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HOW A SOCIALIZATION OF THE GERMAN BANKING SYSTEM MIGHT LOOK

By Axel Troost and Philipp Hersel

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Reorganizing the Banking Sector

In the fall of 2008, the global financial sector was on the brink of collapse. After decades of neoliberal restructuring marked by a rapid rise in social inequality, widespread privatization (particularly of pensions) and, above all, deregulation, the banking sector collapsed virtually overnight.

To this very day, substantial changes have yet to be made. When the governments saved the banks, they promised fundamental reforms in the financial sector to prevent a repeat of this "state rescue" in the future. But since then hardly anything has occurred. Except for a few new rules such as capital requirements for banks, the sector can go on as before, doing business as usual.

The excessive power of the banks, the subordination of politics to their needs, and the tremendous civic distaste for the bank rescue appear to offer good conditions for the rise of the left. For years, the left had focused on stronger regulation, the reduction in social inequality and a halt to continued privatization. But in the face of the crisis, it was evident that the left had no specific concepts for how the financial sector should be reorganized from a leftist perspective. Put simply, the international left proved to be largely speechless in the face of the crisis.

In this policy paper, Axel Troost, member of the German Parliament and Deputy Chairman of the Left Party, and Philipp Hersel, research fellow of the left parliamentary group in the German Bundestag, help to overcome this speechlessness. Instead of merely complaining about the situation, they seek to formulate concrete answers to the question of what could and must be done differently on the political level.

Drawing on a functional conception of banks, Troost and Hersel plead for a return to core business activities in the banking sector, which must be accompanied by socialization. In other words, they seek a democratic embedding of the banks in their economic and social environment. A new start in the banking sector initially requires a systematic cleansing of the balance sheet; fundamentally, it should be possible for banks either to become insolvent or receive support through state recapitalization and be transferred to public property. A consolidation of the German banking sector must be based on two pillars: cooperatives and public trusts. The financially bloated and speculative capital market business would no longer be admissible. Troost and Hersel argue that the left will only overcome its speechlessness if it is ready to fight for a fundamental restructuring, socialization and rigorous regulation of the banks.

Stefanie Ehmsen and Albert Scharenberg
Co-Directors of New York Office, October 2012

How a Socialisation of the German Banking System Might Look Like

By Axel Troost and Philipp Hersel

Summary

This paper begins by citing the main causes of the economic and financial crisis: first, unequal distribution, second, financial market deregulation, and third, privatisation, especially of pensions.

It goes on to sketch out the core functions of the banks to which the banking sector should be reduced in future: first, the organisation of *payments*, second, the deposit business with simple and secure possibilities to form *savings*, and third the provision of *loans* to finance public and private-sector investment which is economically and socially useful ("PSL" for short). A return to this core business needs to be backed by *socialisation*, i.e. democratically anchoring the banks in their economic and social environment.

An evaluation of the three-pillar banking system in Germany, with its public-law, co-operative and private banks, shows that the main need for change is to be found in the private-sector commercial banks and the Landesbanken. Not only did these two groups of banks make the highest losses: they have also departed the furthest from the core PSL functions.

If there is to be a new start in the banking sector, there must be a thorough consolidation of bank balance sheets. The banks must fully disclose their balance sheets and write off the losses which they have so far kept hidden. Most commercial banks and Landesbanken will find it impossible to survive this step in terms of their balance sheets. In principle, banks should then enter insolvency. However, where their size and degree of integration means that their failure poses a threat to the financial system, they will be supported by recapitalisation from the state and transferred to public ownership.

It is desirable for the German banking sector to be consolidated in two pillars: a pillar of public-law banks (Sparkassen and restructured Landesbanken) and a pillar of co-operative banks (Volksbanken and Raiffeisenbanken). At local level, there should only be Sparkassen (municipality-owned local credit unions) and Volksbanken and Raiffeisenbanken (co-operatively owned local credit unions). Above local level, the commercial banks (which are to be transferred to public ownership) and Landesbanken should be formed into new regional Sparkassen. In parallel to this, the co-operative banking system can set up regional co-operative banks. Many financial services (such as the nation-wide supply of cash to automated teller machines) will be provided on a uniform nation-wide basis via strengthened co-operation within the respective pillar. This strengthening of joint operations within the pillar will also make it possible for the banks to support large financing transactions and foreign business operations, despite the fact that the banking structure will be more decentralised than it is today. Overall, a reduction in the size of the banking sector is unavoidable, because the financially

overblown and speculative capital market business is no longer permitted. At the same time, this severely curtails the powerful influence enjoyed by the financial sector over government and the real economy.

Whether local or regional: the statutes governing the public-law and co-operative banks will follow the model of the Sparkassen and commit these banks to focussing their operations on the common good and to a business model based on the core PSL functions. The powers of the banks' own controlling bodies (administrative or supervisory boards) will be strengthened, and the composition of these bodies expanded to include representatives of civil society organisations, e.g. trade unions, nature conservation and environmental associations, consumer associations, social bodies and movements, welfare associations, etc. The members of the controlling bodies must be democratically legitimated, e.g. by direct election. Further to this, advisory boards will be set up, e.g. on questions of steering loans in the overall economy or on the development of individual sectors.

Every socialisation of a banking system will inevitably reach its limits if—owing to the financial system's unacceptable complexity and due to a lack of information and expertise—the majority of the population basically does not understand what is going on in the financial sector. The reduction of the banks to their core PSL functions will make a substantial contribution to alleviating this complexity. In addition, there is a need for an information and education campaign on the financial system for the general public, especially within the school curriculum.

In parallel to the restructuring and socialisation of the banks, strict regulation is required. The capital adequacy requirements for the banks must be significantly increased and designed in an anti-cyclical way. The volume of turnover and the volatility on the financial markets must be restricted by a financial transaction tax or stopped entirely by the prohibition of certain financial instruments such as higher-order derivatives and OTC trading.

There will be a "reversal of proof" for financial instruments: permission to use them will be made subject to a new approval system for financial instruments. Financial instruments can only be marketed following detailed scrutiny, evaluation and approval from a financial standards inspection body.

Corrections must be made to the remuneration systems for and the liability borne by the bank managers. Bankers must be subject to salary caps and liable with their private assets. Bonuses will be abolished.

Changes to the law and the establishment of a public European rating agency must reduce the power of the rating agencies and the significance of their ratings.

In future, monetary policy must take far more resolute action against bubbles on asset markets. This necessitates precisely targeted instruments like an active minimum reserve.

Finally, the banking sector needs at last to be subject to effective and motivated financial oversight. There must be a new culture of supervision. On the one hand, initiatives in this direction should involve clearer statutory rights of intervention for the supervisory bodies. On the other, the authorities must be required to point to gaps in supervision at an early stage and to call for remedies, rather than to sit and watch as a banking crisis takes shape.

I. Introduction

1. Three Initial Hypotheses

The causes of the economic and financial crisis seen since 2007 basically lie in three factors, for which the governments led by Helmut Kohl, Gerhard Schröder and Angela Merkel bear the political responsibility.

Growing Inequality

Since the 1980s, all the Federal Governments (from Kohl to Schröder and Merkel) have organised a pro-active redistribution of assets and income from bottom to top. The poor have found that their declining income is less and less able to cover their basic needs. In combination with the governments' austerity policies, this has meant that the demand for goods and services is stagnating or even declining in certain sectors. This is not offset by the higher incomes of the rich, because they have a greater propensity to save and so the money goes not into consumption but into the formation of savings. However, the growing savings of the rich do not meet with sufficient possibilities for productive investment, since weak demand means that the production capacities are already underutilised today. As an alternative, the wealthy take their money to the financial markets and invest in a largely stagnating stock of assets like real estate, shares, bonds, derivatives and commodities. The inevitable consequence is price rises – or speculative bubbles – for these assets, which just as inevitably burst at regular intervals and result in financial crises.

Deregulation and Liberalisation

Over the last 35 years, the neoliberal policy has increasingly pruned back the regulation by the state of the financial markets, or has deliberately refrained from keeping up with the development of the financial markets. This has resulted in the creation of a closely integrated international system of some very large and influential financial institutions. They use their political influence to expand their scope for commercial activity, to increase their yields, to avoid effective supervision, and at the same time to take on higher and higher risks. To this extent, therefore, the liberalisation of the financial markets is a reciprocal process of submissive policy-making on the one hand and the exertion of interest-led influence by the financial industry on policy-makers on the other. For their part, the unfettered financial markets have substantially encouraged the redistribution of wealth from bottom to top by making it possible for the owners of assets to benefit from (admittedly unsustainable) double-digit yields.

Privatisation

The privatisation of previously publicly owned institutions is the third factor which strengthens the power of the financial markets and increases their sphere of activity. On the one hand, privatisation is an expression of the neoliberal ideology that the market is fundamentally superior to the state. On the other hand, privatisations are forced ahead because when demand is stagnant the growing savings cannot be placed in net new investment. To put it another way: if the stock of investment really refuses to grow, the only way to expand the possibilities for private investment is to reduce the "market share" of the state and to hand this share to the private capital market. In this way, previously publicly owned companies and services and parts of welfare insurance have become fields for investment over the last 20 years. For example, the "Riester" pension sys-

tem is moving large amounts of additional capital to the financial markets in order to create a capital stock for future pensions. As a consequence, private insurance companies emerge as additional seekers of potential investments and thus inexorably fuel the formation of bubbles on the financial markets. This is of course no way to create secure reserves.

The prevailing policy, with its combination of redistribution of wealth, deregulation and privatisation, is largely responsible for the economic and financial crisis. However, this policy should not only be criticised as a cause of the crisis, but also in terms of its underlying principles. Even if there had been no major crisis, all of the three approaches are wrong, and they would still need to be halted and reversed.

2. Three Core Functions and Three Principles for a Re-orientation of the Banking Sector

The financial crisis, which has now been going on for nearly three years, has shown clearly that the current global financial system is not a model for the future. The criticism and the alternatives derived from this must not, however, be restricted only to reversing deregulation and dealing with the deficiencies in financial oversight by the state. The large banks in particular have proved that they are less and less capable of meeting the needs of a functioning financial sector. In contrast to many other sectors dominated by private capital, this incapability does more than pose the danger that the individual institutions threatened by insolvency will fail. In a way that no other sector does, a banking sector dominated by private capital threatens society as a whole: with incalculable costs and anarchic conditions. The Left Party Parliamentary Group believes that a fundamental re-ordering of the financial system, including the question of power to dispose of the banking capital, is overdue.

The main element of such a re-ordering is a new definition of, or a return to, the core economic functions of the banking sector. The false principles which have become established in recent decades were primarily propagated by the financial markets: shareholder value, lean government, competition to attract investment and tax competition. This process needs to be reversed, and the financial sector needs to be reduced to the role of a service provider for the overall economy. Accordingly, the banking sector's core functions are: first, to ensure a reliable and low-cost system of payments including a corresponding supply of cash; second, banks need to be reduced to the role of capital collection bodies which offer secure, comprehensible and sustainable ways to save, rather than going in for risky business with the clients' and the bank's own money; third, banks need to fulfil their financing function by financing the investments by the companies and the state with loans at acceptable conditions. These core functions of the banking sector are referred to here as PSL (payments, savings and loans).

The aim has to be to substantially reduce the size of the financial sector and to diminish its economic and political power. As a service provider for the real economy and society, the financial sector must not be understood any longer as a place where value is added on its own account, but must be regarded as infrastructure needed for the economy as a whole. There are three principles for this reduction of the financial sector.

First, there must be a strong policy of redistribution back from top to bottom, affecting primary distribution (wages, profits and income from assets) and secondary distribution (taxes, charges and transfers). To this end, the Left Party Parliamentary Group has already presented a large number of proposals and demands, not least in the fields of economic, employment, labour-market, health, pension and tax policy.

The second principle of a re-orientation has to be far-reaching regulation of the financial markets and their actors. This paper provides an overview of this.

The third principle has to be a halt to and reversal of privatisation, and the courage to undertake more socialisation. This involves far more than just a re-nationalisation of previously privatised companies and welfare insurance systems. Just as a thorough privatisation policy embraces (and has embraced) more and more parts of society, the reverse is also true: the principle of socialisation cannot be restricted to one specific sector. However, the manifest failure of the banking sector during the crisis is a good reason to launch the socialisation project in this sector. The following sections sketch out how the start on socialising the banking sector could look given today's conditions. Should these conditions (e.g. the current financial problems of many private banks) change, the proposals should be developed further in order to ensure that the aim of socialising the banking sector remains attainable.

Here, socialisation should be regarded as the subordination of the financial sector to steering and control by society and the anchoring of the sector in society. Socialisation therefore necessarily involves the second principle, regulation. After all, it is clear that steering and control of the banking sector necessitate regulation by laws, and that compliance with these laws needs to be monitored.

The German Banking System – Three Pillars

1. Public-Law Banks („öffentliche rechtlich Banken")
    a. 430 Sparkassen: municipality-owned local credit unions, serve clients in their specific local/regional territory with „conventional financial services" like current and savings accounts, loans to individuals and SMEs; Sparkassen also include savings banks subsidiaries to finance real estate activities
    b. 8 Landesbanken: state-owned banks, serve clients (wealthy individuals, larger corporations, states, Sparkassen) nation-wide/globally incl. subsidiaries on abroad e.g. by loans and complex finanical services incl. investment-banking, capital market operations; serve as settlement centers for Sparkassen.

2. Co-operative Banks („Genossenschaftsbanken")
    a. 1120 Raiffeisenbanken and Volksbanken: cooperatively-owned credit unions, similar activities and territorial limits like Sparkassen, but co-operatively owned by their member, i.e. clients.
    b. WGZ-Bank, DZ-Bank: 2 "Central banks" of the Raiffeisenbanken and Volksbanken and owned by them, serve similar clients with similar services like Landesbanken

3. Private Banks („Private Geschäftsbanken")
    a. 4 large commercial banks (e.g. Deutsche Bank, Commerzbank): leading banks in investment banking and capital marked operations for big corporations
    b. approx. 100 special and regional banks: specialized e.g. in real-estate financing, covered bonds, shipping, BMW-Bank etc.
    c. approx. 100 branches of foreign banks, e.g. international commercial banks
    d. approx. 25 private bankers: Niche banking, e.g. for wealthy individuals

II. A New Structure for the German Banking System

1. The Three Pillars of the "Old" Banking Sector: Separating the Wheat from the Chaff

The three pillars of the German banking system (see also box on next page) performed very differently during the financial crisis. The performance of the public-law banking sector was extremely mixed. Apart from a few exceptions, the Landesbanken were deeply caught up in the turbulence of the crisis because they took on irresponsibly risky business in the global financial casino which had nothing to do with their original mandate. They thus fostered and exacerbated the crisis. As the owners of these banks, the taxpayers now have to shoulder their dramatic losses. Since the public sector, as the owner, has the financial capacity to do this and to furnish the Landesbanken with sufficient fresh capital, the Landesbanken have not suffered restrictions on their ability to provide loans, despite the high losses on the equity side.

The Sparkassen provide an exact opposite to the mistakes by the Landesbanken, as they kept almost entirely out of risky financial deals and proved their worth during the crisis as the backbone of the credit supply, especially for small and medium-sized enterprises (SMEs). In addition, they are the market leaders when it comes to providing private customers with low-cost payment services and with offers of private savings schemes, especially in sparsely populated regions.

The second pillar, the association of co-operative banks, also performed well during the crisis, apart from certain losses by DZ Bank, its central institution. Like the Sparkassen, the Volksbanken and Raiffeisenbanken make an important contribution towards supplying SMEs with credit and providing payment and savings services.
The private banks, the third pillar, returned the worst performance. These banks include the banks listed on the stock exchange, such as large banks like Deutsche Bank and Commerzbank, the regional banks, and the specialist banks like IKB and Hypo-Real-Estate. But the pillar of private banks also includes the far smaller, elitist family-owned private bankers such as Bankhaus Metzler or Sal. Oppenheim (owned by the Oppenheim family from 1789 until the emergency takeover by Deutsche Bank in 2009). Deutsche Bank plays a special role in the third pillar, since it was involved in global investment banking earlier and more intensively than other private German banks. Thanks to this prominent position, Deutsche Bank had an advantage in terms of knowledge and expertise which enabled it to pull out of market segments which were turning risky by quickly selling on its risky securities to other banks like IKB. As the world market leader in foreign exchange training and an important developer of and trader in risky derivatives (e.g. certificates, options, CDOs, CDS, etc.), Deutsche Bank played a major role in causing the crisis but has nonetheless suffered disproportionately small losses.

The other private banks, in contrast, slid deep down into the crisis. Since, unlike the Landesbanken, they did not have a public owner by their side to replace their lost equity, they would have long since collapsed were it not for the support of the public sector. Unlike with the Landesbanken, the government support for the private banks has not caused them to focus more strongly on the core functions of the banking sector (payments, savings and loans—PSL). Of the three pillars, the private banks are refraining most from supplying the economy with credit in the current crisis. This is especially true of the subsidiaries of foreign banks like HypoVereinsbank or Citibank, because they are affected by the problems of the parent companies. It is true that the government and the

central bank have pumped billions into the rescue and liquidity of the private banks, but they have failed to impose any conditions on these banks to deploy this money usefully as loans for the real economy. Given this situation, it is no comfort that only 11 percent of the loans to the domestic "non-banking sector" (i.e. companies, state, private individuals) come from the private commercial banks in any case, so that they appear fairly dispensable.

In overall terms, it can be said that the Sparkassen and co-operative banks—unlike the private commercial banks and the public-law Landesbanken—were only marginally involved in the risky deals of the global financial casino, and concentrated instead on the core functions of the banking sector set out above.

It would appear that banks in public and co-operative ownership can at least partially evade the dictates of the desire for profit. However, public ownership alone is no guarantee that an institution will take this opportunity. But private commercial banks have no alternative to an unconditional orientation to profits, because the financial markets systematically enforce the dictate of the profit motive.

In view of this, a socialisation of private commercial banks can probably only succeed if they have first been liberated from the dictate of the profit motive by being transferred to public or co-operative ownership.

Because the Sparkassen and co-operative banks are far less exposed to this dictate, they especially have a business model in common. They do not have to follow every risky short-lived financial market trend. They can concentrate on the solid banking business needed by the overall economy. This is also reflected in their structure. Sparkassen, Volksbanken and Raiffeisenbanken tend to be small-scale and very much anchored in their region. This includes on the one hand the municipal or regional ownership or patronage, and on the other hand the networking with stakeholders like local chambers of industry, commerce and crafts, sports and charity associations, as well as leading local authorities from religious communities, trade unions and intellectuals. To put it another way: Sparkassen, Volksbanken and Raiffeisenbanken are integrated into their local environment; they can be said to be territorially socialised. This fits in with the fact that these two pillars of the banking system adhere to a strict territorial principle, meaning that there is a high degree of autonomy and responsibility at least within this pillar. Together with the size of the balance sheet of a small or medium-sized Sparkasse or Volksbank, which is at least partially within the understanding of a normal person, these local links to economic reality give these banks the necessary grounding, a sense of reality which the managers of the private banks and the Landesbanken lost a long time ago.

2. The Private Commercial Banks: If Possible, Let Them Go Bankrupt, If Necessary, Support Them and Bring Them Under Control

In conjunction with the above-mentioned goal of reducing the massively overblown financial sector, only one conclusion can be drawn from the problems of the private banking sector described above: private banks should disappear from the banking sector, as far as possible through insolvency, because they are the furthest from our ideas of a socialised banking sector.

For this reason, the Left Party does <u>not</u> advocate the preservation of the three-pillar model of the German banking system, but sees the future in a further development and linkage of the public-law (Sparkassen and Landesbanken) and co-operative (Volksbanken and Raiffeisenbanken) pillars.

However, the qualification "as far as possible" is highly significant. Unfortunately, banks—and particularly the large private banks—are so tightly interwoven with other banks and companies that the collapse of one bank can trigger a serial collapse of other banks and companies. It is difficult to assess this risk of "systemic relevance",[1] but regrettably it must not be underestimated.

There is thus the need for a procedure to wind up or socialise troubled "systemically relevant" commercial banks without a cascade of collapses. There is also the need for a way to either close down or socialise private banks which are not threatened by bankruptcy. This paper will now look at these two procedures in greater detail.

Troubled Systemically Relevant Commercial Banks

One indispensable precondition for a functioning banking system is a warts-and-all disclosure of the risks of losses which are still lying hidden in the balance sheets and which not least make it more difficult for the banks to provide credit. To this end, the non-performing assets of the individual banks need to be outsourced into separate units at market prices. If it is not possible to ascertain market prices at present, the "junk" papers must be valued at a price of 0. With this approach, which is advocated not least by Nobel Prize laureate Paul Krugman (cf. "New York Times," January 18, 2009) and by the German Institute for Economic Research (DIW-Wochenbericht 13/2009), many of the banks will have to declare enormous losses which they will not be able to offset with their scarce amounts of equity. In terms of accounting, these banks are then insolvent.

At this moment, banks will have to face a new insolvency and restructuring procedure which, once the bank's entire equity has been consumed—i.e. a total loss for the shareholders—envisages in a second step at least partial participation of the unsecured creditors in the losses. Creditors, including depositors, should initially only be compensated to the extent of the statutory deposit insurance of 100,000 euros in future. For any further-reaching claims, proportional participation in the losses, altered reimbursement conditions, etc., can be stipulated. Secured creditors, such as the owners of Pfandbriefe, will continue to be paid from the collateral which is safeguarded from insolvency.

Only if this participation of the shareholders and creditors in the losses is insufficient to prevent the collapse of what afterwards is still a systemically relevant institution should the state support the residue of the bank with fresh capital for systemic reasons. Since the old equity has already been fully or largely used up, the first euro of equity the state puts into the bank will make it the sole owner or co-owner of the bank. At the same time, it will have to intervene resolutely in the operations of the nationalised commercial bank. The principle for the bank's operations must be a restructuring of the bank to coincide with the core functions of "payments, savings and loans" (PSL). Business activities which do not fit in with this must be ceased.

1 The concept "systemically important financial institution" is defined as follows: due to its size and/or the degree of its integration with other financial institutions, the collapse of this bank creates a substantial risk that a proportion of banks and insurance companies which is of relevance to the survival of the financial system will also become insolvent. Since the state only has limited information about the precise interlinkages within the banking sector, it is difficult to measure this risk. Further to this, there are psychological factors like the loss of trust on the part of bank customers which can lead to the risks of a run on the bank, i.e. that the bank's customers storm the bank to withdraw their deposits. In view of these imponderables and the great risk of erroneous assessments, the threshold for a bank's systemic relevance tends to be set too low rather than too high. When private banks are assessed, this caution is all the greater because—in contrast to the voluntary system of associated liability of the public-law and co-operative banks—there is no truly robust deposit insurance.

This creates a dilemma. The Sparkassen and co-operative banks successfully pursue the "PSL" business model for private individuals and small and medium-sized companies. Of course, the aim cannot be for a commercial bank which has been recapitalised by the state and is now under the control of the state to compete with the very banks which are far closer to the principle of socialisation, i.e. the Sparkassen and co-operative banks. The only way out of this is for them to provide PSL services for large customers.[2]

However, if the aim is also to arrive at a PSL business model for the Landesbanken which serves the common good, all the thinking in this direction will have to focus on precisely the same clientele. Ultimately, the state will not be able to avoid the need to produce an integrated concept for nationalised private banks and Landesbanken which corresponds to the real need for PSL services for this clientele. In certain cases, this can and must mean that commercial banks which have been nationalised due to the pressures of systemic relevance are wound up or merged with other parts of former private banks or Landesbanken. The possibility of the state funding the creation of massive overcapacities for PSL services for large customers must be prevented.

Non-troubled Private banks

As already mentioned, Deutsche Bank is an exception amongst the private commercial banks. It is true that information about risks of losses on the balance sheets of Deutsche Bank is not in the public domain. However, it is possible that, when all the balance sheet risks are disclosed and written off, Deutsche Bank would not automatically move into state ownership via such a restructuring and recapitalisation procedure. Different ways towards socialisation need to be taken for this case.

The private banks which do not move into state ownership via the insolvency and restructuring process described above will of course continue to be subject to statutory banking regulation. Section III of this paper sets out in greater detail how this banking regulation needs to be tightened up as a lesson from the crisis. Basically, the new regulations must mean that, in order to reduce the potential risk of the financial sector, many transactions and financial instruments which go beyond the PSL business model will have to be prohibited or rendered unattractive in any case. So there is the hope that the remaining private banks will find themselves forced to concentrate on PSL business. However, since all the other banks will already be busy in this field of business, it will not be possible to make all that much money with a PSL business model. At best, the remaining private banks will give up of their own accord. If they do not, it is certainly necessary to prevent them from having more than a niche existence.

As Small as Possible, as Large as Necessary and Controllable

One contributory feature here is that there should normally be restrictions on the size of all banks, including socialised banks. As described above, the decentralised nature and reasonably sized balance sheets of the Sparkassen, Volksbanken and Raiffeisenbanken are important criteria for their success. In a country with many large companies, territorial authorities and welfare insurance funds, however, there will always be demands which are too large for a Sparkasse or Volksbank to cope with. At the point where these banks cease to be able to handle a loan or deposit, the social-

2 Large customers could include not only large companies but also public institutions like territorial authorities, welfare insurance funds, etc. There will certainly also be large customers in the sense of "high net worth private customers". However, as a left-wing policy of redistribution of wealth takes effect, this group of customers should and hopefully will become much smaller.

ised and much downsized Landesbanken and former commercial banks will come into play. A substantial reduction in size will automatically derive from the loss of entire branches of business which can no longer be pursued due to tighter regulation (cf. complex securitisations and other derivatives, proprietary trading, etc.). However, since it is in the nature of institutions to expand themselves and their sphere of influence, there must also be restrictions on size beyond the constraints on operations. It is true that the organs of social control for socialised banks will themselves oppose every new sign of megalomania, but a statutory restriction on size can also serve as a guideline and must be stipulated in such a way that it is well below the threshold of systemic relevance. Socialised banks will only live up to their intentions if they remain controllable by society in all circumstances, in the worst case even at the moment of their collapse. Should socialised banks encounter difficulties, it is first necessary to examine the extent to which the socialised banks can offer one another mutual support. Since there is no comparable support between the remaining private banks, the restriction on the size of the latter must be much tighter.

When banks exceed the restrictions on size in future, an unbundling procedure will have to kick in automatically. The parts to be hived off in order to reduce the size of the bank will then either be wound up or socialised as a separate bank.

As a consequence, private banks are likely to stay reduced to an existence as insignificant niche banks.

3. What Does Socialisation Actually Mean?

What will distinguish the socialised banks of the future from today's Sparkassen, co-operative banks and Landesbanken?

The Sparkassen and co-operative banks show that a bank can be very successful if its statutes stipulate that its purpose is not abstract orientation to profit, but the exercise of a certain business model in a certain region.

Whereas the Sparkassen are formally oriented to the common good, the purpose of the co-operative banks is to serve their members. But the benefit for the individual member of the co-operative is not defined in terms of what yield the member receives for his share of the co-operative capital, but in that the member gains a benefit as a customer using the services of the bank. This is the central difference between a bank as a joint-stock company on the one hand and a bank as a co-operative on the other, even if in formal terms both banks are privately owned.

A socialised bank must be characterised by the fact that the core functions of payments, savings and loans (PSL) are stipulated in its statutes as the area of its operations and its business model, and that these activities are only carried out in a certain geographical area. The region covered by the business operations determines which geographical section of a society is responsible for the societal control.

Local Socialisation

This means that much will remain the same for the business activities of the local Sparkassen, Volksbanken and Raiffeisenbanken. They should remain local institutions and be controlled by the local structures of society, i.e. the municipalities, local institutions and local civil society. Of course, the substantially tighter regulation will apply to them just as much as to all other banks. However, it will hardly affect them, since the activities that will be restricted or prohibited in the future are not really things they did in the past.

At local level, the two forms of banks should be retained as the public-law Sparkasse on the one hand and the co-operative Volksbank or Raiffeisenbank on the other, and should continue to compete with one another. Within the tight confines of the PSL business model and territorial restriction, this competition should take place not via cost-cutting, but in the form of a most desirable competition in terms of quality and closeness to the customer.

The current management structures of the Sparkassen, Volksbanken and Raiffeisenbanken can serve as a basis for future work. Overall, the composition of the governing boards of the Sparkassen will need to become more pluralistic. To this end, not only representatives of political parties, but also non-party, expert citizens should join the governing boards, e.g. with a certain proportion of the seats on the governing board being filled via direct elections.

In many cases, there are also rigidities to be remedied in the supervisory boards of the Volksbanken and Raiffeisenbanken. These are an expression of the fact that the true concept of the co-operative has disappeared into the background in the case of many co-operative banks. This trend needs to be reversed, and the participation of the members of the co-operative needs to be expanded again—e.g. via more informative co-operative assemblies which take better account of the prior level of knowledge of the members.

Both forms of banks have examples of advisory boards which, for example, bring together the interests of individual industries (such as the construction industry) or sectors (such as the skilled crafts sector). These advisory boards must be expanded to include stakeholders which are oriented towards the needs of the economy as a whole and the common good, such as trade unions, nature conservation and environmental associations, consumer associations, welfare institutions and social movements, social associations, etc.

Regional Socialisation

The situation at regional level is much more difficult. Many Landesbanken have done severe damage to the image of a public-law banking system which is oriented to the common good, particularly in terms of their business models and their internal management structures.

So a fresh, radical start is needed. Here, the parts of the ex-Landesbanken and ex-commercial banks which are to be socialised and which are worth retaining will be merged at regional level and transformed into a new structure of regional Sparkassen and regional Volksbanken and Raiffeisenbanken; these will orient their PSL business model to large-scale customers and will serve geographically defined regions. For example, the regions could be those of the twelve existing Sparkassen associations, or several Länder could form a banking region. The Sparkassen and co-operative banks of the respective region or of the respective association would then also serve as owners of the regional Sparkassen and regional co-operative banks.

Economic and social anchorage—i.e. socialisation—in the region is very important, so that on the one hand the needs of the large regional customers can be met, and on the other the regional control structures can ensure that the banks keep their feet on the ground.

The size of the balance sheet and the territorial extent of such regional Sparkassen and regional co-operative banks will be sufficiently large to finance large-scale projects. They could also take on the function of clearing houses for local Sparkassen and co-operative banks. Regional banks should form associations to handle nation-wide tasks, such as the administration

of non-performing loans or the operation of nation-wide computer centres. As is the case today with the Sparkassen and co-operative banks, the association format will ensure that, despite regional structures, there are uniform standards and customer service nation-wide (such as nation-wide free access to ATMs of the respective bank category).

There is a need for control bodies like the municipal sponsorship or co-operative structures which subject the regional Sparkassen and the regional Volksbanken and Raiffeisenbanken to an effective control which has been legitimated by society. It is necessary to examine the extent to which the executive and governing boards of the socialised banks can be elected so that they have a direct democratic mandate. In addition to politicians and "experts" designated by political parties, organisations of civil society—such as chambers of commerce and crafts, company organisations, consumer initiatives, environmental organisations, welfare associations, social movements, etc.—must be integrated into such control bodies (even more than at local level).

In addition to the scrutiny and auditing of the business activities, the tasks of such bodies must include the (continuing) development of the business strategy. The repossession of the banking sector as an instrument of democratically developed economic policy is a central element of strategic development, albeit one which cannot be handled by the banks and the new banking control authorities alone. The main responsibility for the development of such strategies is to be found at the level of the Länder and the Federal Government. An open debate in society must at last be held again at these levels regarding the aims of economic policy: what sort of industrial, employment, environmental, structural and regional policy do we want? Only then does the question arise as to how the socialised banks can serve these objectives.

In order to cope with this task, additional advisory boards should be set up alongside the regular control bodies and arching over the individual regional co-operative banks or regional Sparkassen, e.g. on questions of macroeconomic credit steering and the development of individual sectors and industries.

Supra-regional and International Banks

The socialisation process sketched out here explicitly does not envisage any large-scale public-law or co-operative banks active nation-wide. Instead, uniform nation-wide banking services should be provided via a horizontal division of labour in the association of the regional Sparkassen and the regional Volksbanken and Raiffeisenbanken. This dispenses with the need for large top-tier institutions whose size could pose additional risks to the systemic stability of the financial system. Given their many years of experience operating in associations, the associations of the remaining public-law and co-operative pillars should certainly be capable of meeting the needs of cross-border companies doing business abroad. Today's network of parallel establishments of many Landesbanken abroad must be replaced by joint associate branches. However, it is also necessary to review whether foreign branches really are necessary to the current extent.

Apart from this, the aim should be that German firms operating abroad should if possible use the expertise of the banks based there (which will hopefully also have been socialised), just as we believe it appropriate for foreign companies in Germany to co-operate with the socialised banks here. If we ourselves aspire to exert democratic influence on overall economic development via the banking sector, we must of course allow all other democratic societies to do the same. For this reason, loose and decentralised, pan-European associations of similarly positioned public and co-operative banks should be aimed at in the medium term.

No Control Without Expertise

Not least, the prospect of socialisation necessitates a financial education campaign. There has to be adequate understanding in the general public if a society is to be able to take enlightened decisions. Not least at this point, we come back to where we started. The financial sector must not merely shrink in order to reduce its risks for the economy and society and its influence on government. Without a shrinkage and at the same time a considerable reduction in the complexity of the financial sector, social control of the banking sector is simply impossible.

III. On Regulation: New Rules for All Banks

So far, this paper has presented processes and principles for a restructuring of the banking system. Hereafter, the rules will be sketched out according to which the "normal operations" of a banking system are to function. These rules primarily aim to restrict the risks of losses in the banking sector and in this way to avoid costs for society at large. Even socialised banks are capable of taking wrong decisions and suffering losses. The need to reduce risk via better regulation therefore naturally also applies to socialised banks.

However, the less the banks have been restructured in the sense outlined above and subjected to social control, the more important this re-regulation is. If, contrary to our proposals, the current three-pillar banking system with large private banks and unpredictable Landesbanken remains in place, the regulation proposed here will be all the more important.

1. Equity Capital of the Banks

In order to reduce the danger of credit-fuelled financial bubbles in future, the banks need to make greater provision for risks and to be forced to exercise restraint. A highly effective means to achieve this is the capital adequacy requirement for banks issuing loans. The reference rate for the backing of credit with capital, which currently stands at 8 percent under the Basle II rules, must be substantially increased to a corridor between 12 and 20 percent. At the same time, the capital adequacy rules must be adapted to the economic cycle. In boom times in particular, the euphoria can easily result in banks being excessively willing to provide credit, whilst in a recession, as can be seen from the looming credit crunch, they can equally excessively hold back. So it would make sense to have a cyclically based range between 12 percent in a recession and 20 percent in a boom.

In addition to a general reduction in the possibilities for the banks to create credit, higher capital adequacy rules would also strengthen the capacity of the banks to cope with losses, so that even substantial losses would not immediately cause them difficulties. If the banks have smaller possibilities to create credit, the steering effect of monetary policy can be greater. The tighter rules reduce the volume of risky credit transactions and high credit leverage, and thus help overall to shrink the banking sector.

It is often said that a disadvantage of higher capital adequacy requirements is that they would deepen a credit crunch in a crisis. In the model of socialisation sketched out above, this problem is solved by the state—as the owner of the banks, but unlike the shareholders in the

private banks—providing the banks with sufficient fresh capital to prevent a credit crunch.

The very large differentiation of capital adequacy requirements envisaged by Basle II in line with the creditworthiness of the borrowers has resulted in an incomprehensible system of rating models and procedures. These rating procedures must be substantially simplified and harmonised. Individual risk-assessment procedures run by the bank itself must be abolished. This is also necessary in order to overcome the polarising effect of Basle II which often favours large companies over small ones. This polarising effect derives from the reliance on individual factors in creditworthiness checks. Here, smaller companies with a smaller equity ratio generally do worse than large firms—because the equity ratio for example plays a leading role in these checks. This business-based view loses sight of the macroeconomic perspective. If the bankers treat smaller, supposedly more vulnerable companies worse by cutting or charging more for their credit and instead favour large firms, this in turn increases the systemic risk, because large loans are at risk of non-performance in a crisis. Instead, the small firms should be strengthened and the large ones should not be given additional preferential treatment. This can occur for example via a uniform percentage rate for the capital adequacy requirement for all corporate credit—irrespective of the equity ratio of the company in question. This is equivalent to cross-subsidisation: the weaker companies pay less, and the stronger ones pay more than they would if they were rated individually.

This may run counter to commercial logic, but it makes absolute sense from the macroeconomic point of view in terms of systemic stability and the avoidance of oligopolies. In the model of the socialised banking sector, this could be achieved by having the regional Sparkassen and regional co-operative banks assigning part of their revenues from large-scale business to the local Sparkassen and co-operatives, not least with a view to achieving a structural balance across the regions.

Further to this, the instrument of capital adequacy could also be developed further as a steering instrument in terms of economic and social policy. Loans to economically or socially undesirable sectors or to their business models, such as financial investors or the nuclear and genetic engineering industries could be subjected to higher capital adequacy requirements. Banks themselves must not be allowed to be the owners of investment companies like hedge funds or private equity funds with a duty to feed in more capital. It is self-evident that the PSL business model of socialised banks *per se* excludes the possibility of investment in and loans to such funds.

2. Reform of the Remuneration Systems and of Managerial Liability

When the crisis began, the defenders of capitalism tried to explain it away as primarily being the result of the greed of a few financial managers. The two Merkel governments have responded in a show of activism with the Act on Appropriateness of Remuneration for Board Members and the Act on the Supervisory Requirements Regarding the Remuneration Systems of Banks and Insurance Companies, focusing mainly on psychological aspects of the crisis. The new legislation has, however, proved to be vague, with no binding impact in practice, or only making it possible to cap bankers' salaries once an institution is in difficulties.

In contrast to this one-sided analysis, the structural causes of the crisis – the global increase in unequal distribution of societal wealth, the submissive deregulation of the financial markets and the privatisation of previously public goods and services—were described at the start of this paper. Even if the greed of bank managers is not the central cause of the crisis, the remu-

neration systems and the liability of the bank management must be fundamentally changed. In order to ensure that the remuneration systems for managers and board members do not produce any harmful incentives, these incomes must be firmly tied to the incomes of ordinary employees. For this reason, the Left Party demands that a managerial income may not exceed twenty times that of an employee in the lowest salary group which is subject to the payment of social security contributions. Stock options and bonuses are prohibited and the possibility for individuals to deduct business expenses from taxation of severance pay is restricted to a million euros per person. The rate of increase of these top salaries must not exceed the general development in salaries and wages. To ensure that the managers of the financial sector in particular can be made liable, as co-causers of the crisis, the Left Party demands a special levy on taxable income of more than 600,000 euro for this group. To this end, the income tax rate for the remuneration of these people is temporarily increased to 80%.[3]

Members of boards and supervisory boards who take decisions of great financial import must be fully and personally liable for wrong decisions. For this reason, directors and officers insurance policies which companies conclude for their managers must be banned. Furthermore, membership of supervisory boards must lose its function as a retirement pastime for ex-board members, and instead the controlling function must be strengthened. For example, members of supervisory boards often end up supervising the decisions and strategies they themselves took or introduced, and therefore lack the necessary distance. For this reason, it is vital that former board members must not be allowed to take up a mandate on the supervisory board of the same company until at least five years after they left the company. It is equally vital for at least half the mandates on the supervisory board to be allocated to the employees and their trade unions. Also, following Norway's example, 50% of all mandates on supervisory boards must be filled by women.

3. Streamline the Financial Market

There is a need for a substantial restriction of trading using financial instruments and for better quality control of the financial instruments themselves.

This must start from a reversal of the burden of proof for financial instruments. At present, banking transactions and so-called financial innovations are permitted as long as they are not explicitly forbidden. But when, for example, pharmaceuticals and technical equipment (e.g. cars) are brought onto the market, the state takes the opposite approach and makes their sale subject to approval. There must also be this sort of approval test system in the financial sector as part of financial supervision, responsible for the testing and licensing of financial services and instruments. Financial instruments would then first have to be subjected to an approval test which assesses them in terms of criteria like systemic riskiness, microeconomic and macroeconomic sustainability, social and environmental compatibility, consumer protection, etc., and licenses them with a classification before they can be offered on the market. Even if this reversal of the burden of proof appears very far-reaching, it is ultimately merely a general deployment of existing procedures already applied in individual cases. For example, it is already the job of the financial supervisory au-

3 A special levy is justified by the fact that the group on which the levy is imposed must evidently be closer to the aim pursued by the imposition of the levy than any other group or taxpayers in general. This is undoubtedly the case here. It makes no difference whether the companies employing the people on which the special levy is imposed themselves make use for example of the services of the Financial Market Stabilisation Fund. For example, banks which themselves have not encountered difficulties sold their customers Lehman certificates which have since become worthless, at the same time benefiting from commission on these sales.

thorities to certify financial products supported by the state (e.g. "Riester" pension contracts) before they can be offered by insurance companies.

Many products, and especially second-order or higher-order derivatives[4], have nothing more in common with the original function of risk diversification and risk insurance, and merely serve the purpose of speculation in the global financial casino. Such products are superfluous and should be banned. Whilst securitisations in the simple form of the Pfandbrief have a useful financing and asset-securing function, multiple-order securitisations and their subdivision into tranches are mainly suited to concealing risks. Even in the case of first-order securitisations, the issuing institute should retain liability for at least 20 percent of the amount securitised in order to enhance the banks' awareness of the risks in issuing credit. Banks should no longer be permitted to engage in securities transactions on their own account.

In future, derivatives may only exist as standardised futures or swaps, etc. which are traded exclusively via stock exchanges or other central counterparties. Central counterparties should act as trading platforms between buyers and sellers and, like a stock exchange, handle the transactions and guarantee that the seller will actually get his money. On the one hand, this enables a much better collection of the statistics on these transactions. On the other, this model ensures that in the case of default by the buyer, no uncontrollable chain reaction of payment defaults cascades throughout the entire financial market. Options would be prohibited. The upshot would be that the intransparent and sometimes very risky over-the-counter trading we see today would cease.

A financial transaction tax must immediately be introduced on the remaining financial transactions in shares, bonds, foreign exchange and simple derivatives. Although a global financial transaction tax is desirable, even just the EU-wide introduction of such a tax would have a substantial steering and revenue effect. The internationally valid tax rate should be at least 0.05 to 0.1 percent. As long as the international negotiations on such a tax continue, countries like France, the UK and Germany, which have spoken out in favour of the financial transaction tax in principle, should form a "coalition of the willing" and introduce a financial transaction tax at national level with a minimal tax rate of at least 0.01 percent. Another reason why off-floor trade in derivatives should only be allowed via central counterparties is so that all transactions can be registered for taxation and reported to the relevant financial supervisory authorities.

4. Role and Responsibility of the Rating Agencies

The failure of the rating agencies is that they did not recognise problems and dangers on the financial markets and/or that they did not publicly warn of the risks. The role of the rating agencies has increased greatly due to the enormous growth of the financial markets since the early 1990s. The entry into force of the Basle II rules and the Solvency Ordinance in Germany in December 2006 gave a further huge boost to this role. The experiences of the New Economy crisis at the beginning of this decade and the current financial crisis show, however, that confidence in the judgement of these institutions is unjustified. There are three structural reasons why it is doubtful that rating agencies can make a contribution towards stable financial markets:

4 Derivatives—i.e. derived financial instruments—of higher orders are financial instruments which have been derived several times over. A bet on tomorrow's dollar exchange rate is a simple derivative. A bet that, out of 15 bets on tomorrow's dollar exchange rate only 10 will be successful, is a second-order derivative. Higher-order derivatives exponentially increase the complexity and unpredictability of developments on the financial markets.

1. The serious methods to measure the probability that a claim (e.g. a loan, a security, etc.) will not be honoured are almost all based—inevitably—on longer-term statistical time series about the companies or papers to be rated, and also to a very small extent on their environment. However, financial innovations, and especially the "structured" products, are mainly based on novelties for which there cannot be any long-term experience. Rating agencies necessarily always have to chase after financial innovations, and by the time they have caught up with them and rated them, a new wave of innovation has begun. The asymmetry of information between the issuer and the public is not reduced, and indeed is sometimes exacerbated, by the rating agencies.

2. It is the task of rating agencies to assess the microeconomic creditworthiness of a company, an issuer, a bond, a loan or loan package, or another "structured financial product". They do this using corporate data, relative figures and various stress scenarios. The assessment of the probability that a credit will be repaid is undertaken on the basis of these data and not in the macroeconomic context. However, the same financial products can have different qualities under different circumstances. These circumstances are not covered by the rating.

3. Rating agencies are private companies whose revenues and profits depend on contracts with the companies whose products they are to assess, and who have an enormous interest in a positive rating. Even without corruption and obvious distortion, this results in a structural tendency to select the most positive of various possible ratings. In view of the high degree of sensitivity and contagiousness of financial markets, however, a more cautious rating would normally be appropriate. For this reason, ratings tend to have a pro-cyclical effect. When the financial markets are booming, they exacerbate the excesses in prices and risk assessment. When the situation turns negative and individual cases show that the positive ratings were not justified, the ratings are downgraded with the consequence of panicky—and often economically irrational—selling and collapses in prices.

Three main conclusions should be drawn from this for the banking sector. First, the role of the ratings of these agencies must be greatly restricted. Banks should rely less on external ratings and more on self-made, thorough assessments of the loan applications by borrowers. Second, the oligopoly of the three dominant agencies, Standard&Poors, Moody's and Fitch, must be broken up. And, third, the false incentives deriving from the fact that the agencies are paid for their supposedly "objective rating" by the very people they are rating must be ended.

Whilst the first conclusion requires a reform of the capital adequacy rules for banks (Basle III), there is a different solution for the second and third conclusions, i.e. the establishment of a public rating agency at European level.

This model would offer three major advantages:

⇒ Since a public rating agency is not driven by the profit motive, the conflict of interest between maximising the revenues on the one hand and the neutrality of the rating on the other will disappear. The current tendency for over-optimistic forecasts caused by this would cease. Similarly to the public financial oversight authorities, the rating agencies would be funded by a general system of contributions paid in by the companies using (or having to use) these ratings.

⇒ The macroeconomic blindness of the private-sector rating agencies would be overcome in that the assessment of financial products no longer covers just the individual creditworthiness of the

issuer, but also the macroeconomic circumstances.

⇒ A public rating agency gains insights into actors and financial market products which it can, if necessary, pass on to the financial supervisory authorities. These authorities can thus recognise problems more quickly and thus intervene more effectively.

The staff of the new public rating agency can be recruited from the national central banks. There is a large pool of people there with the necessary skills in the fields of finance, corporate finance and macroeconomics; at the same time, many of these staff are underdeployed due to the loss of functions at the national central banks following the monetary union, and job-shedding has begun. So the establishment of a public rating agency would not merely be an important instrument of financial oversight, but also a useful employment programme for highly qualified staff.

5. New Monetary Policy to Prevent Financial Bubbles

The bursting of the internet bubble on the stock markets in 2001, and—even more than this—the bursting of the real estate and securitisation bubble from 2007 showed very clearly that inflationary processes are by no means restricted to consumer goods. In the cases mentioned here, the prices of assets like stocks and real estate in particular shot up. The consequent crash in asset prices, which inevitably happens sooner or later, threatens the entire financial system. In the interest of systemic financial stability, central banks will in future need to pay much more attention to the development of asset prices, e.g. via monitoring systems based on clearly defined indicators. When there are signs of price bubbles, central banks will also need new instruments so that they can take targeted action against them. The current instruments of monetary policy, consisting of a single key interest rate, entirely lack complexity, in view of the extremely different developments in price on the various markets.

Another necessary instrument is the "active minimum reserve", which was proposed back in the 1970s by the Alternative Economic Policy Working Group (at the time primarily in terms of industrial policy). Unlike the usual minimum reserve, whereby the banks have to deposit a certain percentage (currently 2 percent at the ECB) of the deposits of their customers with the central bank[5], the active minimum reserve is the obligation to deposit a reserve for assets on the active side (e.g. on loans, securities, etc.) with the central bank. For example, if the real estate sector is booming and there are the first signs of bubbles on the housing market, the central bank could impose a targeted increase in the active minimum reserve rate for bank loans to the real estate sector, make it more expensive to issue loans in this sector, and thus take targeted action to counter a real estate bubble.[6]

Such an active reserve not only has the advantage that it can partially offset the inadequacies of a single rigid key interest rate: another benefit is that the current constitution of the European monetary union permits the national central banks of the eurozone—as is also the case with general minimum reserve—to stipulate specific national active minimum reserves. In this way, whilst the key ECB interest rate remains the same, action could be taken against speculative

5 The normal minimum reserve is a passive reserve, because the banks have to deposit reserves with the central bank relating to components of their passive side—in this case, customer deposits.

6 When such means are used, of course, it is necessary to ensure that the tackling of a real estate bubble (for instance) does not simply shift the excess liquidity into a different bubble, e.g. on the stock market. In line with the initial hypothesis of redistribution of wealth, such excess liquidity can ultimately only be resolved by a redistribution from top to bottom.

increases in real estate prices in Portugal and against a stock exchange boom in Slovenia.

6. A New Culture of Banking Supervision

One of the very few specific statements in the CDU/CSU-FDP coalition agreement on financial market issues says that the supervision of banking should be pooled at the Bundesbank, and the concept of the single regulatory authority, the Federal Financial Supervisory Authority (BaFin), should be abandoned. However, just as the BaFin has been an embarrassing failure as a supervisory authority in the financial crisis, this is equally true of the Bundesbank, which is responsible for the "ongoing surveillance" of the banks.

The Federal Government and the two executive authorities, BaFin and Bundesbank, lack the serious political will to supervise the banks. This lack of political will found expression again and again in the parliamentary committee investigating the Hypo-Real-Estate crisis. The supervisory officials kept repeating the point that the supervisory authority is not the better banker, and therefore ultimately has to rely on the expertise of the banks and respect their decisions, since they know better in any case. In view of this pathetic lack of self-confidence, it is hardly a surprise that the financial supervisory authority has not once made full use of the limited powers it has to intervene during 20 years of deregulation.

Above all, we need a new culture of a "will to supervise" in the financial oversight system. Measured against this need, the Federal Government's planned pooling of the banking oversight at the Bundesbank is just a diversionary manoeuvre. First, the supervisory bodies need to be given further-reaching rights to intervene in the banks (e.g. to scrutinise business models); second, they must make effective use of these rights to intervene; third, they must have enough staff of the right quality; and fourth, they must be obliged to inform the government, the parliament and the public early on about any signs of gaps in their supervisory powers, and to ask for this to be remedied.

The shrinkage and the related stripping of power of the banks is itself an important contribution to better supervision. After all, this reduces the pressure on the supervisory authorities occasionally to "turn a blind eye" in the interest of keeping Germany competitive as an international financial centre. Often, the banks threaten to appeal to the administrative courts against decisions and measures taken by the supervisory authorities. Naturally, the legislature is called on here to increase the scope for the supervisory authorities to act: the clearer and more comprehensive the statutory rules are for day-to-day supervision, the less the supervisors will need to justify or defend in court the specific actions they take against the banks they are supervising.

The financial approval test described earlier on in this paper must be a central element of the financial oversight. By undertaking risk assessments in the course of an approval procedure for financial instruments, the supervisory bodies would have had information about the risks of certain financial instruments much earlier.

In parallel to a substantial strengthening and widening of the national supervisory structures, the banking oversight system also needs to be put on a European footing. The process which has begun in this direction at EU level is therefore welcome in the sense that it has at least identified structural weaknesses. But so far it has made a fairly timid impression when it comes to equipping the supervisory authorities with effective rights to intervene. Furthermore, it has been repeatedly delayed and watered down by certain national governments, and especially the Federal Government. The main point of contention is the extent to which a European financial oversight

can independently take supervisory action, and even close down a bank, or whether it may only make corresponding recommendations to national authorities. If there is to be truly effective European financial supervision, many national interests still need to be overcome or set aside. In particular, those member states with large financial centres like London and Frankfurt must not dominate the other countries in the common European financial oversight system. Similarly, the strengthening of European oversight structures must not be used as a pretext for a downward harmonisation of oversight standards.

The planned strengthening of the "macroprudential oversight", i.e. the monitoring of the systemic stability of the financial sector, is an especially important aspect of the European process of oversight reform. A substantial expansion of this field of oversight is certainly long overdue. But the planned transfer of this oversight function to a body based with the ECB leads one to doubt whether critical opinions from academia and civil society on questions of the stability of the financial system will actually be heard there. These doubts are mainly fed by the ECB's hardliner tradition on monetary and fiscal policy, and its quasi-religious emphasis on its "independence", especially from those who have different views. It has basically taken over both of these vices from the Bundesbank.

It is also necessary to criticise the fact that there are no sufficient guarantees of transparency of the findings and measures of the supervisory authorities in the context of the planned European System of Financial Supervisors (ESFS) and the European Systemic Risk Board (ESRB).

When an effective system of European financial oversight which has serious political backing has been set up, it will also make a lot of sense for it to work closely together with the public European rating agency mentioned above. After all, like the financial approval system, this would have a good insight into the potential risks, or the concentration and heightening of these risks, relating to certain financial market instruments and actors.

Outlook

The proposals made here on the structure and regulation of a future banking sector are not set in stone, nor do they claim to be complete. They should rather be regarded as a stimulus for debate; they also venture far into specific details on certain proposals (e.g. on the future shaping of the banks' control bodies). The paper provides such specific detail not because it believes it has already found the best possible solution in detail. Rather, the aim is to provide the reader with a specific concept for a positive version of a banking system of the future—going beyond the abstract principle of *socialisation*.

So it remains an ongoing task to make this utopia a reality and to fundamentally change the banking sector. There will continue to be a banking sector—that is unavoidable. We must ensure that society is not rolled over by the banks again. Society has it in its power to prevent this. It is up to it to actively shape the banking sector.

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