Finnish Alternative
1999	Techmark, Br Exchange	National Nasdaq
1999	Nuovo Mercato, It Exchange	National Nasdaq
1999	SMAX, Ge Exchange	National Nasdaq
1999	Austrian Growth Market, Au Exchange	National Nasdaq
2000	Nuevo Mercado, Sp Exchange	National Nasdaq
2000	ITEQ, Ir Exchange	National Nasdaq
2000	<i>iX-Nasdaq Merger, Br-Ge Exchanges</i>	<i>Binational Nasdaq</i>
2001	Nasdaq Europe, US Exchange	Pan-European Nasdaq
2002	NextEconomy/NextPrime, Euronext	Multinational Nasdaq
2003	Prime Standard, Ge Exchange	National Nasdaq
2005	Alternext, Euronext	Multinational AIM
2005	Entry Standards, Ge Exchange	National AIM

<sup>a</sup>Unrealized proposals are set in italics.

Such empirical findings pose a difficult challenge for leading social science theories. Scholars interested in the causes and processes of cross-border institutional convergence rarely entertain the possibility of regional-level factors, let alone the actions of supranational bureaucrats, as independent sources of change. In one leading approach researchers locate causes in structural changes at the global level.<sup>11</sup> In a second approach scholars emphasize the constraining effects of factors internal to national polities.<sup>12</sup> Both perspectives make a priori assumptions that eliminate the possibility of an alternative causal path, whereby independent regional-level actors spark processes of domestic change.

This article takes markets as institutional expressions of politics, though not necessarily of the national variety, and expects highly motivated political actors, not merely global forces and economic opportunists, to drive market formation. The theoretical hurdle is to identify *where* overlapping layers of political actors and rules are likely to breed clashing conceptions of markets, *who* within that context have motives and abilities to upset established patterns of exchange and governance, and *under what conditions* they are likely to do so. Synthesizing ideas and observations from the sociology of markets,<sup>13</sup> constructivism,<sup>14</sup> American political development,<sup>15</sup> historical institutionalism,<sup>16</sup> and supranationalist and governance EU perspectives,<sup>17</sup> I argue that in Western

<sup>11</sup> For materialist approaches, see Jeffrey A. Frieden and Ronald Rogowski, "The Impact of the International Economy on National Policies: An Analytical Overview," in Keohane and Milner (fn. 7). For sociological approaches, see Martha Finnemore, *National Interests in International Society* (Ithaca, N.Y.: Cornell University Press, 1996); Kathleen R. McNamara, "Rational Fictions: Central Bank Independence and the Social Logic of Delegation," *West European Politics* 25 (January 2001); idem, "Where Do Rules Come From? The Creation of the European Central Bank" in Alec Stone Sweet, Neil Fligstein, and Wayne Sandholtz, eds., *The Institutionalization of Europe* (Oxford: Oxford University Press, 2001).

<sup>12</sup> Berger (fn. 7); Robert Boyer, "The Convergence Hypothesis Revisited: Globalization but Still the Century of Nations?" in Berger and Dore (fn. 7); Paul J. DiMaggio and Walter W. Powell, "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields," in DiMaggio and Powell, eds., *The New Institutionalism in Organizational Analysis* (Chicago: University of Chicago Press, 1991).

<sup>13</sup> Neil Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-first Century Capitalist Societies* (Princeton: Princeton University Press, 2001); idem, "Social Skill and Institutional Theory," *American Behavioral Scientist* 40 (February 1997), 397–405.

<sup>14</sup> Michael Barnett and Martha Finnemore, *Rules for the World: International Organizations in Global Politics* (Ithaca, N.Y.: Cornell University Press, 2004).

<sup>15</sup> Daniel Carpenter, *Forging Bureaucratic Autonomy: Networks, Reputations and Policy Innovation in Executive Agencies, 1862–1928* (Princeton: Princeton University Press, 2001).

<sup>16</sup> Thelen (fn. 8).

<sup>17</sup> Michael W. Bauer, "Limitations to Agency Control in European Policy-Making: The Commission and the Poverty Programmes," *Journal of Common Market Studies* 40 (September 2002); Ernst B. Haas, *The Uniting of Europe: Political, Social and Economic Forces, 1950–1957* (Stanford, Calif.: Stanford University Press, 1958); Adrienne Heritier, "Overt and Covert Institutionalization in Europe," in Stone Sweet, Fligstein, and Sandholtz (fn. 11); Nicolas Jabko, "In the Name of the Market," *Journal of*

Europe during the last twenty-five years, supranational officials in Brussels have been a source of opposition to established conceptions of the scope, regulation, and purpose of markets. Seeking regional as opposed to nationally bounded markets, they are prime candidates for instigating struggles over markets and thereby catalyzing institutional innovation.

Standard EU approaches expect autonomous bureaucratic action under narrow conditions contingent on aggregated preferences of EU governments and other veto actors as well as on inherent characteristics of particular issues and delegated functions.<sup>18</sup> Finding supportive evidence in high-profile contests between European Commission leaders and governments, they are reluctant to link the causal effects of EU bureaucrats to general theories of institutional change. They do not, moreover, expect supranational influence in hard cases like finance, where governments jealously protect national regulatory sovereignty<sup>19</sup> and cannot account for variation in the influence of Brussels over time in a policy area where preferences and monitoring regimes of governments remain relatively stable. While some scholars anticipate European Commission influence under broader sets of conditions,<sup>20</sup> they too tend to focus on the leadership in Brussels, rather than on the seemingly innocuous actions of career civil servants.<sup>21</sup>

I show that the civil servants in Brussels—by forging new interests, embedding themselves in supportive coalitions, liberally interpreting Europe-wide laws, and framing political discourse to make their behavior seem legitimate and useful to others—create autonomy for themselves from other key actors and craft the political landscape in which they operate. As the effects of day-to-day bureaucratic actions accumulate, the chances of sparking market-creation opportunities for themselves and others increase. What appears to be abrupt change is actually the culmination of small steps against which no one felt compelled to mo-

*European Public Policy* 6 (September 1999); Sonia Mazey and Jeremy Richardson, "Institutionalizing Promiscuity: Commission-Interest Group Relations in the EU," in Stone Sweet, Fligstein, and Sandholtz (fn. 11); Wayne Sandholtz and John Zysman, "1992: Recasting the European Bargain," *World Politics* 42 (October 1989).

<sup>18</sup> For an example of the rational institutionalist approach, see Mark A. Pollack, *Engines of European Integration: Delegation, Agency, and Agenda Setting in the EU* (Oxford: Oxford University Press, 2003).

<sup>19</sup> Jonathan Story and Ingo Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems* (Cambridge: MIT Press, 1997).

<sup>20</sup> The governance approaches, which tend to accept the EU's supranational actors as givens, are reviewed in Markus Jachtenfuchs, "The Governance Approach to European Integration," *Journal of Common Market Studies* 39 (June 2001).

<sup>21</sup> Exceptions include Heritier (fn. 17).

bilize. Such an approach directs attention beyond the leadership skills at the helm of the European Commission to the political skills of career civil servants. It demands a focus on extended periods of background process in addition to contests in the public arena; requires a broadening of standard measures of influence; and expects institutional change to produce unintended consequences and follow an incrementalist rather than a punctuated equilibria logic.

The remaining sections use the twenty-five-year history of stock market experimentation in Europe to illustrate and develop this approach. Sections I and II discuss the puzzles and competing hypotheses. Section III presents the empirical evidence. Section IV, the conclusion, summarizes and identifies theoretical implications.

### I. THREE PUZZLES: THE CREATION, FORM, AND TIMING OF EUROPE'S NEW MARKETS

By the early 1990s Europe's first experiments with smaller-company stock markets had failed. Governments, industry groups, financial insiders, and stock exchanges revisited the issue and came to independent decisions that reflected national differences. In December 1992 the London Stock Exchange (LSE) announced the closure of its 1980s market, the Unlisted Securities Market (USM). With implicit support from the U.K. Treasury,<sup>22</sup> the exchange fought off a public campaign by national financial services companies to pressure it into creating new markets (one, especially pushed by venture capitalists, modeled on the Nasdaq form) and in April 1994 reiterated its intention to end the decade-long experiment in smaller-company markets.<sup>23</sup> In 1993 the Paris exchange<sup>24</sup> implemented a series of reforms to its 1980s market, the Second Marché. The reforms followed recommendations from a two-year review that ignored efforts by venture capitalists and others to create a new market based on the Nasdaq Stock Market.<sup>25</sup> With little widespread perception of a smaller-company financing problem in Ger-

<sup>22</sup> Letters between chancellor of the exchequer and CISCO leader, available in CISCO historical files (London, March 1993).

<sup>23</sup> The proposed Nasdaq copy was called the Enterprise Market (see Table 1). Speeches delivered by CISCO CEO Katie Morris during 1995 and 1996, available in CISCO historical files, London.

<sup>24</sup> The Paris stock exchange was the Société des Bourses Françaises (SBF-Paris Bourse), then the Parisbourse, and now, after its merger with the Amsterdam, Lisbon, and Brussels exchanges, Euronext.

<sup>25</sup> The proposed Nasdaq copy was called Marché européen des Sociétés Entrepreneariales de Croissance, or MESEC. See Table 1. Chabbal (fn. 1); COB, "Le Second Marché" (Paris, 1992); COB and SBF, "Le Second Marché" (Paris, 1993).

many, the Frankfurt exchange left its 1987 smaller-company market, the *Geregelter Markt*, largely unchanged.<sup>26</sup> As recently as May 1994, none of the leading European exchanges (or the smaller ones not discussed here) had plans for new markets. *Why then did the LSE create AIM in 1995 and Techmark in 1999, the Paris bourse open the Nouveau Marché in 1996, NextEconomy/NextPrime in 2002, and Alternext in 2005, and the Deutsche Boerse introduce the Neuer Markt in 1997, Prime Standard in 2003, and Entry Standard in 2005?*

Financial arrangements reflect political bargains, telling us who controls the price of capital as well as who is able to obtain it.<sup>27</sup> John Zysman's basic insight about the political and distributional nature of finance remains relevant in the age of mobile capital, even in the case of financial markets, which are often depicted as neutral, impersonal mechanisms of allocation. The science of matching particular organizational forms of financial markets with desired outcomes is surprisingly immature. Yet the history of new stock markets in Europe shows not only that different sets of rules governing financial markets create winners and losers but also that political actors manipulate the rules in ways they believe will promote pet groups and policies.

For stock markets, the key policy levers are the rules determining which types of companies may exchange shares for investment capital. These rules fall into two categories—barriers to listing and informational standards—that together help distinguish different stock market forms. During the decades after World War II, even in the equity-oriented British financial system, the barriers to listing (that is, requirements concerning company size, years in operation, history of profits, and minimum number of circulating shares) practically guaranteed that only large, established companies could list shares in Europe. Smaller companies, even those with a history of profits, had a limited set of financing options that included bank loans, government credit schemes, arrangements with larger companies, or access to networks of family and friends.

### 1977–95

Europe's first smaller-company stock markets, known as feeders, established lower barriers to listing. In 1980, as shown in Table 2, only companies with a capitalization of five hundred thousand pounds ster-

<sup>26</sup> Author interviews with Easdaq official, Leuven, April 26, 2000, and with EASD board member, Schwalback, May 12, 1999.

<sup>27</sup> John Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Ithaca, N.Y.: Cornell University Press, 1983).

TABLE 2  
BARRIERS TO LISTING: NEW MARKETS IN BOLD

		<i>Minimum Capitalization, Assets, Equity Capital</i>	<i>History of Company Accounts, Trading Record</i>	<i>Minimum Number and Amounts of Shares in Public Hands</i>
France	Main Market	none, 2000	3 years of accounts	25% with flexibility, 600,000 shares if shares over FF 30 million
	<b>Nouveau Marché 1996</b>	<b>1.5 million euro in shareholder equity prior to listing</b>	<b>none</b>	<b>20%, 100,000 shares, 5 million euro value</b>
	Second Marché 1983	none, in practice FF 50 million, 1993 none, 1983	2 years of accounts none	10% 10%
Germany	<b>Prime Standard 2003 (Regulated Market)</b>	<b>liable equity of 750,000 euros</b>	<b>3 years of accounts</b>	<b>minimum float of 10,000 shares</b>
	Main Market	2.5 million DM with flexibility	3 years of accounts	25% with flexibility, 1.25 million euro
	<b>Neuer Market 1997</b>	<b>1.5 million euros</b>	<b>3 years of accounts with flexibility</b>	<b>20% with flexibility and a float of 5 million euros. Only common stock. 100,000 minimum shares</b>
	Geregelter Markt Freiverkehr Markt	500,000 DM none	none none	none none
United Kingdom	Main Market	700,000 pounds (scientific companies, 20 mill. pounds), 1992	3 years (with exceptions)	25%
		700,000 pounds, 1990	3 years	25%
		500,000 pounds, 1980	5 years	25%
	<b>Techmark 1999</b>	<b>50 million pounds (with flexibility)</b>	<b>1 year (with flexibility)</b>	<b>25% and at least 20 million pounds</b>
	<b>AIM 1995</b>	<b>none</b>	<b>none</b>	<b>none</b>
	Third Market 1987	none	1 year	no requirement
	USM 1980	none, 1990	2 years	10%
		none, 1980	3 years	10%

SOURCES: Hartmut Schmidt, *Special Stock Market Segments for Small Company Shares: Capital Raising Mechanism and Exit Route for Investors in New Technology-Based Firms* (Brussels: Commission of the European Communities, 1984); idem, *Advantages and Disadvantages of an Integrated Market Compared with a Fragmented Market* (Brussels: Commission of the European Communities, March 1977); ELBAAssociates and Consultex (fn. 80); COB (fn. 25, 1992); Graham Bannock, *European Second-Tier Markets for NTBFS* (London: Graham Bannock & Partners, 1994); Nikko Research Center, *The Nikko Monthly Bulletin: New Stock Markets and Venture Capital in Europe* (London, June 1995); Coopers & Lybrand, *EASDAQ, the Nouveau Marché, AIM: An Update 1996* (London, 1996); BVCA and DLA, *A Guide to the Stockmarkets* (London, 2000 and 2002); Simon Johnson, "Which Rules Matter? Evidence from Germany's Neuer Markt" (Manuscript, Sloan School of Management, MIT, Cambridge, 2000); and Web sites of the exchanges.

ling, five years of company accounts, and a willingness to sell 25 percent of equity to the public could list shares on the LSE's main market. The USM eliminated any minimum capitalization and reduced the company accounts requirement to three years and the public shares minimum to 10 percent. The Paris bourse's 1983 Second Marché similarly reduced the necessary number of years a company had to be in operation, from three on the primary market to zero.

The feeder markets failed to alter financing patterns significantly. The exchanges created these markets in response to political pressure but lacked economic incentives for promoting and supporting them. Although the exchanges technically made it easier for smaller firms to list shares, they did not adopt measures to attract investors, a necessary condition for improving their capital-raising prospects. They conspicuously rejected designs that would lure internationally mobile investors as had the Nasdaq, which channeled capital to young enterprises in the U.S. There, by requiring companies to reveal high levels of information according to widely accepted accounting standards, investors were (at least in principle) able to calculate the high risks of buying shares in young firms and invest accordingly. Rather than mimic the U.S. form or otherwise seek to appeal to investors, the European exchanges took the easy route of merely lowering the bar for the requirements that smaller companies had to meet in order to list shares.

The flawed setup was not an accident. The exchanges during these years operated in the absence of cross-border competition for investors and listing firms. They sought to preserve protectionist arrangements, whereby national financial intermediaries relied on revenues from larger company stock markets and intimate lending relations with smaller firms. The exchanges were well aware of the Nasdaq model, an alternative long considered in public debates in several capitals.<sup>28</sup> Fearing such a market would undermine existing business and force local securities firms to compete with outsiders, the exchanges used their empowered positions and close ties with national Treasuries and Finance Ministries to block initiatives. This is why the 1980s feeder markets embodied a perverse set of incentives that prompted investors to wait until the best young companies graduated upwards to *feed* new listings to the main national market. In the end, these markets were appendages of protected domestic financial systems that left smaller-company

<sup>28</sup> Harold Wilson, *Evidence on the Financing of Industry and Trade, Report of the Committee to Review the Functioning of Financial Institutions* (London: Her Majesty's Stationery Office, 1977), 110–43; Dautresme (fn. 1), 2:180–205.

finance in the hands of domestic banks, brokers, accountants and other service providers. Not surprisingly, they withered as the exchanges and local intermediaries found fewer and fewer reasons over time to promote them.

### 1996–2005

The new stock markets, created in the context of lively competition among Europe's stock exchanges, differed starkly from their predecessors and have substantially altered the distribution of financial resources. Energetically promoted and designed by the national exchanges to attract mobile capital under the control of international asset managers, most of these new markets required companies that wanted capital to disclose high levels of financial information. They thus mimicked the Nasdaq's principle and underlying bargain about who is allowed to raise capital from regulated financial markets and what they must do to obtain it. Table 1 illustrates the quarter-century pattern from feeder to Nasdaq copy, with the turning point coming in the early 1990s.

Despite significant variation, the exchanges in most cases devised new informational requirements that far exceeded minimum domestic regulatory ones. Table 3 isolates this trend in France, Germany, and the U.K. Frankfurt's Deutsche Boerse, for example, was particularly ambitious. Companies listed on the Neuer Markt had to provide public information in English, supply quarterly reports, and provide accounts in accordance with standards considered rigorous and transparent by international investors (that is, USGAAP, IAS, or national standards with reconciliation). At the time, not even the most established corporations on the main stock markets had to follow such rigorous requirements.<sup>29</sup> AIM was the exception, in that the LSE sought to attract investors to AIM by making local financial services firms stake their reputations on the quality of relatively unknown companies they brought to market.

Between 1977 and 1995, then, national stock exchanges created smaller-company stock markets based on the feeder principle and, between 1996 and 2005, on the U.S. Nasdaq bargain. The exchanges had not warmed to the Nasdaq form. With support from national governments, they had on at least four occasions in the 1980s blocked proposals for the adoption of the U.S. model. As recently as the early 1990s, in fact, they had perceived proposals to adopt the Nasdaq form both

<sup>29</sup> "Playing by the Rules: How Neuer Markt Gets Respect," *Wall Street Journal*, August 21, 2000, 1; Vitols (fn. 6); The main markets have now caught up. Since 2005 all publicly listed EU companies must report consolidated accounts in accordance with IAS/IFRS (Regulation [EC] 1601/2002, July 2002).

TABLE 3  
COMPANY INFORMATIONAL STANDARDS: NEW MARKETS IN BOLD

		<i>International (USGAAP, IAS/IFRS or National with Reconciliation) or National Accounting Standards?</i>	<i>Quarterly Reports?</i>	<i>English: Optional, Required, or Neither?</i>	<i>Ad Hoc Disclosure of Significant News?</i>
Euronext (Merger of Fr. Bel, Ne & Por)	<b>Alternext 2005</b> <b>NextEconomy,</b> <b>2002</b>	<b>either</b> <b>IFRS, 2005</b>	<b>no</b> <b>yes, 2004</b>	<b>optional</b> <b>required</b>	<b>yes</b> <b>yes</b>
France	Premier Marché	IFRS, 2005 French GAAP, IAS, or USGAAP with reconciliation, 2000	yes turnover only	required optional with French summary	yes yes
	<b>Nouveau Marché</b> <b>1996</b>	<b>French GAAP, IAS</b> <b>or USGAAP with</b> <b>reconciliation</b>	<b>yes</b> <b>(audited)</b>	<b>optional with</b> <b>French</b> <b>summary</b>	<b>yes</b>
	Second Marché, 1983	National, 1993	no	optional with French summary	yes
		National, 1983	no	optional with French summary	yes
Germany	<b>Prime Standard,</b> <b>2003</b>	IFRS	<b>yes</b>	<b>required</b>	<b>yes</b>
	Main Market	IAS/IFRS, 2004 National	yes no	required optional	yes yes
	<b>Neuer Markt 1997</b> Geregelter Markt 1987	<b>International</b> National	<b>yes</b> no	<b>required</b> neither	<b>yes</b> yes
United Kingdom	Main Market	IFRS, 2004 either	yes, 2004 no	required required	yes yes
	<b>Techmark, 1999</b>	<b>IFRS, 2004</b> <b>either</b>	<b>yes</b> <b>yes</b>	<b>required</b> <b>required</b>	<b>yes</b> <b>yes</b>
	AIM, 1995	<b>either (USGAAP,</b> <b>IAS/IFRS, or</b> <b>national)</b>	<b>no</b>	<b>required</b>	<b>yes</b>
	USM, 1980	National	no	required	yes

SOURCES: Hartmut Schmidt, *Special Stock Market Segments for Small Company Shares: Capital Raising Mechanism and Exit Route for Investors in New Technology-Based Firms* (Brussels: Commission of the European Communities, 1984); idem, *Advantages and Disadvantages of an Integrated Market Compared with a Fragmented Market* (Brussels: Commission of the European Communities, March 1977); ELBAssociates and Consultex (fn. 80); COB (fn. 25,1992); Graham Bannock, *European Second-Tier Markets for NTBFs* (London: Graham Bannock & Partners, 1994); Nikko Research Center, *The Nikko Monthly Bulletin: New Stock Markets and Venture Capital in Europe* (London, June 1995); Coopers & Lybrand, *EASDAQ, the Nouveau Marché, AIM: An Update 1996* (London, 1996); BVCA and DLA, *A Guide to the Stockmarkets* (London, 2000 and 2002); Simon Johnson, "Which Rules Matter? Evidence from Germany's Neuer Markt" (Manuscript, Sloan School of Management, MIT, Cambridge, 2000); and Web sites of the exchanges.

as competitive threats to cozy national financial systems and as naïve schemes with little chance of succeeding, and they used their resources to prevent their adoption.<sup>30</sup> *Why then did they widely borrow the U.S. design for their new markets?*

Finally, the U.S. National Association of Securities Dealers (NASD) created the Nasdaq Stock Market in 1971. By the early 1980s Europeans were familiar with the American market and began to perceive it as a source of successful financing for young, high-technology firms. The European exchanges borrowed the principle after a lag of more than two decades. *Why did the exchanges adopt the Nasdaq principle in the middle of the 1990s, and why did they do it in a cluster?*

## II. COMPETING EXPLANATIONS

Three sets of explanations about institutional convergence capture prominent trends in recent scholarship. I label them “mobile capital and economic competition”; “ideological diffusion and the logic of appropriateness”; and “domestic polity and intergovernmental agreements.” Each suggests different, plausible answers to the questions posed in the preceding section and provides contrasting expectations (see Table 4) about what we should observe in the empirical record if the respective explanations yielded valid accounts of the creation, form, and timing of the new stock markets. To these standard approaches, I have added my own, “supranational bureaucrats and incremental change,” which expects interventions by European Commission civil servants to be a source of independent effects.

### MOBILE CAPITAL AND ECONOMIC COMPETITION

Some scholars argue that the increasing ease with which capital crosses borders (a global-level phenomenon) explains the breakdown of cozy relations between national stock exchanges, securities regulators, and finance ministries, as well as the cross-border convergence of domestic financial institutions. Through a second-image-reversed process, local financial services firms—intermediaries between national stock exchanges and their customers—become agents of change, empow-

<sup>30</sup> FIBV, *Workshop: Financing Small and Medium-Sized Businesses for Future Growth. Proceedings* (Milan, July 6–7, 1995); Story and Walter (fn. 19). Author interviews with Easdaq official, London, May 3, 1999; with Paris exchange executive, Paris, May 18, 2000; and with European Commission official, DG2, Luxembourg, June 7, 1999. Author telephone interview and written communications with FESE official, October 2004.

TABLE 4

## OBSERVABLE EMPIRICAL EXPECTATIONS ABOUT EUROPE'S NEW STOCK MARKETS

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- *Why did the exchanges create new markets?*
- *Why did they adopt the Nasdaq organizational form?*
- *What accounts for the timing?*

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1. Mobile Capital and Economic Competition	<p>1a. National financial services firms articulate a coherent preference for new national stock markets and the adoption of the Nasdaq principle.</p> <p>1b. National stock exchanges and governments and supranational European officials respond to the lobbying of financial services firms or economic efficiency concerns by creating new markets modeled on the Nasdaq principle.</p> <p>1c. The timing of institutional copying follows a measurable increase in cross-border capital mobility.</p> <p>1d. Once one national exchange creates a Nasdaq copy, others follow in rapid succession.</p>
2. Ideological Diffusion and the Logic of Appropriateness	<p>2a. National stock exchanges, their governments, and supranational European officials identify new markets and the Nasdaq principle as solutions to problems that they had not previously perceived.</p> <p>2b. The timing of market copying follows the persuasion campaigns of global teachers, who believe modern financial systems must have Nasdaq-like markets.</p> <p>2c. The timing follows the widespread acceptance among financiers and supranational and national policymakers that the Nasdaq form is a vital element of economic success.</p>
3. Domestic Polity and Intergovernmental Agreements	<p>3a. The conspicuous success of the U.S. in financing entrepreneurs leads domestic policymakers with different financing traditions, independently, to the same solutions: new markets and the adoption of the Nasdaq form.</p> <p>3b. National officials' similar preferences for new domestic markets and the Nasdaq principle are functional responses to shared domestic problems.</p> <p>3c. National stock exchanges copy the Nasdaq form to various degrees and make subsequent changes in divergent directions.</p> <p>3d. Support by supranational European officials for smaller-company markets and the Nasdaq form reflect aggregated preferences of national governments.</p>
4. Supranational Bureaucrats and Incremental Change	<p>4a. European Commission officials identify stock markets as a solution to Europe's problems and articulate an independent preference for pan-European designs.</p> <p>4b. European Commission officials play midwife to new Europe-wide industry lobbies, help shape their agenda to promote pet proposals for pan-European markets, and take a secondary role in the public arena.</p> <p>4c. European Commission officials act strategically by choosing the Nasdaq and other American forms and interpreting new EC laws liberally.</p> <p>4d. Bold European Commission initiatives follow several years of incremental interventions and trigger change processes that run in unintended directions.</p>

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ered by altered levels of relative mobility among the relevant actors.<sup>31</sup> As restrictions to cross-border transfers of financial assets decrease, these local firms are expected to rely more on global investors for their revenues, to develop new preferences over stock markets and other microfinancial institutions that favor emulating international best practice, and to acquire the ability to do business in foreign markets. A credible threat of exit would thus be expected to empower global investors vis-à-vis local firms and the latter vis-à-vis national stock exchanges and their government supporters. The new reality or its possibility would draw exchanges into cross-border competition and pressure them to adopt those foreign models considered most efficient for retaining customers.

This logic implies pluralist causation, whereby public authorities respond to pressure from mobile actors in order to attract highly desirable financial activity to their jurisdictions. Recent research on diffusion processes finds a relationship between competition among governments for investment and the clustered liberalization of capital flows.<sup>32</sup> Under conditions of high levels of capital mobility, stock exchanges in different countries might be expected to behave similarly. If one exchange met the demands of financial services firms for a Nasdaq copy, for example, foreign governments, under a potential or explicit threat from mobile firms to gravitate to the new market, might be expected to respond quickly by pressuring their respective exchanges into creating a Nasdaq copy of their own. Scholars point to yet another possibility related to the particularities of the EU. Because mobile firms are likely to face entrenched government-stock exchange relationships, some expect them to lobby European Commission officials. Others expect the Brussels officials to recognize latent firm preferences and intervene on their behalf.<sup>33</sup>

By the logic of these explanations, an easing of restrictions on cross-border capital movements would have several observable empirical implications.

<sup>31</sup> Henry Laurence, *Money Rules: The Politics of Finance in Britain and Japan* (Ithaca, N.Y.: Cornell University Press, 2001); Benn Steil, ed., *The European Equity Markets: The State of the Union and an Agenda for the Millennium* (London: RIIA, 1996).

<sup>32</sup> Beth A. Simmons and Zachary Elkins, "The Globalization of Liberalization: Policy Diffusion in the International Political Economy," *American Political Science Review* 98 (February 2004).

<sup>33</sup> For alternative ways by which supranational officials respond to company preferences, see Andrew Moravcsik, "A New Statecraft? Supranational Entrepreneurs and International Cooperation," *International Organization* 53 (April 1999); Alec Stone Sweet and Wayne Sandholtz, "Integration, Supranational Governance, and the Institutionalization of the European Polity," in Wayne Sandholtz and Alec Stone Sweet, eds., *European Integration and Supranational Governance* (Oxford: Oxford University Press, 1998).

- 1a. National financial services firms articulate a coherent preference for new national stock markets and the adoption of the Nasdaq principle.
- 1b. National stock exchanges and governments and supranational European officials respond to the lobbying of domestic financial services firms or economic efficiency concerns by creating new markets modeled on the Nasdaq principle.
- 1c. The timing of institutional copying follows a measurable increase in cross-border capital mobility.
- 1d. Once one national exchange creates a Nasdaq copy, others follow in rapid succession.

#### IDEOLOGICAL DIFFUSION AND THE LOGIC OF APPROPRIATENESS

A second body of scholarship also locates the causes of institutional convergence at the global level. Here, rather than being motivated by an economic logic, national officials and elites are expected to adopt foreign institutions perceived as most appropriate for organizing a modern society. In this context, global structural change means spreading a world culture of Weberian rationalization. Causality lies in the sociological processes of diffusing a set of norms that seems universal and natural to policymakers. The behavior is motivated by the process of dissemination and the logic of appropriateness, instead of by economic interest or political calculus. Institutional sociologists, constructivists, and Gramscian IR scholars focus on the spread of modern "liberalism"<sup>34</sup> and in the main agree that policymakers follow a set of universally accepted liberal principles, including the primacy of market mechanisms, that represent progressive, rational, and modern change.

Focusing on the relationship between problems and solutions is a good way to distinguish between behaviors driven by expected consequences and those motivated by a sense of appropriateness. In ideological diffusion arguments, policymakers are expected to embrace liberalism as a "solution" because they believe it is appropriate. Solutions are not functional reactions to previously recognized problems. Instead of responding to the financing problems of smaller companies, public officials and stock exchanges create new markets and identify the problems they might solve at the same time.

<sup>34</sup> John Boli and George M. Thomas, eds., *Constructing World Culture: International Nongovernmental Organizations since 1875* (Stanford, Calif.: Stanford University Press, 1999); Robert W. Cox, "Gramsci, Hegemony and International Relations: An Essay in Method," in Stephen Gill, ed., *Historical Materialism and International Relations* (Cambridge: Cambridge University Press, 1993); Martha Finnemore, "Norms, Culture, and World Politics," *International Organization* 50 (Spring 1996); Stephen Gill, "Global Structural Change and Multilateralism," in Stephen Gill, ed., *Globalization, Democratization and Multilateralism* (New York: St. Martin's Press, 1997); McNamara (fn. 11, 2001); Steven Weber, "Origins of the European Bank for Reconstruction and Development," *International Organization* 48 (Winter 1994).

Constructivists, in particular, have highlighted agents in the dissemination process who house and develop global norms and principles, disseminate them across borders, and believe deeply in their mission.<sup>35</sup> A host of possible agents—global consulting firms, networks of finance economists, domestic bureaucracies, or international or regional organizations, including the European Commission—might persuade stock exchanges, financial firms, governments, and supranational officials that a modern financial center must include a Nasdaq-like market. Such a process suggests the timing of the new markets would coincide with discrete “teaching” efforts by at least one of these agents.<sup>36</sup>

An alternative explanation expects institutional mimesis to follow the emergence of a new “ideational consensus.”<sup>37</sup> American forms would become so legitimate among financiers, smaller companies, and policymakers that national exchanges, governments, and EU officials would be expected to face negative “reputational consequences” by not copying it.

I derive three observable expectations about Europe’s new stock markets from these ideological diffusion explanations:

2a. National stock exchanges, their governments, and supranational European officials identify new markets and the Nasdaq principle as solutions to problems that they had not previously perceived.

2b. The timing of market copying follows the persuasion campaigns of global teachers, who believe modern financial systems must have Nasdaq-like markets.

2c. The timing follows the widespread acceptance among financiers and supranational and national policymakers that the Nasdaq form is a vital element of economic success.

#### DOMESTIC POLITY AND INTERGOVERNMENTAL AGREEMENTS

Other scholars have advanced explanations that feature domestic actors and processes as the causes of cross-border institutional convergence.<sup>38</sup> They offer at least two logics and expect both to obtain when policymakers in different countries, concerned about domestic politics and the relative competitiveness of their jurisdictions, experience similar problems (either because of a shared external shock or through independent but parallel national evolutions) and seek to solve them. In the first, public authorities arrive independently at similarly functional and

<sup>35</sup> Margaret E. Keck and Kathryn Sikkink, *Activists beyond Borders: Advocacy Networks in International Politics* (Ithaca, N.Y.: Cornell University Press, 1998).

<sup>36</sup> Finnemore (fn. 11).

<sup>37</sup> Simmons and Elkins (fn. 32).

<sup>38</sup> Berger (fn. 7); DiMaggio and Powell (fn. 12).

efficient solutions to the perceived problem.<sup>39</sup> In the second, because of failures with previous national experiments, policymakers face high levels of uncertainty and therefore satisfice by selecting solutions that appear to have worked well in other countries.<sup>40</sup>

Comparativists tend to be skeptical about the impact of adopting foreign forms, stressing the constraining effects of prior arrangements and the complementarities among domestic institutions.<sup>41</sup> They find that previous government-finance relations largely determine who reacts to problems, how they interpret them, and what the range of possible solutions will be. They expect variation in the extent to which policymakers in different countries actually adopt the same foreign institution and subsequent changes to go in divergent directions. National exchanges, despite claiming to have copied U.S. forms, would be expected to adopt American models in a formalistic and superficial sense and over time to make changes that best suit domestic vested interests.

Finally, some scholars extend the domestic polity logic to understand regional developments. They expect the adoption of similar policies and institutions or the borrowing of foreign ones to reflect political bargains struck between participating governments, whose positions ultimately may be reduced to aggregated domestic preferences. In the EU context, interventions by supranational organizations would represent the aggregated desires of national governments, whether encoded in law or not. The actions of Commission officials are expected to be extensions of previous delegations of power by national governments and rational calculations about the costs and benefits of monitoring a supranational bureaucracy; seemingly independent actions by Brussels officials that appear to run counter to the aggregated preferences of member governments would actually reflect the latter's subtle influences.<sup>42</sup>

These explanations yield several observable implications about Europe's new markets:

- 3a. The conspicuous success of the U.S. in financing entrepreneurs leads domestic policymakers with different financing traditions, independently, to the same solutions: new markets and the adoption of the Nasdaq form.

<sup>39</sup> Boyer (fn. 12).

<sup>40</sup> DiMaggio and Powell (fn. 12).

<sup>41</sup> For examples from the politics of finance literature, see Richard Deeg, *Finance Capital Unveiled: Banks and the German Political Economy* (Ann Arbor: University of Michigan Press, 1999); Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca, N.Y.: Cornell University Press, 1996). The sociology of markets literature makes parallel arguments. See Fligstein (fn. 13, 2001).

<sup>42</sup> Pollack (fn. 18); Jonas Tallberg, "The Anatomy of Autonomy: An Institutional Account of Variation in Supranational Influence," *Journal of Common Market Studies* 38 (December 2000).

3b. National officials' similar preferences for new domestic markets and the Nasdaq principle are functional responses to shared domestic problems.

3c. National stock exchanges copy the Nasdaq form to various degrees and make subsequent changes in divergent directions.

3d. Support by European Commission officials for smaller-company markets and the Nasdaq form reflect aggregated preferences of national governments.

#### SUPRANATIONAL BUREAUCRATS AND INCREMENTAL CHANGE

Emphasizing the constraints of existing arrangements runs the risk of eclipsing politics and political action and its role in prompting institutional innovation. Yet if political contestation is a likely source of change, then in the study of contemporary Europe the traditional division of causes into global and domestic categories obscures a third possibility. In this region, convergence and, more broadly, domestic institutional change may have roots in the EU, one of the most important developments in world politics and economics of the twentieth century and a maturing regional polity. In a wide range of policy areas, including finance, what happens within countries can no longer be understood without reference to European-level legislation, procedures, politics, and actors. The EU as a producer of public policy has reached a critical mass,<sup>43</sup> and its supranational agents are often the instigators of fierce clashes over economic institutions, especially regarding the boundaries, governance, and purposes of markets. The challenge for scholars has been to articulate theoretical reasons for treating the EU and other supranational institutions as autonomous political actors that produce independent effects, rather than agreements among states or microcosms of globalization. One answer lies in the bureaucratization of supranational political space, a common aspect of extranational institutions and a characteristic feature of the European polity.<sup>44</sup>

Contrary to global and domestic polity approaches, much of what European Commission civil servants do and the effects of their actions cannot be reduced to changes at the international level or formal or informal agreements among governments. Motivated by the prospects of advancing the European integration project, forging regional markets from national ones, expanding their own authorities, and improving the EU's international position,<sup>45</sup> Brussels bureaucrats are expected to

<sup>43</sup> Mazey and Richardson (fn. 17).

<sup>44</sup> Barnett and Finnemore (fn. 14).

<sup>45</sup> For a recent discussion of European Commission motivations and why scholars tend to make similar assumptions about them, see Pollack (fn. 18), 35.

be central and independent players behind cross-border harmonization processes, especially in sectors like finance that are characterized by fragmented and protected domestic industries. Interventions, which they interpret as practical solutions to problems, are likely to provoke reaction from incumbents with large stakes in nationally circumscribed markets and thereby instigate political contestation.

In this approach, the accumulation of quotidian bureaucratic action over extended periods of time produces independent effects. With relatively few legal powers, European Commission civil servants are expected to rely heavily on political skills<sup>46</sup> to make their actions seem useful and legitimate to others and thereby create autonomy for pursuing their goals from governments and the European Parliament.<sup>47</sup> Frequently observed bureaucratic actions include creating new interests and catalyzing supportive coalitions,<sup>48</sup> shaping political discourses and setting the terms of debates,<sup>49</sup> and otherwise reconstituting the social and political world.<sup>50</sup>

By this logic, the place to look for the effects of bureaucratic interventions is in background processes, rather than solely in treaty-making negotiations, legislative procedures, and other deliberations that involve head-to-head contests against governments in the main political arena. Understanding institutional change as a largely incremental process that periodically yields more easily observed abrupt shifts, the explanation gives as much emphasis to why and how issues move into the political spotlight and to the development of new frames and constellations of interests as to the particular outcomes of high-profile battles.

The impact of bureaucrats is thus expected to be a more frequent aspect of EU political life than in principal-agent and other standard EU approaches, which expect infrequent autonomy from legislative officials and then only when the latter decide to give civil servants wide discretion. The more the above types of bureaucratic actions accumulate in a given issue-area, the greater the chances that their interventions will provide openings for opportunistic actors, threaten beneficiaries of the status quo, and shake up existing arrangements. In recognizing a broader range of ways by which bureaucrats affect change processes, the

<sup>46</sup> Fligstein (fn. 13, 1997); Neil Fligstein and Iona Mara-Drita, "How to Make a Market: Reflections on the Attempt to Create a Single Market in the European Union," *American Journal of Sociology* 102 (July 1996); Alec Stone Sweet, Neil Fligstein, and Wayne Sandholtz, "The Institutionalization of European Space," in Stone Sweet, Fligstein, and Sandholtz (fn. 11).

<sup>47</sup> Barnett and Finnemore (fn. 14); Carpenter (fn. 15).

<sup>48</sup> Heritier (fn. 17); Mazey and Richardson (fn. 17); Sandholtz and Zysman (fn. 17).

<sup>49</sup> Bauer (17); Fligstein and Mara-Drita (fn. 46); Jabko (fn. 17).

<sup>50</sup> Barnett and Finnemore (fn. 14); Stone Sweet, Fligstein, and Sandholtz (fn. 46).

approach offers an alternative notion of influence. Because European Commission officials are better positioned to affect behind-the-scenes processes than the ultimate negotiations in formal forums, their interventions are likely to trigger change and innovation but are unlikely to determine particular outcomes once an issue migrates to the public arena and draws additional powerful actors into the fray. The approach thus expects Brussels bureaucrats to have an important impact on institutional change processes, while at the same time anticipating unintended consequences to result from their activism.

From this explanation, I generate four empirical expectations:

- 4a. European Commission officials identify stock markets as a solution to Europe's problems and articulate an independent preference for pan-European designs.
- 4b. European Commission officials play midwife to new Europe-wide industry lobbies, help shape their agenda to promote pet proposals for pan-European markets, and take a secondary role in the public arena.
- 4c. European Commission officials act strategically by choosing the Nasdaq and other American forms and interpreting new EC laws liberally.
- 4d. Bold European Commission initiatives follow several years of incremental interventions and trigger change processes that run in unintended directions.

### III. EXPLAINING EUROPE'S NEW MARKETS: THE EMPIRICAL RECORD

I develop the historical record from multiple sources, including the financial press, private and public sector reports, secondary scholarship and archival research, and interviews conducted in eight European countries.<sup>51</sup> Each of the three standard approaches captures some elements of the European new markets story. Yet the supranational bureaucrats approach, by expecting European Commission officials to play a central role, did a better job of explaining their creation, form, and timing.

#### THE CREATION OF NEW MARKETS

The national stock exchanges of Europe created the 1990s markets in reaction to a perceived competitive threat from Easdaq, a proposed

<sup>51</sup> I interviewed stock exchange executives, national government and European Commission officials, financiers and executives with the European Private Equity and Venture Capital Association (EVCA), International Federation of Stock Exchanges (which changed its name to the World Federation of Exchanges), the Federation of European Securities Exchanges, the City Group for Smaller Companies in London (renamed Quoted Companies Alliance), and the European Association of Securities Dealers in Brussels (which merged with the Association of Private Client Investment Managers and Stock Brokers).

pan-European Nasdaq copy backed by the European Commission but owned and managed by private financiers. The exchanges feared the new market would form the basis for a European-level entrepreneurial financial sector and draw activity away from traditionally protected businesses. The earliest reports that a private group was about to launch Easdaq began to circulate in the financial press in June 1994. The financiers were mainly venture capitalists associated with the European Venture Capital Association (EVCA).<sup>52</sup> Officials from the same division of the European Commission that supported the pan-European market had a decade earlier, in a seemingly innocuous intervention that drew little attention and no opposition, helped to create and then finance this political voice and interest group for European venture capitalists.<sup>53</sup>

Venture capitalists cared a great deal about the failure of the 1980s feeder markets because they had expected to use them for selling their investments in risky young companies. The number one item on EVCA's political agenda in the early 1990s was, understandably, to improve the range of profitable exit mechanisms in Europe.<sup>54</sup> Because of the potential to get a higher price, the preferred mechanism was to sell shares to the public through a listing on a stock market.<sup>55</sup> There was initial speculation that the U.S. Nasdaq itself and the Paris and other European exchanges were helping EVCA create Easdaq. Within months, however, the European Commission emerged as the sole supporter of the politically marginal and resource-poor venture capitalists, who were not part of the national networks of financial insiders. The Commission's direct intervention took the form of financial support for two preliminary studies, followed by subsidies for the early months of operations.<sup>56</sup>

The LSE and the Paris bourse were first to respond, by reversing respective decisions, made only months before, to close and reform their

<sup>52</sup> EVCA retained its acronym but has since changed its name to European Private Equity and Venture Capital Association.

<sup>53</sup> Bull EC (European Commission Bulletin of the European Union/European Community) 12-1981, 2.1.18, 1981; Bull EC 11-1982, 2.1.24, 1982; Bull EC 6-1983, 2.1.46, 1983.

<sup>54</sup> William D. Bygrave, Michael Hay, and Jos B. Peeters, eds., *Realizing Investment Value* (London: Financial Times/Pitman Publishing, 1994); EVCA, *Venture Capital Special Paper: Capital Markets for Entrepreneurial Companies* (Zaventem: EVCA, 1994).

<sup>55</sup> Other less desirable options include sales to larger companies in the same industry (trade sale) or to other financiers.

<sup>56</sup> Commission officials funded Easdaq through a nonprofit organization for this purpose discussed below. The European Commission (DG13) used resources from the second phase of the Strategic Programme for Innovation and Technology Transfer, 1989-93 (SPRINT), approved by the representatives of EU member state governments, which then extended the program for an additional year. See Council Decisions 89/286/EEC and 94/5/EC; Bull EC 1.2.144, 1993; Bull EC 2.1.69, 1989. DG23 gave funds from a multiannual program approved by the government representatives for small and medium-size enterprises, which ran from 1993 to 1996. See Council Decision 93/379/EEC.

feeders (see Section I). Three months after the June 1994 Easdaq announcement, the LSE shifted course by announcing the opening of AIM, which it hoped would undermine the pan-European upstart. For a short period, the Paris exchange flirted with the idea of supporting the venture capitalists. But in February 1995, in a codecision with the Trésor, the exchange declared its intention to create its own new market, called the Nouveau Marché, even though it had just reformed its 1980s feeder.<sup>57</sup>

These two early experiments underestimated the later competitive reactions, especially from the Frankfurt-based Deutsche Boerse, which, like the owners of Easdaq, more closely emulated the Nasdaq rules when it launched the Neuer Markt in March 1997. The contest to become the center of entrepreneurial finance in Europe had begun. The Neuer Markt's stunning early success prompted the LSE to lift AIM's regulatory standards in August 1997.<sup>58</sup> Then, fearing this reform would prove insufficient to prevent Frankfurt's rise, in November 1999 the London exchange created Techmark and endowed it, like Easdaq, with exceptionally demanding informational requirements. (See Table 3.) At first the Paris exchange attempted to manage competition and combine forces with the other continental exchanges, not only in response to Easdaq but also to prevent the feared domination by London, the historic leader of European equity finance. Euro.NM, a federated network of the Paris, Frankfurt, Amsterdam, Brussels, and, later, Milan new markets, however, fell apart once the German exchange began to believe the Neuer Markt could make it alone. In November 1996 the Paris bourse began to converge the Nouveau Marché's rules closer to the Nasdaq principle.<sup>59</sup>

Comparing cases occurring immediately before and after the Commission intervention provides strong evidence against the expectations of domestic polity explanations. The difficulty for smaller companies in raising capital, the failure of the 1980s feeder markets, and their connection to structural unemployment were prevalent themes in many, though not all, European capitals. Nevertheless, this shared perception of a problem did not lead to independently derived similar solutions (Table 4, expectations 3a and 3b), let alone to copying seemingly successful American institutions. Until the Easdaq announcement, domestic financial elites in different countries made quite different decisions about how to address smaller-company finance.

<sup>57</sup> Bruno Roger and Pierre Faure, *Rapport du Groupe de Travail "Nouveau Marche"* (Paris: SBF-Bourse de Paris, February 1995). Author interview with Trésor official, Paris, June 6, 1999.

<sup>58</sup> David Mandell, "Alternative Investment Mood," *CISCO Voice* (December 1997), 8–10.

<sup>59</sup> "Nouveau Marché Rule Change," *Financial Times*, October 30, 1996, 28.

The evidential record also demonstrates that the Commission's actions in support of Easdaq cannot be reduced to subtle influences of national governments working behind the scenes (Table 4, expectation 3d). National treasuries and finance ministries backed units within the European Commission that were trying to stop the intervention at an early stage.<sup>60</sup> Once the Commission's role became public, in fact, an angry backlash broke out. Ministers of finance backed their respective national exchanges' vehement opposition to the Commission's "interference" in creating Easdaq, claiming it was an illegitimate actor in the realm of financial institutions. In the U.K. the Treasury maintained its position that private market actors alone should determine the supply of new markets.<sup>61</sup> In France the Trésor and the stock exchange together rallied to oppose the Easdaq project and enlisted French commissioner Edith Cresson in the battle.<sup>62</sup>

Some ministers representing their countries in the EC Industry Council and elsewhere gave vague support to Commission schemes that might overcome resistance to domestic innovation and solve problems facing smaller companies.<sup>63</sup> But these representatives had little more leverage over the evolution of financial institutions in the European political arena than they had at home. Influence instead rested with their counterparts at the head of treasuries and ministries of finance, working through the Economic and Financial Affairs Council (Ecofin) at the European level. The historical record—both before and after Easdaq's creation—leaves little doubt as to their preferences concerning the Commission and financial markets. Since the late 1970s and early 1980s, when Brussels officials attempted top-down integration of national equity markets, national ministers of finance, reflecting the agendas of their respective exchanges, have objected to Commission involvement.<sup>64</sup>

The reasons national exchanges successfully enlisted their respective finance ministry's support in blocking Commission-backed schemes for pan-European markets lie in the cross-cutting goals of governments. On

<sup>60</sup> Author interview with official from the former DG15, Brussels, June 2004. DG15's and the stock exchanges's opposition to the Easdaq initiative came out in the open during a FIBV conference. See especially the comments of Jose Fombellida, DG15 in FIBV (fn. 30).

<sup>61</sup> Letters between Chancellor of the Exchequer and CISCO leader, March 1993, available in CISCO archives in London.

<sup>62</sup> Author interviews with Trésor official, Paris, June 6, 1999; and DG13 official, Luxembourg, May 5, 2000.

<sup>63</sup> Author's written correspondence with DG Enterprise official, May 8, 2001. See Council Decisions 89/286/EEC, 93/379/EEC and 94/5/EC.

<sup>64</sup> European Commission, *Towards a European Stock Exchange*, XV/231/81 (Brussels: November, 1980).

the one hand, national governments were interested in financial innovation that might benefit smaller firms and their economies. On the other hand, by the late 1980s they were concerned about the fate of their respective financial centers in the integrated European financial system of the future.<sup>65</sup> Government officials therefore sought to promote change, but only to the extent that it supported national exchanges.

Commission bureaucrats thus intervened in Easdaq in spite of formidable national opposition. Some commissioners, the politically appointed leaders of the European Commission,<sup>66</sup> backed these officials, gave Director General Heinrich von Moltke (the top Easdaq-promoting civil servant) and his staff the green light to carry out actions in support of the new market, rejected the complaints of fellow commissioner Edith Cresson and showed very little contrition for doing so. Despite tremendous pressure on civil servants in Brussels to couch their interventions in market-driven language, von Moltke conveyed the prideful sentiment of his officials and the commissioners at an Easdaq conference in June 1996, when he said the new market represented “one of the fruits of the Commission’s policy in this area.”<sup>67</sup>

The empirical record also runs counter to another domestic polity expectation—that the organizational forms of the new markets would diverge over time (Table 4, expectation 3c). While national exchanges initially adopted and enforced the actual Nasdaq rules in varying degrees, the constraints of cross-border competition pressured them to bring their markets closer to the American principle. (See Table 2 and Table 3.) When stock prices on the Neuer Markt collapsed due largely to scandals rooted in poor compliance with the new rules, for example, the Frankfurt exchange at first redoubled its enforcement efforts.<sup>68</sup> Unable to restore the Neuer Markt’s reputation, however, it created Prime Standard in 2003. The 2003 movement of the Neuer Markt’s best companies to Prime Market, with more Nasdaq-like rules and better enforcement, demonstrates the ongoing competitive pressures.<sup>69</sup> Lately, a new round of convergence under competition was under way. The

<sup>65</sup> Story and Walter (fn. 19).

<sup>66</sup> They were Raniero Vanni d’Archirafi (Italy) and Christos Papoutsis (Greece).

<sup>67</sup> Heinrich von Moltke, “The Role of DG XXIII with Regard to EASDAQ” (Paper presented at the conference “EASDAQ—The European Stock Market for Growing Companies,” Brussels, June 26, 1996).

<sup>68</sup> “Bourse Tightens Rules on Market,” *Financial Times*, July 23, 2001, 16.

<sup>69</sup> Prime Market continues to make stock market financing available to young companies but is not exclusively for them. Its creation followed the Euronext exchange’s 2002 launching of the Next-Economy market.

continental exchanges have taken note of AIM's success and, as of early 2006, are mimicking the LSE's example of multiple organizational designs in yet another round of market making.<sup>70</sup>

The comparison of before-and-after cases from the early 1990s also raises serious doubts about some expectations derived from the ideological diffusion hypotheses. As their vociferous opposition and lobbying activity demonstrates, the stock exchanges were not persuaded to create Nasdaq copies by the European Commission, and global consultants, investment banks, and other likely idea carriers did not play important roles (Table 4, expectation 2b).<sup>71</sup> In fact, the decisions the exchanges and their governments made immediately before the Easdaq intervention suggest the persistence of distinct national beliefs about how best to organize financial markets. Many policymakers and financiers in Europe of course considered the Nasdaq Stock Market an unmitigated success in the U.S. This perception, however, was as prevalent in the mid-1980s with the rise of such listed companies as Intel, Microsoft, and Apple as in the booming 1990s,<sup>72</sup> making ideational consensus an unconvincing explanation for the timing of the new markets (Table 4, expectation 2c).

#### MOTIVATIONS AND STRATEGIES OF COMMISSION OFFICIALS

An expectation from the mobile capital explanation—that once one national exchange creates a Nasdaq copy, others will quickly follow (Table 4, expectation 1d)—accounts fairly well for the clustered pattern of market copying. Once one exchange created a new market, it altered the economic incentives of foreign exchanges, which followed in rapid succession. This logic explains, at least partially, the far-reaching effects of the commission intervention. Understanding the cluster mechanism alone, however, is unsatisfying. It offers an account for the timing of the followers but not the first mover and cannot explain why the Easdaq proposal set off a competitive process unlike previous pan-European initiatives.

<sup>70</sup> In creating the Alternext Market, the Euronext exchange borrowed the AIM model whereby local intermediaries back listed firms and thereby send signals to investors, keeping costs down. See Euronext, "Alternext: A Tailor-Made Market for Small and Mid Caps" (Paris, 2005).

<sup>71</sup> The U.S. Nasdaq and large international banks became interested only once the new market competition was under way. The Deutsche Boerse did commission McKinsey to advise on how best to respond to Easdaq, AIM, and the Nouveau Marché. But McKinsey and other global consulting firms were not key actors. Author interviews with Merrill Lynch economist, Frankfurt, May 13, 1999; managing director of Morgan Stanley Dean Witter, London, April 1999; and Deutsche Boerse executive, Frankfurt, May 2000.

<sup>72</sup> Fn. 28.

As Table 1 demonstrates, there was no shortage of proposals for new, smaller-company stock markets in the 1980s and early 1990s. Until the 1994 Easdaq initiative, however, the exchanges did not perceive any of them as credible competitive threats. Political and legal barriers, the lack of support from established financial elite and the exchanges' successful efforts to undermine proposed markets had all but eliminated the possibility of cross-border competition. What made the 1994 initiative different was the combination of its pan-European scope and the uncertainty about whether a new market could survive. Brussels bureaucrats were largely responsible for both.

Officials from the two subdivisions of the European Commission<sup>73</sup> that backed the venture capitalists were ardent promoters of adopting a pan-European smaller-company stock market. In the late 1970s a small group endorsed the idea of venture capital as a solution to the widely held perception that Europe lagged behind the U.S. in the area of technological innovation, causing economic problems such as unemployment, slow growth, and declining international competitiveness.<sup>74</sup> They set out to make Europe's regulatory and financial arrangements more conducive to venture capital investment.

National governments also made many of the same linkages and began to promote venture capitalism as well.<sup>75</sup> Despite a wide variety of approaches, however, they shared a single theme. All sought to promote *national* venture capital industries. The Commission's efforts, by contrast, fostered a *European* venture capital industry.

Why did these Brussels civil servants prefer a European-level approach? The answer lies largely in the supranational bureaucracy's identity as the guardian of the European integration process and promoter of the EU's position in the global economy.<sup>76</sup> An abundance of empirical scholarship shows Commission officials inclined to blame problems on fragmented national economies and see solutions in further European integration, which is one reason EU analysts typically as-

<sup>73</sup> The organization and labels for the European Commission's divisions, directorates-general, have since changed. The subdivisions that strongly promoted the Nasdaq form were Innovation, DG13, and Small-and-Medium-Sized Enterprises (SMEs), DG23.

<sup>74</sup> European Commission, "The Community and Industrial Innovation" (Brussels: Commission of the European Communities, 1978); European Commission, "European Venture Capital Pilot Scheme," DG Information and Innovation, EUR 9082 EN-FR final, (Brussels, 1984); author interview with European Commission official, DG Enterprise, Innovation Policy, Luxembourg, May 5, 2000.

<sup>75</sup> European Commission (fn. 74, 1984).

<sup>76</sup> See Neill Nugent, "At the Heart of the Union," in Neill Nugent, ed., *At the Heart of the Union: Studies of the European Commission* (New York: St. Martin's Press, 1997); Sandholtz and Zysman (fn. 17).

sume Brussels civil servants are classic competence maximizers in favor of increasing their own official responsibilities as well as those of the EU.<sup>77</sup> Two decades of reports, studies, proposals, and policies, as well as my interviews, substantiate these patterns and assumptions in the history of Europe's new markets.<sup>78</sup> Here, the functionaries believed that the biggest obstacle to venture capitalism in Europe and the benefits it promised was the absence of an integrated financial market. In the words of von Moltke: "We came to the conclusion that the logical answer to this problem [of undercapitalized SME's] was the creation of a true European capital market for SMES, which could play the role in Europe currently played by Nasdaq in the USA, a market focussed on young companies with high growth potential, especially in high-tech areas."<sup>79</sup> Even those officials opposed to the pan-European scheme, as discussed below, favored regional markets in principle. Their opposition was based on arguments about the feasibility of such markets when regulation remained at the national level.<sup>80</sup> In addition, unlike their colleagues, they were carefully monitored by finance ministries and stock exchanges, in part because they had promoted pan-European schemes of their own several years before.<sup>81</sup> This empirical record of autonomous and contrasting preferences of commission officials is evidence that their actions were motivated by independently developed goals (Table 4, expectation 4a) and did not simply reflect the subtle influences of governments or any other actors (Table 4, expectations 1b and 3d).

Easdaq's pan-European scope offered private sector actors an alternative to national financial systems and thereby posed a potential threat to the domestic exchanges. But the regional design is not a complete explanation for why the exchanges perceived the 1994 initiative as a

<sup>77</sup> Fn. 45.

<sup>78</sup> European Commission (fn. 74, 1978); European Commission, "Prospects for the Creation of a European-Level Capital Market for Entrepreneurial Companies" (Meeting with the press, in preparation for June 21, 1994, Brussels); European Commission, "Reporting on the Feasibility of the Creation of a European Capital Market for Smaller Entrepreneurially Managed Growing Companies," COM(95)498 (Brussels, 1995). See also European Commission documents COM(83)277, 1983; EUR 9082, 1984; EUR 9756, 1985; EUR 1152, 1990 and COM(93)528, 1993. Author telephone interview with official from the former DG13, May 4, 2000. Author interviews with officials from the former DG2, Luxembourg, June 7, 1999; and with the former DG15, Brussels, June 8, 2004. Author's written correspondence with DG Enterprise official, May 8, 2001.

<sup>79</sup> Von Moltke (fn. 67), 4.

<sup>80</sup> European Commission (fn. 64); ELBAssociates and Consultex, *The Feasibility of Creating ECU-EASD: A European Association of Securities Dealers to Trade over the Counter in ECU-denominated Shares* (Geneva, 1985). Author interviews with an official who opposed giving subsidies to Easdaq from the former DG15, Brussels, June 2004; with a former executive of the Amsterdam stock exchange, Brussels, June 8, 2004; and with an executive of the Paris stock exchange, Paris, May 18, 2000.

<sup>81</sup> European Commission (fn. 64).

credible threat, unlike previous proposals for similar markets.<sup>82</sup> A second critical factor was the officials' creative interpretation of new EC legislation. The long-awaited passage of the EC 1993 Investment Services Directive (ISD)<sup>83</sup> fell well short of its alleged goal, to integrate the sector by extending the principle of mutual recognition, a form of shared sovereignty, to European financial services entities, including stock exchanges. Reaching agreement over investment services proved more difficult than for banking, insurance, capital liberalization, and other financial areas targeted for integration in the late 1980s. After four years of tough negotiations, Europe's governments only produced a watered-down agreement. On the surface, an exchange regulated in one EU country could, by 1996, operate in another via electronic networks and computer terminals. But ambiguous passages and escape clauses handed a victory to continental exchanges and other interests seeking to repel London's attack on their trading businesses and slow the pace of change to allow for modernization.<sup>84</sup> Only in 2004, eleven years later, were financial elites ready to revisit these sensitive issues and clarify the rules of cross-border competition.<sup>85</sup>

The importance of the ISD, however, does not lie only or primarily in the content of the actual text (there was no mention of a pan-European stock market, let alone the Nasdaq organizational form) or the precise intentions of the member governments. Instead, its salience, like that of so many other pieces of EC legislation, stemmed largely from the unintended opportunities it offered policy entrepreneurs.<sup>86</sup> Created to manage processes of change, the ISD opened the door to challengers of the status quo. No one, including the exchanges, knew what a European "passport" in the financial services would mean. Commission officials, in a deliberate attempt to push the envelope and test the limits of the new legislation, took advantage of these unknowns by backing Easdaq and arguing that the new EC legislation would enable it to compete in all member countries.<sup>87</sup> "Until now it has been difficult to

<sup>82</sup> There were four previous proposals for pan-European Nasdaq copies: ECU-EASD (1985), European OTC Market (1989), European Securities Market (1989), and MESEC (1994).

<sup>83</sup> Council Directive 93/22/EEC.

<sup>84</sup> Article 15.5 is the main source of ambiguity concerning stock exchange competition. Benn Steil, *Regional Financial Market Integration: Learning from the European Experience* (London: RIIA, 1998), 40–43; and Story and Walter (fn. 19), 21–22, 266–69.

<sup>85</sup> The 2004 Markets in Financial Instruments Directive or MiFID (Directive 2004/39/EC of the European Parliament and Council of the European Union) repealed the ISD.

<sup>86</sup> Stone Sweet, Fligstein, and Sandholtz (fn. 46).

<sup>87</sup> Steven Weber and Elliot Posner, "Creating a Pan-European Equity Market: The Origins of EASDAQ," *Review of International Political Economy* 7 (Winter 2000), 545.

contemplate the creation of a true pan-European stock market,” reads a 1995 commission publication. “With the coming into force of certain Community legislation, most importantly the Directive on Investment Services in the Securities Field on 1st January 1996, the opportunities will improve markedly.”<sup>88</sup>

Had the LSE, the Paris bourse, and the other European exchanges known that historical advantages would continue to favor them, they might have reacted more slowly, taking a wait-and-see approach. After all, Easdaq’s 2001 demise suggests that the support of a bureaucracy hardly ensures success in overcoming formidable obstacles to creating new markets. Even the original U.S. Nasdaq itself, after its 2001 purchase of the failing Easdaq, was unable to compete.<sup>89</sup> Stock markets rest on a web of relations between financial intermediaries, investors, companies seeking capital, and service providers. In hindsight, the officials’ hope for the Easdaq project seems naïve. But at the time the possibility of success mattered most to the exchanges. Perceptions and uncertainties, not a reasoned assessment, stoked fears of competition and quickly brought a reaction and new rival markets.

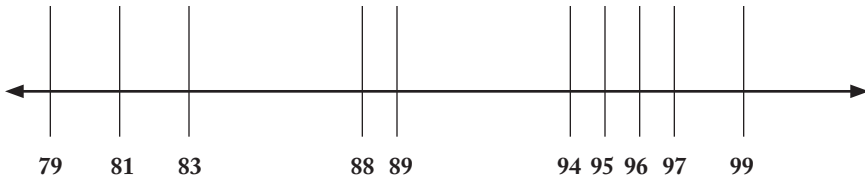
#### VENTURE CAPITALISTS AND MOBILE CAPITAL

A key expectation from the capital mobility explanations is that the timing of institutional convergence will follow a measurable increase in capital mobility (Table 4, expectation 1c). An examination of quantitative measures, however, shows the insufficiency of capital mobility as an explanation for Easdaq and the other markets. Openness indicators, focusing on government restrictions on inward and outward flows, reflect some of the underlying costs of moving capital across borders.<sup>90</sup> The timeline shown in Figure 2 demonstrates that many European countries had lifted capital restrictions more than a decade before the burst of stock exchange competition in the mid-1990s. The U.K., Germany, and the Netherlands liberalized in 1979, 1981, and 1983, respectively.

<sup>88</sup> European Commission (fn. 78, 1995), 7.

<sup>89</sup> In March 2001 the Nasdaq bought Easdaq, changed its name to Nasdaq Europe, and then closed it in November 2003. Jos Peeters purchased Nasdaq’s controlling interest in Nasdaq Europe in December 2003 and has recently sought to revive the Easdaq idea. See [www.Easdaq.be](http://www.Easdaq.be).

<sup>90</sup> I use Quinn’s widely used measure of openness in combination with the new Kastner and Rector measure. While Quinn’s measure gives annual openness scores for each country, the Kastner and Rector measure, also based on IMF data, identifies by month and year any major changes in government policies. Dennis Quinn and Carla Inclán, “The Origins of Financial Openness: A Study of Current and Capital Account Liberalization,” *American Journal of Political Science* 41 (July 1997); Scott L. Kastner and Chad Rector, “International Regimes, Domestic Veto Players, and Capital Controls Policy Stability,” *International Studies Quarterly* 47, no. 1 (2003).



1979, U.K. Liberalizes  
 1981, Germany Liberalizes  
 1983, The Netherlands Liberalizes  
 1988, EC Capital Liberalization Agreement; Italy Liberalizes  
 1989, France Liberalizes  
 1994, Easdaq Announcement  
 1995, London's AIM Opens  
 1996, Paris's Nouveau Marché Opens  
 1997, Frankfurt's Neuer Markt Opens  
 1999, London's Techmark Opens

FIGURE 2

## CAPITAL MOBILITY AND THE TIMING OF THE NEW MARKETS

Other European governments liberalized later, following EC commitments.<sup>91</sup> Italy and France made their last major liberalizations in 1988 and 1989, respectively. If increased levels of capital mobility accounted for the competition, the openness data suggest that it would have occurred in the early 1980s among the early liberalizers and on a region-wide basis several years sooner than it did.

The empirical record shows, instead, that the Commission's intervention, not new levels of capital mobility, empowered venture capitalists with respect to the stock exchanges. The Brussels-backed Easdaq gave venture capitalists a foreign alternative to national markets and thus a credible threat of exit. This evidence supports the supranational bureaucrats explanation (Table 4, expectation 4d) and suggests that, even for highly mobile actors, threatening to leave will likely ring hollow if there is nowhere else to go. Venture capitalists in Europe had been able to take their business across borders for over a decade. They only managed to influence stock exchange behavior when there was a viable alternative market on which they could list their companies, and this required the intervention of a political actor.

<sup>91</sup> Council Directive 88/361/EEC.

Is it possible that changing levels of capital mobility, despite the inability to account for the timing, shaped the preferences of venture capitalists? Is the creation of Easdaq and the other new markets primarily a pluralist story about the European Commission responding to the demands of venture capitalist firms?

The venture capitalists did not adopt coherent preferences as capital mobility explanations expect (Table 4, expectation 1a). They agreed on the need for stock markets but were deeply divided on the issues of scope (whether national, pan-European, or international markets would best serve their businesses) and form (whether the Nasdaq or an alternative was the most efficacious design). I found evidence of fractured preferences in internal EVCA conflicts<sup>92</sup> and in the industry press and the public writings of leading venture capitalists.<sup>93</sup> A small minority thought no new market was necessary because in an age of mobile capital European companies could list on the U.S. Nasdaq itself. Most, however, thought this idea would limit stock market financing to a small group of European companies and argued for new Europe-based markets.

The main rift was between EVCA members wanting to avoid confrontation with domestic financial elites and those believing that the national exchanges would never be the right vehicle for solving their problems. EVCA's board was weighted in favor of the former approach.<sup>94</sup> They preferred new domestic markets organized in ways that harnessed the resources of national financial services companies, rather than European designs based on a foreign principle that might alienate local support. The opposing faction, headed by former EVCA chair Jos Peeters, believed the ideal form was obvious: the one they thought investors wanted, a Nasdaq-like market that would draw liquidity from throughout Europe. In the end, the Brussels civil servants shaped the outcome by putting their resources behind Peeters. The funds from the Commission, according to a former EVCA executive, "was a way for Peeters' Working Group to get around the conservative board,"<sup>95</sup> evidence in support of the supranationalist bureaucrats explanation (Table 4, expectation 4b). Even Peeters, who sees his own role as somewhat more substantial and that of the Commission's as somewhat less than my

<sup>92</sup> Author telephone interview with former secretary general of EVCA, April 27, 2000; EVCA (fn. 54).

<sup>93</sup> Maurice Anslow, "EPEE', 'PAREX', 'NASDAQ' or 'EASDAQ'?" *European Venture Capital Journal* 26 (February–March 1993), 1; Jos B. Peeters, "A European Market for Entrepreneurial Companies," in Bygrave, Hay, and Peeters (fn. 54).

<sup>94</sup> Author telephone interview with former EVCA executive, April 27, 2000.

<sup>95</sup> *Ibid.*

depiction here, concedes that there was always good support within the Commission. "The little drops of money were great help," he said.<sup>96</sup>

Expectation 1b leaves open the possibility, however, that levels of capital mobility may be at work in an indirect way. Here, European Commission officials, acting as custodians for venture capitalist firms, are expected to choose the Nasdaq form because it represents best practice or the most economically efficient form known, even if the firms themselves fail or are unable to articulate a preference for it on their own. The evidential record casts doubt on this explanation as well—and not only because AIM, with an eclectic homegrown design, is thus far the most successful but least Nasdaq-like of Europe's new markets and has apparently become as of 2005 the latest form to emulate. (See Table 1.) The Brussels officials who promoted the American model, for example, were well aware of the formidable arguments that it could not succeed in Europe, regardless of its record in the U.S. Their commission colleagues with the most financial expertise, mirroring the views of many financiers, were among the most ardent opponents, contending that Europe lacked the necessary equity culture, high-risk companies, and the legal, fiscal, and regulatory systems for U.S.-style entrepreneurial finance.<sup>97</sup>

The above evidence combined with documentation of Commission officials soliciting proposals from venture capitalists and others for a pan-European stock market modeled on the U.S. Nasdaq runs counter to the pluralist expectations implied by mobile capital propositions (Table 4, expectation 1b). Supranational public authorities did not serve as vessels through which venture capitalists achieved their goals. Indeed, the record points the causal arrows in reverse, as the supranational bureaucrats explanation suggests.

#### COPYING THE NASDAQ FORM: A STRATEGY

When stock exchanges compete, they vie in large part to attract global institutional investors. Because the latter were familiar with the Nasdaq form and perceived it as the most legitimate and efficient way to organize a smaller company market, Easdaq's near replication of the Nasdaq rulebook instantly set a new standard that its competitors felt compelled to meet. This is why cross-border competition became a battle over which new market would become the future Nasdaq of Europe. But the empirical record strongly suggests that perceptions about the

<sup>96</sup> Author interview with Jos Peeters, Leuven, April 26, 2000.

<sup>97</sup> Fn. 80.

appropriateness of the Nasdaq principle were not the primary reasons that the bureaucrats pushed for its adoption in the first place.

They instead preferred the American form for largely political and strategic reasons.<sup>98</sup> Determined to achieve their goal of a Europe-wide market, the officials wanted a form that would help overcome predicted opposition. The Nasdaq principle was an obvious choice. Structural unemployment, at the center of European politics by the early 1990s, opened the door for an expanded range of policy ideas that might solve it. Pointing to the Nasdaq's role in creating American jobs, the officials suggest—in their own publications as well as outsourced studies—that a similar market would solve the unemployment problem in Europe, just as it had in the U.S., and it would do so without making painful political decisions about labor markets or social welfare systems.<sup>99</sup> Commission officials, as much as any other European political actor, promoted this political discourse that linked jobs, venture capitalism, and the Nasdaq form, and they did so largely to make it difficult for the exchanges and their governments to maintain public stances against a pan-European market.

The point is subtle and deserves further elaboration, for clearly ideas and framing contributed importantly to the new markets' origins. The ideological diffusion explanation expects that Commission officials believe in the appropriateness of the Nasdaq form and identify it as a solution to problems not previously perceived (Table 4, expectation 2a). The key distinction is between this approach whereby supranational officials act as "norm entrepreneurs" committed to specific technical beliefs and the functionalist view that they use ideas, as they would other available tools, to redress previously conceived problems.<sup>100</sup> Comparing Easdaq to the unrealized proposals for pan-European stock markets suggests that Commission officials believed the Nasdaq form would indeed solve a problem—of a political, not economic, nature—traceable to 1985, when European Commission President Jacques Delors

<sup>98</sup> Author telephone interview with official from the former DG13, May 4, 2000; author and Weber's interview with commission officials from the former DG23, Brussels, June 1997; Weber and Posner (fn. 87).

<sup>99</sup> European Commission (fn. 78, 1994 and 1995). See Commission-funded studies: Coopers & Lybrand, "Corporate Finance: EASDAQ—a New Opportunity?" (London, 1995); "New Survey Shows Need for European Over-the-Counter Securities Market, Information Bulletin, December 23, 1985" (Brussels: EVCA, 1985).

<sup>100</sup> For the linkages between rationality and norm-based behavior, see Martha Finnemore and Kathryn Sikkink, "International Norm Dynamics and Political Change," *International Organization* 52 (Autumn 1998); Susan K. Sell and Aseem Prakash, "Using Ideas Strategically: The Contest between Business and NGO Networks in Intellectual Property Rights," *International Studies Quarterly* 48 (March 2004).

endorsed a proposal for a Europe-wide market.<sup>101</sup> Then, as in 1989, Brussels decided not to intervene, in part for lack of a political discourse with which to frame the issue and ensure that finance ministries and exchanges would have a difficult time countering it in public. Commission officials in 1989 tried to sell the pan-European market idea as a solution to the hollowing out of local financial centers. But this framing had little traction.<sup>102</sup> In 1994 they found a more compelling discourse in the linkage between unemployment and U.S.-style entrepreneurial finance.

European Commission officials were thus less converts to the Nasdaq form than strategic actors interested in taking advantage of its broad appeal. But the evidence in support of the supranational bureaucrats arguments (Table 4, expectation 4c) and challenging the ideological diffusion explanation does not stop here. Easdaq's promoters harnessed Nasdaq's legitimacy by making it seem as though the two markets were similarly regulated. Because Easdaq was privately owned, commission officials were prohibited from directly giving it financial resources. They instead funded the European Association of Securities Dealers (EASD), a nonprofit organization, set up in 1994 mainly for this purpose.<sup>103</sup> The name EASD was deliberately chosen to evoke the American NASD (National Association of Securities Dealers), exploit its legitimacy as a respected regulator of the Nasdaq Stock Market, and give the impression that the Easdaq-EASD relationship was equivalent to that between Nasdaq and the NASD. EASD, however, had no official regulatory authority whatsoever.<sup>104</sup> Its function was to provide a legal vehicle for funding the venture capitalists. In the words of a former EVCA chief executive, "Commission officials went out of their way to find a solution to funding the Easdaq project, given the incredible restriction of the Commission."<sup>105</sup> A former EASD official who had first worked for Peeters's working group was more forthright: "From 1994-96, it was all mirrors. We had to convince [financial] players to get involved or miss out."<sup>106</sup>

<sup>101</sup> Correspondence between Eugene Schulman and Jacque Delors, January 14, 1985. Author interview with Eugene Schulman of ELBAssociates and Andrew Sundberg of Consultex, Geneva, May 8, 2000. ELBAssociates and Consultex (fn. 80); "OTC Market for Europe Gains Support," *Wall Street Journal*, December 23, 1985, 11.

<sup>102</sup> See ELBASSOCIATES, Consultex, and Scottish Financial Enterprise, *Creating the European Association of Securities Dealers and an Integrated European Securities Market: A Proposal to Manage a Programme for the European Commission* (Geneva, September 1989).

<sup>103</sup> Author interviews with former EVCA official, London, April 1999; and with official of the former DG2, Luxembourg, June 7, 1999. Written communication from DG Enterprise official, May 8, 2001.

<sup>104</sup> The official external regulator was the Belgian Banking and Finance Commission.

<sup>105</sup> Author telephone interview with former EVCA executive, April 27, 2000.

<sup>106</sup> Author interview with former EASD official, London, April 26, 1999.

## MORE EVIDENCE

The framing problem was only one reason that the civil servants decided not to intervene in three separate 1989 initiatives. In the wake of the Single European Act and the run-up to "Europe 1992," the idea of a pan-European smaller company market was taken up by an inter-divisional group, organized to explore ways to push along the single market project.<sup>107</sup> At the end of the day, prointervention officials did not believe they could overcome opposition from stock exchanges, their governments, and other divisions inside the bureaucracy.<sup>108</sup>

Their estimations changed in 1994, and the reasons behind the shift offer final support for the supranational bureaucrats explanation. The officials' liberal interpretation of new EC legislation and their promotion of an appealing political discourse had fostered a climate of possibility. Above all, there was now a venture capitalist interest group ready to lead and take advantage of any backing the commission was willing to give. Ten years after catalyzing national venture capitalists into an organized European interest group, the bureaucrats hid behind it to launch Easdaq. The empirical evidence thus links the timing of the new markets, as it does their creation and form, to the intended and unintended consequences of European Commission officials' interventions (Table 4, expectations 4b, 4c, and 4d). After fifteen years of forging seemingly small permissive conditions, skilled civil servants inside the supranational bureaucracy calculated that an intervention in 1994 was likely to result in the desired pan-European market but ended up launching a competitive market-making process that continues to bring surprises and change to the allocation of capital. Without the interventions of Brussels functionaries, some type of institutional change in smaller company finance might have eventually occurred; but it is unlikely the national exchanges would have created new stock markets, modeled them on the U.S. Nasdaq form, and done so in the middle of the 1990s.

<sup>107</sup> The European Commission's Secretariat General's office headed the group that included DG2 (Economic Affairs), DG13, DG15, DG16 (Regional Policy), DG28 (Credit and Investment), and DG23.

<sup>108</sup> Scottish Financial Enterprise notes from meeting between Andrew Sundberg, Eugene Schulman, SFE and the Commission's Inter-DG Working Group, Brussels, October 11, 1989; author interviews with Eugene Schulman of ELBAssociates and Andrew Sundberg of Consultex, Geneva, May 8, 2000.

## IV. CONCLUSION

This study, while uncovering evidence in support of all the considered perspectives, concludes that a supranational bureaucrats approach accounts for the creation, form, and timing of the new markets better than the other approaches. It finds actions of Brussels officials to be the most important causes in a complex process of institutional change. By contrast, explanations emphasizing the role of global factors largely overlook the importance of local political actors and therefore prove inadequate. For example, American ideas about how best to organize smaller-company stock markets were obviously disseminated to Europe. Contrary to the expectations of ideological diffusion, however, Europeans adopted these ideas only when highly motivated political actors found them advantageous for framing a pet project. Widely accepted new notions of what it means to be a competitive stock exchange in contemporary Europe, moreover, resulted from a dynamic process initiated by political action; they did not bring about the creation of the new markets.

The historical record, likewise, reveals the limits of the mobile capital approach. Intense competition over investors pressured the exchanges to create similar markets, transforming them into institutional innovators. Cross-border rivalries over attracting investment flows, furthermore, could have occurred only under conditions of high levels of capital mobility. Nevertheless, such evidence provides only a partial explanation, falling short even in its portrayal of the effects of competition. For while stock exchanges failed to dampen the battle over investors, their tactics succeeded in halting the exodus of other customers—small, national, capital-seeking companies. The domestic polity perspective, in this respect, serves as a corrective. It expects national elites to stabilize and co-opt sudden onslaughts of competition. Indeed, using established financial relationships to prevent smaller domestic firms from listing on foreign exchanges undermined the prospects of the upstart Easdaq and continues to hamper the LSE's goal of turning AIM into Europe's answer to Nasdaq.<sup>109</sup>

By limiting the range of causal factors to the national arena and emphasizing the constraints of existing arrangements over potential sources of change, however, the domestic polity approach, even in combination with the two others, is poorly suited for addressing many of the most

<sup>109</sup> This is despite the London market's impressive record in attracting non-European companies. See "Why Aim Is Foreign Target of Choice," *Financial Times*, September 3, 2005, 3.

intriguing questions. What ignited the competition? Why did national elites fail to prevent the process from getting started, as they had in the past? Why did the competition take on its particular nature—a battle over which exchange could best mimic the Nasdaq form? And why did it happen in the 1990s, not in the 1980s? The answers lie primarily in seemingly unobtrusive interventions by civil servants working for the European Commission. Their goal of stimulating venture capitalism in Europe ultimately led them to pursue a Europe-wide stock market—an idea that put them on a collision course with national elites. The supranational bureaucrats forged and subsidized a supportive coalition, liberally interpreted new regional legislation, and found ways to frame problems and solutions that resonated broadly. To create a stock market from scratch is an enormous undertaking that stands little chance of success without the backing of empowered financial incumbents. Coming on top of the previous Brussels interventions, however, the Easdaq proposal stirred up enough uncertainty to draw the exchanges into an unanticipated competition. The accumulated effect of small bureaucratic measures over a fifteen-year period thus explains why the Brussels-backed initiative ignited a cross-border rivalry and led to the creation of Europe's new markets. It accounts for why the exchanges perceived Easdaq but not earlier proposals as a threat and why they sought to emulate the Nasdaq form.

The causal role of supranational bureaucrats shows that scholars of institutional change in contemporary Europe who assume away independent regional effects run the risk of underestimating the impact of the EU polity on domestic outcomes. This article avoids the problem by paying attention to skilled civil servants in background processes, instead of focusing exclusively on highly public confrontations at single moments in time. It thereby embraces a broader notion of influence<sup>110</sup> than that employed in principal-agent and other analyses of bureaucratic autonomy, as it specifies a priori bases for treating supranational institutions as autonomous political actors, in Europe and possibly beyond.

A focus on small, incremental actions over time helps not only to expose sources of bureaucratic autonomy but also to advance conceptual understanding of institutional change.<sup>111</sup> In particular, the above empirical findings suggest how it is possible to conceive of an incremental process as a cause of abrupt change. The 1994 proposal for a pan-European

<sup>110</sup> Michael Barnett and Raymond Duvall, "Power in International Politics," *International Organization* 59 (Winter 2005).

<sup>111</sup> Thelen (fn. 8).

stock market was an easy-to-observe intervention. Without a systematic investigation of previous, less obvious changes, one might easily mistake what was a cumulative force for a discrete cause.

Finally, the politics that gave rise to Europe's new stock markets has implications for generic theories of market formation, a particular type of institutional change. First, my findings confirm several propositions about the political and sociological nature of markets, the constraining effects of existing governance arrangements on market formation, and the typical reactions by empowered economic incumbents and their governments to new and unstable markets.<sup>112</sup> Second, they suggest that after extending the range of political actors and governance structures beyond the national arena, insights developed primarily in the domestic context may also be relevant for accounting for the formation of markets across borders. Last and most important, scholars have been more interested in understanding the constraints and stabilization processes that impede market formation than in explaining how politically weak economic challengers overcome formidable obstacles in the first place. While some recent research locates the impetus for market innovations in exogenous factors,<sup>113</sup> this article delves deeper, tracing new markets to specific agents of change, clashing visions, successful framing, and political tensions that inhere in the institutions of the EU polity. Thus, to the extent that competing conceptions of the scope, regulation, and purposes of markets are also endemic to other polities, the political origins of Europe's new markets have general significance.

<sup>112</sup> For a comprehensive treatment of what he calls a political-cultural approach, see Fligstein (fn. 13, 2001).

<sup>113</sup> *Ibid.*, 67–98.