

Robert Schuman Centre for Advanced Studies

Who are the Agents of Europeanization?
EC Competition Policy and Germany's Public Law Banks

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European Forum

The European Forum was set up by the High Council of the EUI in 1992 with the mission of bringing together at the Institute for a given academic year a group of experts, under the supervision of annual scientific director(s), for researching a specific topic primarily of a comparative and interdisciplinary nature.

This Working Paper has been written in the context of the 2000-2001 European Forum programme on “Between Europe and the Nation State: the Reshaping of Interests, Identities and Political Representation” directed by Professors Stefano Bartolini (EUI, SPS Department), Thomas Risse (EUI, RSC/SPS Joint Chair) and Bo Stråth (EUI, RSC/HEC Joint Chair).

The Forum reflects on the domestic impact of European integration, studying the extent to which *Europeanisation* shapes the adaptation patterns, power redistribution, and shifting loyalties at the national level. The categories of ‘interest’ and ‘identity’ are at the core of the programme and a particular emphasis is given to the formation of new social identities, the redefinition of corporate interests, and the domestic changes in the forms of political representation.

An emerging focus of European Union studies concerns the impact of European integration on domestic policies and institutions. Among others, Simon Hix and Klaus Goetz suggest this debate is overdue, its emergence retarded by the long immersion of EU scholarship in efforts to explain the dynamics of the integration process.¹ Domestic politics have long served as an explanatory factor in accounts of the integration process, but only recently have themselves been viewed as a dependent variable.² Efforts to assess the relationship between the construction of Europe and domestic political change in the states and societies that comprise the European Union are in their infancy. As Markus Haverland notes, “the shaping forces and dynamics of national adaptation to European legislation are still poorly understood.”³

In a sense, the study of Europeanization – the impact of European integration on national political economies – constitutes a microcosm of the broader debate over globalization and its domestic impact.⁴ A crucial difference – and one that makes European integration a productive “laboratory” for studying the impact of external forces for domestic political change – is that the forces promoting domestic adaptation appear to be much more direct and “concentrated” in the EU. This is so for two reasons. First, for the countries of the European Union, economic integration represents a conscious attempt to foster increased competition within Europe’s internal market in order to promote prosperity. Second, to accomplish this, Europe’s single market process embodies a potent set of market-making mechanisms. The single market, in short, may be conceptualized as an efficient mechanism for transmitting forces of economic liberalization.

This essay asks how the focus of European economic integration on deepening competition encroaches on the ability of governments to use public sector resources to achieve political objectives. EU member countries, though varying considerably in their institutional configurations, are politically regulated market economies with wide-ranging public sector activities. Even in the first decade of the 21st century, the defining feature of the political economies of western Europe – of the “European model” of society – remains widespread, if varied, political regulation of the market economy. For several decades, public resources have been used to achieve a range of objectives by West European governments, from protecting jobs (most West European countries) to securing ties between government ministries and critical segments of the business sector (France), to undergirding federalism (Germany), to fostering redistribution of economic resources across regions (Italy). As Fritz Scharpf reminds us, the “market-correcting” policies pursued by West European governments in the postwar era have been undergirded by popular support as well as a belief that the ends sought through these measures represent legitimate policy goals of national governments.⁵ Therefore constraints imposed on these

policies by the single market process may “reduc(e) the capacity of national political systems to pursue democratically legitimized political goals.”⁶ Or, to view this from the perspective of European institutions, as Susanne Schmidt does, “the Commission has the potential to seriously interfere with those parts of the national economies that are *not* predominantly structured by market principles.”⁷

The case study that informs this paper – the application of European Community competition rules to Germany’s public sector banks – powerfully illustrates this point. The case demonstrates the critical role of European Community institutions in altering domestic political relationships. It also reveals the significance of resulting constraints on the ability of governments to pursue policy objectives through the public sector. Germany’s system of public law banks represent a core element of Germany’s federal structure as well as a central component of the social market economy. The state Landesbanken and local Sparkassen are charged with a series of public service functions, including regional economic development and support for small and medium enterprises – Germany’s vital *Mittelstand*. As a consequence, the public sector banks have developed tight political links with local and state level political party organizations. The public law financial institutions came under the scrutiny of the European Commission beginning in the early 1990s when Germany’s private sector banks raised questions about the impact on competition of the special financial support accorded the public law banks by the state and municipal governments that own them. By the second half of 2001, this process had prompted fundamental reform of the public law banking system marked by sharp erosion of the financial privileges from which they had benefited for more than a half century. Only the extension of European Community competition law to the public sector made this change possible. Attesting to the significance of the European Commission’s role in the reform of the Landesbanken and Sparkassen in the face of powerful domestic political opposition, one representative of Germany’s commercial banking federation asserted that “without Brussels, we would have achieved nothing here in Germany.”⁸

The case raises two critical questions. First, why does this transformation of Germany’s public law banks matter? And second, what does the case reveal more generally about the mechanisms underlying “Europeanization,” the process by which European integration affects national political economies?

First of all, the impact is potentially dramatic for German federalism, the social market economy, and Germany’s overall economic performance. The German federation of public savings banks (DSGV) has warned that the European Commission’s application of Community competition rules to the public law banks in effect establishes minimal capital return requirements – and

not only for public sector banks, but for public law institutions generally. This endangers the provision of public services by shifting the focus of these institutions toward profit maximization. Dramatizing the perceived threat to the public sector posed by the progressive extension of competition law to additional sectors by the European Commission, Germany's largest public law bank warns that "the Commission puts in jeopardy the future viability of all public-sector enterprises throughout Europe."⁹

The public law banks also make a substantial contribution to the constitutional obligation of the German government to equalize living conditions across regions. By inhibiting the regional development functions of the public sector banks, the Commission's application of Community competition law potentially undermines this federal principle of equality of economic opportunity for all regions.¹⁰ Furthermore, public savings banks are the primary bankers for Germany's *Mittelstand*, and finance a large share of business start-ups. To the extent that compliance with Community competition law diminishes the ability of the public law savings banks to perform this public service function, the single market imposes substantial constraints on a crucial dimension of the German strategy for promoting economic growth and employment.¹¹

In July 1999, the European Commission ruled that Westdeutsche Landesbank (WestLB), the largest of Germany's public sector banks, would have to return DM 1.6 billion to the state of Nordrhein-Westfalen because it had not paid a market rate of return on assets transferred to WestLB by the Land government. WestLB promptly challenged the Commission's decision in the European Courts. Justifying its action, WestLB asserted that "It is imperative that the Commission's decision be tested in the courts, given that it has far-reaching implications for any economic activity performed by the public sector."¹² Speaking in the Bundesrat the day following the Commission's decision, the Economics Minister of Nordrhein-Westfalen proposed that the Commission's decision could have dire implications for the entire public sector: "in the future every investment – literally every investment – by the public sector on behalf of public-law enterprises could be declared to be unlawful aid."¹³ Explaining the robust political defense of Germany's public law banks from a theoretical perspective, Richard Deeg writes that "the historical coalitions supporting this model of banking remain firmly committed to it, for its undoing would shock the very institutional core of the German political economy."¹⁴ Indeed, if the competition rules embedded in the single European market can bring about fundamental reform of such purposefully-designed, politically-entrenched, and staunchly-defended public sector institutions in the most powerful EU member state, are there any limits to the transformation of the public sector wrought by Europe's single market process? And, more generally,

what can the case of Germany's public sector banks reveal about the process of domestic political change wrought by European integration ?

Theoretical Approaches to Europeanization

Two concerns are central to the emerging literature on Europeanization. First, what are the mechanisms by which European integration generates the prospect of change? And second, what are the mediating factors that determine the contours of the outcome – i.e., the depth and timing of domestic political change? While intergovernmental bargaining may explain the decision to create Europe's single market, and the autonomy of the Community's supranational institutions is central to explaining the application of single market competition law to public services long governed by politics rather than market rules, the critical question that follows is this: what happens next? What are the consequences when Community regulation meets domestic political structures?

Theoretical approaches to the first question, concerning the dynamics of change, tend to focus on the way in which the European integration process alters the political opportunity structures of domestic political actors. Christoph Knill and Dirk Lehmkuhl cite changes in opportunity structures as the primary mechanism of change in areas of market-making or negative integration; the scope of change depends upon the extent to which European policies redistribute resources between domestic political actors.¹⁵ Similarly, Thomas Risse, Maria Green Cowles and James Caporaso shift the literature's lingering focus on the impact of European integration on the relative power of national executives to a broader consideration of the redistribution of power among a range of domestic actors. Underscoring the conception of Europeanization as a shift in opportunity structures, these authors work from the assumption that domestic actors will seek to take advantage of the availability of additional resources provided by the Europeanization process or the opening of new avenues to pursuing their objectives.¹⁶

Ultimately, the dimensions of domestic political change depend upon how effectively actors are able to exploit new opportunities. This generates the second question at the core of the study of Europeanization: what factors mediate between European-level forces for adaptation and domestic political outcomes? Clear specification of these factors is central to any theory of domestic political change. Most studies of Europeanization emphasize the significance of domestic political factors as mediating variables. Risse, Cowles, and Caporaso, for example, identify several factors that mediate between the adaptational pressures of Europeanization and domestic political structures, including the number of domestic veto points, the ability of formal institutional structures to facilitate change, and domestic organizational and policy cultures.¹⁷

Markus Haverland highlights the importance of institutional veto points, asserting that national systems with centralized structures (Britain, the Netherlands) adapt much more readily to European-level pressures than fragmented or decentralized polities that permit broad access to the policy making process (Germany).¹⁸ As these efforts to explain the scope of domestic political change demonstrate, ultimately two features form the kernel of any theory based on a model of changing opportunities and domestic responses. The first is agency – as Risse, Cowles and Caporaso assert, “institutions do not change institutions; actors do.”¹⁹ The second feature is the articulation of existing structures with the demands of Europeanization – that is, the relative resistance of domestic institutions to change.

In developing a theoretical approach to agency and institutional responses to external pressures, this paper builds on two insights provided by studies of political change outside the European integration literature: the study of institutional transfer, and the study of epistemic communities. The first insight, echoing the findings of Wade Jacoby’s examination of institutional transfer in his book, *Imitation and Politics*, is that domestic political receptors facilitate change. Criticizing existing approaches to the relative success of institutional transfer for portraying transfer either as inevitable (the literature on neo-liberal convergence) or impossible (due to path dependence or the embeddedness of institutions), Jacoby finds that successful institutional transfer requires domestic political agency, or the “pulling in” of institutional change by indigenous reformers.²⁰ Put differently, those pushing for change from the outside need domestic political allies. One of the strengths of this approach is that it avoids determinism: since domestic political change is neither inevitable nor impossible, outcomes remain uncertain.

This insight may be applied to the study of European competition policy and its impact on the public sector. One of the most significant emergent mechanisms favoring the broadening of competition is the ability of private sector actors who compete with public sector activities to utilize European-level institutional channels – the investigatory and enforcement powers of the European Commission and the European Court of Justice – to demand tighter application of European Community competition rules. In essence, the existence of multiple institutional levels comprising the European polity, along with the rigor of European Community competition policy, create a political counterpart to the economic aspect of capital mobility. This *political mobility* of capital derives from the ability of private sector actors to move outside regional or national political arenas in order to combat government practices that privilege public enterprises or reserve entire sectors for public services and thereby exclude private competitors. Hix and Goetz refer to this as a new opportunity for capital to pursue an “exit strategy.”²¹ This is a crucial

development because however privileged the position of business in national political economies, that privilege stops when it encounters the autonomous preferences of the state. Political mobility gives business added leverage to challenge government practices that protect public sector economic activities at the expense of private sector competitors.

Capital's political mobility can operate as a powerful weapon in the cause of economic liberalization. Private sector complaints have undermined elements of regional policy in Italy, overturning a public statute predating the single market that required that authorities purchase a fixed percentage of goods and services from firms headquartered in the Mezzogiorno. The ability of private capital to appeal to the Community regulator, the European Commission, and the European Court of Justice for firm application of competition rules enlists private sector interests in the process of opening public sector activities to competition. An opening to competition in a market segment previously monopolized by the public sector may invite in competitors who then become advocates for further competition. Furthermore, capital's political mobility can have critical consequences that extend to the European level. First, a complaint by a competitor can turn the application of EC competition policy rules toward a particular public undertaking. This may result in changes in the financial relationship between that undertaking and the state, or even in the institutional structure of the public service in question. But the effects may go beyond the single country in which the public undertaking operates. As Susanne Schmidt has shown, when restrictive practices in a country's public sector monopoly must be relinquished because they are declared incompatible with Community law, the government will change its position from defense of restrictive public sector practices to support for sectoral liberalization across the EC. This shift in national preference increases the likelihood of Council approval for Community-level action.²²

Private sector advocates of fuller competition may become critical strategic allies of a European Commission attempting to amass the support required to build a coalition of governments supportive of liberalization. Successful efforts by private sector actors to pursue interests at the European level therefore may reinforce the liberalization agenda of the European Commission, or even force the hand of a Commission that acknowledges the political need for gradualism and restraint in promoting competition. The consequence, as Fritz Scharpf writes, is that "no area of service public is now beyond the challenge of European competition law."²³

But is this form of agency – the political mobility of capital – sufficient to explain the scope and timing of the domestic political change fostered by EC competition rules? According to the political mobility of capital hypothesis,

domestic political change would follow the resort of capital to opportunities at the European level. This, in turn, would depend on the strength of capital's incentives to act at the European level. These incentives will be high when two conditions are met: competitors of public sector undertakings that benefit from restrictive practices face tight constraints on their ability to challenge those practices in domestic politics; and acting at the European level has a positive expected net benefit, meaning that benefits clearly exceed costs.

The first condition for capital to act at the European level holds especially in cases where financial arrangements for public services are codified in public or budgetary law that cannot be challenged in national courts. This is true, for example, of the institutional guarantees extended by municipal and state owners of German public law financial institutions, an arrangement that accompanies their public law status. Spain's public broadcasting companies receive grants from regional government authorities pursuant to budgetary laws. In these instances, private sector competitors are powerless to pursue claims in national courts that these provisions distort competition. The level of constraint on domestic political action also will be particularly high where relations between national government ministries and public enterprises are especially close and opaque, as in the French public sector. For private sector firms in this setting, complaining to the European Commission may represent their first chance to counterbalance the political potency of their public sector counterparts.

The second condition for private sector actors to take advantage of the opportunity to pursue their interests at the European level will be met when those actors can capture private benefits rather than generating public goods. For example, in the case of public tendering, even a well-founded complaint regarding violation of Community public procurement rules generates no benefit to the complaining party if the contract already has been awarded and the recipient of the contract already is providing the contracted good or service. Even where a contract award process must be reopened, the complaining party will perceive little likely benefit if there are a large number of firms competing for the contract. The incentive for private sector action will be far stronger in the case of a state subsidy in which termination or repayment of the illegal aid directly diminishes the ability of the public sector competitor to meet market needs and a small number of private sector firms compete for this share of the market.

Where these conditions are met, we should expect private sector actors to articulate their interests at the European level and the elimination or reduction of restraints on competition to follow. Once competitors call attention to impediments to competition due to restrictive public sector practices, the regulatory authority of the European Commission, backed by the legal authority

of the European Court of Justice, should drive the process of change. The variance of outcomes will correspond to the variation of incentives for capital to act at the European level – whether these vary cross-nationally or cross-sectorally.

Considering the question of agency leads to a second insight beyond that gleaned from Jacoby’s work on institutional transfer – this time drawn from the literature on epistemic communities. This point, which fundamentally challenges the hypothesis that the political mobility of capital determines the extent of required domestic political adjustments to the single market process, is that policy change may depend on the relative receptiveness of actors in dominant institutional positions. For epistemic communities to produce policy change, they need to do more than simply generate collective understandings of policy problems. The experts who act as carriers of these ideas must achieve influence in their domestic institutional settings in order to alter perceptions of interests in ways consistent with the ideas of the epistemic community and its policy prescriptions.²⁴ If this finding is generalizable and can be applied to the study of Europeanization, it suggests that changes in perceptions or strategies among actors in dominant institutional or market positions may be required to bring about shifts in domestic policies and institutional change. If this hypothesis holds, reliance on EC institutions by competitors would simply represent the initial phase of a process requiring support from those public sector actors entrenched in dominant institutional and market positions themselves. We would therefore expect a slower pace of change in response to European pressures. Not only would outcomes be more indeterminate than implied by simply tracing the extent of capital’s political mobility, but we would be especially likely to see variations across national settings – what Risse, Cowles and Caporaso refer to as “domestic adaptation with national colors.”²⁵

Table 1 outlines the competing hypotheses about the agents of change generated in this section and their respective implications for the pace and scope of change in public sector activities:

TABLE 1
DOMESTIC CHANGE AND AGENCY:
Politically Mobile Capital vs. Institutionally Dominant Actors

<i>Hypothesis</i>	<i>Mechanism of public sector change</i>	<i>Implied pace and scope of change</i>
Political mobility of capital	Change ensues when competitors of protected public undertakings choose to appeal to EC competition rules; where claims of restrictive practices are well-founded, application of competition rules by the European Commission, backed by the ECJ, induces change in domestic practices or institutional structures.	Varies with incentives of capital to take advantage of opportunities at European level faced by enterprises that compete with protected public sector undertakings.
Domestic mediators	When the European Commission applies competition rules to a sector (this may be the result of a complaint by a competitor, the request of national governments, or the Commission's own initiative), a political process ensues which involves negotiation both between the Commission and those domestic actors benefitting from state protection and <i>within domestic politics</i> . Only when critical domestic actors have revised their strategies or interests subject to new constraints will domestic reform take place.	Indeterminate. This depends on the political process that occurs among those actors – public sector monopolists and their political supporters – whose positions of market or institutional dominance are threatened by the application of EC competition rules.

The conflict that erupted in the early 1990s between Germany's system of public law financial institutions and Europe's single market process provides fertile territory for studying how Community competition rules foster change in the

public sector of domestic political economies. The dispute brought the institutional apparatus of the EC into confrontation with elements of German federalism and the social market economy. From the perspective of their proponents, the public sector banks represented the type of innovative institutional solution to the deficits of the market characteristic of the social market economy, insuring the provision of critical public services without undermining – and arguably enhancing – competition in the sector. Moreover, the close ties with local and regional party organizations enjoyed by the public law banks ensured their support across the political spectrum and safeguarded their legitimacy. In essence, the public law banks were thoroughly insulated from any genuine domestic political challenge; only the progressive extension of Community competition rules to the public sector and the existence of European Community institutions armed with significant enforcement powers in the realm of competition policy made a challenge to these structures possible.

Reflecting the enhanced political mobility of capital resulting from European economic integration, this challenge emerged from Germany's commercial banks, which saw in Community competition policy an opportunity to attack the privileges accruing to their competitors in the public sector by virtue of their public law status. Failing at the federal level to make their case that the public law financial institutions enjoy unfair advantages that distort competition, the commercial banking federation took its claims outside Germany's domestic arena, to the European Commission. In response, the European Commission had by the mid-1990s staked out a position that identified arrangements governing the public law segment of Germany's banking system as a violation of Community competition law. But did this mark the end of the process of domestic political change, or just the beginning?

The Public Law Banks: Public Services and Political Support

Characteristic of the German system of organized capitalism, the German banking sector incorporates a functional division of labor between different types of financial institutions. The banking system is comprised of three “pillars” – the profit-minded commercial banks, member-oriented cooperative banks, and a network of public law banks. The public law network includes a system of state banks (Landesbanken) as well as local savings banks (Sparkassen). Several factors have fostered deep institutionalization of the public law banks. First, within the three pillar structure of the German banking system, the different types of financial institutions have throughout much of the history of the Federal Republic engaged in activities that complement one another. For example, by providing banking services to Land and local governments and financing local and regional economic development, the public

law banks lend stability and dynamism to the entire banking environment. Second, the public sector banks can claim a high degree of historical continuity for the public service functions they perform, dating back to Imperial Germany. And finally, the close relationship between public law banks and their local and regional governments has fostered political support for the Landesbanken and Sparkassen that is independent of political ideologies and therefore spans the party system. This support reflects the degree to which the public law banks are a critical instrument of the policy autonomy of the Länder.²⁶

The savings banks trace their roots to the early 19th century, when they emerged to fulfill functions in an industrializing economy that were not met by the large-scale investment activities of the private banks. These included the provision of rural credit, financing for urban housing construction and small businesses, and banking services for lower- and middle-income households.²⁷ As the German banking system was reconstituted in the Federal Republic, the savings banks continued to perform these functions, growing in importance along with the sharp increase in private household savings.²⁸ The Landesbanken were established to serve as clearing banks for the networks of Sparkassen and to provide financial services to their state governments. The Landesbanken, which are owned by their state governments and regional savings bank associations,²⁹ comprise some of the largest banking institutions in Germany – half of the 20 largest as of the mid-1990s.³⁰

The public law banks provide a diverse range of public services derived from the fundamental principles of German federalism and the social market economy. These include commitments to finance and advise small and medium enterprises and to support local and regional economic development and cultural projects. Even as international capital mobility has increased, the network of public sector savings banks (Sparkassen) has remained attentive to the long-term financing needs of Germany's *Mittelstand*.³¹ The Sparkassen not only fund about half of Germany's new business start-ups, but also provide services such as small business advising and collective goods like technology centers and regional company networks.³² The Sparkassen and Landesbanken perform similar services for Germany's local governments, providing the majority of municipal loans, offering investment consulting to public administrations, and, especially in the case of the larger Landesbanken, acquiring shares in the interests held by individual Länder.³³ The Landesbanken also are intimately involved in regional economic development and restructuring. Each of the German Länder pursue structural policies intended to promote selected economic activities, such as investment in new technologies, housing construction, or environmental protection. The Landesbanken provide the financial services required to implement these policies.

Given the role played by the savings banks and Landesbanken in state and local government policy implementation, it is unsurprising that the public law banks benefit from broad political support from state and local political leaders. The public law banking system is even further interwoven with political leadership by the presence of government officials – from whichever parties govern at the regional or local level – on the boards of their Landesbanken or local savings banks.³⁴ Government officials, typically from state finance ministries, often move into top positions at the Landesbanken when they leave government service. In sum, the political ties of the public law banks are territorial rather than partisan. Since governing coalitions tend to be stable across localities and regions in Germany, but display substantial variation across the national territory, political support is deeply institutionalized, particularly across the two largest political parties, the SPD and CDU/CSU.

As implementation of Europe's single market accelerated in the early 1990s, then, Germany's public law banking system appeared to be well insulated from the reach of EC competition policy. The public law banks were extensively involved in the provision of public services critical to individual households, small businesses, municipal and state governments, and regional economic development, and had deeply-rooted political support from senior regional and local party officials. Moreover, while the European Commission in its application of Community state aid rules often had demanded the restructuring of entities dependent upon subsidies to keep them in operation, the public sector banks did not rely on state subsidies to meet their operating costs, but were in fact profitable, even as they provided public services.³⁵

Mobilization of Private Sector Competitors and Germany's Public Law Banks

The public law status of the savings banks and Landesbanken carries important benefits designed to compensate these financial institutions for their public service obligations and to insure that they will be able to carry out these functions. The three-pillar structure of the German banking sector facilitates public service provision within a competitive market environment. Conflict between the different types of financial institution in theory is muted provided that the activities of the three pillars remain complementary. However, the public law banks and commercial banks clearly compete with one another, and this competition has intensified since the 1980s with the liberalization of Europe's financial markets. The Landesbanken, in fact, are not only the primary financial institutions of their state governments and the central institutions of the regional savings banks, but also are universal commercial banks. The Landesbanken and their Land governments view earnings from commercial banking activities as crucial to their financial capacity to execute their public service functions. Conflict between different types of banking institutions is

driven by this competition. But the conflict that burst forth in the 1990s was not entirely new. During the debate over a new banking sector law in the early 1960s, for example, the private banks attacked the favorable regulatory and tax treatment of the savings banks as an unfair competitive advantage. While the tax exempt status of savings banks was eliminated in the late 1960s as savings banks profits grew in response to the rapid rise in private household savings in the Federal Republic, the conflict was hardly resolved, and commercial banks continued to complain about the privileged treatment of the public law institutions.³⁶

Even as implementation of Europe's single market proceeded in the late 1980s and early 1990s, Germany's Landesbanken and Sparkassen continued to enjoy substantial regulatory advantages. There were three dimensions to these benefits. First, state and local governments guaranteed both the institutional functions (Anstaltslast) and the liabilities (Gewährträgerhaftung) of their public law banks. This means that Land governments were committed to providing their public sector banks with the resources necessary to fulfill all of their functions. The full guarantee of bank liabilities meant that both depositors and creditors could be certain that their funds were protected.³⁷ As a direct consequence of these guarantees, the public sector banks obtained higher credit ratings. This, in turn, lowered their borrowing costs.³⁸ Indeed, in 2000 there were 22 public sector credit institutions that garnered a "Triple A" rating from credit agencies in Germany, as well as 4 in Austria. Only 5 additional banks in the entire EU matched this rating.³⁹

A second benefit accruing to the public sector banks also relates to their liability guarantee and consequent high credit ratings. Because they did not have to fear the impact of investment risk on their credit ratings and costs of raising capital, the public sector banks could engage in higher-risk investments than financial institutions in the commercial sector. This enabled the Landesbanken in particular to extend their influence far beyond their regions. Westdeutsche Landesbank, for example, the largest of the Landesbanken, does more than one-third of its business abroad, and earns two-fifths of its returns there.⁴⁰ It is particularly strong in East Asia, an especially high-risk investment market. Under its politically powerful chief executive, Friedel Neuber, WestLB also pursued ambitious expansion plans in London financial markets, in French banking and insurance, and, after 1989, in East European markets. In short, in response to financial market liberalization, the Landesbanken beginning in the late 1980s became deeply involved in corporate lending and international investment banking, competing directly with large commercial banks in Germany and other European Union countries.⁴¹

Finally, governments demanded far lower returns on their equity from public sector banks than private shareholders expected from the commercial banks. As Sinn argues, government capital invested in public sector banks should on economic grounds earn *higher* returns than equity in private banks precisely because of the liability guarantee carried by that capital. In fact, the public sector banks consistently provide lower returns on capital than the private banks.⁴² Moreover, the public law status of the Landesbanken, coupled with their intimate role in the implementation of Land level policies, makes them a natural destination for state resources earmarked for regional development functions. This is illustrated by the 1991 decision of the state parliament of Nordrhein-Westfalen to integrate its Housing Promotion Agency (Wohnungsbauförderungsanstalt, or Wfa), which had operated as an independent public law institution from its founding in 1957, into the Westdeutsche Landesbank. This step ultimately brought the internal German conflict between different types of financial institutions to the European level and triggered the application of European Community competition law to Germany's public law banks.

The government of Nordrhein-Westfalen justified the transfer of Wfa assets totaling DM 5.9 billion to WestLB as a means of reducing the cost of administering the Land's low-cost housing development programs.⁴³ According to the Land government, plans to achieve greater administrative efficiency in the housing promotion program had been under discussion since the 1970s.⁴⁴ But the transfer also accomplished an increase in capital needed by WestLB to comply with capital adequacy rules established in the 1988 Basle Convention.⁴⁵ Indeed, five additional state governments – Lower Saxony, Berlin, Schleswig-Holstein, Hamburg, and Bavaria – emulated the Nordrhein-Westfalen maneuver as a means of meeting the new capital requirements. Transfer of the housing program assets was therefore an alternative to privatization, a new issue of shares by the bank (a step WestLB's private sector competitors had to take in order to achieve capital adequacy), an injection of capital from the state budget in a time of fiscal scarcity, or a contraction of the bank's business in order to restructure its risks. But the transferred assets also exceeded the amount needed by WestLB for capital adequacy, and therefore permitted WestLB to expand its commercial activities.⁴⁶ Germany's commercial banks, which had hoped in vain that the Bundesaufsichtsamt für das Kreditwesen, Germany's banking supervisory body, would not permit the public sector banks to treat the housing development assets as core capital, viewed this as a serious threat given the aggressive expansion undertaken by WestLB since the late 1980s.

In response, WestLB's private sector competitors sharpened their attack on the benefits accruing to the public sector banks. The Bundesverband deutscher Banken (BdB), Germany's federation of commercial banks

(representing approximately 300 privately owned banks, including the giants Deutsche Bank and Dresdner Bank) argued with increasing vehemence that the privileges of the public law banks limited their growth potential in the domestic German market, while public resources subsidized the far-flung investment banking and corporate lending activities of the Landesbanken abroad. Lodging a complaint with the European Commission in 1993, the commercial banks initially sought to have the integration of the Wfa declared invalid based on the capital adequacy directive adopted by the European Community in the wake of the Basle Accord. However, the Commission's internal market Directorate General was reluctant to overrule the approval of the measure by Germany's federal banking supervisory authority. The BdB then took a different approach, complaining to the European Commission's competition policy DG that the increase in the bank's equity capital comprised an illegal state aid that distorted competition in the single market because WestLB had not paid an adequate rate of return on the capital.⁴⁷ The BdB sought to exploit the political opportunity opened by the increasingly aggressive enforcement of state aid rules from Brussels.

Acutely aware of the intensely political nature of the issue, the Community's Competition Policy Commissioner, Karel van Miert, encouraged Land NRW, WestLB, and the commercial banking federation to resolve the issue internally. Such an approach also was favored by Germany's federal Finance Ministry, which wished to prevent conflict with Brussels and avoid tension with the Länder. Hoping to facilitate a German solution to the problem, the Commission participated in 16 meetings with German federal and state authorities, representatives of WestLB, and of other Landesbanken between July 1994 and June 1997.⁴⁸ However, confident that it could justify the rate of return paid to the Land government and in the power of its political support, WestLB was not willing to offer enough of an increase in its return to the state to satisfy the BdB.⁴⁹ After several rounds of discussion facilitated by the federal government and including the Bundesverband Oeffentlicher Banken (VÖB), the association of public sector banks, the BdB announced that it was no longer prepared to participate in talks at the national level, and that it would pursue the issue exclusively in Brussels.⁵⁰

In January 1997, the Commission's competition DG informed the Landesbanken and commercial banks of its intention to open a formal investigation of the Wfa case. The VÖB, whose chairman, Friedel Neuber, also served as chairman of the WestLB, argued that in pursuing their complaint, the commercial banks were simply reacting to the growing market presence of the public sector banks. The VÖB joined the smaller DSGV, the Federation of German Savings and Giro Banks, in a threat to withdraw support for European

monetary union.⁵¹ However, the threat was counterproductive and opened the first cracks in the political defense of the public law banks. The position came under widespread attack in the German press. The FDP parliamentary party labeled the effort “attempted blackmail,” calling it “a typical example of the inclination of the public law sector to block competition.” The FDP declared that “The interests of the public law banks cannot be placed before that of Germany’s competitive position and before the goal of European integration.”⁵² Germany’s commercial banks, on the other hand, now hoped that the Westdeutsche Landesbank case would draw the European Commission’s attention beyond the matter of the state housing development funds to the much more significant issue of state loan guarantees extended to the Landesbanken. Unwilling to take on this politically sensitive issue directly, the BdB hoped the Commission would embark on a more far-reaching scrutiny of the German banking system.⁵³

Guarantees Under European Scrutiny

At the June 1997 intergovernmental summit, the German government secured the agreement of other member state governments to a “Declaration of Public Credit Institutions” annexed to the June 1997 Amsterdam Treaty. The statement acknowledged that Germany’s public credit institutions are entitled to full compensation for the public service functions they perform. Some supporters of the public sector banks believed they had built a fire wall against any possible Commission intervention on competition policy grounds. In a press release, the DSGV presented its interpretation of the declaration, asserting that “The European Commission acknowledges that the member states have the right to self-determination in the structuring of their financial infrastructure.” From the perspective of the savings bank federation, the declaration confirmed that “the organizational form and activities of the Sparkassen and Landesbanken are fully compatible with European Community competition rules.”⁵⁴

Why wasn’t this declaration, accepted by the national governments of all EU member states, sufficient to protect the public law banks against the reach of Community competition policy? The declaration was in fact an egregious defeat for the public sector banks and for the German Länder. In seeking an intergovernmental agreement to protect Germany’s unique public law banks, the German federal government was acting at the insistence of the Länder. Concern among the Land governments about the application of Community state aid rules to the public law banks was heightened by the European Commission’s January 1997 decision to open a formal investigation into the transfer of housing development resources to WestLB. In February 1997, the Land government of Schleswig-Holstein, occupying the rotating Bundesrat presidency, introduced a

draft resolution concerning the broader question of state guarantees. The resolution called upon the federal government to seek agreement in the intergovernmental conference to a protocol to Article 222 of the EC Treaty (which commits the Community to neutrality regarding public vs. private ownership) which would declare that state aid rules do not apply to the institutional and liability guarantees of the public law banks.⁵⁵ The resolution was adopted unanimously by the Bundesrat. In short, the Länder sought to preempt any threat to the status of the Landesbanken and Sparkassen by explicitly excluding them from Community competition rules. The resolution sought legitimacy by basing its defense of the public law banks on the need to preserve the diversity of governing structures and forms of public sector enterprise throughout the EU. The Kohl government had been reluctant to take up this initiative because of its broader support for the Community state aid regime and its fear of losing political credibility within Europe in the area of competition policy.⁵⁶ But Chancellor Kohl came under severe pressure from the Minister-Presidents of several Länder to pursue the idea of writing protection of the public law banks into the Treaty revision.

The protocol sought by the Länder would have had legal force. However, the German government was unable to obtain support for such a measure in the European Council.⁵⁷ The declaration obtained by the German government, which is not attached to a Treaty article and has no legal significance, simply states that compensation should be strictly limited to that required by public service duties.⁵⁸ Moreover, the declaration refers to the Commission's view that Community competition rules permit compensation for services of general economic interest performed by Germany's public law credit institutions. The statement therefore left open the question of the admissibility of state guarantees of bank liabilities. Ultimately the German government's effort to secure protection of the public law banks was important by virtue of its perverse consequence: it publicized the guarantees behind the Sparkassen and Landesbanken, until then a feature of the social market economy little-known outside Germany, and made the system a focus of scrutiny at the European level. Representatives of the German government and of individual Länder describe this as a case of the German government having "shot itself in the foot."⁵⁹

After the Amsterdam declaration, there remained opposition to the benefits granted to the Landesbanken from other member state governments and from the European Commission, which expressed concern about the ability of the large Landesbanken to use state guarantees of their liabilities to obtain more favorable credit ratings.⁶⁰ Competition Commissioner Karel van Miert had expressed the view as early as 1996 that the system of guarantees was inconsistent with EC competition policy. The Commission had come under

heavy political pressure from the German government not to pursue this issue, and again called upon the Landesbanken, Länder, commercial banks, and federal government to resolve the matter internally. In order to intensify the pressure for a German resolution to the guarantees problem, the Commission in November 1998 presented before the Council of member state Economics and Finance Ministers (ECOFIN) its report on public service provision in the banking sector, which indicated that the guarantees represented illegal state aid.⁶¹

The report was designed to address the claim that the Landesbanken and Sparkassen were exempt from Community state aid rules by virtue of their provision of services of general economic interest – in other words, according to Treaty article 90(2). In the report the Commission challenged the justification for the guarantees provided to the public law banks on three fundamental grounds. First, simply providing a national financial services network across all regions does not by itself constitute a service of general economic interest. Where a service offered can be provided by a market actor, any compensation provided by the government violates EC competition rules. The report contrasted the German public law banking system with that in Sweden, where a public credit institution set up under the auspices of the postal service is required to serve sparsely-populated areas not served by any other credit institution, and is justly compensated for performing that public service function. As for financial services for regional and local economic development, the Commission asserted that these must be evaluated on a case-by-case basis. Were the states and municipalities to allow all financial institutions to offer these services on a fee basis, some would in fact be offered by profit-motivated commercial banks. Moreover, in cases where state assistance is provided to institutions set up for exclusively public functions, such as raising capital for state governments, government support “may not spill over in any way into competitive activities of the institution.”⁶² Compensation for public service functions, that is, can not cross-subsidize commercial activities.

The Commission’s report also purposefully noted that state aid to savings banks with purely local impact does not come under state aid rules when the activities of local banks do not affect trade between member states. This point signalled that the dispute over state guarantees could be resolved with minimal disruption to the small and medium Sparkassen. But the defense of the public law banks from German political leaders repeatedly underscored the unity of the system. It was only two years later, in the context of discussions over reform of the public law banks, that the local Sparkassen began to perceive a clear difference of interests from the Landesbanken.

The WestLB Ruling

By mid-1998, the European Commission in the course of its formal investigation of the Wfa transfer to WestLB had received comments from two additional national banking associations – the French and the British – in support of the BdB complaint. The Association Francaise des Banques pointed specifically to the boost given by the asset transfer to WestLB’s presence in France’s municipal finance sector.⁶³ Meanwhile, the European Commission staked out a clear position on the issue of state guarantees, indicating that those provided to the Landesbanken violated EC competition rules. Significant support for the Commission’s position emerged among EU member state governments; at the November 1998 ECOFIN Council, the German government was isolated in its opposition to the Commission’s report.⁶⁴ But the Sparkassen and Landesbanken were able to draw on extensive cross-party political support in the early stages of the controversy.

Despite high-level political opposition, the European Commission in July 1999 ruled that WestLB would have to repay nearly DM 1.6 billion (\$868 million) of aid to the Land of North Rhine Westphalia. The Commission reasoned that a market investor would have demanded a higher rate of return than that received by the Land government for the housing development funds transferred to West LB. The kernel of the Commission’s position was that while member states are free to use public assets to achieve policy objectives, market economy rules apply once those assets are used for commercial activities. As phrased in the Commission’s decision, “as soon as the State decides to assign public-purpose assets to a commercial use, it should seek a remuneration corresponding to market terms.”⁶⁵ According to the Commission’s assessment, the state of Nordrhein-Westfalen did not seek such compensation in the case of the Wfa asset transfer; the repayment demanded reflects the difference between a market rate of return and that paid by WestLB, plus interest.⁶⁶

The Commission’s decision had significance far beyond the immediate case of the transfer of capital to WestLB in 1992. Within months after the new Commission assumed office in May 1999, the competition directorate under Commissioner Mario Monti began investigating cases involving similar infusions of capital into six additional Landesbanken.⁶⁷ Germany's Federation of Public Banks (VÖB) reacted with outrage, asserting that the Commission’s objective was to alter Germany’s institutional structures and system of property ownership.⁶⁸ The VÖB insisted that since the banking structure is a core part of the social market economy, and essential to funding local and regional development, it lies outside the jurisdiction of the European Commission. Referring to principles of subsidiarity and a “Europe of the regions,” the VÖB called upon the European Parliament and the German Bundestag to impose

tighter controls on the activities of the European Commission. Arguing along similar lines, and reflecting an unusual cross-party political alliance with the CSU's Edmund Stoiber, Bavarian premier, Henning Scherf, SPD leader of the Bremen government, called the progress of European integration a danger for federalism.⁶⁹ And in defiance of Brussels, the Bundesrat on the day following release of the Commission's decision in the WestLB case passed a resolution defending Germany's public sector banking system.⁷⁰

WestLB and the state of Nordrhein-Westfalen adopted a two-track response to the Commission's decision. First, both WestLB and Nordrhein-Westfalen challenged the decision in the European Court. However, since a legal challenge does not have a suspensive effect according to EC law, WestLB was required to comply with the Commission's decision unless and until it is annulled by the courts. Accordingly, the government of Nordrhein-Westfalen offered to take a larger equity stake in WestLB in lieu of a cash repayment of the aid. The Commission ruled out this approach, asserting that it would not compensate for the advantages accruing to the Landesbank from the use of state funds.⁷¹ Germany's federal government also filed a complaint against the European Commission in the ECJ. Given the SPD/Green coalition's reliance on the opposition-controlled Bundesrat to endorse its program of tax and pension reforms, and the fact that the threat to the Landesbanken and Sparkassen affected every Land government, the federal government had little choice but to support the legal action of Nordrhein-Westfalen and WestLB.

The public sector banks remained determined to use their political leverage to force the Commission to back down. Several political leaders at the state level threatened in the year immediately following the decision on the WestLB case to use their power in the German Bundesrat to block any proposed institutional reforms designed to prepare the EU for enlargement. Noting that some EU issues still require unanimous support from member state governments, Detlev Samland of the SPD, Nordrhein-Westfalen's Minister for European Affairs, warned that "The Commission must consider very precisely if it really wants a legal confrontation with Germany."⁷² Samland's threat to veto institutional reforms was seconded by Henning Scherf, premier of Bremen, and Edmund Stoiber of Bavaria.⁷³ As of early 2000, the conflict between European Community competition rules and central elements of German federalism and social market economy appeared irresolvable.

Resolution on German Terms? The Koch-Weser Group

Although the decision on the WestLB state aid case directly involved only a single Landesbank, the decisive classification of the transfer of housing development assets as an illegal state aid clearly affected additional Landesbanken. Moreover, the emerging scrutiny of the entire system of state guarantees provided to all Landesbanken further indicated the need for a coordinated response. At a formal level, Community state aid rules identified the federal government as the partner of the European Commission responsible for implementation of a state aid decision. In the months following the WestLB decision, the Minister-Presidents of the Länder called upon the federal government to coordinate negotiations over a solution to the problems faced by the Landesbanken. The result was the formation in fall 1999 of the Koch-Weser group, an informal roundtable led by Caio Koch-Weser, State Secretary at the federal Finance Ministry, and including representatives of the public sector institutions. The purpose of the Koch-Weser group was to facilitate discussions between the public law banks of measures that could resolve the conflict between state guarantees and EC competition rules and to carry out negotiations with the European Commission.

From the outset, there were critical cleavages within the Koch-Weser group. One cleavage ran between the federal and Land governments. The federal government accepted the legitimacy of the Commission's involvement, preferred to minimize conflict with Brussels, and therefore wished to find a way to rapidly resolve the issue. The Länder rejected Brussels' authority and believed that Germany's public law structures were outside the competence of the Commission. Officials from the Länder hoped to negotiate a new understanding about the scope of Community competition law rather than redefining the structure of the Landesbanken, to which they hoped to make no more than marginal adjustments. In spite of this divide, the federal government recognized that it would be very costly politically to impose its will on the Länder, and did not attempt to do so. A second cleavage ran through the Länder themselves, a product of the different structures and levels of dependence of their Landesbanken on commercial activities to fund their public service functions; this cleavage deepened as market conditions intensified pressures, especially on WestLB, for decisive steps toward reform.

The Koch-Weser group considered several options for addressing the incompatibility of state guarantees with Community competition rules. One possible resolution, supported by some CDU/CSU politicians at the federal level, was for the public sector banks – both Landesbanken and Sparkassen – to pay a market rate of interest to state governments for the capital to which they have access and a market rate of return on the guarantees provided to them. The

CDU/CSU parliamentary group's competition policy spokesman, Hartmut Schauerte, argued that such an approach would not only improve competition in the banking sector, but also would carry fiscal benefits for state governments and improve the international reputation of the German financial sector.⁷⁴ But this proposed resolution of the tension between state guarantees and EC state aid rules ultimately proved unviable. Since the guarantees provided to the Landesbanken were for an unlimited amount and duration, determining a market premium would prove difficult. The potential for controversy over the amount paid would prolong market uncertainty; as discussed below, the value of certainty increased over time for WestLB and the other Landesbanken.

Splitting commercial activities from public service functions represented a more definitive solution. Operationally separate, the latter would continue to benefit from state guarantees; the former would no longer be underwritten by the state. Such a breakup of the bank's operations might or might not be accompanied by privatization of the commercial unit. Though careful to emphasize that it had nothing to say about the ownership structure of Germany's public banks, the European Commission encouraged a comprehensive and final resolution of the conflict through the splitting off of private from public functions. While notifying the German government officially in January 2001 that state guarantees of the Landesbanken constituted a state aid incompatible with Community law, the Commission also underscored that since the system of public law banks predated the EC Treaty, the guarantees would be treated as "existing aid." Consequently, the Landesbanken were not liable for repayment of the value of past state guarantees, and the guarantees provided on any debt already issued would remain in place. Despite these incentives to comply with Community competition rules, both the Landesbanken and Land governments remained hesitant to fundamentally restructure the public law banking system.

The Interests of the Public Sector Banks Redefined

Until fall 2000, the official position of the Koch-Weser group reflected an unwillingness of the Land governments to yield to the Commission. The Länder continued to wage a positional war against the application of Community state aid rules, insisting both that the Commission's assault on the Landesbanken was inconsistent with the principle of a "Europe of the regions" and that the guarantees did not in any case constitute state aid. However, during the course of 2000, the political base undergirding the Landesbanken began to weaken. A shift in perceptions of the Landesbanken and Sparkassen among German political elites created the necessary conditions for a resolution of the conflict.

How was this possible given the deep institutionalization of Landesbanken and Sparkassen political support? As state and local politicians declared their defiance of the Commission in the months following the WestLB decision, no one, including Germany's BdB, had yet lodged a formal complaint about the liability and institutional guarantees. In December 1999, this changed. The European Commission received a formal complaint from the European Banking Federation (EBF) alleging that state guarantees gave a competitive advantage to Germany's public sector banks within the euro-zone.⁷⁵ The complaint specifically named three of Germany's public law institutions: Westdeutsche Landesbank, Stadtsparkasse Köln, and Westdeutsche Immobilienbank, but chose these institutions from different segments of the public law sector in order to target the entire system of guarantees. The EBF essentially served as a vehicle through which the BdB channeled its complaint to the Commission. The Commission itself had encouraged the complaint by repeatedly admonishing the BdB that it would not proceed in the absence of a formal complaint. With the complaint in hand, the Commission could claim that it had no choice but to apply state aid rules to the guarantees provided to the public law banks. Recent European Court cases in which third parties had won judgments against the Commission for failing to act on their state aid complaints – as in *Telecinco*, the Spanish public broadcasting case – lent credibility to the Commission's claim.⁷⁶ And since the complaint came from the European level rather than directly from the BdB, it signalled that this was not simply a matter of Germany's commercial banks attempting to gain competitive advantage. Rather, the case involved a breach of Community competition rules with Europe-wide implications.

The support for Germany's private banks provided by the EBF further undermined the position of the Landesbanken and contributed to an erosion of their support from the political parties at the federal level. Unsurprisingly, the FDP, freer to take up the cause of the commercial banks both because of its programmatic commitment to liberalism and its lesser political stake in the fate of the Landesbanken and Sparkassen, was first to condemn the position of the public sector institutions. But the critical blow – to the Landesbanken in particular – came when the national leadership of the large parties began to view their position as untenable. In July 2000, the European Affairs spokesperson for the CDU/CSU parliamentary group, Peter Hintze, asserted that the Landesbanken had far overstepped their initial mission, and had become “overly large, internationally active investment banks.” Hintze called for full privatization of the Landesbanken. Most significantly of all, he justified the European Commission's case in terms of Germany's domestic political needs: “fair competition is a central requisite of the functioning of the social market economy.”⁷⁷ Similarly, the CDU/CSU parliamentary group's competition policy spokesman, Hartmut Schauerte, argued that “The time for privileges that narrow

competition has passed,” and that “From the perspective of competition, the European Commission can not decide otherwise than to prohibit these privileges.”⁷⁸ And Friedrich Marz, leader of the CDU/CSU Bundestag delegation, argued that the Federal Republic lacks an instrument of national subsidy control; by providing effective control of subsidies for Germany’s public sector banks, Brussels was filling in this gap.⁷⁹

In Nordrhein-Westfalen, Christian Democrats on WestLB’s executive committee began to promote splitting up and partial privatization as a solution in 2000. Following a series of municipal election victories that gave the CDU control of local savings banks with seats on WestLB’s supervisory board, the CDU gained control of the board. Jurgen Ruttgers, NRW’s CDU leader, in November 2000 announced the board’s support for breaking up and partially privatizing WestLB.⁸⁰ But CDU leaders were clear to distinguish the fate of the Landesbanken from that of the Sparkassen.⁸¹ European Affairs spokesperson for the CDU/CSU parliamentary group, Peter Hintze, argued that the legitimacy of the regional responsibilities of the Sparkassen must be fully distinguished from the case of the Landesbanken, and that their role should be determined by local political leadership.⁸² Moreover, some state level political leaders began to rally around the Sparkassen at the expense of the Landesbanken. Wolfgang Clement, Minister-President of Nordrhein-Westfalen, argued before a BdB forum that the European Commission must make it clear “that the German savings bank system – as we know it today – remains.”⁸³ The president of the federation representing the *Mittelstand* (Bundesverband mittelständische Wirtschaft) endorsed this position, while deriding the Landesbanken for “juggling currency and shares in the Far East.”⁸⁴

At the federal level, the governing SPD publicized its view that the Landesbanken could not legally defy Brussels, and tried to craft a compromise solution. In a July 2000 meeting with representatives of the states, Chancellor Gerhard Schröder proposed that the public credit institutions establish a barrier between public functions and commercial activities (with the former backed by state guarantees). The reactions to this general approach did not break neatly along party lines; the concept of splitting Landesbank activities was rejected by Henning Scherf, SPD leader of the Bremen government, Edmund Stoiber (CSU), Minister-President of Bavaria, and Bernhard Vogel (CDU), premier of Thuringia. Others, including Peter Steinbrück (SPD), Nordrhein Westfalen’s finance minister, and Sigmar Gabriel (SPD), premier of Lower Saxony, were more supportive of Schröder.

As the federal/Land cleavage became more pronounced, pressure on the Koch-Weser group intensified. The Commission’s decision in the WestLB case and its formal announcement that state guarantees constituted illegal state aid

created market uncertainty for WestLB, which began to experience a small but observable impact on its cost of raising capital. This, as much as the threat of Commission action on the EBF complaint, provided WestLB with a powerful incentive to seek a final resolution of the conflict with the Commission.⁸⁵ The Commission's investigation of capital transfers to other Landesbanken had a similar impact, concentrating the attention of the Landesbanken on a decisive settlement. In this context, discussions in the Koch-Weser group advanced. In February 2001, a delegation led by Koch-Weser and Peer Steinbrück, Finance Minister of Nordrhein-Westfalen, proposed to the Commission a plan for splitting the public service and commercial operations of WestLB – the latter representing about four-fifths of the bank's assets. The Commission raised several doubts about the proposal, including questions about where the line between the two portions of the operation would be drawn and whether there might remain possibilities for the commercial segment to subsidize the public service portion of the business. The WestLB plan called for a parent public sector institution to provide a letter of unrestricted guarantee to its commercial subsidiary, for which the subsidiary would not provide any remuneration.⁸⁶ But the Commission also expressed reservations in response to efforts of the Land government to protect the state's system of Sparkassen. The restructuring proposal was limited to the Landesbanken and did not address the situation of the Sparkassen, for which it sought to maintain preferential financing terms and to secure an exemption from the EC public sector transparency directive, which in July 2000 had been extended to cover the banking sector.⁸⁷

At the same time, officials of the larger Sparkassen recognized that, with Sparkassen Köln mentioned specifically in the EBF complaint, the savings bank sector would not remain untouched by the application of Community competition law. But the Sparkassen are less dependent than the Landesbanken on liability guarantees because they raise capital primarily through customer deposits rather than through capital markets. Therefore, rather than undergo the sort of scrutiny and uncertainty experience by the Landesbanken, officials of the large Sparkassen came to favor reforms that would remove any doubts about the compatibility of their activities with Community state aid regulations. The smaller Sparkassen, focused exclusively on local or regional markets, still hoped to emerge from the conflict intact.

In May 2001, the European Commission informed the German government that it had 2 months to accede to the requested reform of its guarantee scheme for public law banks and until the end of September 2001 to inform the Commission about how it would accomplish this. Germany would then have until March 31, 2002 to implement the specific measures agreed to achieve compliance.⁸⁸ The solution that emerged from the Koch-Weser group involved the elimination of the liability guarantee (*Gewährträgerhaftung*). The

institutional guarantee (Anstaltslast) is provided to undertakings of the public law form as a matter of German law. But according to the measures adopted to establish compliance between public sector banks and Community law, Anstaltslast would operate with the provision that if the guarantee is used, it will be informed to the Commission as a state aid and subject to the Commission's approval according to the terms of EC competition rules. Reflecting the varying perspectives of the Landesbanken, this arrangement would form the basis of a "platform model" around which the different Landesbanken could structure their own arrangements.⁸⁹ Finally, in June 2001, the German delegation to the European Commission abandoned the insistence on providing a guarantee to WestLB's commercial division, clearing the way for a final settlement of the conflict between Germany's public law banking system and EC state aid rules. The principal issue remaining for negotiation concerned the transition period for eliminating the liability guarantee. The Bavarian state government proposed a period of 10 years, to the Commission's suggested four. But this is a matter of when reforms will be completed; that fundamental reform will take place, and that it will involve a clear separation between public services and commercial activities, are no longer matters of contention.

Conclusion: Domestic Intermediaries of Change

Reflecting a widely-shared view of the magnitude of the change involved, Bavaria's Finance Minister has called the reform of Germany's public law banking sector "a revolution."⁹⁰ It is likely that the rump public service components of the Landesbanken will be substantially depoliticized. Without the profits obtained from commercial activities, the Landesbanken may not be able to provide as extensive an array of public goods as they have in the past. Nonetheless, with the system of local and regional Sparkassen intact, the social market economy model endures, and is perhaps invigorated by the purging of the increasingly internationalized and commercial components of the large Landesbanken.⁹¹

But it is the dynamics of change emerging from the conflict between EC competition rules and Germany's public sector banks that are especially interesting. The dramatic restructuring of Germany's public sector banks, so deeply rooted in German political and economic development and intricately embedded in German federalism, would not have been possible without the emergence of the European level as an alternative arena of interest articulation and a supplementary regulatory mechanism. At the same time, the application of European Community regulatory instruments was hardly mechanical. The process was protracted and involved extensive bargaining both between the European and German levels and within the German political arena.

The application of Community competition law to Germany's public sector banks was a product of two factors: the aggressive expansion of the business of the public sector banks into commercial activities, intensifying direct competition with the private sector; and enhanced opportunities for private sector actors – in this case the BdB, the association of Germany's commercial banks – to challenge at the European level restraints on competition emerging from domestic institutional arrangements. But even though the European Commission, charged with enforcing single market competition rules, found potential merit in the BdB complaint, it encouraged resolution through a domestic political process rather than a European one. Had the threat of Community-level action been perceived as credible by those actors in the most powerful institutional and market positions – particularly the Finance Ministry of Nordrhein Westfalen and top officials of the Westdeutsche Landesbank – a bargain might have emerged within the German political arena. However, the domestic bargaining environment was highly asymmetrical, with Land governments and Landesbanken officials confident that the public law banking system was politically immunized against the application of EC competition rules and therefore facing few incentives to make concessions to the claims of the commercial banks. Within the main political parties, national level leaders that might have preferred a domestic resolution to conflict with the European Commission were constrained by their political need to support the Länder and their own regional party leadership.

Even after the process became “Europeanized,” involving the European Commission and the formal application of Community competition law, the dimensions of reform did not fully emerge until politically central actors in German politics began to recast their conceptions of the nature and role of the Landesbanken and Sparkassen in the political economy of the Federal Republic. In other words, the Commission's competition policy enforcement powers did not lead directly to a resolution of the conflict, which required a long process of negotiation with institutionally powerful actors. Only in the second half of 2001, nearly a decade after the original complaint by the private sector banks regarding the status of the public sector financial institutions, did Germany's Land governments, Landesbank officials, the federal government, and the European Commission approach the terms of a solution that would bring the public law banking system into compliance with Community competition rules.

“Europeanization” had two effects. First, the pressures faced by the Landesbanken to resolve the incompatibility with EC competition rules were directly proportional to their involvement in international markets. WestLB thus faced the most intense pressures, and became anxious to comprehensively resolve the EC competition policy cases pending against it. Second, beginning from a conception of the Landesbanken and Sparkassen as tightly-knit

components of a unitary, inviolable public sector element of the social market economy, first federal-level leaders of the major political parties, then regional politicians, began to distinguish the Landesbanken from the Sparkassen, identifying the latter as the vital core of the public law banking system. These elites had to redefine their understanding of the relationship between the public law banks and the social market economy. In this sense, while the European single market was the driving force of change, those national party leaders who viewed the restructuring demanded from the European level as consistent with the values of Germany's social market economy served as intermediaries in the process of change.

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ENDNOTES

1. Thomas Risse, Maria Green Cowles, and James Caporaso agree, asserting that “much of the literature on European integration...treats the process of integration as the end point of a causal process beginning with domestic and transnational societal interests and ending with European outcomes...” See “Europeanization and Domestic Change: Introduction,” in Risse, Cowles, and Caporaso, eds, *Transforming Europe* (Ithaca: Cornell University Press, 2001), p. 12.
2. See Simon Hix and Klaus H. Goetz, “Introduction: European Integration and National Political Systems,” special issue on “Europeanised Politics? European Integration and National Political Systems,” *West European Politics* 23, No. 4 (October 2000): 1-26; Tanja A. Börzel and Thomas Risse, “When Europe Hits Home: Europeanization and Domestic Change,” European University Institute Working Paper RSC No. 2000/56 (San Domenico, Italy: 2000); Christoph Knill and Dirk Lehmkuhl, “How Europe Matters. Different Mechanisms of Europeanization,” European Integration online papers (EioP) Vol. 3 (1999), No. 7; <http://eiop.or.at/eiop/texte/1999-007a.htm>. For one of the earliest efforts to assess the impact of integration on domestic political institutions and policies, see Y. Mény, P. Muller and J-L. Quermonne, eds, *Adjusting to Europe* (London: Routledge, 1996).
3. Markus Haverland, “National Adaptation to European Integration: The Importance of Institutional Veto Points,” *Journal of Public Policy* 20, No. 1 (2000), p. 84.
4. This debate largely focuses on the tension between convergence and continuing diversity of capitalist democracies. For the convergence argument, see Susan Strange, *The Retreat of the State* (Cambridge: Cambridge University Press, 1996); and Philip Cerny, “International Finance and the Erosion of Capitalist Diversity,” in Colin Crouch and Wolfgang Streeck, eds, *Political Economy of Modern Capitalism* (London: Sage, 1997), pp. 173-181. For the case for diversity, see, among many others, Linda Weiss, *The Myth of the Powerless State* (Ithaca: Cornell University Press, 1998); Robert Wade, “Globalization and its Limits: Reports of the Death of the National Economy are Greatly Exaggerated,” in Suzanne Berger and Ronald Dore, eds, *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996), pp. 60-88; and J. Rogers Hollingsworth and Robert Boyer, “The Variety of Institutional Arrangements and Their Complementarity in Modern Economies,” pp. 49-54; and J. Rogers Hollingsworth, “Continuities and Change in Social Systems of Production: The Cases of Japan, Germany, and the United States,” pp. 265-310, in Hollingsworth and Boyer, eds, *Contemporary Capitalism: The Embeddedness of Institutions* (Cambridge: Cambridge University Press, 1997).
5. Fritz Scharpf, *Governing in Europe: Effective and Democratic?* (Oxford: Oxford University Press, 1999).
6. Scharpf, *Governing in Europe*, p. 49.
7. Susanne K. Schmidt, “Only an Agenda Setter? The European Commission’s Power over the Council of Ministers,” *European Union Politics* 1, No. 1 (2000), p. 45.
8. Interview with director of the regional banking federation for North-Rhine Westfalia, Cologne, May 17, 2001. Author’s translation.
9. Westdeutsche Landesbank, “The Decision of the European Commission on the Integration of the Wfa,” p. 2. The briefing paper adds (p. 7) that “If the historic structures of Germany’s public sector banks were to be changed as a result of the decision at hand, public-sector companies in other industries and member states could sooner or later be affected too.”
10. German Savings Bank and Giro Association (DSGV) and Federal Association of Public Banks (VÖB), “Public-Law Credit Institutions,” p. 13; and DSGV, “Public-Law Credit Institutions in Germany,” Berlin, January 2000, p. 11.

11. German Savings Bank and Giro Association (DSGV) and Federal Association of Public Banks (VÖB), "Public-Law Credit Institutions," p. 5.
12. Westdeutsche Landesbank, "The Decision of the European Commission on the Integration of the Wfa," p. 1.
13. Statement of Peer Steinbrück, Economics Minister of Nordrhein-Westfalen, to the Bundesrat, July 9, 1999, reprinted and translated in Westdeutsche Landesbank Girozentrale, "The Decision of the European Commission on the Integration of the Wohnungsbauförderungsanstalt NRW (Wfa) into WestLB," p. 19.
14. Richard Deeg, *Finance Capitalism Unveiled: Banks and the German Political Economy* (Ann Arbor: University of Michigan Press, 1999), p. 33.
15. See Knill and Lehmkuhl, "How Europe Matters," p. 3, Table 1, and p. 6.
16. Thomas Risse, Maria Green Cowles, and James Caporaso, "Europeanization and Domestic Change," p. 11.
17. Risse, Cowles and Caporaso, "Europeanization and Domestic Change," pp. 9-12.
18. Markus Haverland, "National Adaptation to European Integration," pp. 84-5.
19. Risse, Cowles and Caporaso, "Europeanization and Domestic Change," p. 11.
20. Wade Jacoby. *Imitation and Politics*. (Ithaca: Cornell University Press, 2000), p. 3.
21. Hix and Goetz, "Introduction: European Integration and National Political Systems," p. 12.
22. Referring to this as a "divide-and-conquer" strategy of the European Commission in its effort to advance the cause of economic integration, Schmidt writes that "Once the targeted countries have...incurred the costs of domestic reform, they are themselves interested in comparable community-wide changes." See Schmidt, "Only an Agenda Setter?" p. 47.
23. Scharpf, *Governing in Europe* (1999), p. 61.
24. Setting out this argument, Adler and Haas write that "The impact of epistemic communities is institutionalized in the short term through the political insinuation of their members into the policy making process and through their ability to acquire regulatory and policymaking responsibility..." See Emanuel Adler and Peter M. Haas, "Conclusion: epistemic communities, world order, and the creation of a reflective research program," *International Organization* 46, No. 1 (Winter 1992), p. 374. Also see Peter Haas, "Do Regimes Matter? Epistemic Communities and Mediterranean Pollution Control," *International Organization* 43, No. 3 (Summer 1989), pp. 377-403. Haas examines the community of marine ecologists and other scientists participating in the Mediterranean Action Plan for marine pollution control, and finds (pp. 377-78) that "countries in which these new actors acquired channels to decision making became the strongest proponents of the regime."
25. Risse, Cowles and Caporaso, "Europeanization and Domestic Change," p. 1.
26. Richard Deeg, *Finance Capitalism Unveiled: Banks and the German Political Economy* (Ann Arbor: University of Michigan Press, 1999), p. 32.
27. Richard Tilly, "A short history of the German banking system," in Manfred Pohl and Sabine Freitag, eds, *Handbook on the History of European Banks*, published for European Association for Banking History E.V., Frankfurt am Main (Aldershot, England: Edward Elgar, 1994), p. 305.
28. Tilly, "A short history of the German banking system," p. 308. Also see Jeremy Edwards and Klaus Fischer, *Banks, Finance and Investment in Germany* (Cambridge, Cambridge University Press, 1994), pp. 97-105.
29. For example, Westdeutsche Landesbank, the largest of the public law institutions, is owned 43.2% by the state of North Rhine-Westphalia; 11.7% each by the regional Associations of the Rhineland and Westphalia-Lippe, and 16.7% each by the Savings Banks

and Giro Associations of the Rhineland and Westphalia-Lippe. See “WestLB in Brief,” <http://www.westlb.com/overview>; also see Tilly (1994), p. 479.

30. See Deeg, *Finance Capitalism Unveiled*, p. 82, Table 4; and Hans-Werner Sinn, *The German State Banks* (Cheltenham, UK: Edward Elgar, 1999), p. 12, Table 2.1.

31. Deeg, *Finance Capitalism Unveiled*, pp. 19 and 32.

32. See Deutsche Sparkassen- und Giroverband (DSGV), “Public-Law Credit Institutions in Germany,” Berlin, January 2000; and DSGV and Verband der Oeffentliche Banken (VÖB), “Public-Law Credit Institutions.”

33. See “Public-Law Credit Institutions in Germany,” p. 5; and Westdeutsche Landesbank, “Strengthening the Regions Through Structural Change,” p. 2.

34. To cite one example of many, Ernst Schwanhold, Nordrhein-Westfalen’s Minister for Economics, Energy and Transport, became a deputy member of the Westdeutsche Landesbank supervisory board in February 2000, and head of the board in June 2001. See “Minister Schwanhold ist Vorsitzender des WestLB-Verwaltungsrates,” *Die Welt*, June 5, 2001, p. 13 (Lexis-Nexis Academic Universe).

35. See Hans-Werner Sinn, *The German State Banks* (Cheltenham, UK: Edward Elgar, 1999), Table 2.1, p. 12, and Sinn, Table 3.4, p. 38, which gives an average pre-tax return on equity for the period 1980 to 1994 ranging from 4.9% for WestLB to 10.5% for Suedwestdeutsche Landesbank.

36. Deeg, *Finance Capitalism Unveiled*, pp. 49-50.

37. Sinn, *The German State Banks*, p. 28.

38. The high ratings given to the Landesbanken by rating agencies such as Fitch, S & P, and Moody’s contrast with their much lower financial strength ratings, suggesting that their credit ratings are a direct product of state guarantees. Moreover, the substantial exposure of some Landesbanken to the financial crises in Asia and Russia provide a “test” of this proposition -- their credit ratings did not suffer. See *Financial Times*, July 10, 1999; and Tony Barber, “Privileged Status Under Threat,” *Financial Times Survey of German Banking and Finance*, October 25, 1999, p. 6. Sinn, *The German State Banks*, p. 36, finds that the benefits of higher ratings lower borrowing costs by something like 15-20 basis points, depending upon the financial instrument and maturity.

39. Two of these are in the Netherlands, and three in France. See “Brüssel will schnell über Beschwerde gegen Sparkassen entscheiden,” *Frankfurter Allgemeine Zeitung*, July 28, 2000, p. 13.

40. Sinn, *The German State Banks*, pp. 29-30. From a presence in 24 countries in 1991, WestLB achieved a presence in 35 countries by 1997. See “Commission Decision of 8 July 1999 on a measure implemented by the Federal Republic of Germany for Westdeutsche Landesbank – Girocentrale (WestLB),” Official Journal L 150, 23/06/2000, paragraph 19. Hereafter referred to as “Commission Decision of 8 July 1999.”

41. From 1987 to the end of 1991, WestLB’s assets grew by more than half. See “Upward Bound: WestLB,” *The Economist*, May 16, 1992, pp. 109-110. Sinn, *The German State Banks*, pp. 105-6, Appendix 2, documents some of the activities of public law banks in the mid-1990s, including Westdeutsche Landesbank’s expansion of investment banking in London and its acquisition activity and increased market presence in France.

42. According to Sinn, *The German State Banks*, p. 38, Table 3.4, compared with the average return on equity capital from 1980 to 1994 of the five largest Landesbanken of between 4.9% (WestLB) and 10.5% (SüdwestLB), the five largest private banks returned between 12.0% (Dresdner) and 18.3% (Deutsche Bank).

43. Wfa funds come from annual contributions from the state budget as well as income from housing loans.
44. “Commission Decision of 8 July 1999,” paragraph 111.
45. The Basle Convention harmonized international bank capital regulations throughout the 12 leading industrial countries, ostensibly to curb excessively risky lending and creating conditions for fair competition. The rules called for international banks to achieve a ratio of capital to assets of 4% for core capital and 8% overall by December 31, 1992 (see *Bank Management* 67, no. 8 (August 1991), pp. 6-7). Without the Wfa capital, WestLB’s core capital would have been approximately 2% of assets, far below the required level.
46. The excess capital on which WestLB could expand its commercial activities amounted to DM 2.5 billion. As the Commission concluded in its subsequent investigation of the transaction (following the complaint described in the next paragraph), “by way of the transfer, the Land enabled WestLB, which was operating at the very edge of its equity base, to avoid reducing its business activities and even to expand those business activities open to risk.” See “Commission Decision of 8 July 1999,” paragraph 74.
47. The rate paid by WestLB was 0.6% annually. Moreover, the agreement between Land Nordrhein-Westfalen and WestLB establishing the terms of the transfer stipulated that this would be paid only if WestLB earned profits. See “Commission Decision of 8 July 1999,” paragraph 69. Also see *Financial Times*, January 14, 1997, p. 2; and *The Economist*, “Germany’s Protective Wings,” May 22, 1999, p. 81. The BdB complaint named the five additional Länder that had transferred housing development funds to their Landesbanken, but focused on the WestLB transaction because it was by far the largest.
48. “Commission Decision of 8 July 1999,” paragraph 3. Representatives of the Commission subsequently participated in a meeting with German government officials, WestLB representatives, and the BdB in November 1998.
49. WestLB asserted consistently during the two years immediately following the decision on the Wfa state aid case that the Commission in its calculations had confused pretax and after-tax returns, and that the 0.6% rate of return actually corresponded to a pretax return of 9.4%, close to the prevailing market rate of 10.3% achieved by German banks during the period in question. Moreover, WestLB argued that the investor (the state of NRW) contributing the Wfa assets incurred a lower risk than that associated with an investment of share capital in a commercial bank, accounting for the difference between the 10.3% market rate and the 9.4% rate of return paid by WestLB. See Westdeutsche Landesbank, “The Decision of the European Commission on the Integration of the Wohnungsbauförderungsanstalt NRW (Wfa) into WestLB.” During discussions with the BdB while the complaint was under consideration by the European Commission, WestLB did offer to increase the return by a relatively small but nonetheless significant amount, adding by some accounts a half percentage point.
50. “Bankenverband dringt auf pünktlichen,” *Süddeutscher Zeitung*, March 18, 1997. One columnist pointed out the contradiction of a government that supported the construction of the single European market yet which sought special status for public credit institutions. Accordingly, the private banks would have to pursue their rights outside the national level, since in German domestic politics, the complaints of the private banks “have no chance.” See Winfried Muenster, “Das Thema des Tages: Nur Brüssel sichert den Wettbewerb,” *Süddeutsche Zeitung*, September 25, 1997.
51. *Frankfurter Allgemeine Zeitung*, April 25, 1997, p. 19.
52. Paul K. Friedhof, “Öffentlich-rechtliche Banken gegen den Euro?” Tagesdienst der FDP-Bundestagfraktion Nr. 272, May 7, 1997. Reprinted in “Daten, Fakten, Argumente: Die

Amsterdamer Erklärung zu den öffentlich-rechtlichen Kreditinstituten” (Bundesverband deutscher Banken: Köln, November 1997), p. 7. Author’s translation.

53. Author’s interview with European Commission official, January 21, 1999.

54. DSGVO Press release, June 18, 1997, reprinted in “Daten, Fakten, Argumente,” p. 13. Author’s translation.

55. See “Daten, Fakten, Argumente,” pp. 4-5.

56. Jeffrey Anderson argues that the vast flow of aid to the eastern Länder following unification, as well as a number of additional high-profile cases (including an illegal aid to VW in Saxony and aid to the Bremer Vulkan shipbuilding group, in which aid approved for the east was siphoned off to the west), already had damaged Germany’s credibility as a proponent of a rigorous Community state aid regime. See Jeffrey Anderson, *German Unification and the Union of Europe* (Cambridge: Cambridge University Press, 1999), chapter 5.

57. It is likely that the federal government was unwilling to push too heavily on this issue, and that its efforts merely were sufficient to claim with credibility that the government had made the case but could not win over its European partners.

58. Declaration 37 of the Amsterdam Treaty, which states that “The Conference notes the Commission’s opinion to the effect that the Community’s existing competition rules allow services of general economic interest provided by public credit institutions existing in Germany and the facilities granted to them to compensate for the costs connected with such services be taken into account in full.” While recognizing that the organization of its financial infrastructure to deliver financial services to the regions is a matter for the German government, the declaration concludes that “Such facilities may not adversely affect the conditions of competition to an extent beyond that required in order to perform these particular tasks and which is contrary to the interests of the Community.” It is, of course, the Commission that is responsible for assessing the compatibility of national arrangements with Community interests.

59. Author’s interviews with officials from the Representation of Land Nordrhein-Westfalen to the EU and from the German Permanent Representation to the EU, Brussels, May 15 and 16, 2001.

60. Bettina Schragl, “EU: Kompromiss Bei Banken-Privilegien,” *Wirtschaftsblatt*, June 19, 1997, p. 3.

61. Report of the European Commission to the Council of Ministers: “Services of general economic interest in the banking sector,” adopted by the Commission on June 17, 1998, and presented to the ECOFIN Council on November 23, 1998.

62. European Commission, “Services of general economic interest in the banking sector,” section 3.3.

63. “Commission Decision of 8 July 1999,” paragraph 96.

64. Confirmed in author’s interviews with EU officials, Brussels, January 20 and 21, 1999.

65. “Commission Decision of 8 July 1999,” paragraph 178.

66. See “Commission Decision of 8 July 1999;” and Mario Monti, “Competition Policy and Financial Services,” speech to the European Banking Congress, Frankfurt, November 19, 1999.

67. *Süddeutsche Zeitung*, November 25, 1999, p. 25.

68. *Vereinigte Wirtschaftsdienste*, October 29, 1999.

69. However, Scherf's position was rejected by the SPD's state party organization. See "Nur Porzner für Scherf," *die tageszeitung*, October 19, 2000. (Contrapress media GmbH, Lexis Nexis Academic Universe.)
70. In a veiled threat of opposition to the introduction of Europe's single currency, the resolution asserted that "An intact banking system with efficient public-law banks and the resulting guaranteed availability of financial services to all strata of the population is an indispensable precondition for the success of the monetary union." See Westdeutsche Landesbank Girozentrale, "The Decision of the European Commission on the Integration of the Wohnungsbauförderungsanstalt NRW (Wfa) into WestLB," p. 27.
71. See *Financial Times*, December 2, 1999, p. 16.
72. "NRW warnt Brüssel wegen Sparkassenstreit," *Süddeutsche Zeitung*, July 24, 2000, p. 21.
73. Deborah Hargreaves, "Landesbank issue could hit EU reform," *Financial Times*, January 28, 2000, p. 9; and Thomas Hanke and Haig Simonian, "States resist Schröder's solution to banks dispute," *Financial Times*, July 19, 2000, p. 12.
74. "Union für Kompromiss im Sparkassenstreit," *Frankfurter Allgemeine Zeitung*, July 29, 2000, p. 13.
75. Deborah Hargreaves, "Brussels to act on German bank guarantees," *Financial Times*, July 28, 2000, p. 8.
76. This instance suggests the dual implications of recent gains in third-party rights. On the one hand, the Commission's ability to control the state aid agenda is diminished; on the other, its ability to act vis-à-vis reluctant governments by claiming that its hands are tied is enhanced.
77. CDU/CSU Bundestagfraktion, "Hintze: Landesbanken fit machen für Europa -- Privatisierung sauberste Lösung." *News Aktuell*, OTS Originaltextservice, July 20, 2000; <http://web.lexis-nexis.com/universe>.
78. CDU/CSU Bundestagfraktion, "Landesbanken und Sparkassen müssen öffentliche Garantien marktgerecht verzinsen." *News Aktuell*, OTS Originaltextservice, August 3, 2000; <http://web.lexis-nexis.com/universe>; and Beate Preuschoff, "Unionspolitiker: Klage der Privatbanken im Grundsatz berechtigt," *Vereinigte Wirtschaftsdienste GmbH*, August 3, 2000; <http://web.lexis-nexis.com/universe>.
79. "NRW will Sparkassen erhalten – Niedersachsen: Gemeinsame Strategie," Deutsche Presse-Agentur – Europadienst (Lexis-Nexis Academic Universe), November 23, 2000.
80. "A Bank Breakup that's Just What Germany Needs," *Business Week*, Nov 20, 2000, p. 59.
81. Especially prior to the December 1999 EBF complaint to the European Commission, which included Stadtparkasse Köln among the three named institutions, distinguishing between the Landesbanken and Sparkassen had the advantage of creating a solution acceptable to the Commission. EU law provides a basis for differentiating between the Landesbanken and Sparkassen due to the greater impact of the former on commerce between member states. In addition, in contrast to the large Landesbanken, the Sparkassen do not raise most of their funds on the capital markets (an activity that invokes the benefits of the higher credit ratings generated by state guarantees), relying instead on savings deposits. Reflecting the possibility for smaller, regional Sparkassen to retain their structures even after the EBF complaint, Competition Commissioner Mario Monti raised the prospect of such a distinction in a March 2000 speech before Economic Affairs ministers of the Länder. See Mario Monti, "The Community's State Aid Policy," Speech before the Conference of the 16 Ministers of

- Economic Affairs of the German Länder, March 30, 2000. Speech 00/113; <http://europa.eu.int/rapid/start>.
82. CDU/CSU Bundestagfraktion, "Hintze: Landesbanken fit machen für Europa -- Privatisierung sauberste Lösung." *News Aktuell*, OTS Originaltextservice, July 20, 2000; <http://web.lexis-nexis.com/universe>.
83. "NRW will Sparkassen erhalten – Niedersachsen: Gemeinsame Strategie," Deutsche Presse-Agentur – Europadienst (Lexis-Nexis Academic Universe), November 23, 2000.
84. "NRW will für Sparkassen kämpfen," *Süddeutsche Zeitung*, July 29, 2000, p. 26.
85. Interviews with officials of the European Commission, Brussels, May 15, 2001; officials from the German Permanent Representation to the EU, Brussels, May 16, 2001; and representatives of Westdeutsche Landesbank, Düsseldorf, May 17, 2001.
86. See "Berlin Outlines Full Plans for 'New' WestLB Public-Sector Banking," (Global News Wire, Lexis-Nexis Academic Universe) *Handelsblatt* (English Version), May 14, 2001.
87. European Commission Online (<http://www.europa.eu.int/rapid/start/cgi>), "Commission and Germany start focused discussions on guarantees to public banks," IP/01/187, February 9, 2001.
88. "Commission Orders Germany to Restructure Landesbank Credit System," *European Report*, May 9, 2001, p. 352.
89. See European Commission Online (<http://www.europa.eu.int/rapid/start/cgi>), "Commission requests Germany to bring state guarantees for public banks into line with EC law," IP/01/665, May 8, 2001.
90. "Germany Concedes Ground in Landesbank Dispute," *Handelsblatt* (English version), June 15, 2001; Lexis-Nexis Academic Universe.
91. See Mitchell P. Smith, "Europe and the German Model: Growing Tension or Symbiosis," *German Politics*, forthcoming, December 2001.