Political Deadlock in German Financial Market Policy

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Abstract

The financial crisis revealed weaknesses of the global financial market regulation and of most national supervisory systems. This is also true for Germany, where institutional reforms, this is the reconfiguration of regulation and supervision, have been politically discussed in the aftermath of the crisis. The debate on the German authority BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) and the quarrel between BaFin, the Bundesbank and political actors is the main topic of this article. It emphasizes that utility maximizing strategies of actors led to a kind of political deadlock which prevented policy learning and institutional change. Industrial lobby organizations, political parties and executive bodies had different interests concerning the institutional design of supervisory structures. Due to the veto power of some actors there have been hardly any institutional changes or improvements of supervision in Germany after the crisis.

Zusammenfassung

Die Finanzmarktkrise offenbarte nicht nur Schwächen in der globalen Regulierung von Finanzmärkten, sondern auch in den nationalen Systemen der Finanzmarktaufsicht. In Deutschland wurde daher nach der Krise eine institutionelle Reform von Aufsicht und Regulierung angestoßen. Die Reformdebatte, die sich vor allem auf die Allfinanzaufsichtsbehörde BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) konzentrierte, steht im Mittelpunkt dieses Beitrages. Die Auseinandersetzung zwischen BaFin, Deutscher Bundesbank und politischen Akteuren wird dabei vor dem Hintergrund nutzenorientierter, strategischer Handlungsanreize untersucht. Es zeigt sich, dass die partikularen Interessen einzelner Veto-Spieler einen institutionellen Wandel im Politikfeld Finanzmarktpolitik blockierten.

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1 Introduction

When in 2011 the financial market crisis turned into a debt crisis affecting not only banks and insurance companies but also entire countries, the negative consequences of the 2007/2008 crisis were not even got over. Governments in Europe and other regions have to prevent the collapse of whole economies or even the entire euro zone. Facing new challenges, the political answers to the crisis before are almost forgotten and the implementation of new regulation is hardly recognized publicly. The same applies to the failed reform of the German financial market supervisory system. With regard to supervision, the German government decided to keep the status quo ante before the crisis although the modification of the system had been a main topic on the political agenda for more than one year. With the crisis on the climax, the government announced to improve regulation and supervision for more financial market stability in the future. At this time, the crisis brought the state in and paved the way for government interventions in market processes. In fact, it was even possible that banks – like the German Hypo Real Estate (HRE) – became state-owned after their insolvency due to the threat of contagion and the collapse of the financial system (Altvater et al. 2010). And although some political reactions show "patterns of symbolic policy reform" (Mügge et al. 2010: 314), the violation of a public good, namely the stability and integrity of the financial system including aspects of consumer protection, put forth the agreement that public regulation and supervision must improve. Therefore, political actors reacted in two ways. First, with measures in regulation, this is the rulemaking concerning risk based capital requirements and other restrictions for the business of the financial industry, and second, with measures in supervision, this is the implementation of regulation by special authorities (Handke 2010b). The intended reform of supervisory structures in Germany and the related political non-decision are central issues of this article.

The German single supervisory authority BaFin (*Bundesanstalt für Finanzdienstleistungsaufsicht*) and similar agencies in other European countries are crucial for the success of financial

market regulation. They are not only charged with the supervision and implementation of rules and standards, but they also take part in the establishment of risk regulation within transnational bodies like the European Insurance and Occupational Pensions Authority (EIOPA) or the Basel Committee on Banking Supervision. Further, on the national level, they have to scrutinize internal risk models of companies. In testing these models, supervisory authorities do not only implement rules that cope with the risk of financial businesses, this is the mere risk regulation, but they also have to deal with the severe phenomenon of model risk or model uncertainty. This is "a new risk category [which] can hardly be overestimated" (Sibbertsen et al. 2008: 66), as it covers the mathematical problems of abstracting from reality, to derive risk models predicting the probability of credit default risk. Therefore, the boundaries between risk regulation and supervision are blurring and a supervisory agency like BaFin is involved in both.

Financial market regulation is typically determined by political considerations of governments and "there is little reason to expect that regulatory change will in fact take a form that produces the outcomes so often claimed by its advocates, such as allocative efficiency […] or, for that matter, financial stability" (Perez/Westrup 2010). Regulatory reforms are not only a function of political interests, but moreover, they are hard to develop and cannot be established over night, since financial market rules are very complex. These two aspects led to the national governments' agreement to make joint decisions in regulation, to coordinate their activities internationally and to construct new rules in a cooperative way between European member-states, the United States of America and other industrial countries (FSB 2009). National politicians recognized that "[financial] instability does not respect borders while uncoordinated or competing national solutions may make things worse – as they have in the past" (Underhill/Zhang 2010:291f). With the referral to the intended international cooperation, national governments shift regulatory tasks to a higher political level and take it away from national politics. The German government did not push new rules, but followed European steps – e.g. with the implementation of the directive on

credit rating agencies – without setting the pace in regulation. On the national level the Financial Market Stabilization Act (Finanzmarktstabilisierungsgesetz), proposals for better market regulation via strict capital requirements, and the so-called Restructuring Law (Restrukturierungsgesetz) have been implemented - at least partly.

By proposing institutional reforms for supervisory bodies, the government early demonstrated the capacity and willingness to act. Nonetheless, those plans failed as political agreements and the unanimity to reform the institutional design of German financial market supervision persisted only during the acute crisis. Empirically, supervisory reforms differ fundamentally among the European member states. Some countries like Greece, Lithuania and Slovenia shift competences from their supervisory agencies to the national banks or even abolished their sectoral supervisory authorities. On the European level three new largely autonomous European Supervisory Authorities[1] (ESAs) have been established in early 2011. In contrast, the German supervisory system remained unchanged despite some intended reforms. This system still consists of the single supervisory authority BaFin - as a subordinate agency of the Ministry of Finance (BMF) - and the German central bank. Whilst BaFin is responsible for the entire securities and insurance sectors, the supervision on banks is a split competence of BaFin and the Deutsche Bundesbank. Especially the improvement of the institutional setting in supervision was a central project of German financial market policy. In the end of 2010, however, the ruling coalition decided to keep the status quo ante in most parts and to maintain a supervisory structure with split competences between BaFin and the Deutsche Bundesbank (Handelsblatt 2010b).

This article will show why political asseverations did not materialize into hard financial market policies and why this fact should not be traced back to the simple shift of actors' opinion. The un-

[1] The European Supervisory Authorities EBA (European Banking Authority), ESMA (European Securities and Markets Authority) and EIOPA (European Insurance and Occupational Pensions Authority) succeeded the former Level-3-commitees – CEBS, CESR and CEIOPS – of the so-called Lamfalussy-procedure.

derlying reasons are closely linked to the influence of well-organized business interests, the seconding of clientele party politics and the self-serving orientation of executive bodies. The coincidence of party politics, (fragmented) business lobbyism and the dissension between governmental bodies led to a political deadlock, which admitted hardly any policy learning or institutional change. Utility maximizing actors' strategies in financial market policy, which can be characterized within the framework of rational choice institutionalism, retarded political processes with the result that decisions were procrastinated. Political actions and decisions on plans for regulatory and supervisory reforms lost their touch with the crisis and were discarded. Consequently, it can be observed a rigidity of institutions – these are formal and informal rules (Hall/Taylor 1996) - which is in sharp contrast to other cases like the BSE crisis. Instead of a significant modification of institutions, there is only slight and incremental change, which can be traced back to cost-benefit calculations and strategic orientations of rational actors possessing some veto power. The guiding approach is the rational choice institutionalism (Hall/Taylor 1996), which helps to explain why institution are resilient to temporary external shocks and crises (see also Streeck/Thelen 2005; Streeck 2009; Van der Heijden 2011; Farell/Newman 2011). Theoretical assumptions are complemented with own empirical data. Despite some problems to make competent actors willing to talk about financial market policy during the crisis, in 2010 eight structured interviews, lasting between 30 and 90 minutes, have been conducted with representatives of BaFin, the Bundesbank, the industry and political parties in parliament. The article is structured into three parts, in which empirical data is combined with theoretical interpretations of financial market policy processes.

In the first section, the immediate political reactions and plans for supervisory reforms in the aftermath of the crisis are discussed. The models for new supervisory structures are not judged in reference to their appropriateness, but they are just analyzed in the way of entering the political agenda and becoming a political choice. In the second section, the focus lies on the conditions under which policy ideas hit politics. It will be illustrated

how German financial market policy is influenced by a special set of institutions and self-interested actors. These actors are portrayed as rational utility maxi misers, pursuing individual interests on regulation and supervision as their long-term maxim. The last section combines the policy analyses and the theories of rational action. In doing so, the article offers an explanation for the political deadlock in German financial market policies, which is the result of the impossibility to find a common preference for supervisory models.

2 Political Reactions to the Crisis

When the economic and financial market crisis culminated in 2008, the German government urgently issued a guarantee for private savings (Manager Magazin 05.10.2008). This step caused a psychological effect and re-built confidence in the German financial sector. However, this public warranty did not solve the problems of financial markets or eliminated the underlying causes for market distortions. Programs like the two economic stimulus packages (Konjunkturpakete I+II) or the facilitation of short-time work (Kurzarbeiterregelung) were more effective, but just cured the symptoms of the crisis. However, the government also implemented measures against the underlying causes, for instance, financial market stabilization acts (Finanzmarktstabilisierungsgesetz) and proposals for better market regulation via capital requirements or financial transaction taxes (BMF 2010a). Nevertheless, this cannot hide the fact that most plans conceive financial market regulation as an international or at least European task, which is not manageable at an isolated national level (BMF 2010b). Especially minimum capital requirements (MCR) for banks and insurance companies are key elements of these rules established in circles like the Basel Committee of the Bank for International Settlements (BIS) or the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), which is now EIOPA. The relegation of regulatory matters from the national to a supranational venue implies two consequences. First, governments avoid or suspend national conflicts and shift the accountability for effective regulation to international collec-

tive actors. Second, governments deprive themselves of the ability to shape policies autonomously and thus lose a trait of their self-legitimization (Underhill/Zhang 2010). Consequently, political activities had to focus on national supervision as the only remaining administrative competence.

In addition to the economy stimulating and regulating programs, the new liberal-conservative government of Christian Democrats (CDU) and Free Democrats (FDP), which took office in the end of 2009, agreed to restructure the German system of financial market supervision, as administrative failure was conceived as a main reason for the crisis (Mülbert 2010). One crucial element of this reform was supposed to be the concentration of banking supervision under the roof of the German central bank, the Deutsche Bundesbank (Coalition Agreement 2009). According to the Kreditwesengesetz (§ 7 KWG), the Bundesbank and BaFin already share competences in banking supervision, where the central bank has to do on-site inspections. The reform would have withdrawn competences from the single supervisory authority BaFin, where solely the supervisory tasks in insurance and securities business would have remained. The political agreement was an attempt to change the seven years old institutional structure of German supervision, which was modeled on the British Financial Services Authority by the former government of Green Party and Social Democrats (Frach 2008). In 2002, the German Bundestag had passed the *Finanzdienstleistungsaufsichtsgesetz* (FinDAG), which merged the Federal Banking Supervisory Office (*Bundesaufsichtsamt für das Kreditwesen – BAKred*), the Federal Securities Supervisory Office (*Bundesaufsichtsamt für den Wertpapierhandel – BAWe*) and the Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen – BAV*) to bring the three branches under the roof of BaFin. The new agency was given more autonomy and discretionary power than its predecessors (Frach 2008). This step followed the global trend, “to make public agencies independent of politics” (Tsingou 2010: 33), at least to a certain extent.

It was the initial decision of the CDU/CSU and FDP to take competences away from BaFin and to convey the undivided responsibility for market and solvency supervision in the banking

sector to the Bundesbank. The restructuring was not only promoted by the new government, but it was also backed by some scientific expert reports of the Ministry of Economy and the Cologne Institute for Economic Research (Hüther et al. 2009; Wissenschaftlicher Beirat BMWi 2010). Despite the political proposal and the scientific advice, there was no objective justification for separated supervision, which would have provided a cause-and-effect-relationship between the reasons of the crisis and some administrative failure of BaFin (Greive/Jost 2009). Therefore, the idea to change the system of German financial market supervision provoked a debate on organizational details, since the coalition agreement contained only vague declarations of intent.

In reaction to the announcements of the new government, several actors brought up more or less far-reaching supervisory models. One of the first was the German Bundesbank, whose president Axel Weber presented the "integration model" *(Integrationsmodell)*, which intended the Bundesbank to be the only authority to supervise banks, insurances and other financial service firms (Frankfurter Rundschau 2009). This would not only have abolished the dual system of banking supervision, but with the integration of BaFin into the structures of the Bundesbank, the model would also have demoted the agency to an appendix of the central bank with minor competences in consumer protection and market supervision. At the same time, the Bundesbank rejected demands for ministerial legal and technical oversight over the central bank in case of an integration of BaFin, which is subject to oversight by law (see § 2 FinDAG; FTD 2010). For a start, politicians of FDP and CDU supported the integration model, because it would have partly deprived BaFin of its power. The agency was often hard to control in the years before and such a step would have re-gained ministerial influence (Handke 2010a). However, not only BaFin disapproved of the integration, but also parts of the CDU/CSU opposed this plan, as they did not reconcile with the idea of a total integration without mechanisms of

having a political say in supervisory questions (cf. Interview 1)[2]. Further, the insurance industry rejected the idea of being supervised by the Bundesbank as an alleged ally of the banking business (GDV 2009).

As an alternative option, Leo Dautzenberg, the Spokesman of Finance (*Finanzpolitischer Sprecher*) of the CDU/CSU faction in the Bundestag, proposed the "holding model" (*Holding-Modell*), which should have maintained BaFin as one pillar of a newly created Bundesbank holding (Wallstreet-Online 2010). The model sought to join BaFin, the central bank and the Financial Market Stabilization Fund (*SoFFin*) under the roof of this holding, which would have been headed by an executive board of the representatives of all three pillars. Within the holding not only the structure of BaFin as the single supervisory authority – including the authority to supervise banks – should have been maintained, but also the ministerial oversight over the whole supervisory pillar. This part of the model conflicted with the self-conception of the central bank as the independent guardian of the stability of the financial system (Bundesbank 2007). The Bundesbank strongly opposed the holding model and was finally supported by the FDP, which disapproved of ministerial oversight over the central bank (Handelsblatt 2010a). During the one-year lasting debate, both models pretended to enhance the efficiency of supervision by abolishing the dual system with split competences between BaFin and the Bundesbank. Fundamentally, efficiency was not operationalised and therefore remained on an abstract level. The advantages of pooling competences under the roof of the Bundesbank were hardly distinguishable and could not be derived from objective evaluations (cf. Interview 2). There were even long-known arguments, which dissuaded from a sole responsibility of the central bank due to potential conflicts of interests in supervisory and currency matters (Quintyn/Taylor 2004; Wissenschaftlicher Beirat BMWi 2010).

Retrospectively, once being on the political agenda, the reform models in financial market supervision have been debated

[2] The anonymity of all interviewees' statements was required for their cooperation. Therefore, interviews are only cited with numbers.

fiercely. Nonetheless, just a short time before, political parties and other actors had agreed to rebuilt supervisory structures and had fixed this decision in a governmental program. The question that needs to be resolved is why political decisions concerning supervision were initiated, and why a reform of this system – which would have been a kind of institutional change – did not take place, though. At first sight political decisions during the crisis can be interpreted as results of "garbage can" processes (Cohen et al. 1972) under circumstances of bounded rationality, which are made under time or factual constraints. This regularly occurs in moments where severe problems or external shocks force actors to decide quickly to prevent escalations or aggravations of political situations. This is also true for the financial crisis, since public attention, political reactions and the academic debate leave no doubt that the latest financial market crisis was a serious problem in these terms (see e.g. Altvater 2010; Mügge et al. 2010; Underhill et al. 2010). However, institutional change in financial market regulation and especially plans for the reform of financial supervision are likely not the result of irrationality or arbitrariness. Rather, intended modifications of institutional settings can be traced back to individual preferences and strategic orientations of political and administrative actors (Mügge 2010; Interview 3). The following chapters will not only provide a thorough look at German financial market policy, but also examine whether the same interest driven behavior led to political deadlock and the fail of institutional change, since strategic orientations predominantly focused on influence and the capacity to control administrative bodies and not on policy improvements or the financial market integrity as a common good.

3 Rational actors in German financial market policy

As environmental policy, security policy or transportation policy, financial market policy can be shaped as an own field with specific subjects, actors and institutions (Grunow 2003; Frach 2010). These institutions in financial market policy are interpreted as "exogenous constraints, [which cover the actors'] behavioral repertoires (or strategies), the sequences in which the actors choose from them, the information they possess when they make their selections, and the outcome resulting from the combination of actor choices" (Shepsle 2008: 24). In particular, regulation and supervision – comprising financial market rules, their implementation and the sanctioning of violations – can be interpreted as specific financial market institutions.

The main objective of financial market policy, as a kind of public regulatory policy, is to provide financial market stability as a public good. It is "a public good that is not provided by the financial markets" (Rude 2008: 4), since it meets the criteria of non-rivalry and non-excludability leading to instances of market failure (Samuelson 1954). This is why the state provides market stability and tries to preserve it against negative market effects. Regulation and supervision are two ways of achieving this goal with the help of authoritative and coercive measures. As in other policies, regulation is either market regulation or risk regulation (Döhler 2006). Market regulation covers every governmental action directed on the establishment or maintenance of a competitive market, for example the prohibition of illegal cartels or the liberalization of monopolized sectors. In contrast, risk regulation does not establish markets, but limits the threats and negative externalities of the private production of goods and services. Risk regulation comprises most of the standards, for instance, in the food or drugs sectors and even in the financial sector. As information asymmetries and externalities are mainly to the disadvantage of consumers (Barth et al. 2004), German financial market regulation is characterized by disclosure requirements (e.g. §26a KWG; §55 VAG), minimum capital requirements (MaRisk; § 10 KWG) and prerequisites for business operations (e.g. §§ 5-10 VAG). Risk regulation is always challenging due to the inher-

ent uncertainties, but in the financial sector it is extraordinarily difficult because of model risk. The existence of model risk exacerbates these uncertainties in measures to prevent negative incidents in the future (Sibbertsen et al. 2008). Consequently, supervision in financial markets contains accompanying risk regulation and risk management by supervisory agencies, which is different from other policies like food safety (Lindemann 2006). Therefore, supervisory arrangements in financial market policy are crucial and perhaps even more decisive for regulatory success than in other areas.

Decisions concerning the detailed construction of regulatory and supervisory mechanisms as well as the extent of the public good provision are made with the involvement of many actors who either belong to the group of 1) providers of regulation and supervision, 2) regulatees or 3) benefiting third parties. The last group is important as the beneficiary of supervisory actions of administrative bodies and as the electorate of political parties. In financial market policy this group, which contains consumers and other affected people and collectives, influences the behavior of the first mentioned two groups. However, these third parties are for the most part badly organized and therefore not involved in decision-making or bargaining processes (Handke 2010a). The following remarks therefore just pertain to those groups of actors that shape and determine policy programs directly. On the one hand, there are subjects to regulation and supervision, especially banks, insurance companies, security firms and business interest groups. On the other hand, legislative and executive bodies like the Bundestag, the Ministry of Finance (BMF), the German Bundesbank and BaFin belong to the group of suppliers of regulation and supervision. This group shows a division of tasks, which assigns rulemaking to parliament, political parties and the BMF. The implementation of rules is mainly a matter for BaFin and the Bundesbank. As fixed in the Basic Law (Art. 88 GG), the Bundesbank is a completely independent administrative body, which is assigned most of the operational tasks in banking supervision (Bundesbank 2008). Supervisory tasks in the other financial sectors and all sovereign measures in banking supervision lie with the responsibility of BaFin, which is “subject to the legal and

technical oversight of the Federal Ministry of Finance" (BaFin 2010c).

Besides the Bundesbank and BaFin, the BMF is a crucial actor in German financial market policy. The ministry is not only responsible for the federal budget or currency matters, but it is ultimately responsible for market supervision and every act of sovereignty. This is why the ministry exercises the legal and technical oversight over BaFin. For that purpose the BMF does not only hold out specialized departments for every financial market sector, but additionally a dedicated oversight-department, which coordinates organizational, budgetary and personnel matters. Furthermore, the BMF is the only ministry, which has issued a detailed guideline for the oversight over BaFin on the agency's website (BaFin 2005).

The struggle for control over BaFin is one aspect which is relevant in terms of actor's strategies in financial market policy. In the most general sense, every actor pursues policy and politics oriented strategies, which either focus on programs concerning regulation and supervision, or on the own position of power and influence. This is closely linked with the plans for reforms of the institutional supervision and the ability to have a big say in supervisory matters. Against this background, the positions in regard to the reform models of some political parties, executive bodies and others can be considered as attempts either to gain more power or to ward off the loss of autonomy. To elucidate this instance, the following remarks sketch the preferences of the most important organizational and collective actors.

Rational Organizational Actors

From a rational choice perspective it can be assumed that the actors on the supply side – the BMF, BaFin and the Bundesbank – share distinctive preferences as bureaucratic organizations. In the first instance, all three try to keep their institution alive and foster their persistence and growth in terms of staff and budget (Niskanen 1979). Consequently, they pursue strategies emphasizing the importance of their work and corroborating the need for more resources, whether it is necessary or not (Blais/Dion 1990). However, budgetary resources are solely invested in more per-

sonnel in pessimistic theories of public administration. More optimistic theories consider public organizations to be policy-oriented bodies, too. Bureaucrats, who are interested in efficient programs, a good standing and a great renown of their organization, shape an agency in accordance to such objectives (Downs 1967). This is closely linked with the "bureau shaping" strategy of organizations, which avoids public conflicts and critique, due to the interest in a convenient working environment (Dunleavy 1991). All three orientations can be imputed to strategies of the Bundesbank, BaFin and the BMF.

BMF

The German Ministry of Finance pursues inherent organizational interests, which cover personnel resources as well as other amenities including the failure-free running of the own portfolio. The BMF has a large remit, ranging from economic matters and taxation to financial market policy. Besides the BMF, eight subordinate ministerial authorities (*nachgeordnete Behörden*), including BaFin as the largest one, are occupied with these tasks (BMF 2009). Regarding financial market policy, the ministry has not only specific interests in terms of regulatory and supervisory tasks, but also in terms of the organizational structure of BaFin. Despite BaFin's status as a public law institution, which grants some budgetary and legal independence, the BMF still has the legal and technical oversight. In fact, this situation is in line with the policy orientation and the bureau shaping assumption, as long as the BMF can control BaFin largely, and at the same time benefits from the existence of a partly independent agency, which can be blamed for policy problems, if necessary (Thatcher 2002).
With regard to financial market aspects, the BMF is interested in BaFin's efficient task fulfillment without showing any irregularities that necessitate ministerial interventions. Like other ministries, the BMF has scarce personnel resources to accomplish tasks and limited capacities to handle incoming information (BRH 2005; BMF 2010c). In financial market matters, the limitation of capabilities is particularly serious and leads to situations where technical oversight, due to the lack of sufficient qualified staff, can be applied only occasionally (cf. Interview 4). Conse-

quently, the crisis revealed two insights: first, the performance of the BMF is poor in unforeseeable and grave cases like the collapse of Hypo Real Estate (Bulletin of the German Parliament 16/14000), and second, the ministry is utterly dependent on the thorough work of BaFin even in daily business (Bulletin of the German Parliament 16/14133). Furthermore, essential ministerial tasks, like the policy formulation in laws on finance, had to be outsourced to private law firms due to time pressure and the lack of enough personnel with expert knowledge (Hanke 2009).

The weaknesses of the BMF in financial market policies are unproblematic as long as there are no market disturbances, as BaFin is a reliable agency and even works with a kind of anticipatory obedience towards the BMF (cf. Interview 5). However, the ministry is aware of the dependence on BaFin and the challenge to control an agency that gained lots of discretionary power and actual autonomy in supervision and regulation since its establishment (Sturm et al. 2002; Döhler 2007; Handke 2010a). This is why the BMF has issued a guideline for the ministerial oversight over BaFin, which corroborates the claim to exercise power over the agency and to keep at least the existing amount of influence. With regard to the reform plans in supervision, the ministry neither headed the group of reform supporters, nor promoted any restructuring. The policy orientation of the BMF and its interest in ministerial influence on the official machinery can serve as an explanation for this behavior. Against this background, the ministry remained on the sidelines of the debate and avoided definite statements until the end of 2010, when it publicly supported the latest coalition's agreement, which laid down the maintenance of the existing supervisory structures and the continued existence of BaFin (Dow Jones 2010; Dautzenberg/Kalb/Meister 2010).

BaFin

In comparison to the BMF, BaFin's interests in supervisory reforms are even more essential, because it is the core competency of the agency. In financial market policy, BaFin has two main tasks, which are, firstly, the supervision of banks, insurers and other financial intermediaries in Germany (§ 4 FinDAG); and secondly, the contribution to regulatory standard setting in cooperation with supranational or transnational bodies like the Basel Committee or the former level three committees (L3L) of the European Lamfalussy procedure, which are now European agencies[3]. On the national level, BaFin is responsible for the implementation of regimes like Basel III for banks and Solvency II for insurers, which are established in those places.

The German structures of supervision, which are codified e.g. by the German Banking Act (*Kreditwesengesetz, KWG*), the Insurance Supervision Act (*Versicherungsaufsichtsgesetz, VAG*) or the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz, FinDAG)*, provide BaFin with large discretionary powers. With these, BaFin has certain independence in terms of regulation, supervision and organizational aspects of the agency, despite the ministerial oversight (Quintyn/Taylor 2004). The integration into transnational networks, like the L3L and their successors, supports this independence in the same way as BaFin's legal status as a public law institution (*Anstalt des öffentlichen Rechts*) does (Handke 2010a). Although BaFin can be still instructed by the BMF, the regulatory standard development is often too complex for concrete interventions. Further, the integration of BaFin into network structures of supervisory authorities delimits the ministerial scope of influence and emphasizes objective solutions under factual constraints (cf. Interview 6). Nonetheless, independence

[3] In January 2011 the new European supervisory agencies EBA (European Banking Authority), ESMA (European Securities and Markets Authority) and EIOPA (European Insurance and Occupational Pensions Authority) emerged from the former L3L committees CEBS, CESR and CEIOPS and gained more power in transnational supervision. The agencies and even their bodies enjoy a maximum independence from national influence (cp. COM 2009).

cannot be unlimited, because technical oversight is formally infinite (Döhler 2002) and "the government [can] override or preempt, at no cost to itself, supervisory actions directed at troubled banks, thus keeping such banks open and risking higher costs to society in the future" (Quintyn/Taylor 2004: 7).However, even the existing discretion is a challenge. In the ongoing supervision of business operations, BaFin faces the tension between the requirements of a free and competitive market and the objective to provide the public good of market stability, including consumer protection. Decisions like the dismissal of managers (§ 36 KWG) or the assessment of the provision with funds (§ 10 KWG) are particularly characterized by a trade-off between those goals. Further, supervisory decisions are affected by the political influence of the BMF, which intervenes on a case-by-case basis, as it did, e.g. with the German *IKB Deutsche Industriebank AG* (cf. Interview 7). Political influence is indeed twofold. BaFin is not only subject to the legal and technical oversight of the BMF, but in addition, a governing board consisting of parliamentary, ministerial and interest group representatives controls the management of the agency (§ 7 FinDAG).

To maintain the restricted, but existent autonomies and discretionary powers, is a high ranked objective on BaFin's preference order, because it puts the agency in the position to pursue and to realize policy goals in regulation and supervision as essential elements of financial market policy (Sanio 2002). Especially in the negotiations on international or European regimes, the chance for BaFin to be heard in supervisory networks depends on its renown and reputation, which are in turn a function of size, staff and remit of the agency (cf. Interview 8). Consequently, from BaFin's point of view, the enlargement in those aspects is a sine qua non for success and a good performance in policies on the international and European level, where regulation is established.

The policy orientation goes hand in hand with a kind of the agency's self-serving interest, this is that "bureaucrats are […] themselves assumed to constitute an interest group seeking to shape public policy and organization, though what they seek to maximize is much debated" (Hood et al. 2003: 125f). There is a

permanent effort of BaFin to maximize budgetary and personnel resources, to retain existing competences and to obtain new ones (Kaserer 2006). Such expectations are reinforced by empirical observations, like the continuous increase of staff and the latest successful request for more than 240 additional jobs in 2011 (Kaserer 2006; BaFin 2010a).

Regarding the governmental reform plans, which intended to concentrate banking supervision under the roof of the Bundesbank, BaFin considered its interests to be affected. Especially the continued existence of BaFin as an autonomous authority and the broad policy orientation were threatened. However, as neither the directorate, nor Jochen Sanio as the president publicly commented the debate, only the employees of BaFin alone protested against the possible relocation of their jobs (Luttmer/Tartler 2010). Representatives of the agency were not involved into direct political negotiations, but behind closed doors, they nonetheless insisted towards the BMF on the maintenance of a single financial supervision in the first place, and the consideration of social consequences for the employees in the second place (cf. Interview 9). As a matter of fact, the holding model with a location guarantee for the site in Bonn was the only acceptable plan for BaFin, albeit not a desired one. With this preference, which was proposed to the BMF and political actors, BaFin was in opposition to the Bundesbank.

Bundesbank

The financial market crisis is not the first time that competences and capacities of the Bundesbank are debated and scrutinized (Heinemann/Schüler 2004). Due to the loss of tasks in monetary policy, coming along with the European integration and the shift of competences to the European Central Bank, the Bundesbank – with about 9000 employees – came into the position to have too many (personnel) resources in relation to its remaining responsibilities (Frach 2008). Consequently, in the founding years of BaFin, the central bank was involved in political processes and considered as a crucial actor for reforms in supervision. At that time, the Bundesbank already tried to obtain the sole responsibility for banking regulation and supervision with the aim to justify

its capacities (Frach 2008). However, political actors decided in another way and did not follow the central bank's demands, because they were afraid of a loss of political influence (Döhler 2008). The establishment of the single supervisory authority BaFin was a setback for the Bundesbank, which still did not change its strategic orientation to maximize resources and competences. The latest crisis and the coalition's agreement was therefore a welcome opportunity to pursue these preferences anew (cf. Interview 10).

With the proposal of the integration model, the Bundesbank benefited from the first-mover advantage (Lieberman/Montgomery 1988) and channeled the public debate into a favored direction. This step of the directorate of the Bundesbank can be understood as a preventative strike in order to nip unpleasant suggestions in the bud (cf. Interview 11). This is why the Bundesbank did not only agree with the proposal of being a single banking supervisory authority, but also tried to push the limits and to gain as many competences as possible to justify its organizational facilities. The relationship between the Bundesbank and BaFin was in this way marked by a fundamental conflict, which touched elementary organizational preferences, especially the continued existence of each organization. As a result, both authorities sought the contact to political actors and the support of political parties.

Political Parties

Concerning the development of policies, the public choice theory distinguishes two main determinants of rational behavior. On the one hand, there are rational strategies of bureaucratic organizations like BaFin or the BMF; on the other hand, there are those of politicians and parties (Lane 1990). In the last case, the suppositions of individual behavior of politicians, who seek for reelection, power, financial capabilities, prestige and political aims, are extended to collective actors, this is political parties (Lane 1990).

The interests of political parties regarding structural matters of financial supervision in Germany differ considerably and depend on whether a party is part of the federal government or part of the

parliamentary opposition. For this reason, the autonomy of BaFin and the trade-off between the intended independence of the agency as well as government's objective to control BaFin as a delegate or agent, is a function of party interests (Aulich et al. 2010).

During the crisis, the German government coalition changed in 2009 from a Grand Coalition of Social Democrats (SPD) and Christian Democrats (CDU/CSU) to a Conservative-Liberal government with the involvement of the Free Democratic Party (FDP). The change of government also brought about a changing orientation concerning regulatory and supervisory matters, which was driven by the guiding principles of the relevant political parties. Being voted out of office, the SPD hardly took part in the debate on supervisory reforms, while the governing parties were disputing heavily on the reform models on the agenda (cf. Interview 12). The strategies of the FDP and the CDU/CSU focused on the well-known vote seeking, office seeking and policy seeking aspects of political behavior. To point out these strategies more concretely, the governmental concepts of Andrei Shleifer and Robert Vishny can give a useful insight (1999).

With three ideal-types – invisible hand, grabbing hand and helping hand – they describe government actions and explain analytically, how party interests determine policies and political outcomes (Shleifer/Vishny 1999). The invisible hand is a prescriptive concept according to Adam Smith, which suggests letting the market work in free processes of individual actions without the interference of government. From the invisible hand perspective, the analysis of strategies of political parties is not fruitful, because there is no political activity on markets and therefore nothing to examine in terms of politics (Shleifer/Vishny 1999:3). On the contrary, the helping hand perspective – first designed as a prescriptive model, too – pays more attention to politics, because it takes social conflicts on welfare into account. Public welfare is not only the basis for political contestations, but also the guiding paradigm of governmental and party programs. Shleifer and Vishny, however, characterize the grabbing hand behavior of governments and parties, which puts emphasis on the

politics dimension and expresses a skeptical view on government activities in the market, as the most convincing one (1999).

Not only after the financial market crisis, but also some time before, aspects of consumer protection in market supervision gained higher importance in comparison to aspects of market stability and the freedom of markets (Kaserer 2006). This development is closely related to the helping hand model, which contains a strong common good orientation and the effort of governments to maximize social welfare. Although not every single decision of a party can be explained with one of the ideal-types, at least the basic orientation can be roughly characterized. Political parties like the SPD, the Green Party and the left wing party *Die Linke* may follow the helping hand paradigm, which implies that deficits are inherent to market processes and which therefore provides prescriptive arguments for government market interventions (Shleifer/Vishny 1999). Basically, helping hand politicians are interested in regulation and supervision, that is, minimizing market deficits like negative externalities, monopolies and information asymmetries. On the basis of a level playing field for the financial industry, they try to safeguard market stability as a public good with the help of significant government interventions (Czada 2003: 18). With regard to financial market supervision and regulation, a government with a helping hand orientation relies on structures, where „the faith in the market is replaced by a faith in public servants together with the belief that government programs are less costly to administer than markets" (Andolfatto 2004: 5). This implies a preference for a supervisory authority, that implements regulation impartially and with a strong emphasis on common interests. Thus, the establishment of BaFin as a largely independent single supervisory authority, founded in the years of the governmental coalition of SPD and Green Party, is in accordance with the predictions of the helping hand model. Consequently, those parties did not put BaFin's continued existence into question during the political debate in the aftermath of the crisis, but neither did they publicly defend the agency against the attacks of other parties (cf. Interview 13).

It was an easy way for the new government to make BaFin the scapegoat for omissions in German financial market supervi-

sion, as long as the parliamentary opposition did not expect any benefit from keeping the agency out of the line of fire. Especially the SPD had no incentive to defend BaFin, as the criticism publicly aimed at the agency was a chance to distract attention away from own neglects during the period when the BMF was headed by an SPD-minister. The political agenda was therefore set by those who criticized BaFin either for an alleged poor performance in some cases of banking failure, or due to some individual grabbing hand motivations.

The descriptive grabbing hand concept presumes that governments pursue a variety of aims, which are not specifically orientated towards the enhancement of the common good or even the development of a welfare state. Rather, it can be deduced from this model that "governments behave 'selfishly'[…] either on their own behalf or on behalf of their supporters" (Andolfatto 2004: 6). Grabbing hand politicians rely on the market and its mechanisms to regulate the behavior of market participants adequately. Principally, governmental interventions should be rare exceptions, applied to few extraordinary situations. This is also true for financial markets, where the state should not manipulate market processes or even own banks and other financial service providers. If regulation and supervision are still necessary for the viability of the market, "bureaucrats must have as little discretion as possible in exercising their powers" (Shleifer/Vishny 1999: 12). Such an orientation of politicians is advantageous for the financial industry as long as the maximization of profits is the guiding principle. Accordingly, political parties, that find their electoral base within or around the financial sector, are keen on advancing policies for the purpose of their clientele. In the German political system, the liberal and conservative array of political parties – this is CDU/CSU and FDP – may be assigned to the grabbing hand actors, who are not necessarily in favor of strong financial market regulation and supervision (Dalla Pellegrina/Masciandaro 2008). The patronage of special interests in financial market policy is possible, because of pronounced information asymmetries and lacks of transparency among the consumers as the second large group of the electorate. As long as clientele politics are below the threshold of public perception,

grabbing hand politicians do not run the risk of losing votes from those who do not benefit from their policy (Heinemann/Schüler 2004). Despite that, Hood et al. hold the opinion that political patronage in risk regulation is not the rule, but occurs empirically in just a few instances (2003: 117). German plans for the reforms of supervisory structures, which have been developed after the change of government in 2009, however, bear the hallmarks of a grabbing hand policy in favor of special interests (Kaiser 2010). The proposals of CDU/CSU and FDP were not only in line with the demands of the banking industry, but also with the interests of well-liked institutions like the German Bundesbank (Bulletin of the German Parliament 16/14000).
With regard to the autonomy of BaFin, the pursuit of a helping hand or a grabbing hand strategy is crucial. If coalitions change, not only the orientation in these strategic terms can alter, but also the preferences concerning institutional designs. Whilst a government pursuing the helping hand strategy prefers „a stable balance between the need for political control and accountability and pressure for local agency autonomy and professional independence", a government with the grabbing hand orientation accepts that „this balance will wax and wane"(Aulich et al. 2010: 214). In German financial market policy, this change of preferences went along with more or less explicit lobbying of the financial industry.

Financial Industry

In order to make sure that their interests are regarded in policies, single financial service providers or industrial associations try to keep close contact with actors of the political decision-making process. These are, in the first place, likeminded political parties and individual politicians, but also politicians who are at least not in opposition to the industry's interests (Beyers 2009: 20). Representatives of banks, insurances or other finance companies pursue their strategies with all means and are "often well-organized and [face] powerful incentives to overcome information problems and to influence legislation e.g., through campaign financing, vote support or provision of biased information" (Heinemann/Schüler 2004: 101). The provision of information address-

es not only political actors, but also the supervisory authorities, which are necessarily behind with detailed information on business models and specific risks within single companies (Kessler 2008). Although finance companies seek for the maximization of profits and their entrepreneurial freedom, they are nonetheless interested in institutions, which provide actors' compliance with treaties and fundamental standards for effective competition (Freriks/Widmaier 2000). However, companies prefer market regulation, which can provide protection against competition from abroad, to risk regulation, which often includes unpleasant prohibitions or causes high compliance costs (Danielsson 2004). This is true despite the fact that interests are not homogenous amongst the financial branches, since private banks and public banks have as much different preferences as banks and insurance companies, for example (Bergset et al. 2009; Osetrova 2007). A shared preference exists in regard to supervision, e.g. the implementation of rules and the monitoring of compliance, which is perceived as a cost factor that must be minimized. Supervision causes expenses due to duties of documentation, record-keeping, reporting and on site checks, which are time-consuming and engage personnel (cf. Interview 14). As long as supervision does not give rise to similar possible advantages as regulation, the extent and intensity of supervisory measures should be reduced from the perspective of the industry. Referring to the performance of BaFin, the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft, GDV*) criticizes, firstly, a lack of internal coordination, which causes multiple supervision on the expense of companies, and, secondly, obstructive and anachronistic reporting and information obligations (GDV 2006). However, insurers are by and large satisfied with the work of BaFin.

In sum, the financial industry is – even though quite heterogeneously – interested in as much regulation as needed for preparing a level playing field. This covers minimum capital requirements for banks according to the average assessment of risk dispersion in the banking sector, as well as solvency capital requirements for insurers. In comparison, supervision is accepted only reluctantly and the industry tries to keep this cost factor at the lowest level. It should be taken into account that "the effectiveness of

supervision [as an interpersonal task] relies to a large extent on convention and norm, rather than on formal law, and [that] the tools of persuasion are subtle" (Ward 2002: 13). Therefore banks and insurance companies try to achieve good relations with the supervisory authorities and the political parties (cf. Interview 15). There is still no evidence for agency capture of the Bundesbank or BaFin, although cooperative interaction is desired by the supervisors and the financial industry due to the chance to reduce costs on both sides. However, the debate on supervisory models revealed the particular closeness between insurers with BaFin and banks with the Bundesbank.

With regard to supervisory reform models, the financial industry did not adopt one unanimous position. In fact, the banking sector with its Association of German Banks (*Bundesverband der Deutschen Banken, BDB*) was in favor of a model, which would have given the sole responsibility for banking supervision to the Bundesbank (Schmitz 2010). At the same time, the insurance sector – e.g. Allianz and Munich Re – strongly rejected any reform, which would have transferred competences in insurance supervision to the Bundesbank (Handelsblatt 2010c). Before this dissent became obvious, the government of CDU/CSU and FDP focused on the banking business as the main subject of the financial market crisis. Consequently, the coalition agreement of 2009 took into consideration the specific interests of the banking industry, which conceded the improvement of regulation and supervision, but insisted on the single banking supervision under the roof of the Bundesbank (Bulletin of the German Parliament 16/14000). Only after that, the insurance industry opposed the government's plan of concentrating banking supervision at the expense of BaFin as well as the integration model and the holding model (GDV 2009). Finally, both groups of regulatees lobbied for their own preferences, since their individual interests in prudential supervision and considerate cooperation with the supervisory authority were affected. This, however, was not the only reason for the failed institutional change.

4 Conclusion: Why is there a Political Deadlock?

The financial market crisis was a trigger for political debates and scientific discussions on financial market supervision and regulation. For the German case it is evident that supervisory reforms – as the only remaining, exclusive national competence – have been initiated under public, economic and political pressure. Nonetheless, the supervisory reform is an example for political non-decision resulting from dissent in regard to institutional settings (cf. Table 1). Not only have the attitudes of banks and insurers towards the supervisory models differed, but also the positions of political actors, BaFin, the BMF and the Bundesbank. The entire debate was marked by the self-interest of political and executive actors, expressing incompatible preferences and strategic orientations.

BaFin and the Bundesbank wanted to keep the status quo of their organizational settings or even tried to enlarge competences and resources. However, reputation and international prestige preserved the Bundesbank from being blamed during the crisis, so that among the responsible authorities BaFin was the only remaining scapegoat. Therefore, all plans to reform the supervisory system focused on the dismantling of BaFin. At first, the CDU-led ministry of finance and the conservative parties exercised their right to organize governmental affairs and issued reform plans which proved their capacity to act. However, the holding model signaled grabbing hand attempts to the Bundesbank, since not only BaFin would have been ‘punished’ for the alleged emancipation of the agency and failures during the crisis, but the concentration of banking supervision under the roof of the Bundesbank would have been also a gateway for ministerial oversight over the central bank. The autonomy of the Bundesbank still enjoyed a kind of sanctity and was even defended by the FDP. Therefore, the holding model provoked the resistance of the Bundesbank, which instead promoted the integration model. In turn, the denial of CDU/CSU to accept this alternative can be explained by the threat of a total loss of control over financial market supervision when integrated in an autonomous central bank. This is a remarkable aspect, as the FDP and the conservative parties in government are partisan veto-players which were able to prevent a change of the status quo (Tsebelis 2002). This is

also true for strong lobby organizations agitating their specific interests in political fora. As said before, financial sector interests are heterogeneous, but they are nonetheless relevant enough to be considered as substantial requests. While banks – especially private banks – appreciated the planned Bundesbank-centered supervision, the insurance industry feared discrimination and inappropriate supervision (Fromme et al. 2010). Both sides were able to form coalitions with some veto power, finally leading to the maintenance of the institutional status quo. The rough preferences in the following table show the distinct lack of unanimity, although the definitions of agreement, refusal and indifference are as simplistic and tendentious as the assignment of positions to actors. Nonetheless, the divergences are supposed to be the underlying cause of the political deadlock in financial market policy.

Table 1: Actors' preferences in regard to supervisory reform models (author's design)

Actor / ***Model***	BMF	BaFin	Bundesbank	Helping Hand Parties	Grabbing Hand Parties	Banks	Insurers
Coalition Agreement	-	-	+	-	+	+	-
Integration Model	-	-	+	+	-	+	-
Holding Model	o	o	-	+	+	-	-

"+" = in favor; "-" = against; "o" = indifferent

As long as actors in financial market policy stick to their utility maximizing interests and preferences, they cannot agree on a common supervisory model. Simultaneously, no single political actor can decide alone and regardless of other positions, because political costs – in terms of lost voter or clientele support – would be too high. The struggle for new structures and institutional change in German financial market supervision showed a typical back and forth situation in politics, where no group of actors was able to prevail. Consequently, institutional change in terms of regulation and supervision turned out to be limited. While there is at least some tightening of regulatory provisions

such as minimum capital requirements, supervision remains largely unchanged. Although new policy concepts, which entered the stage in reaction to the crisis, were supported for a short time, dissenting essential long-term orientations did not change. They were only temporarily suppressed in crisis management and became visible soon after. As a matter of fact, the political deadlock owing to the actors' insistence on individual interests first led to procrastination and finally to the failure of intended institutional reforms.

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