U.S. House of Representatives
Committee on Financial Services
The European Union's Financial Services Action Plan

Testimony by
Professor Desmond Dinan, School of Public Policy, George Mason University
May 22, 2002

1. The European Union's Basic Governing Institutions

The European Union's basic governing institutions are the European Council, the Council of the European Union (generally known as the Council of Ministers or simply the Council), the European Commission, and the European Parliament.

The European Council

The European Council, which came into existence in the 1970s, consists of the most important political leaders in the member states (either heads of state or government) and the Commission president. It meets at least three times a year, once in Brussels and at least once in the country holding the rotating Council presidency. Foreign ministers and a Commission vice-president accompany the heads of state and government to most sessions during the mostly two-day events, and an army of national and Commission officials hovers in the wings. Meetings of the European Council are major media events. The European Council discusses political and economic developments in the EU, reaches political agreements on contentious legislative proposals and important challenges confronting the EU (such as enlargement), and provides overall strategic direction.

Legally speaking, the European Council is not an EU institution. The EU treaty only acknowledges the European Council's existence and general political importance. The reason for this reticence is fear of formally tipping the EU's institutional balance in an intergovernmental direction. Composed almost exclusively of national leaders, the European Council is a forum for the negotiation of intergovernmental agreements on the basis of consensus (the informal rules of the European Council do not provide for voting, although on rare occasions voting has taken place there). The existence of such a high-level body, while necessary for the functioning of the EU, is at odds with the delicate balance between the need to share sovereignty and the desire to retain national control that underlies the institutional architecture of the EU.

The Lisbon Declaration of March 2000, in which the heads of state and government set the strategic goal for the EU to become "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion," is a good example of the European Council in action. While not legally binging, the declaration obviously carries great political weight. The European Council holds an annual spring meeting to review progress on the Lisbon strategy. It was at the first such annual review, in Stockholm in March 2001, that the European Council endorsed the report by the Committee of Wise Men (the Lamfalussy Report) on the regulation of European securities markets. The European Council prods and pressures the EU institutions to implement the Financial Services Action Plan, but does not have the authority to enact legislation itself.

The Council of Ministers

The Council of Ministers is the EU's main legislative decision-making institution. The Council consists of government ministers from the member states (usually national government ministers but, in the case of Belgium and Germany, occasionally ministers from the regions). Although, legally, there is only one Council, in practice there are sixteen Council formations. These range from the Council of foreign ministers (the General Affairs Council), to the Council of finance ministers (the Economic and Finance Ministers Council, or Ecofin), to the council of environment ministers. Each council discusses issues and enacts legislation within its area of responsibility. However, the General Affairs Council acts as a coordinating body and a decision-maker of last resort when the other councils are deadlocked on a legislative proposal. (If the General Affairs Council cannot break the deadlock, it sends the issue up to the European Council for a political decision). Ecofin is the key council formation with respect to financial services.

The presidency of the Council and of the European Council rotates among member states every six months. Each country tries to achieve something significant during its presidency. For instance, because of its center-right, pro-business ideology, the Spanish government, currently in the presidency, is eager to make its mark in the area of market liberalization in general, and implementation of the FSAP in particular. Hence the political push from Madrid to resolve the row between the Commission and the European Parliament (EP) over procedural aspects of the Lamfalussy Report (see point 2, comitology, below). The Council, and especially the presidency, is assisted by a secretariat of EU civil servants.

The EU's treaties provide for decision-making in the Council in most policy areas by qualified majority voting. Each member state has a number of votes, depending roughly on its population size. A qualified majority consists of about 73 per cent of the total number of votes. Clearly, it is easier to block than to enact a proposal in the Council. Proponents or opponents of a measure form voting alliances in order to block or enact a proposal. Larger member states, with the largest number of votes, are key members in such coalitions, the composition of which varies from issue to issue.

In practice, member states dislike voting in the Council. They prefer to reach agreement by consensus. This tends to slow down decision-making. Much depends on the expertise of the presidency, which chairs all Council meetings, at all levels. The presidency strives to reach agreement, declaring at the appropriate time that, as consensus has been reached, a formal vote may not be necessary.

Ministerial meetings of the Council, which take place in Brussels or Luxembourg about once a month (depending of the workload of the particular Council formation) and last for a day or two, form the tip of the Council structure. Below the surface lurks a mass of subordinate committees and working groups. Dozens of Council committee and working group meetings take place in Brussels on any given day. The Committee of Permanent Representatives (known by its French acronym, Coreper) is the most important committee. The Permanent Representatives are senior national officials, with ambassadorial rank, who reside in Brussels and meet regularly to prepare the Council's agenda. Often the PermReps reach agreement among themselves on legislative proposals, which the Council then endorses. In other cases the PermReps narrow the areas of disagreement as much as possible before passing the file up to the Council for a decision. Coreper is one of the least understood but most powerful bodies in the EU's decision-making system.

The European Commission

The Commission consists of the college of commissioners as well as the staff of European civil servants (the Eurocracy). Member states appoint the commissioners for five-year terms: two commissioners each from the large member states, one each from the others. (The Nice Treaty, the latest round of EU treaty reform, which has not yet been ratified, provides for one commissioner per member state). The EP must approve the member states' candidate for Commission president and also votes on the proposed college of Commissioners as a whole. The EP may throw the Commission out of office by a vote of two-thirds of the parliament's members.

Commissioners are usually senior politicians, often including former prime ministers (Romano Prodi, the current president, is a former Italian prime minister). Commissioners do not represent their countries of origin. On the contrary, they take an oath in the European Court of Justice not to take instructions from national governments and instead to pursue the "European" interest. Yet close ties to national governments and awareness of national political situations informs commissioners' decisions.

Each commissioner has responsibility for a particular policy area. The Commission bureaucracy is divided into departments (called Directorates-General or DGs) along similar functional lines. Frits Bolkestein, a veteran Dutch politician and an economic liberal, has responsibility for the internal market, including financial services, and is in charge of the Internal Market DG.

The Commission has the exclusive and jealously guarded right to enact legislation in economic policy areas. The Commission is also the EU's executive arm, although the Council (and increasingly the EP) oversees the Commission's implementation of EU legislation. The Commission acts as a watchdog to ensure that member states transpose Community legislation into national law, and may being member states to court for alleged non-compliance. Finally, the Commission is a think-tank and lobby for further European integration.

The European Parliament

The EP consists of 626 members, who are directly elected every five years (the next direct elections will be in May 2004). The turnout in EP elections is well below the turnout in national and local elections. This reflects voters' uncertainty about the role of the EP and general disillusionment with the institutions and policies of the EU. The EP meets in plenary session, mostly in Strasbourg but occasionally in Brussels, about twelve times a year. Plenary sessions last about a week and generally seem chaotic affairs, with crowded agendas and all eleven official languages constantly in use. When not in plenary session, Members of the European Parliament (MEPs) hold committee and party group meetings in Brussels and visit their constituencies. Committees in the EP are organized mostly along functional lines. The influential Committee on Economic and Monetary Affairs (ECON) deals with financial services. MEPs sit not in national groups, but in party political groups. The Socialists, Christian Democrats, and the Liberals are the largest of these.

The EP has considerable budgetary, legislative, and oversight authority. But neither the Council nor the Commission depends for its survival on having majority support in the parliament. In that sense the EP is unlike most national parliaments, from which most national governments are formed. Of course the EU is unlike most national political systems, not least because there is no single EU government. Uncertainty about the nature of the EU, and of its institutions, contributes to the increasing alienation of its citizens.

MEPs come from a variety of backgrounds and have many interests. A few are avowed Euroskeptics, elected to the EP in order to try to rollback European integration. Most advocate further European integration. The EP's leadership—the president, vice-presidents, committee leaders, and mainstream political group leaders—is determined not only to deepen European integration but also to strengthen the EP's role in the EU institutional and decision-making system.

2. The Decision Making Process

As mentioned above, the Commission has the exclusive right to draft and propose legislation, based on the principle that the Commission will always adopt a "European" rather than a national approach. DGs draft legislation in their particular functional area. They may do so on the basis of a specific treaty requirement (such as the construction of the customs union in the 1960s) or on the perceived need to achieve the treaties' general objectives (such as maintenance of the single market). Interest groups, national governments (either separately or collectively via the Council), and the EP may urge the Commission to introduce legislation. Similarly, interest groups may lobby the Commission to amend or to drop a draft legislative proposal. The Commission has various formal and informal networks for consultation on draft proposals. The Lamfalussy Report specifically called for wider, deeper, and quicker consultation at this stage of the legislative process. The college of the Commission discusses draft legislation before submitting a formal proposal to the other institutions. In rare cases the college takes a vote, but decides by a simple majority (the president has the casting vote).

There are two kinds of legislative decision-making procedures: consultation and co-decision. As the name implies, the EP has a limited role in the consultation procedure. However, most legislation (including financial services legislation) is enacted by codecision, in which the EP's role is equal to that of the Council.

Codecision

Codecision is a relatively recent procedure. The EU introduced it in the Maastricht Treaty in 1992 and revised and extended it in the Amsterdam Treaty in 1997 in order to enhance the organization's democratic legitimacy by strengthening the EP's legislative role. Some member states, as well as the Council secretariat, resented the EP's growing influence and doubted whether the cumbersome procedure would ever work. If only to dispel such doubts, the EP soon mastered codecision. Contrary to popular belief, codecision works well and relatively expeditiously.

In the codecision procedure, the Commission submits its legislative proposal jointly to the Council and the EP for a first reading. Each institution runs the proposal by its legal service to ensure that it conforms with the provisions of the relevant treaty article. The Council secretariat then sends the proposal to Coreper, which in turn sends it to the relevant working group. Similarly the EP's leadership sends the proposal to the relevant committee.

Based on a recommendation by the relevant committee, the EP (in plenary session) adopts an opinion on the proposal. This usually includes numerous suggested amendments. The EP communicates its opinion to the Council.

Subject to qualified majority vote (QMV), the Council may adopt the EP's opinion. More often than not the Council adopts a common position, which may include some of the EP's suggested amendments. The Council sends the common position back to the EP.

If the Council adopts a common position, within three months the EP must either approve the common position; reject it by an absolute majority of its members; or propose amendments to the common position by an absolute majority of its members and forward them to the Commission and the Council for a second reading.

If the EP amends the common position, the Commission delivers an opinion on the EP's amendments. Within three months, the Council must either approve the EP's amendments by QMV, except those amendments on which the Commission issued a negative opinion (the Council can approve these only by unanimity); or call a meeting of the conciliation committee, consisting of representatives of the Council and the EP, to work out a joint text.

Within six weeks of being convened, the conciliation committee either fails to agree on a common text, in which case the proposal is deemed not to have been adopted; or agrees on a joint text by a qualified majority of the Council's representatives and by a majority of the EP representatives.

If they agree on a joint text, the Council must approve it within six weeks by QMV and the EP must approve it within six weeks by an absolute majority of the votes cast (this is a lower threshold than an absolute majority of its members).

If either institution fails to approve the joint text, the proposal falls.

With respect to codecision, the Lamfalussy Report proposed that the EP and the Council expedite decision making by reaching agreement at the first reading stage. Both institutions seem amenable to that suggestion and have already enacted legislation without going to a second reading or convening the conciliation committee.

<u>Comitology</u>

Once enacted, legislation must be implemented. The Commission is the EU's executive arm. Thus the Commission issues approximately 2,000 directives, regulations, and decisions annually (see Point 4, below). Such measures are necessary in order to give EU legislation practical effect. Jealous of their national prerogatives, however, and suspecting that the Commission would alter EU legislation through its implementing measures, early in the EU's history member states devised a complicated procedure known as "comitology" to constrain the Commission's executive powers. The cumbersome comitology procedure includes three types of committees—advisory, management, and regulatory—all chaired by Commission officials but made up of national civil servants. Management and regulatory committees are able to send proposed implementing measures back to the Council for review. The Commission sees comitology as an affront to its executive authority.

Comitology has always been a bone of contention between the Council and the Commission. The EP entered the fray when it acquired legislative authority equal to that of the Council. If national officials sat on the comitology committees, the EP asked, why should parliamentarians (or EP officials) not sit there as well? Comitology became a battleground between the Commission, Council, and EP throughout the 1990s until they negotiated a truce in 1999. The most controversial procedural aspects of the Lamfalussy report pertain not to the codecision procedure but to comitology. By proposing changes to executive decision making and the establishment of a powerful European Securities Committee, Lamfalussy opened a procedural Pandora's Box. The EP endorsed the Lamfalussy Report in February 2002, almost a year after the report was issued, only when the Commission made various concessions with regard to implementing measures. The EP hopes to reopen the comitology debate and press for treaty changes in the forthcoming Intergovernmental Conference on EU reform.

3. **Role of Member States' Leaders and Parliaments**

Member states leaders play a key role in EU decision-making through the Council and European Council (see Point 1, above). National parliaments are generally excluded from EU decision-making, although some of them (like the Danish parliament) have elaborate arrangements with their national governments to monitor EU legislative proposals and influence their national leaders' actions in Brussels. Until 1979, when the first direct election to the EP took place, MEPs came from national parliaments, and were therefore only indirectly elected to the EP. There was then a close connection between national parliaments and the EU system. Since direct elections, national parliaments have been cut adrift. Moreover, with greater provision for the use of QMV in Council decision-making, national parliaments are less able to hold their governments accountable for their actions in Brussels. As long as unanimity was the rule, a national parliament could threaten to sanction its government if the government did not veto a legislative proposal. With QMV now the rule, national governments can reasonably claim that they were outvoted (or would have been outvoted if a vote had in fact taken place) in the Council. Once enacted in Brussels, EU legislation must be transposed by national parliaments into national law. As EU law is binding on the member states, transposition is a formality. National parliaments have little discretion when it comes to transposing EU legislation into national law.

Inevitably, this has engendered resentment on the part of national parliamentarians, some of whom have agitated since the early 1990s for a greater role in EU decision-making. National parliaments have devised various institutional links among themselves and with the EP, but still lack a formal role in the EU system. The role of national parliaments is a major issue on the agenda of the current Convention on the Future of the EU, which is preparing the ground for the next Intergovernmental Conference.

4. **Types of EU Mandates**

There are three main types of mandate:

- *Directives* are addressed to member states and are binding as to the results to be achieved. However, member states may decide themselves how to incorporate directives into national law.
- *Regulations* lay down binding rules that apply directly in all member states.
- *Decisions* lay down binding rules that apply directly in the member state to which they are addressed; decisions can also be addressed to individuals or enterprises.

Directives are the most common legislative instruments in the EU. They are usually used to lay down policy principles that member states are obliged to follow. Regulations and decisions are concerned more with the detailed application of EU law.

The Council (acting as the sole legislative decision-maker), the Council and the EP (acting jointly as legislative decision-makers), and the Commission (acting as an executive body) may issue directives, regulations, and decisions. The Council or

Council/EP generally issue directives; the Commission generally issues regulations and decisions.

The institutions may also issue non-binding reports, recommendations, or opinions. These are largely hortatory.

5. The Lamfalussy Reforms

Concerned about the state of market disintegration in the financial services sector, despite its inclusion in the original single market program, the Commission issued the Financial Services Action Plan (FSAP) in May 1999. The purpose of the plan was to draw attention to the financial services sector, thereby generating political momentum for the enactment of the forty-two measures that the Commission deemed necessary to integrate capital and financial services markets across the EU. The Commission proposed a deadline of 2005 for implementation of the plan.

The Commission's strategy was consistent with its approach to market integration generally in the EU. For instance, the single market program included a number of proposals (289) and a deadline (1992). Although the single market was not completed on time (as the existence of the FSAP proves), it generated considerable political, popular, and business support. The Commission hoped to generate similar support for the FSAP.

The European Council endorsed the FSAP in Lisbon in March 2000, incorporating it into the EU's "Lisbon strategy." Disappointed with the slow pace of implementation, however, France (in the Council presidency) proposed later in the year setting up a small committee to review the plan. The Commission and the other member states invited Alexandre Lamfalussy, a retired Belgian banker and former head of the European Monetary Institute (the forerunner of the European Central Bank), to chair a committee of "wise men" to give new impetus to the FSAP.

The Lamfalussy Committee presented its report in February 2001. The report highlighted three fundamental weaknesses in the legislative and regulatory process: it was too slow; did not allow swift adjustment to a rapidly changing market environment; and produced directives or regulations of poor quality. The report urged faster and more efficient securities market legislation, calling for implementation of these measures by 2003. In order to improve the quality of legislation, the report recommended that the EU institutions maintain a continuous flow of consultation with investors, issuers, and financial intermediaries throughout the legislative process, in complete transparency.

Specifically, in order to speed enactment and implementation of better financial services legislation, Lamfalussy addressed four levels of decision-making. Level One involves the codecision procedure. Here Lamfalussy recommended more consultation in the pre-proposal stage. As for the codecision process itself, Lamfalussy recommended that the Council and the EP reach a decision after the first reading stage (see Point 2, above). As was already the case, the ensuing legislation (in the form of directives or regulations) would set out general, framework principles.

Level Two involves technical implementation (the enactment of so-called "secondary legislation") at the European level. Lamfalussy proposed establishing two new committees: the European Securities Committee (made up of senior representatives of the Commission and the member states) and the European Securities Regulators Committee (made up of national regulators). Based on advise from market participants, end-users, and consumers, the European Securities Regulators Committee would advise the Commission on technical implementing measures. The Commission, in turn, would make a proposal to the European Securities Committee. The European Securities Committee would vote on the proposal within three months. The Commission would then adopt the measure. The EP would be kept fully informed and could adopt a non-binding resolution if the proposed measure exceeded the Commission's mandate.

In Level Three, the European Securities Regulators Committee would develop guidelines, recommendations, and common standards in order to ensure consistent implementation and application of the implementing measures through the EU.

In Level Four, as was already the case, the Commission would check compliance with EU legislation and take legal action against member states suspected of breaching EU law.

5. Key Legislative Obstacles to Implementation of the FSAP

There is always a big gap between rhetoric and reality in the EU. The European Council is prone to issue extravagant declarations and communiqués. The Lisbon declaration, with its lofty goal of turning the EU into "the most competitive and dynamic knowledge-based economy in the world," is a typical example. Day-to-day decision-making in the EU, by contrast, is far more prosaic. Even with the best will in the world, proposals are not always drafted on time, deadlines slip, and inter-institutional strains emerge.

The EP's negative reaction on comitology grounds constituted the biggest institutional obstacle to implementation of the Lamfalussy Report. At first the EP insisted on the right to "call back" a Commission proposal to the European Securities Committee. The Commission saw this as a threat to its executive authority. Only when the Commission reassured the EP that it would keep the EP fully informed of the European Securities Committee's work, review the Level Two process in due course, and support the EP's insistence on raising comitology in the forthcoming Intergovernmental Conference did the EP approve the Lamfalussy Report in February 2002.

In an article in the *Financial Times* in March 2002, Lamfalussy expressed confidence, following the EP's approval of the report, that EU securities legislation will be enacted more quickly than before and will be able to adjust more rapidly to changing market circumstances, but was less sure about the quality of legislation. The main obstacle now, according to Lamfalussy, is inadequate staffing in the Commission, the EP, and the new CESR. "Without sufficient and able staff," he wrote, "it will be virtually impossible to respect legislative deadlines while maintaining the adequate standards." Lamfalussy therefore called for more staff to be seconded from national regulatory authorities for two or three year periods. This is unlikely to happen, not only because national authorities are short-staffed, but also because the powerful staff unions in the Commission and the EP fiercely resist the secondment to their institutions of national officials.