

**“The New Transatlantic Regulatory Relations in Financial Services”**

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## **“The New Transatlantic Regulatory Relations in Financial Services”**

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This article examines the new transatlantic regulatory relations in financial services. It maintains that shifting boundaries of regulatory authority inside the EU changed the distribution of external bargaining power and thereby altered the pattern of Euro-American dispute management. The argument challenges constructivist, realist and functionalist explanations of cross-border cooperation and explains why presumptions of continued US financial hegemony have not been borne out. The empirical section compares the management of six “hot” transatlantic conflicts from the securities industry and concludes that the root cause of more cooperative transatlantic relations is EU financial regulatory transformation, which enhanced the bargaining power of European regulators. The more accommodative stance of US financial authorities stems largely from the lobbying of American financial companies that operate in Europe and have much at stake in the shape of new EU financial regulations. The European move towards a regional regulatory regime, carried out for largely internal reasons, triggered new private sector political behavior and US regulatory positions and thereby altered transatlantic relations in financial services. The paper’s approach links insights concerning interdependent relationships and firm political behavior with core questions about the deep composition of the international system and sources of structural power within it; advances debates on linkages between internal dynamics of politics and international affairs and the EU’s place in the global political economy; and suggests causal propositions about the sources of bargaining power.

## **“The New Transatlantic Regulatory Relations in Financial Services”**

American and European banks, insurance companies, asset managers and other financial services companies have long competed in multiple jurisdictions with distinct and sometimes incompatible regulatory systems. Beginning in the 1990s, problems sparked by these regulatory differences were at the center of a host of often intense conflicts. This article explains change in the way American and European authorities managed them.

Until four years ago, US regulators jealously guarded their sovereignty in handling transatlantic disputes. Throughout the 1980s and 1990s, national central bankers, treasury and finance ministry officials and securities supervisors interacted in a web of bilateral connections and multilateral forums such as the Bank for International Settlements (BIS), the International Organization of Securities Commissions (IOSCO), the Financial Action Taskforce of the Organization for Economic Co-operation and Development (OECD), the Joint Forum and the Financial Stability Forum.<sup>1</sup> Cooperation tended to be fragmented by sub-sectors.<sup>2</sup> In the area of securities markets, the focus of this paper, the US Securities and Exchange Commission (SEC) set the agenda, which began in 1989 to include regulatory in addition to enforcement issues.<sup>3</sup> Typically, US officials successfully exported American solutions by pressuring, persuading or outmaneuvering their European counterparts and resisted making accommodations to

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<sup>1</sup> See GAO 2004, 39-41. Bach calls it a transgovernmental regulatory network (Bach 2004).

<sup>2</sup> The Financial Stability Forum and Joint Forum are exceptions.

<sup>3</sup> Bach 2004. European national and US regulators established bilateral relationships and promoted the sharing of enforcement-related information codified in memoranda of understanding. These are published on [www.iosco.org](http://www.iosco.org).

European demands and proposals. If adjustments were going to be made, European national regulators tended to make them.

Between 2002 and 2006, by contrast, US authorities made significant concessions in several high-profile transatlantic conflicts. European regulators did not achieve all their goals but did much better than in the past. Transatlantic relations in financial services, in short, entered a new stage characterized by mutual accommodation and institutionalized in a mesh of on-going and formalized dialogues.

Led and coordinated by the US Treasury and the European Commission, the dialogues not only added a layer to and changed the tenor of the old country-to-country bilateral and multilateral interactions but also shifted attention to EU-US bilateralism. The new structures are anchored by the “EU-US Regulatory Dialogue on Financial Services” introduced in May 2002<sup>4</sup> and also include negotiations in accordance with the September 2002 Norwalk Agreement, the March 2003 initiated SEC-CESR (Committee of European Securities Regulators)<sup>5</sup> cooperative framework, and the June 2005 CESR-CFTC (Commodity Futures Trading Commission) “Common Work Program to Facilitate Transatlantic Derivatives Business.” Whereas in the past US regulators interacted primarily with their *national* European counterparts, today EU member states are also represented by several European-level bodies<sup>6</sup> and the International Accounting

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<sup>4</sup> The Dialogue was part of the “Positive Economic Agenda” introduced at the US-EU Summit in May 2002.

<sup>5</sup> CESR is comprised of the EU national securities regulators and a representative from the European Commission. CESR advises the European Commission on securities regulation and coordinates the policies of its members.

<sup>6</sup> The CESR, newly created in June 2001, for example, is now part of regularized interactions with the SEC and the CFTC. The SEC-CESR cooperative framework focuses on managing mutual regulatory risks and coordinating and (where possible) converging regulatory approaches, and the CESR-CFTC agreement structures cooperation over the supervision of derivatives markets. See [www.cesr-eu.org](http://www.cesr-eu.org).

Standards Board (IASB).<sup>7</sup> The European Commission, an EU supranational bureaucracy with legislative, executive and regulatory powers, plays the most important European role, engaged directly in discussions with the US Treasury, Federal Reserve Bank, the SEC and the Public Company Accounting Oversight Board (PCAOB). In the last four years, visits by high-level financial authorities from both shores have given the new cooperative relationship stature and publicity.<sup>8</sup>

What accounts for regulatory cooperation in financial services at a moment when transatlantic relations in general are experiencing unusual stress? Questions about managing cross-border regulatory conflicts under conditions of economic interdependence have long engaged political scientists and are part of a broader literature about why and how rules governing global economic activity originate and change.<sup>9</sup> I focus on two aspects of the new Euro-American relations in financial services: Why did US officials become more accommodating and European officials, more influential; and why did the shift occur in 2002 and 2003?

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<sup>7</sup> The IASB, the EU's new accounting standards setter, is engaged with its American counterpart, the Federal Accounting Standards Board (FASB), to make the US and the EU's new standards fully compatible. See discussion below.

<sup>8</sup> On the US side, Chairman of the House of Representatives' Committee on Financial Services Michael Oxley, Secretary of the Treasury John Snow, and SEC Chairmen William H. Donaldson and his predecessor, Harvey L. Pitt, led delegations to Europe. European Commissioner for Internal Market, Taxation and Customs Charles McCreevy and his predecessor, Frits Bolkestein, both visited Washington several times to meet with Treasury, FRB, SEC, CFTC and Members of Congress, and Director General of DG Internal Market Alexandar Schaub testified before Oxley's committee in May 2004. Schaub's Testimony is available at <http://financialservices.house.gov/index.asp>. *International Herald Tribune*, Regulators Seek Meeting of Minds, 5-6 July 2004, 15.

<sup>9</sup> For recent research on global economic governance, see Hall and Biersteker 2002; Held and McGrew 2002; Kahler and Lake 2003; Barnett and Duvall 2005. For recent examples of dispute management in the transatlantic sphere, see Farrell 2003; Young 2003; Meunier 2005; Petersmann and Pollack 2004. For work specifically concerned with cross-border regulatory cooperation in financial areas, see Coleman and Underhill 1995 and Simmons 2001.

My structured comparisons of the management of six “hot” transatlantic issues from the securities industry<sup>10</sup> reveals that the primary causes behind the new more symmetrical relationship lie in regulatory transformation inside the EU. The enhanced bargaining power of European officials resulted largely from an abrupt shift that moved regulatory authority significantly from the national to the supranational level across multiple financial sectors. The main transmitters of this EU development to US authorities were American financial services companies. With lucrative operations in Europe, they had much at stake in the shape of the embryonic EU financial regulatory regime and recognized the bolstered ability of European officials to affect their pan-European businesses through the adoption of uncoordinated rules or retaliation against American unilateralism. These politically savvy, American-based financial outfits pressured US officials to come to terms with counterparts empowered with new carrots and sticks and to find ways to make the new European regime compatible with the US system. The construction of a European-level regulatory regime thus had largely accidental international consequences: It triggered new private sector political behavior and US regulatory positions, thereby altering transatlantic relations in financial services.

Such empirical findings present a challenge for standard approaches to regulatory cooperation, which tend to ignore macro-political processes like the shifting boundaries of financial regulatory authority in Europe. While often well suited to accounting for variation across issue areas at a single moment, perspectives inspired by realism and

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<sup>10</sup> I divide the financial services industry into three somewhat artificial but standard categories: banking, insurance and securities/investment services. The last, which is the focus of this study, includes investment banking, brokering and dealing, clearing and settling and managing assets.

functional institutionalism are inadequate for explaining change over time.<sup>11</sup> A common assumption of this literature, for example, is fixed configurations of bargaining power, including US financial hegemony.<sup>12</sup> Although alternative approaches from further afield, emphasizing deliberative processes<sup>13</sup> and dissemination of cultures and ideologies,<sup>14</sup> do provide theoretical grounds for explaining change, the empirical record demonstrates that a shared transatlantic regulatory culture was an outcome, not a cause of improved relations.

This paper connects macro-scale transformation taking place inside a polity to micro processes of cross-border regulatory cooperation.<sup>15</sup> If the international state system is undergoing deep transformation, the fifty-year-old European project, with its complex multi-levels of governance, is at the epicenter.<sup>16</sup> The theoretical challenge scholars face is to specify causal mechanisms by which the supranational integration process shapes global arrangements.<sup>17</sup> Recent research focuses on whether and how the rules defining the EU's "single voice" in formal trade negotiations – those determining common negotiating positions and delegations of power to the European Commission – influence the EU's bargaining power in transatlantic and multilateral forums.<sup>18</sup> By drawing attention to the frontiers of regulatory authority, this study shows that other aspects of regional integration also bear on EU leverage. Shifting boundaries of

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<sup>11</sup> Simmons 2001, combining realist and functional institutionalist insights, is perhaps the best example of the standard approach.

<sup>12</sup> Sobel 1994; Oatley and Nabors 1998; Simmons 2001.

<sup>13</sup> Risse 2000; Farrell 2003.

<sup>14</sup> Finnemore 1996.

<sup>15</sup> Pierson 2004.

<sup>16</sup> Ruggie 1993.

<sup>17</sup> Traditional realists hint that a unified Europe would alter the global distribution of power but do not specify mechanisms by which this might happen and rarely take the European integration process seriously. For a partial exception, see Aggarwal 1985.

<sup>18</sup> Jupille 1999; Meunier 2000; 2005. For an alternative perspective, see Young 2003. Scholars of the EU have generally paid more attention to how the regional polity affects domestic societies (Posner 2005).

authority, I argue, may alter the distribution of structural power and thereby shape patterns of international dispute management. Under certain forms of interdependence, the geographic widening of regulatory authority captures foreign companies and thereby enhances bargaining power. Such an approach links insights concerning interdependent relationships<sup>19</sup> and firm political behavior<sup>20</sup> with core questions about the deep composition of the international system and sources of structural power within it;<sup>21</sup> advances debates on linkages between internal dynamics of politics and international affairs and the EU's place in the global political economy; and suggests causal propositions about the sources of bargaining power that might apply beyond the EU to federations like the United States.

The remaining sections use the history of transatlantic regulatory dispute management in the securities industry to illustrate and develop this approach. Sections I, II and III discuss relevant background, the pattern to be explained and my argument. Section IV presents competing hypotheses and empirical evidence. Section V, the conclusion, summarizes and identifies theoretical implications.

## **I. Background**

High levels of interdependence, associated with the post-Bretton Woods return of global finance, is the background precondition to the transatlantic regulatory disputes that emerged over the last fifteen years in the financial services sectors.<sup>22</sup> During this period,

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<sup>19</sup> Hirschman 1980 (1945); Aggarwal 1985; James and Lake 1989; Vogel 1995; Oatley and Nabors 1998; Richards 1999; Keohane and Nye 2001 (1977).

<sup>20</sup> Friedan and Rogowski 1996; Laurence 2001.

<sup>21</sup> Ruggie 1993; 1986.

<sup>22</sup> Coleman and Underhill 1995.

Americans and Europeans were voracious buyers of one another's securities.<sup>23</sup> Affiliates of US and European banks, brokerage houses, asset managers, stock exchanges, insurers and other financial services firms operated extensively in one another's home markets.<sup>24</sup> The largest US investment banks, for example, received roughly twenty percent of their net revenues from their European businesses.<sup>25</sup> And the relationship was hardly a one-way street.<sup>26</sup> In the US, European banks and insurance companies complied with federal and state regulations in part by setting up American entities, occasionally acquiring partial exemptions.<sup>27</sup> Inside the EU, the extension of the mutual recognition principle to insurance, banking and investment services regulation in the late 1980s and early 1990s arguably helped US firms, because of their pan-European strategies, more than their European counterparts. By establishing foreign entities regulated by one national regulatory regime (often the UK's), US financial services companies could at least in principle operate in any other EU national market.<sup>28</sup> Indeed, American financial outfits became leaders in a number of sectors on the continent, most notably in investment banking.

Given this interpenetration of financial services sectors, it is not surprising that regulatory disputes occurred. Foreign affiliates typically endured the high costs complying with the regulations of multiple jurisdictions and the complications that arose from incompatibilities. Coordinating and reconciling regulations across borders can be particularly challenging in the financial services sector because of the central role it plays

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<sup>23</sup> Treasury Bulletin, Table CM-V-5. Steil 2002.

<sup>24</sup> See Hamilton and Quinlin 2005. Bureau of Economic Analysis, Department of Commerce, Tables 10 and 11.

<sup>25</sup> SIA uses this statistic regularly. For example, see Lackritz 2005.

<sup>26</sup> See Bureau of Economic Analysis, US Department of Commerce, Tables 6.3, 10 and 11 and Nutter 2005.

<sup>27</sup> The SEC's reporting requirements for foreign firms listing on US exchanges (they can reconcile national standards with US GAAP) is an example of a partial exemption from national treatment.

<sup>28</sup> For a discussion of the 1988 US-EC "deal," see Story and Walter 1997, 288.

in the allocation of capital. Decisions made by financial companies strongly affect other industries and economic growth and have far-reaching political and social implications. As John Zysman argued two decades ago, alternative types of financial arrangements are intimately tied to domestic politics, creating different groups of winners and losers and affecting the ability of governments to carry out policies.<sup>29</sup> How firms are financed, moreover, shapes companies and industries and affects the risks citizens must bear, how they save for retirement, where they work, their job security and ability to buy homes, and the disparity between rich and poor.

Given the economic and political salience of financial services, policymakers must weigh competing goals in deciding how and to what degree to open their sectors to foreign companies.<sup>30</sup> The wide range of motivations<sup>31</sup> – old fashioned protectionism, competitive advantage concerns, genuine belief in the overall benefits of liberalization, pressures from electoral constituents and legitimate goals to protect domestic industries – has frequently made it difficult for European and American authorities to agree on whether and how to coordinate regulations and integrate financial services industries. Paradoxically, conflicts became more intense in the aftermath of major reforms to national regulatory systems in the EU member countries, which had moved their regimes closer to the American model, especially those governing securities markets.<sup>32</sup> The new similarities changed expectations of European firms and regulators about the prospects

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<sup>29</sup> Zysman 1983.

<sup>30</sup> There is a large literature about the causes and direction of financial regulatory reform. See, for example, Cerny 1989; Moran 1991; Sobel 1994; Vogel 1995; Loriaux, Woo-Cumings et al. 1997; and Laurence 2001.

<sup>31</sup> Steil 1996, 1998 and 2002; Strange 1994; Posner 2005; Bach 2004; Lutz 1998; de Montricher 2005; Moran 1991; Laurence 2001; Story and Walter 1997. Author's interview with senior staff officials of Committee on Financial Services, US House of Representatives, Washington DC, May 6, 2004.

<sup>32</sup> The reasons for convergence and the degree of change are hotly debated (Cerny 1989; Loriaux 1991; Moran 1991; Pauly 1994; Sobel 1994; Coleman 1996; Vogel 1996; Perez 1997; Story and Walter 1997; Deeg 1999; Adelberger 2000; Ziegler 2000; Laurence 2001; and Verdier 2003).

for deeper transatlantic integration and emboldened them to demand that the SEC recognize their regulations.

## **II. Old and New Transatlantic Relations**

The six major transatlantic disputes to emerge between the mid-1990s and 2006 in the area of securities regulation reveal a clear pattern of Euro-American conflict management. The disputes festered at a low level of intensity during the 1990s as the US refused to agree to European demands for mutual recognition. These and new types of conflicts became acrimonious during a two-year span between 2002 and 2003. With the exception of one aberrant case, Euro-American conflict management then entered a period of mutual accommodation and cooperation. The most puzzling observation (from the standpoint of scholars, participants and policy analysts expecting continued US financial hegemony) is that American officials became more accommodating and European officials, more influential. This section describes the empirical pattern in detail, while the next offers my explanation for it. For both, I develop the historical record from multiple sources, including interviews with officials on both sides of the Atlantic, transcriptions and personal observations of public hearings, private and public reports, secondary scholarship and the financial press.

### **[TABLE 1]**

*The 1990s*

In 1997 the SEC's Office of International Affairs began to focus on how to manage increasingly apparent differences in regulatory approaches.<sup>33</sup> Yet as the number of European-US regulatory conflicts mounted, the SEC was no more inclined to share regulatory sovereignty with foreign authorities or make adjustments to American rules than they had been previously when the disagreements were primarily over enforcement issues.<sup>34</sup> In the view of American regulators, the European reforms to their regulations did not meet US standards. They maintained that the current regime of national treatment and non-discrimination worked reasonably well and that exceptions could be used to manage the most costly negative effects of multiple and conflicting regulatory requirements.<sup>35</sup> The SEC, moreover, was as effective during the late 1990s as it had been before in getting what it wanted.<sup>36</sup> Since the 1980s, it had used a range of strategies to achieve its goals with respect to European regulators, who were often more concerned about their own competition over which national financial center would emerge as the future financial capital of Europe than about whether they were conceding too much to the SEC's agenda.<sup>37</sup> Its officials used their expertise and prestige to persuade, their markets to cajole, and multilateral settings, like IOSCO, to take advantage of divisions among Europeans.

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<sup>33</sup> See, for example, SEC 1997.

<sup>34</sup> Simmons 2001.

<sup>35</sup> The SEC had changed its approach to some degree. Before the late 1980s, for example, the SEC was so domestically oriented that it had minimal interest in how US regulations affected the ability of foreign firms to compete in their home markets. Interview with former SEC official, Washington DC, May 20 2004. Also, new issues, such as the influx of foreign issuers in the US, prompted the SEC to reconsider traditional positions. Interview with SEC staff members, Washington, DC, August 17, 2004.

<sup>36</sup> On the SEC's relative autonomy and power within the US political system, see Bach 2004.

<sup>37</sup> Story and Walter 1997.

Of the six major disputes (see Table 1), the two that began in the mid-1990s exemplify the lopsided nature of transatlantic relations during this period.<sup>38</sup> The conflict over mutual recognition of accounting standards started when Europeans proposed a mutual recognition regime, whereby EU companies with listings in the US would use national accounting standards and vice versa.<sup>39</sup> American regulators showed little interest in mutual recognition regimes or convergence initiatives. The SEC's view was that the rest of the world would eventually adopt US accounting standards.<sup>40</sup> US Generally Accepted Accounting Principles (US GAAP) was already accepted by all EU regulators, and the SEC did not consider European standards and International Accounting Standards (IAS) to be as rigorous.<sup>41</sup> The SEC continues to this day to require European companies listed in the US using non-US standards to reconcile them with US GAAP.

Likewise, the conflict over the rules governing stock exchange competition emerged in the mid-1990s. The dispute began with European demands for a change away from transatlantic competition based on national treatment to a mutual recognition regime, whereby European stock exchanges place their screen monitors on traders' desks in the US and vice versa without having to comply with additional host regulatory requirements.<sup>42</sup> Stock exchanges in the EU had more competitive electronic trading systems than the NYSE or Nasdaq, a legacy of the cross-border competition over the

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<sup>38</sup> I date the beginning of the dispute surrounding the EC Financial Conglomerates Directive to 1999 when US financial firms began to contemplate the law's future implications. In some respects, however, the conglomerates dispute was an extension of an unresolved US-EU conflict over capital adequacy requirements. See Coleman and Underhill 1995 for a discussion.

<sup>39</sup> Commission 1995.

<sup>40</sup> Simmons 2001, 611, fn 93; Bach 2004, Chapter 5, 30; and van Hulle, 6.

<sup>41</sup> See Arthur Levitt, The World According to GAAP, *Financial Times*, 2 May 2001, 21.

<sup>42</sup> Franke and Potthoff 1997. Author's interview with Federation of European Securities Exchanges (FESE) official, June 9, 2004, Brussels.

future EU financial center.<sup>43</sup> The EU exchanges wanted to use their advantages to win back trading of European company stocks listed in the US and gain direct access to American investors.<sup>44</sup> Moreover, European regulators, having applied the mutual recognition principle within the EU, considered it an appropriate means for deepening economic integration.<sup>45</sup> These European entreaties met steadfast US resistance, despite threats from the European Commission to turn the conflict into a trade issue.<sup>46</sup> The SEC argued that mutual recognition might threaten the ability to carry out their primary domestic mandate – protecting investors – emphasizing the dangers of sharing regulatory sovereignty, especially in sectors like equity markets where individuals regularly participate.<sup>47</sup> From the European perspective, however, US politicians and the SEC were protecting the NYSE and Nasdaq, in fear that mutual recognition might undermine the US financial services industry and cause financial activity to move off shore.<sup>48</sup>

*Intensification, then Cooperative Management of Disputes*

Beginning in 2002, a fundamental change occurred. Making mutual adjustments became a routine part of managing conflicts. As before, national treatment and non-discrimination still characterized this new regime. What was novel, however, was the growing frequency and importance of exemptions, exceptions and examples of both sides making adjustments to new and old legislation to accommodate the laws of the other.

Five of the six cases demonstrate the shift.

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<sup>43</sup> Steil 1998 and 1996; Story and Walter 1997; Coleman and Underhill 1995.

<sup>44</sup> For a detailed discussion, see Steil 2002.

<sup>45</sup> On the politics behind the 1993 Investment Services Directive, see Steil 1998; Coleman and Underhill 1995. 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>46</sup> Author's interview with European Commission official (Internal Market), June 9, 2004, Brussels.

<sup>47</sup> As Steil 2002 points out, the SEC's arguments are far from air tight.

<sup>48</sup> See Conley 1997 for the potential for US markets to go off shore.

The resolution of a conflict over the 2002 EC Financial Conglomerates Directive (FCD)<sup>49</sup> came after months of acrimonious exchanges and suspicions. The FCD requires that the holding company of non-EU companies be subject to consolidated supervision. This means that a single regulator must oversee all parts of large financial conglomerates including the domestic and foreign banking, insurance and securities operations. A home-regulator can be the supervisor under the new directive so long as its regulatory system meets EU equivalency standards.<sup>50</sup> US financial services firms, especially investment banks operating in Europe, complained loudly.<sup>51</sup> At the time of the directive's adoption, US supervision was based on a different operating principle and would not have met the new EU standards. An EU finding of non-equivalency might have been extremely harmful to US-based investment banks because of costly and unwanted changes that included accepting an EU authority as its global consolidated regulator. The conflict crested in winter of 2002. There were suspicions in the US that EU officials wanted to “‘push back’ on the US apparent ‘hegemony’ of financial market regulation...and impose ‘EU’ supervisory rules on banks...Some US supervisors expressed surprise and consternation that the EU and its member state supervisors would presume to ‘pass judgment’ on US rules and supervision.”<sup>52</sup> Others suspected the Europeans were reneging on a 1989 agreement that allowed US banks to continue to operate in the EU under the national treatment principle, rather than comply with new requirements.<sup>53</sup>

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<sup>49</sup> Directive 2002/87/EC of the European Parliament and of the Council of the European Union.

<sup>50</sup> Tafara 2004.

<sup>51</sup> See the Securities Industry Association's key issues section at [www.sia.com](http://www.sia.com). Also see reports by the Financial Services Roundtable's Global Financial Issues Committee at [www.fsround.org](http://www.fsround.org).

<sup>52</sup> Source withheld, pending permission .

<sup>53</sup> Author's Interview with senior staff official, US House of Representatives, May 6, 2004, Washington, DC. See Underhill 1997, 117, for a discussion of this agreement.

By mid-2002, however, American and EU officials were able to come to a common understanding of how to manage the international spillovers of the FCD. Instead of ignoring it, retaliating or pressuring the EU to make adjustments, US legislators and supervisors responded by making their own regulations more compatible with the new EU law.<sup>54</sup> The SEC can now look at the whole capital of a firm, just as its EU counterparts do, and the Europeans have accepted the changed US regime as meeting their equivalency requirements.

The new SEC rule represents a major change. The American supervision of financial services companies is deeply rooted in the Depression-era Glass-Steagall Act, the consequential industry structure of separate investment and commercial banking firms and the underlying objective of protecting investors. This combination produced the SEC's very rigorous capital requirements for broker-dealers,<sup>55</sup> a regime distinct from the EU's new system that reflects a different history of consolidated supervision and a banking industry without sharp divisions between lending and securities businesses.<sup>56</sup> The SEC's rule change demonstrates a remarkable adjustment for other reasons as well. Because of the fragmentation of financial regulation among different regulators, adopting a new holding company for investment banks was complicated by the involvement of

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<sup>54</sup> First, Congress made provisions in the 1999 Financial Modernization Act that enabled the SEC to create of a new holding company, the supervised investment bank holding company (SIBHC), by amending the Securities Exchange Act of 1934 ( Federal Register, Vol. 69, No. 118, June 21, 2004, Rules and Regulations, 34472 [Release No. 34-49831, File No. S7-22-03] and 34478 [Release No. 34-49830, File No. S7-21-03]. Then, the SEC further amended the act, giving US investment banks a second vehicle for consolidated supervision, the consolidated supervised entity (CSE), which is an alternative to the SEC's traditional net capital rule. While the SEC explicitly designed both the SIBHC and the CSE to meet EU equivalency standards, the large US investment banks have opted for the latter. These are Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch and Morgan Stanley. See Alix 2004 3, **fn #8**.

<sup>55</sup> The US system is a source of pride for some SEC regulators who believe it prevented the Drexel Burnham and other financial scandals from turning into much worse crises.

<sup>56</sup> See Coleman and Underhill 1995, for a discussion of some of the transatlantic differences.

several other financial regulators.<sup>57</sup> Finally, the FCD also set in motion a series of efforts by US investment banks and securities officials to make the Basel II Capital Accord more responsive to the particular needs of investment banks.<sup>58</sup>

Three transatlantic disputes arising from the passage of the US Sarbanes-Oxley Act of 2002 were also eventually managed through a process of mutual accommodation. Washington's rapid reaction to the Worldcom, Enron, Adelphia and other corporate scandals paid little or no attention to the legislation's international effects. Two financial services regulatory issues brought immediate and angry European complaints and a third followed once the costs of the new legislation were apparent. US regulators made accommodations for European concerns in all three.<sup>59</sup>

The first involves provisions in the act that required foreign auditors of US-listed firms and of foreign affiliates of American companies to register with a new body, the Public Company Accounting Oversight Board (PCAOB), and be subject to inspections, investigations and disciplinary proceedings.<sup>60</sup> Of the three, this new international reach of the US auditing regime generated the sharpest and angriest EU response, which

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<sup>57</sup> Some have claimed, in fact, that the SEC took advantage of the pressure from the private sector for consolidated supervision to extend its authority, undermining the underlying bargain of the 1999 US Financial Modernization Act, which officially unwound Glass-Steagall (Callcott 2003).

<sup>58</sup> The FCD's and the CSE's capital adequacy requirements largely reflect Basel II, an approach tailored to commercial banks. As US regulators had not supervised investment banks in the same way as commercial banks, American participation in the development of Basel II only began to reflect the interests of investment banks following the EU's adoption of the FCD. The Basel Committee/IOSCO task force is one manifestation of this change (Alix 2004; GAO 2004, 88).

<sup>59</sup> Campos 2003; Tafara 2004; Vitols and Kenyon 2004.

<sup>60</sup> Ross 2004. Under the previous regime, foreign firms complied with US public company auditing rules on a national treatment/non-discrimination basis. The new laws move away from industry self-regulation and establish much more rigorous oversight that makes compliance for foreign auditors onerous and, at times, impossible.

included a terse statement from the region's economic and finance ministers and a threat to retaliate.<sup>61</sup> The acrimony did not subside until late 2003.

At the time of Sarbanes-Oxley's passage, 333 European companies were publicly listed in the US and were audited by 58 EU-based auditors.<sup>62</sup> The two main problems were the costs of duplicative oversight and conflicts that put foreign firms complying with US measures in violation of home country laws. The initial US position of making modest accommodations gave way to greater flexibility in implementing the act.<sup>63</sup> First, it extended the registration deadline to July 2004 from October 22, 2003, after previously extending it to April 2004.<sup>64</sup> Second, PCAOB created a rule allowing foreign auditors to omit information required of US-based auditors if disclosure would violate home country law.<sup>65</sup> Finally, it has developed a creative cooperative framework with EU and other foreign regulators on a 'sliding scale,'<sup>66</sup> and indeed Europeans have made concessions of their own to assist PCAOB make adjustments and to coordinate auditing committee composition with the new US rules.<sup>67</sup>

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<sup>61</sup> European Council (2003). 2513rd Council Meeting, Economic and Financial Affairs, Luxembourg, June 3 [9822/03 (Presse 149), 16. Author's interview with European Commission official, June 9, 2004, Brussels.

<sup>62</sup> Ross 2004.

<sup>63</sup> Ibid., 11-12.

<sup>64</sup> Bryan-Low, Cassell (2003). The First Year: Modest Digs, Tough Job for an Accounting Cop, *Wall Street Journal*, July 23, C1; *Wall Street Journal*, Accounting Watchdog Gives Non-U.S. Firms Registration Reprieve, October 29, 2003, 1.

<sup>65</sup> PCAOB Rule 2105. PCAOB Release No. 2004-005 (June 9, 2004, PCAOB Rulemaking Docket Matter No. 013).

<sup>66</sup> Ross 2004. Burns, Judith (2004). Ledger Domain: New Rules for Foreign Numbers, *Wall Street Journal*, June 10, C5. PCAOB will rely on home-country authorities to varying degrees for carrying out inspections, acquiring information and other requirements of the new law, depending on the compatibility of the latter's regulatory system.

<sup>67</sup> *Wall Street Journal*, US and EU Reconcile Audit Issues, 26 March 2004, B2. The more compatible the EC regulatory system, the easier it will be for PCAOB to involve European regulators in the enforcement of US auditing rules and the SEC to accept European corporate governance practices. The European Commission jumped at the opportunity to add another directive to the original FSAP list. The 8<sup>th</sup> Company Law Directive introduces in the EU an auditing regulatory regime, designed in part to make cooperation with PCAOB easier. European companies, for example, will be required to establish audit committees (or something similar) with non-executives as currently mandated in the US.

The second Sarbanes-Oxley spillover concerned new requirements for corporate board and audit committee independence, putting some European companies, especially German firms, with US listings in an untenable bind.<sup>68</sup> If not modified, these companies would have had to decide whether to comply with US rules to keep their listing and direct access to US investors or continue following domestic laws and forgo their US presence. The affected companies have two boards. While management boards have no outside members, supervisory boards have employee representatives. Both compositions violate Sarbanes-Oxley.<sup>69</sup> This issue was resolved more quickly than the first, as the SEC made concessions in April 2003 to accommodate the affected European firms.<sup>70</sup> First, because the body responsible for auditing within the corporate structure was independent of management, the SEC interpreted German company boards to be compliant with audit committee requirements. Second, the US securities regulator made an exception permitting non-management employees to serve on auditing committees even though such arrangements are forbidden under SEC rules. Finally, it accepted a broader definition of an “audit committee financial expert” to accommodate home country practice.

The increasing costs under the Sarbanes-Oxley regime of maintaining a listing on US stock exchanges<sup>71</sup> triggered a third transatlantic dispute in February 2004. This one was over SEC rules governing the termination of reporting and registration obligations. European firms and regulators pressed for a modernization of a decades-old regime that made it nearly impossible for foreign companies to escape the SEC’s reach, even after a

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<sup>68</sup> Steil 2002; and Tafara 2004.

<sup>69</sup> Steil 2002, 11; Vitols and Kenyon 2004, 31-34.

<sup>70</sup> Campos 2003; Tafara 2004. SEC (2003) Standards Relating to Listed Company Audit Committees. [Release Nos. 33-8220; 34-47654; IC-26001; File No. S7-02-03], April 25.

<sup>71</sup> GAO 2006.

delisting.<sup>72</sup> By proposing new rules, the SEC has taken a conciliatory tone in its initial response. Even though EU firms and officials argue that the proposed changes do not go far enough to alleviate the problems,<sup>73</sup> few question the SEC's aims to make adjustments and the debate has now turned to the likely real-world effects of the proposed measures.<sup>74</sup>

Finally, in the accounting standards dispute that began in the 1990s (introduced above), the SEC began in 2002 to make concessions to the EU, embracing a process intended to harmonize transatlantic standards. In a stunning turnabout, the US securities regulator is now encouraging convergence, with the ultimate goal being a mutual recognition regime.<sup>75</sup> The IASB, the new EU standard setter, and Financial Accounting Standards Board (FASB), the US standard setter, institutionalized the convergence process in the Norwalk Agreement of September 2002, which committed the parties to make existing US GAAP and IAS/IFRS standards fully compatible and to coordinate future changes.<sup>76</sup> Because compatibility of standards lies as much in implementation and enforcement as in the similarity of principles, moreover, the SEC's Office of Chief Accountant is working closely with the European Commission in preparation for the eventual mutual recognition regime.<sup>77</sup> Finally, there is now a "roadmap" in place for

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<sup>72</sup> Letters voicing European complaints and an SEC discussion of them are available on [www.sec.gov](http://www.sec.gov). Especially see SEC 2005, 10-12 and the comments in response to it. (Proposed Rule: Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12 (g) and Duty to File Reports Under Section 15 (d) of the Securities Exchange Act of 1934, December 23.)

<sup>73</sup> Wright, David J. (2006) Comments on Proposed Rule: Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12 (g) and Duty to File Reports Under Section 15 (d) of the Securities Exchange Act of 1934, March 1.

<sup>74</sup> In the words of one SEC Commissioner, "It is the intention of the Agency to provide significant relief, and to make it very plausible for European and other foreign companies to leave our markets if they desire." Campos, Roel C. (2006). Speech by SEC Commissioner: Regulatory Role of Exchanges and International Implications of Demutualization, Armonk, New York, March 10, [www.sec.gov](http://www.sec.gov).

<sup>75</sup> Nicolaisen 2004. Also see SEC 2004.

<sup>76</sup> The text of The Norwalk Agreement is available at [www.sec.gov](http://www.sec.gov). International Financial Reporting Standards or IFRS is the new label for IAS.

<sup>77</sup> Tafara 2004.

eliminating the US GAAP reconciliation requirement “as early as possible between now and 2009 at the latest.”<sup>78</sup>

### *An Aberrant Case*

As the management of these five disputes show, transatlantic relations in financial services moved towards a more even balance, whereby American regulators were as likely to make adjustments as their European counterparts.<sup>79</sup> The one aberrant case is the behavior of US officials concerning the rules governing stock exchange competition. Despite the greater frequency and intensity of EU complaints in 2003<sup>80</sup> (including a threat from the European Commission to turn stock exchange competition into a trade issue<sup>81</sup>) and cooperation over other disputes, the SEC avoided making accommodations.

### **III. Explaining Change**

What accounts for this movement towards symmetry? For each dispute, we might expect case-specific factors to affect the outcome. Yet is there a common and significant causal story across cases? The question presents a conundrum for some standard approaches to regulatory cooperation and global governance because they tend to assume static configurations of economic incentives and bargaining power.

In the functional institutionalist tradition, the difficulties of state-to-state cooperation are seen as analogous to market failures, in which problems related to

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<sup>78</sup> SEC 2005.

<sup>79</sup> For one SEC Commissioner’s list of US adjustments made, see Campos 2003.

<sup>80</sup> Bolkestein, Frits (2003). EU-US Regulatory Cooperation on Financial Markets: A Matter of Necessity, Speech at European American Business Council, Washington, DC, February 24; Bolkestein, Frits (2003). The Transatlantic Relationship in Financial Services, Speech at The Institute for International Economics, Washington, DC, October 14.

<sup>81</sup> Author’s interview with European Commission official (Internal Market), June 9, 2004, Brussels.

uncertainty, informational asymmetries, high transaction costs, commitment assurances and the absence of focal points undermine otherwise advantageous exchange.<sup>82</sup> Scholars argue that the prospects of joint benefits drive actors to create public goods in order to overcome these obstacles and that particular solutions correspond to the type of bargaining problem associated with given issue areas (e.g. coordination and collaboration problems).<sup>83</sup> Conflicts in similar issue areas are expected to result in similar management solutions.<sup>84</sup>

The historical record shows that the European and American officials rarely lose sight of the potential gains from larger markets to their financial services companies and consumers. Yet, the functionalist argument, designed to explain bargaining outcomes under conditions of fixed incentives, does not offer a logic for why US officials might abruptly change their views about the best way to achieve goals. It thus is inadequate for explaining transatlantic financial regulatory relations, where the same conflicts over time present different bargaining dynamics. In the accounting standards dispute, for example, network externalities initially conferred first mover advantages to the US, whose officials had few incentives to engage in mutual recognition agreements or convergence projects and good reasons to believe market forces would pressure Europeans eventually to adopt American standards.<sup>85</sup> By 2002, however, the bargaining dynamics were closer to a deterrence game in which credible threats on each side prompt cooperative solutions.

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<sup>82</sup> Keohane 1984, 31-46 or 88-103.

<sup>83</sup> Stein 1983.

<sup>84</sup> Simmons 2001 is a sophisticated modification of the approach.

<sup>85</sup> Simmons 2001, 609-11.

A second standard approach emphasizes the causal role of the distribution of bargaining power.<sup>86</sup> Surprisingly, however, it is difficult to find in this scholarship even a hint that European-US financial relations were about to be transformed, let alone an explanation for it. Like functionalist arguments, these are static accounts, assuming continued US dominance in global financial regulatory developments without contemplating the possibility of change.<sup>87</sup> In Beth Simmons's explanation for cross-border financial regulatory interactions, for example, "financial power" is the source of US dominance.<sup>88</sup> As a financial hegemon, she maintains, the US (and sometimes the UK) does not need to adjust its own policies in response to external pressures. Her model seeks to explain whether the US will expend resources to achieve its goals or wait for market forces to pressure others to adjust.<sup>89</sup> Published in 2001, Simmons's approach accounts fairly well for regulatory relations in the 1980s and 1990s. Yet, without a systematic examination of the sources and distribution of financial power and why they might change over time, it does not help us understand later trends, including the more symmetrical pattern in transatlantic relations observed since 2002.

### *Financial Regulatory Transformation in the European Union*

To capture such a trend requires an approach designed to explain change. This paper's argument offers one such approach by emphasizing "epochal" change – transformation in the configuration of power as well as in the core elements that comprise

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<sup>86</sup> Hirschman 1980 (1945); Aggarwal 1985; Krasner 1991; Keohane and Nye 2001 (1977). See Martin 1992 for a synthesis of power and functionalist approaches.

<sup>87</sup> Sobel 1994; Oatley and Nabors 1998; Simmons 2001.

<sup>88</sup> Simmons 2001.

<sup>89</sup> Simmons 2001, 592-601.

the global political economy.<sup>90</sup> In the area of finance, the EU, where a sudden acceleration of regulatory innovation significantly shifted jurisdictional authority from the national to the regional level, is an obvious nucleus of such transformation.<sup>91</sup>

After the introduction of the euro, in a rare display of consensus, EU policymakers took a giant leap forward in removing the remaining obstacles to a single financial market.<sup>92</sup> The effort, shared equally in the euro zone and London (with perhaps the most to gain), led directly to two intertwined and internal EU projects. The Financial Services Action Plan (FSAP), proposed in May 1999 and endorsed by the European Council in March 2000, provided the content – the proposed legislation deemed necessary to integrate European national financial services industries.<sup>93</sup> As of 2006, EU policymakers had met the original timetable set by the European Commission for adopting new legislation<sup>94</sup> and were entering a consolidation stage focused on consistent implementation and enforcement and correcting poorly performing legislation.<sup>95</sup>

The second is the Lamfalussy Process, which alters rule-making procedures for insurance, banking and investment services legislation<sup>96</sup> and establishes coordination mechanisms for transposition, implementation and enforcement. In the name of expediting and improving the production of EU financial rules, the process introduced

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<sup>90</sup> Ruggie 1993 ; 1986.

<sup>91</sup> Other works also emphasizing the importance of EU financial developments include Jabko 2006, Posner 2007 and 2005, Coleman and Underhill 1995 and Underhill 1997.

<sup>92</sup> For explanations of the EU's financial transformation, see Posner 2007 and Jabko 2006.

<sup>93</sup> Commission 1999.

<sup>94</sup> Among the more important pieces of legislation already adopted (though not in every case implemented) are European Company Statute (October 2001), Money Laundering Directive (November 2001), Directives on UCITS I and II (January 2002), Regulation on International Accounting Standards (July 2002), Conglomerates Directive (December 2002), Market Abuse Directive (January 2003), Directive on Occupational Pensions Funds (June 2003), Prospectuses Directive (July 2003) and the Markets in Financial Services Directive (April 2004).

<sup>95</sup> Commission 2006; Hertig and Lee 2003; *Financial Times*, Work in Progress, 10 May 2004, 12 and *Financial Times*, Report Queries Need for EU Financial Regulation, 7 May 2004, 6.

<sup>96</sup> Lamfalussy 2001 and 2000. Originally, the Lamfalussy Process only included the securities industry. It now includes banking and insurance as well (Lannoo and Levin 2003).

two innovations in the formal legislative procedures. It distinguished between broad framework legislation produced through normal co-decision procedures and detailed rules created through committees of experts, national regulators and European Commission officials; and it introduced a more transparent process involving public hearings and opportunities for outside commentary. The Lamfalussy Process also spawned an elaborate informal network of new and reformed committees that links national finance ministries and regulators, the European Commission, the European Parliament and private sector experts.

*Connecting Large-Scale Transformation to Regulatory Relationships*

The scholarly hurdle in analyzing epochal change is to specify how large-scale phenomena are likely to affect political relationships on the ground. Yet any causal association between the EU financial transformation and change in transatlantic regulatory relations must explain why and how internal European developments might affect US officials. The link, I propose, lies in understanding the nature of US-European financial interdependence, and especially the politically well-organized American companies, whose affiliates are highly reliant on markets in several European countries.<sup>97</sup> What might we expect to happen when these firms anticipate a shift from national to regional regulation? I argue that US companies would want to ensure that European reforms favor their businesses and conform closely to American regulations and, to achieve these goals, would pressure US politicians and regulators to cooperate with their European counterparts.

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<sup>97</sup> Hamilton and Quinlin 2005.

Before the shift, US financial houses had access to national markets in Europe and were able to circumvent unfavorable regulations by setting up operations in London or Luxembourg and exercising the principle of mutual recognition. By creating a single set of rules with which foreign financial services companies operating in Europe must comply, EU policymakers would affect the ability of US firms to compete in the same way that American authorities have long influenced European companies. The firms might logically support a single set of rules in the EU but only as long as it did not favor local competitors and was compatible with US regulations so as to avoid extra compliance costs. Facing the proposed EU financial integration project, US financial services firms would likely turn for assistance to US politicians and regulators. With the potential to do as much harm to US firms as American authorities have long been able to do to European companies, we would expect EU regulators to find themselves in a much stronger position when bargaining with their US counterparts than in the past. Such logic for more balanced relations holds whether American authorities respond directly to pressure from constituent firms or from EU authorities responding to theirs.

### *Empirical Expectations*

If this argument for the change in transatlantic regulatory relations were correct, we would expect that the way Europeans integrate their own financial services industries shapes dispute management outcomes because it affects their interactions with US regulators.<sup>98</sup> Even though the FSAP and Lamfalussy Process are rapidly integrating national regulatory regimes, they have not affected every financial regulatory issue

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<sup>98</sup> Thus, my causal variable is the type of regional financial integration.

equally or at the same time. My study thus takes advantage of variation in the independent variable over time and among sub-sectors.

There are several principles for integrating economies. When Europeans use principles such as harmonization or standardization – which mandate or move toward a single set of rules with which local and American firms must comply – we would expect an increase in EU relative market power and a more accommodative behavior on the part of US regulators. This is because EU officials would have to set competition rules for foreign firms. Would they have to comply with the new EU-wide rules or would the way they are regulated at home have to meet new equivalency standards? Either way, EU officials could credibly threaten to use their authority in ways that damage the businesses of US firms. I call this type of integration “deep integration,” and it characterizes several sub-sectors covered by the FSAP. By contrast, looser forms of integration such as the principle of mutual recognition do not create a single set of rules for companies operating in the EU, and we would not therefore expect a change in Europe’s bargaining power with the US. This type of integration typified efforts before the FSAP and the Lamfalussy Process. I summarize these empirical expectations in Table 2.

**[Table 2]**

The argument, in sum, is that internal EU institutional reforms affect underlying power relations among regulators and thereby serves as an important determinant of dispute management outcomes. Once again, I expect any particular case to have multiple causes but for EU institutional reforms to appear prominently among them. We should find a general pattern across cases, consistent with the above empirical expectations,

which explains continuity of conflict in some cases and the timing and direction of more balanced EU-US relations in others.<sup>99</sup>

#### **IV. Explaining New Transatlantic Regulatory Relations**

##### *Financial Conglomerates*

US and European officials successfully resolved the conflict over the EU conglomerates directive by 2005, when all major US investment banks were able to meet the equivalency criteria. Both sides agree that relations between officials dealing with the issue vastly improved.<sup>100</sup> While mutual adjustments were made, the key question is why the SEC changed the way it regulates broker-dealers. The answer rests in the way EU countries integrated this regulatory domain: In agreeing to the FCD, member states converged contrasting national approaches into the same set of regulations for governing conglomerates – and captured the European affiliates of US investment banks in the process. The potential harmful effects to these US firms were the primary impetus behind the US adjustment as well as the original American decision to participate in the “EU-US Financial Regulatory Dialogue.”<sup>101</sup> Even before December 2000, when the European Commission formally opened the directive’s consultation period, US financial services companies were concerned about possible negative implications and did not cease to pressure US lawmakers and regulators until their interests were protected.<sup>102</sup>

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<sup>99</sup> On what types of effects to expect from structural power, see Keohane and Nye 2001 (1977), 9-17.

<sup>100</sup> Author’s interview with EU official, Washington, DC, November 4, 2005.

<sup>101</sup> Source of US official withheld, pending permission.

<sup>102</sup> Reacting to the concerns of the US securities industry, the US Congress included provisions in the 1999 US Financial Modernization Act (known as the 1999 Gramm-Leach-Bliley Act) that would allow companies and the SEC to comply with future EU “equivalency standards” (SEC 2003a, 62911). See also Alix 2004, 3.

Some elements of the new American regulatory regime for investment banks have antecedents in piecemeal reforms adopted since the early 1990s.<sup>103</sup> But the timing and evidence of firm-lobbying strongly supports my explanation. Some international relations scholars in the constructivist tradition explain change by emphasizing the role of international organizations and other forums in generating and disseminating common ideas about appropriate regulation of economic activity.<sup>104</sup> Here, the expectation is that European and American officials, working under the auspices of international financial forums, develop a shared regulatory culture (i.e. set of principles and norms for governing competition and setting standards within and across borders) that later facilitates transatlantic cooperation. High officials and politicians espouse this viewpoint in their speeches, which laud the new more cooperative relations and claim the discussions and consultations have helped to clarify one another's regulatory systems, anticipate and manage problems and coordinate reforms.<sup>105</sup>

Common understandings, however, did not prompt transatlantic cooperation in the conglomerates dispute. The conflict occurred in 2002 and 2003 despite the fact that the EU directive was based on the 1999 principles of the Joint Forum on Financial Conglomerates, which US regulators supported and used as their own model.<sup>106</sup> Thus, a common approach to conglomerates, while ultimately making cooperation possible, was

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<sup>103</sup> The SEC publicly downplays the adjustments it has made, claiming "the new rules formalize and strengthen" the SEC's role as a consolidated supervisor (Tafara 2004). Also see SEC 2003a and Alix 2004, 4.

<sup>104</sup> Finnemore 1996; McNamara 2003 and 1998.

<sup>105</sup> Quarles 2003; Bolkestein 2004; Miller 2004; Nicolaisen 2004; and Schaub 2004. Also, see the speeches from the European Commission sponsored conference, The Euro: One Currency, One Financial Market, New York, April 19-20, 2005.

<sup>106</sup> Joint Forum of Financial Conglomerates, "Supervision of Financial Conglomerates," BCBS/IOSCO/IAIS, February 1999.

not initially apparent to American officials and did not alleviate their deep suspicions of European motives.

A second constructivist explanation of change draws from the Habermasian tradition. Frequent consultations and deliberation are expected to lead to mutual learning, a better understanding of one another's positions, trust and cooperative outcomes.<sup>107</sup> Officials on both sides of the Atlantic, in public pronouncements and in the interviews I conducted, consistently mentioned the importance of the "EU-US Financial Regulatory Dialogue" in managing the conglomerates as well as the accounting standards and the three Sarbanes-Oxley conflicts. The historical record offers indisputable evidence that regularized and intensified transatlantic communications since 2002 resulted not only in improved understandings of one another's positions but also in persuasion, reasoned consensus and expanded expectations about the possibilities of cooperation.<sup>108</sup> After 2003, in fact, disputes became successively easier to manage and officials have been able to avert new problems with personal phone calls.<sup>109</sup>

Nevertheless, to maintain that the newly institutionalized discussions account for the resolution of the conglomerates dispute or for the more balanced relationship in general would confuse outcome for cause. Such an explanation lacks an a priori logic for why and how officials engaged in international disputes begin to communicate.<sup>110</sup> Throughout the 1990s, US regulators were more or less dismissive of EU concerns, and there was little cross-Atlantic communication. The FCD improved the EU's bargaining

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<sup>107</sup> Risse 2000. Henry Farrell uses this type of explanation to account for the management of the EU-US dispute over the rules governing data privacy (Farrell 2003).

<sup>108</sup> For blueprints of proposed new and ambitious agendas for transatlantic cooperation, see EU-US Coalition 2005; Lackritz 2005.

<sup>109</sup> Author's interview with EU official, Washington, DC, November 4, 2005.

<sup>110</sup> Some constructivists consider recognition among the participants of a power balance a precondition of argumentative rationality. See Risse 2000, 11 and 16-19. Also, see Farrell 2004 on trust and power.

position and thereby changed the calculations of American officials. Contrary to constructivist expectations, the new formal and frequent interactions and communications among transatlantic officials only came after the EU had improved its bargaining position and US officials had shown a willingness to make concessions.

It is hard to imagine US regulators would have been part of a new dialogue, created the new holding company rule and done so when they did, if they had had another option acceptable to American investment banks. Although created for internal reasons, the FCD deeply constrained the range of choices available to American officials.<sup>111</sup> Making no adjustments was not an acceptable alternative from the perspective of US firms, which successfully lobbied Congress and found support for their cause in an SEC eager to expand its powers.<sup>112</sup> The US made concessions because making no adjustments would have placed American companies in a precarious position and undermined the SEC role as their primary regulator.

### *Managing the Sarbanes-Oxley Disputes*

Both sides consider the cooperation displayed in managing the spillover effects of Sarbanes-Oxley to be a success story and are especially pleased by the handling of the auditing regulation dispute, which officials cite as a model for EU-US relations in financial services.<sup>113</sup> Why did US officials make so many adjustments? Several factors, specific to these three cases, played a role. For example, US stock exchanges, well

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<sup>111</sup> Even though EU policymakers created the FCD for internal reasons, there is evidence that they used the equivalency clause strategically to achieve goals in negotiations with US counterparts in a broader array of issues. They did this by dragging out the equivalency determination. See Lackritz 2005.

<sup>112</sup> Interview with a staff official, US House of Representatives, May 6, 2004, Washington, DC.

<sup>113</sup> Wall Street Journal, US and EU Reconcile Audit Issues, 26 March 2004, B2; Bolkestein 2004; Schaub 2004.

represented in Washington, feared the new American law would undermine their foreign issuer business.

The main causal factor, however, comes from Europe. After introducing sweeping regulatory change that had the potential to affect negatively European firms competing and raising capital in the US, American officials faced the real possibility of EU retaliation. In the past, before the FSAP and the Lamfalussy Process, EU retaliation would have been an empty threat. But the shift towards a supranational regulatory regime meant that European policymakers could, in a relatively short period of time, levy equal harm to US firms operating in Europe. While not the main intention of their financial regulatory transformation, European policymakers quickly realized that equivalency and reciprocity clauses, inserted into new Europe-wide legislation, could be powerful weapons for enhancing bargaining power.<sup>114</sup> These new weapons, brought to the attention of American officials by US firms operating in Europe, pressured US regulators to make adjustments.

Participating officials interpret the management of conflicts stemming from Sarbanes-Oxley as a major test of the new “EU-US Financial Markets Regulatory Dialogue.” Reminiscent of constructivist expectations, they tend to attribute the outcomes to diplomatic skills (especially those of PCAOB Chairman McDonough), new working relationships and levels of trust among authorities, and learning on both shores.<sup>115</sup> While personal skills, relationships, and frequent consultation and communication made mutually beneficial management easier and produced common

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<sup>114</sup> US source withheld, pending permission. European Council (2003). 2513rd Council Meeting, Economic and Financial Affairs, Luxembourg, June 3 [9822/03 (Presse 149), 16.

<sup>115</sup> Author’s interview with European Commission official (Internal Market), June 9, 2004, Brussels. Author’s interview with US officials, identity withheld pending permission.

norms and principles, interpretations that rely on them do not address the more fundamental issue of why the US was willing to discuss the conflicts in a formalized dialogue in the first place. When the Sarbanes-Oxley disputes erupted, the dialogue was still in the earliest stages and the conglomerates conflict had not yet been resolved. Pressure from US-based financial companies concerned about their European businesses explains why American officials used the dialogue instead of reverting to former unilateral habits.

### *Accounting Standards for Publicly Listed Companies*

Several factors contributed to the new proclivity of US regulators towards a mutual recognition regime for accounting standards. First, the corporate scandals of the 2000s fuelled a domestic debate about the effectiveness of the US disclosure regime and created a window of opportunity for those in favor of substantial revision and undermined claims of its superiority relative to other standards. The Sarbanes-Oxley Act mandated that the SEC investigate the merits of shifting US GAAP towards a principles-based model and required that US standards setters consider convergence with international standards among criteria used to create new standards.<sup>116</sup>

A second set of factors revolves around changes within the IASB itself, which led to an increased compatibility between IAS/IFRS and US GAAP and made cooperation

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<sup>116</sup> US Sarbanes-Oxley Act of 2002 (Title I, Section 108, b.1.A.v and d.) SEC, 2003 #414. Also see MacDonald 2002; FASB 2004. For a discussion, see Dewing and Russell 2004, 301. The IASB-FASB convergence project, though still in its early days, represents extensive cooperation characterized by mutual adjustments. See [www.fasb.org/intl/convergence\\_iasb.shtml](http://www.fasb.org/intl/convergence_iasb.shtml). SEC 2003b; MacDonald 2002; FASB 2004. and *Financial Times*, Accounting Rules: US and IASB Test Joint M&A Standard, 30 June 2005, 18.

somewhat easier.<sup>117</sup> Thus, unlike in the other cases, the dissemination of a common regulatory approach – developed inside a private standard-setting organization (IASB) and approved by a US-embraced international organization (IOSCO) – is not merely a distant background cause. In the accounting case, this constructivist variable contributes to the timing of the American reversal.<sup>118</sup> Yet the argument should not be overstated. Despite the similarity in basic principles, the two sets of standards remain vastly different and the challenge to converge them is formidable. A FASB study on the differences and similarities between the two sets of standards is a 500-page document.<sup>119</sup> Even when the EU and the US accept FASB and IASB as functional equivalents, financial analysts and investors will still need to learn two separate “languages” and implementation and enforcement will remain uneven.

As in the other cases, a primary factor behind the new US stance and its timing lies in EU decisions and regulatory changes. European policymakers passed in July 2002 the regulation mandating that companies listed on EU stock exchanges apply IAS/IFRS by 2005.<sup>120</sup> The action almost certainly is the main cause of the timing of the US shift, as American officials made initial gestures two months later towards redressing long-held EU demands for a mutual recognition regime.<sup>121</sup>

European influence, however, began to increase even before the EU actually adopted the regulation. In 1995, the EU announced its new strategy toward

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<sup>117</sup> For a chronology of IASB/IAS, see <http://www.iasplus.com/restruct/chrono.htm> and <http://www.iasb.org/about/history.asp>. For histories, see Steinberg, Arner et al. 1999; and Knorr and Ebberts 2001.

<sup>118</sup> IOSCO, “A Resolution on IAS Standards,” May 2000. Herdman, Robert K. (2002). “Moving Towards the Globalization of Accounting Standards,” Speech by SEC Staff, Cologne, Germany, April 18.

<sup>119</sup> FASB 1999.

<sup>120</sup> Regulation (EC) No 1606/2002.

<sup>121</sup> IOSCO, “A Resolution on IAS Standards,” May 2000. Herdman, Robert K. (2002). “Moving Towards the Globalization of Accounting Standards,” Speech by SEC Staff, Cologne, Germany, April 18.

harmonization of accounting standards.<sup>122</sup> Rather than adopt US GAAP or create its own standards, the EU decided to put its weight behind IAS. The move began to alter the prospects for the international standards project in two ways. EU adoption of IAS had the potential to turn the Europeans into the most influential players behind the IASC (IASB's predecessor) and create a global rival to US GAAP and the prestige and authority that accompany it. Suddenly, the IASC initiative to improve its standards had new meaning and potential.

By 1999 the EU strategy had piqued US interest, and US SEC Chairman Arthur Levitt had become involved in the IASB's improvements project. At the time, consensus was building in the EU for the European Commission's ambitious FSAP, which featured harmonization to IAS as a central component.<sup>123</sup> In 1998, Belgium, France, Germany and Italy had changed national laws to permit domestic companies to report in accordance with the international standards. Perhaps most important to the SEC, the UK was a driver behind the renewed integration of European finance. Washington saw the UK as the primary rival to US dominance in financial regulation. The British turn toward Europe was a blow to Americans who had cultivated the US-UK accounting alliance with the hope of re-centering IASC around a core group of like-minded standard setters.<sup>124</sup> Levitt's involvement in the IASC was thus in part an attempt to preempt the possibility of a rival with alternative ideas. In 2000, the same year that the European Commission proposed complete standardization, not merely harmonization, the SEC

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<sup>122</sup> Commission 1995.

<sup>123</sup> Commission 1998; 1999.

<sup>124</sup> The British-US accounting alliance was the foundations of the "Group of 4 + 1" countries – the US, UK, Australia and Canada, plus an IASC representative (Simmons 2001, 611, fn 93).

issued a concept release asking for comments on the application of IAS in the US.<sup>125</sup> In 2001, the SEC Chief Accountant endorsed the global convergence of accounting standards.<sup>126</sup>

The above sequence of events shows how movements toward standardization in the EU transformed the calculations of US regulators even before the formal regulation was passed in 2002. The new regulation not only mandated that all listed companies apply IAS/IFRS by 2005, but also set up an elaborate endorsement mechanism designed in part to counter the SEC's influence over the IASCF board members and IASB standard setters.<sup>127</sup> Shortly after the regulation's passage, the Norwalk Agreement illustrated the changed US position.

EU progress toward standardization was thus a key variable behind the altered US stance. The adoption of IAS/IFRS in Europe created the possibility of capturing US firms raising capital in the EU's then fifteen member countries under a single authority. Although largely unplanned, the equivalency clause inserted into the EU legislation gave European policymakers a credible threat to force US companies to provide IAS reconciliation to US GAAP if the SEC refused to offer mutual recognition. Indeed, Europeans have delayed clarifying the meaning of equivalency in part to maintain pressure on the US.<sup>128</sup> Standardization has thus improved Europe's bargaining power vis-à-vis the US, because each side now perceives the other capable of doing significant harm to its firms. The verdict is still out as to whether the EU's endorsement

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<sup>125</sup> Release Nos. 33-7801, 34-42430; International Series Release No. 1215; File No. S7-04-00 at <http://www.sec.gov/rules/concept/s70400.shtml>.

<sup>126</sup> Herdman, Robert K. (2002). "Moving Towards the Globalization of Accounting Standards," Speech by SEC Staff, Cologne, Germany, April 18.

<sup>127</sup> van Hulle 2004.

<sup>128</sup> Dam and Scott 2004, 4; *Financial Times*, Europe Urged to Be Cautious on US Change, 8 November 2005, 28. Interview with European Commission official, Washington DC, May 5, 2004.

mechanisms are sufficient for influencing the IASB and overcoming its perceived biases in the long run.<sup>129</sup> However, perceptions, not reality, of what might emerge in Europe have fuelled the regulatory competition from the start.

*Cross-Border Rules Governing Competition among Stock Exchanges and Other Trading Enterprises*

Among the six disputes, the stock exchange conflict stands out. Despite continued EU demands and threats<sup>130</sup> and much improved overall transatlantic regulatory relations, the SEC has successfully avoided making accommodations. Contrary to constructivist expectations, the constant interactions and communications embedded in the dialogue have not resulted in a resolution to this issue. Nor does the evidence support a functionalist explanation, whereby stock exchange competition embodies qualities and incentives that make a mutually satisfactory solution particularly difficult to achieve. Having resolved a similar conflict inside the EU, Europeans demonstrated that cooperation in this area is possible.<sup>131</sup>

A primary reason for the continued US intransigence stems from the principle by which the EU integrated the sector. The application of a 1993 mutual recognition regime in Europe, plagued by controversies over its meaning and multiple loopholes, created no single set of rules with which US stock exchanges and other providers of trading services (that is, investment banks internalizing trades) would have to comply.<sup>132</sup> As a consequence of this loose form of integration, US exchanges and investment banks

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<sup>129</sup> Barber 2004; Kerrison 2004. *Financial Times*, IAS 39, 7 July 2004 and *New York Times*, When Politicians Write Accounting Rules, Reality Can Be Forgotten, 23 July 2004, C1.

<sup>130</sup> Author's interview with European Commission official (Internal Market), June 9, 2004, Brussels.

<sup>131</sup> Coleman and Underhill 1995.

<sup>132</sup> ISD Article 15.5 is the main source of ambiguity. Steil, pp 40-43. Coleman and Underhill 1995.

played one EU regulator against another, and no single European body could make credible threats to harm them. The Nasdaq Stock Market, for instance, the US exchange most interested over the last fifteen years in extending its facilities to Europe, faced relatively few legal and regulatory obstacles to pursuing its EU goals. By purchasing the upstart Belgian-regulated Easdaq in 2001, the Nasdaq was able to offer its US stocks to Europeans across the EU. And, if its Easdaq purchase had been thwarted, the Nasdaq had a backup plan in place: authorization by British authorities to provide trading services to intermediaries in the UK.<sup>133</sup> Likewise, American broker-dealers based in London were able to circumvent continental prohibitions against internalization of trades.

A second reason for the continued SEC position is that US stock exchanges were not only able to set up operations in Europe but were actively against change. Under the current rules, European and other foreign companies, seeking more direct access to US investors, listed shares in the US and thereby created a vibrant business for NYSE, Nasdaq and other American financial services companies. It is thus difficult to evaluate the relative weight of EU integration and foreign issuer revenues in shaping the lobbying positions of US exchanges – both add to preferences in favor of the status quo.

Arguably, however, the lobbying effort of US investment banks was of equal or more importance to the SEC. Organized in the Securities Industry Association, these firms were the first and most consistent actors in pressuring Washington to change its general orientation towards Europe.<sup>134</sup> Here, the evidence is clear. The loose integration of EU rules governing trading did not threaten the internalization businesses of US

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<sup>133</sup> Steil, pp. 40-43. *Financial Times*, Nasdaq Europe Makes Debut, 10 June 2001, 9.

<sup>134</sup> According to staff of the House Financial Services Committee, the exchanges were relatively silent on this and other transatlantic issues. The lobbying came primarily from SIA. Interview with staff official, US House of Representatives, May 6, 2004, Washington, DC.

broker-dealers, nor did it have significant effects on the EU's relative bargaining power. EU policymakers are in the process of replacing the ISD. In April 2004, they adopted new framework legislation and are now devising technical measures, which will determine the effective degree and quality of regulatory integration. To date, however, transatlantic relations in this issue area remain asymmetrical.

### *Alternative Explanations of Change?*

One remaining plausible alternative to my argument is that a sudden increase in levels of interdependence, not a change in European regulatory boundaries, sparked new problems for transnational financial firms, which then became the agents of change in a second-image-reversed process leading to cooperation.<sup>135</sup> The timing of improved relations would be expected to coincide with a spike in levels of interdependence. An examination of quantitative measures, however, reveals the problems with this hypothesis. If an increase in interdependence accounted for cooperation, the change should have occurred several years sooner. Whether evaluating general indicators of interdependence, such as those measuring financial openness,<sup>136</sup> or more specific indicators, such as net purchases of EU securities by American investors or revenues of affiliates of US investment banks, the statistics point to a sharp increase in financial integration in the late 1980s and early 1990s.<sup>137</sup> There exists the possibility of a tipping logic, whereby the accumulation of incremental increases in interdependence suddenly sparked change at a certain saturation point. Yet given that transatlantic relations

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<sup>135</sup> Laurence 2001. On the role of increased interdependence on global governance, see Cerny 1995; Keohane and Nye 2001 (1977).

<sup>136</sup> Openness indicators, focusing on government restrictions on inward and outward flows, reflect some of the underlying costs of moving capital across borders (Quinn and Inclán 1997; Kastner and Rector 2003).

<sup>137</sup> See Hamilton and Quinlin 2005 for an analysis.

improved simultaneously across many issue areas, such an explanation seems unlikely. The more persuasive argument is that interdependence creates problems rather than determines solutions.

Finally, it would be unfair to expect mainstream functionalist and realist approaches, designed to explain variation across issue areas at a single moment in time, to explain change in the configuration of bargaining or other types of structural power. Yet traditional approaches to interdependence and power often assume that alterations in power distribution can ultimately be traced to change in the relative size of consumer or producer markets.<sup>138</sup> Is it possible that market size explains transatlantic regulatory relations better than the shifting of regulatory frontiers?

The expansion or contraction of market size is certainly a source of international bargaining power. If market size explains the new transatlantic relations, however, we would expect American regulators to have made fewer, not more, adjustments in recent years and a pattern of continued US domination. US regulators would have gained power relative to their European counterparts because by most measures the size gap between American and European national markets, either individually or aggregated, expanded not contracted over the last decade. The US-to-European ratios of equity market capitalization and total value of share trading, for example, increased from approximately 2:1 in 1994 to 2.5:1 in 2003.<sup>139</sup> US markets remain by far the largest for almost every financial asset, and as all recent studies attest, the one potential challenge to US capital

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<sup>138</sup> Hirschman 1980 (1945); Aggarwal 1985; Krasner 1991; Keohane and Nye 2001 (1977).

<sup>139</sup> World Federation of Exchanges. For the US, I combined figures from the NYSE, Nasdaq and Amex. For Europe, I added the figures from the LSE, Euronext and Deutsche Boerse.

markets dominance – sudden growth in the aftermath of a single European financial market – still remains a far-off goal.<sup>140</sup>

A focus on shifting borders of regulatory authority illuminates why larger markets enhance bargaining power: In an interdependent world, increasing the size of domestic markets is likely to increase the concentration of foreign firms who must comply with local laws. Global influence in this context depends heavily on the degree to which foreign firms from large countries participate in and rely on a regulator's markets.<sup>141</sup> Indeed, the international power of US regulators has long stemmed from the number of foreign firms who depend on their financial markets and must comply with their rules. European and other foreign regulators bend to SEC preferences because they want their firms to be able to continue operating in and benefiting from American financial services markets and fear the US regulator's ability to prevent it.

An increase in market size is one way to bolster the concentration of foreign companies. But scholars have missed a second source.<sup>142</sup> My study shows that the concentration of foreign companies may also grow or decrease by expanding or contracting the boundaries of regulatory authority. If scholars had paid more attention to such transformative changes within Europe's financial regimes, they might have foreseen that European regulators would wield authority over an expanded number of US firms operating in their jurisdiction and anticipated a change in EU-US financial relations.

My conclusions thus show that an increase in EU relative bargaining power did not depend on the completion of a single financial market, however defined. In fact, it

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<sup>140</sup> For a recent example, see Commission 2004a; b.

<sup>141</sup> See Aggarwal for a discussion of monopsonistic power (Aggarwal 1985, 29-33).

<sup>142</sup> A third source, the purchasing or selling of domestic companies by foreign enterprises, is quite rare. One example might be the UK's permitting foreign banks to buy domestic investment banks.

emerged in the absence of still-elusive financial integration. The observation helps to disentangle effects derived from political decisions from the impact of new economic efficiencies. While policymakers concentrated intently on removing existing obstacles to integrated markets, their new relative influence obtained the moment US firms and regulators anticipated the implementation of the EU regulatory regime.

## **V. Conclusion:**

This six-case comparative study, summarized in Tables 3 and 4, concludes that an approach emphasizing EU integration explains the pattern of transatlantic regulatory relations in financial services better than alternatives. In several instances, case-specific factors affect outcomes. In the conglomerates and auditing cases, for example, disputes presented new opportunities for SEC and European Commission officials, respectively, to pursue their own goals. In the international accounting standards case, high profile financial scandals made it more difficult for Americans to make claims about US GAAP's superiority. Yet in every case, I find that previous EU choices concerning regulatory integration affect its relative bargaining power in interactions with the US. Variation in the way that the US and the EU manage problems largely reflects differences in the way Europeans integrated the regulation of a sub-sector. The new symmetry in transatlantic relations in financial services and the timing of its emergence was driven by deep EU integration across several financial regulatory issues. Financial transformation in Europe, adopted to achieve internal goals and improve international competitiveness, created a new regulatory regime that would apply as readily to US firms formerly operating under twenty-five different authorities as to European ones. In anticipation,

politically organized American financial companies pressured their home authorities to cooperate and coordinate with European counterparts.

**[Table 3]**

**[Table 4]**

The historical record reveals the limits of constructivist approaches in explaining cooperation. Common principles help to illuminate aspects of the accounting standards case. Overall, however, the approach fails to offer an explanation for the timing and pattern of transatlantic relations. Likewise, explanations based on deliberative processes have severe shortcomings. Regularized interactions and communications between European and American officials at multiple levels and across several agencies greatly increased trust and set off an independent logic of their own. Conflicts that might have become public disputes only three years ago are now averted by personal exchanges between officials who know and trust one another. Yet the empirical record demonstrates that these developments are outcomes, not causes, of the fundamental shift in bargaining power. Likewise, while high levels of interdependence is a background condition for transatlantic economic disputes, the historical record offers little support for explanations that attribute cross-border regulatory change to increased levels of interdependence. Finally, the expanding transatlantic gap in market size over the period under consideration, belies the assumption that changing market dynamics determine global bargaining power.

The instrumental role of financial services companies, especially American firms, in transmitting EU developments to US authorities, emerged as a prominent theme in the empirical analysis.<sup>143</sup> This finding helps to unite largely disparate insights about interdependence, firm political behavior and deep transformation in the international political economy. At the very earliest stages of the FSAP, long before any legislation had passed, US firms anticipated the potential effects of EU internal decisions on their European businesses. They had been prospering under weak mutual recognition regimes and recognized the potential costs of greater harmonization towards standards and rules uncoordinated or incompatible with the US regime. In response to choices made inside Europe, the already well-organized US financial services industry brought these EU institutional changes to the attention of the US Congress, Treasury and the SEC and lobbied effectively for cooperation and coordination on both sides of the Atlantic.<sup>144</sup> Such findings contextualize and complicate pluralist models of government-firm relations.<sup>145</sup> My analysis shows that exogenous and abstract “price signals” that reorient the political activity of companies originate in macro-political processes, not merely in technologically driven developments.

Paying attention to regulatory frontiers as a source of global influence also contributes to our understanding of the impact of internal institutional change on international affairs. There is a growing interest in the intended and unintended consequences of international institutions.<sup>146</sup> The enhanced EU position in transatlantic finance supports a central theme of historical institutionalism: Institutions do more than

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<sup>143</sup> Wicks 2005.

<sup>144</sup> Ibid., 12.

<sup>145</sup> Frieden and Rogowski 1996.

<sup>146</sup> Barnett and Finnemore 2004; Checkel 2005.

solve problems that their creators intended them to solve. My argument thus specifies a route by which internal institutional reforms may have unintended external spillovers, just as domestic institutions may have multiple unintended effects.<sup>147</sup> Many scholars preserve rationalist assumptions, positing that EU governments pool their sovereignty to intentionally enhance Europe's leverage against non-member countries.<sup>148</sup> By contrast, my approach challenges these assumptions by demonstrating that actions taken inside the EU for primarily internal purposes may accidentally result in increased international influence. Ignoring the possible unintentional effects of institutions systematically underestimates the global impact of European internal developments. This paper contributes by offering clear a priori empirical expectations about the largely unplanned effects of institutional change.

Finally, a study comparing six cases has well-known limitations and raises the question of generalizability. The EU is an obvious wellspring of cases for evaluating further the impact of changing regulatory frontiers on the rules governing global economic activity.<sup>149</sup> But there are also reasons to think that the approach would shed light on the international effects of change inside the US and other large federations. Although not emphasized here, the extraterritorial influence of the US Sarbanes-Oxley Act derives largely from a similar root cause as the EU cases: a shift in the boundaries of regulatory authority the state to the federal level. Foreign companies listing on US stock exchanges had to comply with the new federal corporate governance and auditing regimes, giving American officials new bargaining influence. This important American

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<sup>147</sup> On unintended consequences of domestic institutions, see Thelen and Steinmo 1992; Pierson 2000. On accidental international effects of domestic institutions, see Mattli and Buthe 2003.

<sup>148</sup> Jupille 1999. Meunier 2005 considers both intentional and accidental effects of EU voting rules and delegation decisions.

<sup>149</sup> For example, on the international effects of the EU's data privacy regulation, see Newman 2004.

case suggests that extending research beyond the EU might very well produce exciting results.

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**Table 1: Transatlantic Dispute Management Over Time**

	<b>Management of Conflict Mid-1990s to 2002</b>	<b>Turning Point 2002 -2003</b>	<b>Management of Conflict After 2003</b>
<p><u>Financial Conglomerates</u></p> <p>EU proposes new legislation in 2000. US firms face high compliance costs because US regulations are incompatible and unable to meet EU equivalency provisions.</p>	<p>US concern in 1999 in anticipation of EU proposal for new legislation.</p>	<p>Acrimonious conflict emerges in the run-up to and aftermath of May 2002 passage of EU law. Both sides are suspicious of the other's motives and accuse it of protectionism and ill-intent.</p>	<p>EU and US come to an understanding, and both sides make adjustments. US changes domestic rules in 2004 to meet EU equivalency. EU creates flexible standard for equivalence.</p>
<p><u>Public Company Auditors</u></p> <p>US passes new legislation in July 2002. EU firms face the costs of compliance with multiple regulators, and EU regulators fear an impingement of sovereignty.</p>		<p>Intense conflict follows the July 2002 passage of US law. EU threatens retaliation in July 2003 after US makes only modest changes.</p>	<p>Intensity of conflict dissipates after US makes significant accommodations beginning in October 2003. US makes exceptions for EU firms. EU passes similar legislation to facilitate coordination.</p>
<p><u>Corporate Board Composition</u></p> <p>US passes new legislation in July 2002. Some EU firms cannot comply with US law without breaking their own national laws.</p>		<p>Intense conflict follows the July 2002 passage of US law.</p>	<p>Intensity of conflict quickly dissipates when in April 2003 US adopts flexible interpretation of American and EU laws.</p>
<p><u>Deregistration of Foreign Issuers</u></p> <p>US passes new legislation in July 2002. By 2004, EU firms experience higher costs of listing in US. EU demands modernization of deregistration process.</p>			<p>Conflict begins in 2004 and never reaches the intensity of previous ones. US is in the process of making adjustments by revising rules.</p>
<p><u>Accounting Standards for Publicly Listed Companies</u></p> <p>As EU firms increasingly listed their equity in the US during the 1990s, they faced the costs of compliance with multiple regulators.</p>	<p>Low-level conflict. US largely ignores EU demands, which began in the mid-1990s, for a US change from national treatment to mutual recognition.</p>	<p>Gradual shift in US stance towards mutual recognition, marked by a September 2002 agreement.</p>	<p>Mutual adjustments in formal negotiations to develop compatible standards. In September 2002, US and EU commit to good faith negotiations to create compatible standards. US agrees to mutual recognition by 2009.</p>
<p><u>Stock Exchanges</u></p> <p>Following the modernization of EU stock exchanges, they press for direct access to American investors.</p>	<p>Low-level conflict. Beginning in the mid-1990s, EU asks US to change from national treatment to mutual recognition.</p>	<p>Intensity of dispute heats up. In 2003, EU publicly and privately demands US concessions.</p>	<p>US has not made adjustments. Conflict continues to fester.</p>

**Table 2: Empirical Expectations**

		<b>(t<sub>2</sub>) Expectations for Management of EU-US Conflicts</b>
<b>(t<sub>1</sub>) EU chooses a principle for integration</b>	<b>Loose Integration</b>	<i>No Change in US behavior. US reluctant to make adjustments.</i>
	<b>Deep Integration</b>	<i>US much more inclined to make adjustments. More balanced relations defined by mutual adjustments.</i>

**Table 3: Empirical Findings Across Issue Areas**

		(t <sub>2</sub> ) Management of EU-US Conflicts
(t <sub>1</sub> ) EU chooses a principle for integration	Loose Integration	<i><u>Stock Exchanges and Other Trading Enterprises:</u> US did not make adjustments. Conflict festers since the mid-1990s.</i>
	Deep Integration	<i><u>Financial Conglomerates:</u> EU and US made adjustments.</i>  <i><u>Public Company Auditors:</u> EU and US made adjustments.</i>  <i><u>Corporate Board Composition:</u> US made adjustments.</i>  <i><u>Deregistration of Foreign Issuers:</u> US is in the process of making adjustments.</i>  <i><u>Accounting Standards:</u> EU and US made adjustments.</i>

**Table 4: Empirical Findings Over Time**

<b>Issue Area</b>	<b>(t<sub>1</sub>) Change in EU Approach to Integration?</b>	<b>(t<sub>2</sub>) Change in Management of EU-US Conflicts?</b>
<i>Stock Exchanges</i>	<i>No.</i>	<i>No.</i>
<i>Accounting Standards</i>	<i>Yes, 2002 regulation mandating standardization by 2005.</i>	<i>Yes, mutual adjustments in formal negotiations to develop compatible standards. Conflict started in the mid-1990s. Norwalk Agreement of 2002 commits US and EU to good faith negotiations to create compatible standards. US commits in 2005 to a mutual recognition regime.</i>