1. Conceptual delineation

In the Federal Republic of Germany most credit institutions engage in practically all types of business typical of commercial and investment banks, and are therefore known as universal banks. This combination of operations stands in contrast to the American "divided system". The prototypical universal bank offers at the minimum deposit and credit operations as well as all forms of securities transactions (issuance, brokerage, and securities deposit); indeed the scope of activity of German universal banks often extends beyond these operations to include practically all elements of banking business. The banking system of the Federal Republic of Germany as a whole is not, however, purely universal; although a majority of the banks in the system are universal banks, there are a number of specialized banks as well.

2. Reasons for the development of the German universal banking system

Before describing the essential features and critically considering the structural characteristics of the German universal banking system, it is necessary to inquire into the reasons for its development. Two factors that were of fundamental importance to the gradual establishment of this kind of banking system are especially significant: the economic circumstances, and certain underlying intellectual-ideological currents in existence at the time of the rise of the first German joint-stock banks.

In Germany, economic relations between banks and industry have been very close since the beginning of industrialization and engendered tightly organized forms relatively early. This is attributable to the fact that, in the course of the industrial development process, Germany had at its disposal neither an equity market nor a securities industry capable of meeting the financial needs of great

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industrial enterprises; these needs could be met only through massive extensions of bank credit. Furthermore, the development of the first great joint-stock banks in Germany (around the middle of the 19th century) was undoubtedly connected with the founding of the Société Générale du Crédit Mobilier in Paris in 1852 by the brothers Émile and Isaac Pèreire. The founding of this bank was based on the intellectual heritage, characterized as "early socialism", of the French sociologist, Saint-Simon. Accordingly, the founders believed that the entire economic system could be structured around a banking institution that exercised central management and control of capital. The development of the concept of the "universal bank" gave rise to a series of bank foundings designed to produce institutions capable of engaging in capital transactions in the widest sense.

The fact that the German universal banks apparently evolved in precise accord with the needs of the German economy contributed to the rapid development of German industry, and in fact made it possible in the first place. Without the readiness of the German banks to extend credit to industry and to cooperate in transforming this long-term credit into equity capital or long-term debt, the industrial development of Germany would probably have taken a considerably slower course. Even at these early stages, however, the universal banking principle was subject to frequent criticism.

The efficiency of the German universal banking system continued to justify its existence after both world wars. Especially after 1945 the German capital market was very weak and industry was forced to depend upon long term investment credit to meet its needs. The subsequent establishment of a successful capital market, indispensable for the reconstruction of the German economy, was possible only with the support of universal banks and their deep reservoir of deposits.

The present universality of the range of operations [1] of German banks is also the result of customers' changing demands; changes in the range of operations through the adoption of new types of bank service or through discontinuance of previously offered services are reactions to these rapidly changing requirements. From the perspective of the individual bank this adaptation to changed customer financing, capital investment, and fund transfer needs is a product of the priority accorded to the profit motive. The universal banks have thus evolved into a dynamic, adaptable, and flexible system that, like few other banking groups, is in a position to fulfill both microeconomic and macroeconomic tasks in the monetary and capital fields. Similarly, in the era of the internationalization of the banking business the German banking system is capable of fully meeting increasingly complex transnational demands as well as the needs of the domestic economy. It must be kept in mind that the banking system is also used as a tool by regulatory authorities to eliminate economic bottlenecks and to advance policy priorities such as special investment and financing programs, and capital market and savings promotion. This fact also contributes to occasional changes in the types of operations offered by universal banks.
3. Organization of the universal banking system in the Federal Republic of Germany

A. Structure and market share

The significant division in western market economies between the central bank and business banks is also found in the Federal Republic of Germany: the banking system is composed essentially of the German Central Bank on one hand and the various commercial banking groups on the other [2].

Competition in the German credit industry occurs especially between the private, the public and the cooperative banking sectors. In addition to competition between these groups of credit institutions, there is competition among the banks within the different groups, particularly among the private banks.

There is a variety of opinions regarding the goals pursued by the private credit banks, the public banking sector, and the cooperative banking sphere. According to banking theory, private banks are oriented strictly toward the profit principle, savings banks toward non-profit goals ("public duty"), and cooperative banks toward the member support principle. It is apparent that this is not always the case in practice. In addition, the goal orientation of each of these individual groups has changed over time, as all three banking groups have developed toward the universal bank model.

Despite the occasional effort by the savings and cooperative banks to portray themselves as "non-profit" organizations, profitability has been empirically shown to be an independent policy variable for all these institutions. All three groups may therefore be described in terms of profit, market share, and share of capital, with the priority of the particular variables in goal-setting receiving varying degrees of emphasis.

In view of the fact that nationalization of the private universal banks is projected from certain quarters of the Federal Republic of Germany, it is necessary to recognize that the division of market shares between private and public banks is nearly balanced. To be sure, the apparent market share of the private banks has climbed slightly since 1960, while that of the public banks has correspondingly declined. The increase in the former, however, was caused largely by the growth that has occurred in the business volume of the banks in the cooperative sector (the credit cooperatives and cooperative central banks). When the cooperative sphere is considered as a distinct and independent third banking sector, the market share of the private banks (thirty-eight percent) turns out to be far below that of the public banks. This fact is not sufficiently recognized among the public. Thus the purported economic power of the private universal banks (the pretext for present demands for nationalization) has not served to increase their market share at the expense of the public banks.

B. Supervision of banking in the Federal Republic of Germany

Because of the specific position occupied by the banks, banking has become the most thoroughly regulated and supervised sector of the German economy. The
public is often unaware of this fact. The fundamental statutory regulations are embodied in the Banking Act (Kreditwesengesetz or KWG) of July 10, 1961, current text: May 3, 1976. The basic concerns of the KWG are the guaranty of general order in the German credit system, the maintenance of the ability of the German credit apparatus to function, and the protection of the depositors of credit institutions from the loss of their assets. In order to achieve these goals while retaining the bank’s freedom to determine business policy at a level appropriate to a market economy system, the KWG provides for permanent supervision of the banks as well as official case by case intervention by bank regulators. This potential intervention applies to individual credit institutions, groups of banks, and the entire banking and stock exchange system.

Of further significance for the German credit institutions is the German Federal Bank Act of July 26, 1957. Among other things, this Act defines the sovereign powers of the German central issuing bank, an institution that influences both the monetary and the credit systems.

Certain credit institutions or banking groups, especially those that do not fall under the KWG (or do so only partially), must also observe certain legal norms applicable only to themselves. Various credit institutions created under public law fall under special state supervision in addition to federal bank supervision. All German banks also fall within the jurisdiction of the Federal Cartel Office, whose mandate lies especially in the prevention of interest cartels and other abusive arrangements in the credit industry.

4. Performance of the German universal banking system [3]

A. General performance expectations

It is probably true of every contemporary banking system that governmental regulation of credit is based on a perception of the special role of banks in the economy as well as on theories concerning credit and monetary cycles. Views concerning the macro-economic and political-economic relevance of the banking system are and will remain controversial, especially regarding this specific position of the banking business in the economic order; the appropriate scope of regulation is thus a matter of debate. In the development of economic regulatory tools, the system will be preferred that appears to be best suited to providing the necessary financial environment and to fulfilling economic policy goals, i.e. the optimum choice must fulfill the following conditions:

(1) The banking system must insure that economic, especially monetary and currency, measures “take hold” in order that the range of national economic goals is reached.

(2) The banking system must create an appropriate allocation of capital; that is,
the capital formation and distribution functions of the banking system must be exercised in a manner to achieve the chosen goals.

**B. The general stability postulate in the banking system**

The fundamental goal of the body of German bank regulation is the maintenance of a stable banking system in the interest of the entire economy. Diversification of activities under the universal banking principle limits bank risk and contributes to this stability. If the ability to offer a broad range of services protects the individual institution without creating a misallocation of resources, banks should be allowed to diversify.

It is necessary to explore why, given a free entrepreneurial decision, banks themselves prefer the "function-unifying" model of the universal bank over a specialized bank, and why these individual preferences certainly do not contradict a macroeconomic policy directed to the stability of the credit system. Of course the macroeconomic propriety of an organizational form must be viewed in the controlling institutional context; thus the banking system must be evaluated in terms of its ability to achieve one or more specific goals.

**C. The view of the individual universal bank**

(i) *Earnings stabilization through loss compensation*

Banks typically plan and conduct their business activities with a considerable measure of uncertainty about their success; principles of stability play an important role in the compartmentalization of different types of business by universal banks. The immediate goal of offsetting risks by following a conscious policy of diversification is as important as the larger goal of bank growth. Thus, in order to be better able to ride out market fluctuations, universal banks seek to compensate for losses by offering an array of services that do not have parallel profit curves. The partial counter-cyclicality of the lending industry and the securities business is a prime example: offering both services decreases the probability of a large overall loss, since losses in one sector are balanced by profits in another. An institution that commits all its assets to the execution of credit transactions or to the pursuit of securities dealings is exposed to greater risk than an institution that expands its field of endeavor over both areas simultaneously. The profit performance of the latter type of credit institution has more continuity and exhibits greater stability than the former.

An argument against diversification is that specialization provides greater economies of scale. A large differentiated enterprise, however, can also realize such scale benefits in its technical and labor costs through specialization within the business. This means that economic advantages of the division of labor will exist within the universal bank (at least the larger ones) if the individual areas of business within the bank generate a sufficiently large volume. Just as thoroughly compartmentalized
department stores can compete with specialty shops, so can the special divisions of a "financial department store", a (large) universal bank, exploit the benefits of the division of labor. In addition, the argument that specialization creates a tendency toward decreasing technical elasticity in manufacturing and a limitation of personnel and equipment utilization to specific operations does not apply to universal banks which, through specialization into departments, are able to realize the same advantages as specialized banks.

With respect to the demand conditions and the competitive situation in the Federal Republic, it is also true that the establishment of a more economic volume of business is more probable through the combination of several branches in one bank than through an institution specialized along one or a few related kinds of service.

(ii) Capacity utilization

A further factor favoring the universal banking principle is the possibility of more regular utilization of existing capacities. In the banking business capacity utilization is primarily achieved through maximizing personnel utilization. Because of the peculiarities of banking services capacity is typically geared to peak loads. This creates an inherent over-capacity in the banking industry which must be maintained in anticipation of such peak loads, even in the face of a distribution of demand among different types of banking services. In this context, universal banks are well suited to the achievement of such optimum use under conditions of high capacity and fluctuating demand for banking services.

The banking business operates with high fixed costs with respect to personnel and overhead. These costs result from the gearing of capacities toward anticipated peak loads and from the compensating measures typical of the business. Because of the characteristics of the banking industry, banks usually have a comparatively narrow range of short-term adjustment measures available for the adaption of their technical and organizational apparatus to different demands. In the case of the universal bank, the greater the number of kinds of business undertaken by the institution, the more the random peak loads are spread out. Thus the universal bank is typically able to make the necessary adjustments to compensate for fluctuations in personnel demands. This compensation capacity, which is only really efficient when there is strong diversification, leads to the development of strategies for adaptation to business fluctuations and marks the superiority of universal over specialized banks.

The abilities to influence the proportion of the idle costs to production costs, and to utilize elastic capacities in the different areas of service, allow for fuller capacity operation. Since the proportion of variable costs to total costs in the technical and organizational sectors of the banking business is small, total costs will be only slightly affected by increased utilization. With such a low degree of cost elasticity, offering diverse types of services will be the most efficient system if cost advantages can be realized through reapportionment of fixed costs among a greater stock of
operations over a given time span. Thus, the more numerous the types of operation included in the repertoire of a universal bank, the more likely it is that peak loads will be evenly distributed.

(iii) Price averaging

A broad range of operations not only affords the universal bank increased loss compensation, but also makes possible the development of flexible price policies, particularly in the area of cost accounting. Through such a process a business can achieve a satisfactory profit level over its total array of operations, despite the failure of prices to cover costs in a particular department. While compensation for losses requires a balance of positive and negative developments that, for the most part, are not subject to influence, price averaging embodies consciously executed business policy measures through which low revenues from one type of service are compensated for by correspondingly higher revenues from another kind of service. Furthermore, this compensatory price policy makes it possible for a bank to avoid the allocation of high fixed cost items to individual operations which in most cases would present serious problems. The universal bank will thus attempt to set prices for a complete “bundle” of banking services; even in price negotiations with large customers it will try to charge an overall price that is acceptable to the customer and still assures an adequate profit. The specialized securities bank has by comparison few price policy alternatives available for minimizing revenue risks in the face of negative developments in the securities business. Revenue stabilization of individual universal bank institutions by compensatory cost accounting thus becomes an instrument for stabilization in the entire banking system.

Finally, the universal bank can generally furnish banking services to its customers at a lower price than the specialized bank, because of its favorable cost and revenue situation. This possibility arises, for example, if the universal bank does not need to charge disproportionately higher commissions for its small securities customers. The fact that this capacity would advance the socio-political goal of the promotion of securities ownership among broad classes is mentioned only in passing.

(iv) Marketing in response to customer demands

The universality of the range of operations of German banks is also rooted in the changing demand structure of their customers. Customer needs determine which services will be offered and which discontinued. From the point of view of the individual bank, this adaptation to varying customer financial needs is a course of action complementary to the goals of increasing profit and market share.

The universal character of banks has thus evolved into an important component of marketing policy. Numerous factors, such as abolition of the requirement that branching be based on need, decontrol of interest rates, dissolution of competitive barriers, and the liberal right of entry and consequent sharply increased competition of foreign banks and credit institutions in the Federal Republic, have increased
competition in the German banking system and have forced the universal banks to intensify their marketing activities, especially through the development of new operations. Efforts toward expansion of the banking services offered by universal banks are thus not merely reactions to observable customer demand, but are also acquisitive measures aimed toward latent demand. The underlying concept is that expanded programs of bank operations will create mutually reinforcing relationships among the separate kinds of business and will lead to the bank attaining larger shares of the market.

The attractiveness to bank customers of the availability of universal services has contributed to the trend towards expansion of the range of operations. The average German customer characteristically places particular value on being able, so far as possible, to conduct all his various banking business "under one roof". Universal banks are thus forced to offer a complete range of services out of competitive considerations. The attraction, for customers, of the "department store" character of the universal bank means that no single bank sector can remain aloof from the universalization trend insofar as it is not a purely specialized bank, e.g., a mortgage loan bank. This assimilation of banking services by different banks and banking sectors has led to a sharp increase in competition in the German banking system. As traditional distinctions between the three bank sectors based on customer and service structures have increasingly disappeared, individual universal banks have attempted to obtain an advantage by distinguishing themselves from competitors by the development of more attractive programs of services and the creation of preferences. The resulting substantial conformity of the operational programs of the universal banks is therefore not an indication of deficient competition within the German banking system, but in fact points to the opposite conclusion: since types of banking service are neither secret nor patentable, the individual institution cannot generally allow itself, without suffering market losses, to grant another institution competitive advantages through the development of a new service. Expansion by universal banks has thus occurred not only within the "traditional" elements of the business, but has been characterized in recent years much more by an advance into areas of service previously not offered and in part alien to banks.

(v) Optimal information utilization

This discussion is to be viewed in connection with expansion of the marketing system. The comprehensive accommodation of a client's banking needs has a further side effect: utilization of customer information gathered in connection with existing business relations decreases the cost of procuring information when additional services are incorporated into his portfolio.

D. Macroeconomic aspects of bank universality

The necessity of maintaining the ability of the credit industry to function in the interest of the national economy stands at the center of the debate over banking
legislation. It is assumed that the collapse of a single large bank would endanger the entire economy, as would crises of public confidence hinder the operation of the banking system with consequent damage to the economy. If the susceptibility of the banking system to crisis is the major macroeconomic criterion of evaluation, then the system's ability to adapt to business fluctuations resulting from externally determined demand for services must be examined.

(i) System stabilization through diversification

The special ability of universal banks to attain stability through risk spreading has been described in detail above in the discussion of the microeconomic aspects. The economic literature has already thoroughly established that diversification minimizes risk as negative profit developments in one sector of operations can be neutralized by positive developments in other sectors. Since bank stability, more so than that of other businesses, is dependent upon public confidence in the financial system, and banks must therefore strive to a greater degree than other enterprises to develop policies that will avoid risk, one can speak of universal banks, because of their comprehensive range of operations, as providing a “built-in stabilizer” capable of counteracting danger to the banking system.

(ii) Nationwide credit supply maintenance

An important question in appraising the efficiency of a banking system relates to its capacity to supply credit adequate to the needs of the economy: does the system succeed in smoothly bringing into congruence or in appropriately transforming the structures of capital supply and demand? Since there is a strong preference for high liquidity among capital suppliers in the Federal Republic, banks must assume an important role in the transformation of these resources into middle- and long-term capital supplies for the economy. Universal banks have an advantage in that they are better able to take upon themselves the risk of transformation of the term of loans because they have the ability to transform long-term credits, with the consent of their debtors, through the issuance of securities. This function simultaneously provides the appropriate method of financing and furthers the policy goal of expansion of equity financing.

(iii) Objective overall business perspective

Despite unfavorable conditions in the capital market, the universal bank may still be able to provide financing through credit and, following a favorable development in that market, transform this debt into equity by the issuance of securities. The joining of the credit and securities businesses makes it possible for the universal bank to give objective advice to enterprises planning to issue securities. On the other hand, in the case of a specialized securities bank, there is always the potential danger of a “pressure for returns” from the issuance of a security, made for the security of self survival rather than customer survival. Combination of the securities issuance and deposit businesses creates a solid base for the banks financing the
issue; this is especially useful where the placing of a corporation's issue does not immediately succeed and parts must remain in the banks' own portfolio.

(iv) Capital market quality promotion

An understanding of these problems of transformation of term and kind in the process of balancing capital supply and demand leads to the proposition that the German banks can be expected to assume direct responsibility for the maintenance of an orderly capital market. Since banks are dependent upon the continuation of an orderly market in order to assure collection of their long-term credits, they take measures to avoid issuances by unreliable enterprises, preferring instead companies having adequate capital reserves of their own. Thus weaker companies are precluded from entering the capital market, with a resulting increase in overall quality.

Notwithstanding such characteristics of the banking system of the Federal Republic, a series of criticisms and demands for reform have been made [4].

5. The classical critique of the German banking system and an evaluation of its relevance

Both critics and advocates of the German universal banking system recognize its general efficiency. The critics, however, believe that this efficiency is outweighed by certain disadvantages. They often demand at least the prohibition of certain services, and in some cases go so far as to call for a splitting up of the universal banks into independent credit and deposit banks on one hand and securities banks on the other. The classical criticism is based primarily on potential conflicts of interest engendered by concentration of several sectors of business in a single type of bank. The basic objection is that banks will resolve the competing interests between suppliers and demanders of capital as well as consumers of banking services to the disadvantage of the economically weakest (generally the smaller) customers [5]. These arguments are essentially based on an "anti-big business" sentiment and are mainly directed against the large private banks.

(i) Potential abuse of informational advantage

It is alleged that as a result of the combination of the stock brokerage and credit businesses within one organization, an informational advantage in favor of the banks is created that makes it possible for them to quietly accumulate and dispose of blocks of stock for their own or a favored customer's benefit. In a nutshell, it is asserted that inside information is withheld from general securities customers in order, for example, to protect both credit customers and themselves from the adverse effects that might result from knowledge of unfavorable economic developments. This conduct, it is maintained, creates customer mistrust capable of leading to a decline in confidence in the securities market and an impairment of the functioning of the entire capital market.
It is doubtful, however, that a bank would risk its reputation and its standing by such behavior. Possibly a bank might occasionally withhold information in order to further the reorganization of an enterprise in a discreet manner, but a successful reorganization would ultimately have a positive effect on the value of the shares of the reorganized company, and would consequently financially benefit the investing public.

(ii) Preference for savings over securities brokerage business

Criticism of the combination of the securities brokerage and savings businesses under one roof comes down to the contention that the universal bank might conduct its investment counselling and capital formation functions primarily to further the savings side of its business. This would be so because universal banks are heavily dependent on savings to supply their financing needs, and encouraging savings customers to purchase securities would conflict with their goal. From a macroeconomic view, this would not be in the best interests of both capital market operation and private capital formation. In addition, the charge will be raised from the microeconomic standpoint that biased counselling of the individual customer will not optimize the personal allocation of resources.

This possibility of bias must be balanced by the fact that a universally oriented bank possesses a more comprehensive insight into the financial circumstances of its customers and thus is able to provide more carefully weighed investment counselling than a specialized bank. Further, a specialized securities bank has fewer opportunities to spread costs; consequently, it will have to charge higher commissions and will promote volume turnover “at any price”.

(iii) Preference for credit over securities issuance business

The combination of securities issuance and credit operations is also a much criticized aspect of the universal banks. Critics allege that the German banks tend to promote credit financing for an enterprise even when capital requirements could more appropriately be met with share capital. This banking practice, they argue, results in undercapitalization of the German economy and a corresponding susceptibility of the entire economy to risk, even though such a result is not demanded by underlying conditions in the capital markets.

Although the capital structure of German enterprises is in fact generally thin, this is not the result of the policies of the universal banks, but rather of several other significant factors. In the first place, the German tax system has traditionally discouraged equity financing (considerably until the reform of the corporate tax in 1977, and to a lesser extent today); this has led to the development of extensive credit financing. Secondly, many German enterprises suffered from the outset from a lack of share capital as a result of the general capital shortage after the Second World War. This unfortunate state of affairs, risky to enterprises, could hardly be eliminated as industry rapidly expanded during the ensuing years.

The charge that the universal banks neglect the securities issuance business in
favor of more advantageous credit operations overlooks the fact that stock issuance operations are a lucrative business for banks. Further, the universal banks play an important role in promoting capital formation among broad sectors of the population. The German universal banks are represented in every larger locality by at least one establishment and are able, through a closely woven network of branches, to sell a large volume of securities to the population at large. This ability is generally not available to the securities specialist who, because of cost considerations, is represented only by branches in the large economic and financial centers where he deals mainly with wealthy customers, often institutional investors. If specialized securities banks wanted to reach the same pool of buyers as the existing banks, they would be forced to establish a marketing network similarly close to the customers; however, construction of such a network is unlikely.

(iv) Counselling bias

A major area of universal bank activity is investment counselling for customers. This service is also subject to frequent criticism on the grounds of conflict of interest or bias in favor of larger customers. Such criticism may be countered by reference to the fact that the individual universal bank, subject to extensive competition from other credit institutions, has to balance a policy of short-term manipulated profits against its long-term competitive position. Dishonest investment advice would result in the loss of a customer, and a bank is not likely to jeopardize a long-term, fruitful relationship in order to attain a short-term advantage. The very nature of the universality of the bank's business tends to deter improper conduct. If he discovers misbehavior in one type of operation, a disaffected customer will also break off relations with the bank in other phases of business.

Because of their position in the capital accumulation and distribution process, universal banks have a responsibility to support the official policy of promoting such accumulation through encouragement of savings and private capital formation by broad segments of the population. At the same time, however, bank decisions must comport with certain external data such as the public's savings capability, inclination to same, and choice of savings vehicle. Universal banks advance regulatory goals when, through their network of branches close to customers, they promote savings at times when people exhibit a low readiness to save but possess high saving capability. Further, banks are able to lead depositors step-by-step into diversifying beyond savings accounts into a more sophisticated mix of investment. In terms of their overall business policy, there is no reason for banks to guide funds primarily into forms of investment advantageous to themselves, nor to deter customers from buying securities. The broad range of savings options offered by universal banks (including planned savings, varied investment programs, securities acquisition, and mutual funds) shows that they counsel the saving public in its own interest to invest in many types of capital programs, and in fact often support the promotion of capital formation through the acquisition of securities.

The operational strategies that German universal banks have recently adopted
further indicate that they are intent on employing their significant position in the
capital market for the advancement, not the frustration, of regulatory goals. The
universal banks realize that in order to maintain freedom of action in economic
affairs in the face of government regulation it is good business policy to respect the
macroeconomic goals of regulatory authorities as restrictions upon microeconomic
business policy.

(v) Influence over bank-owned investment companies

Conflict of interest is also charged against universal banks with respect to their
involvement in investment companies of which they are founders and shareholders.
According to critics, unfavorable consequences could ensue from the possibility
that banks would try to sell shares only of associated investment funds. In addition,
universal banks might act to the disadvantage of shareholders by unloading worth-
less securities into portfolios of investment funds, the resulting losses thereby
eroding the confidence of the small investor in capital markets.

The response is that the present German legal regulations protect the investor
by controlling so-called bank manipulations. In addition, close association of uni-
versal banks with investment companies advances the policy of promoting capital
formation and investment in securities at lower income levels. In addition, such a
network affords universal banks broad contact with the population at reduced
advertising costs. (In this context it must be remembered that some foreign invest-
ment companies self-described as bank-independent, e.g., IOS, caused problems for
the German investor because of the lack of a bank-affiliated distribution network.)
A customer who already trusts his bank's traditional services will be likely to regard
stock in mutual funds affiliated with that bank as a safe investment. Further, the
availability of complete investment services at the universal bank will be valued by
the investor, who will find it much easier to choose, from the wide range of invest-
ment opportunities offered, those most appropriate to his own needs.

The ability to market through the branch network allows universal banks to
keep sales costs down as measured by international standards. Advantages are also
available in the area of administrative costs: while bank-independent investment
companies must bear the full costs of investment research, universal banks are able
to utilize existing departments for these tasks at lower expenditure. The costly
establishment and maintenance of their own organizations for stock exchange trans-
actions is eliminated for investment companies that have universal banks as their
shareholders. Finally, universal banks are able to offer to the associated investment
funds preferred stock brokerage fees and, to some extent, preferential depository
charges for the custody and administration of the funds' portfolios.

6. The charge of improper concentration of power in the German universal banks
and an evaluation of its validity

Universal banks are the “house banks” of numerous industrial and commercial
enterprises. This function has developed largely as a result of the tendency of bank
customers, particularly credit customers, to centralize all their banking activities under one roof, thus providing the opportunity to develop the mutual trust and economic familiarity capable of supporting reliance on the banks as a source of financing in times of crisis. This cooperation between banks and all sizes of enterprises resulted in the development of a more intense and continuous bank attention to the affairs of their clients in Germany than in countries without the universal system. It has been frequently cited as the origin of excessive bank influence.

In some public perception this concentration of power is overly large and misused. Rather than discuss the emotional and political arguments, it is more productive to examine the economic criteria that underlie them.

It is argued that universal banks possess a dominant position in the West German economy through capital participation in non-bank enterprises, bank exercise of stock voting rights in shareholders' meetings, presence on supervisory, administrative and advisory boards of the industrial establishment, and policy formulation with respect to the issuance of securities. Even the allocation of credit (as to volume, interest rate, and availability), which is subject to central bank regulation, is viewed as an improper exercise of power [7]. In the opinion of certain socialist and neo-Marxist theoreticians in the Federal Republic, it is particularly through industrial participations, proxy exercise and “domination” of the supervisory boards that a “dominion of finance capital”, a “bankocracy”, has established itself [8].

A. Capital participations

Critics see the “power of the universal banks” as represented particularly by the interweaving of capital (as well as personnel) with non-banking sectors. Of course, if such concentration would eliminate competition, the economic and social-political model of the Federal Republic would be offended; it is necessary, however, to distinguish between the theoretical possibility and the actual realization of an exercise of power on the basis of the above mentioned interconnections. The theme of universal bank capital participations is thus today one of the basic issues in the comprehensive discussion of the universal banking system. Universal banks hold interests in both the industrial and commercial sectors as well as in other enterprises in the financial sector, especially mortgage banks and other financing institutions.

The financial sector participations are explainable as part of the tendency of universal banks to offer a complete range of financial services and are generally tolerated as in many respects a necessary expression of contemporary banking business policy. It is bank participations in industrial and commercial enterprises that are subject to the most frequent criticism. The institutional and historical conditions that gave rise to these participations are both the concentration of securities and credit transactions in the universal bank and the important promotional and issuance role that the banks played in the industrialization process. Moreover, a large number of participations stem from the Great Depression and resulted from efforts
to protect bank credits as well as to enable enterprises to overcome the crisis.

In addition to these more or less unplanned participations, banks have engaged in planned participations, chiefly out of profit motives. From a macroeconomic view, the possibility of offsetting losses is particularly relevant in this context; when revenues from credit transactions decrease, proceeds from equity shares can stabilize the profit position of a bank and thus advance the goal of a stable credit system. Moreover, the buffer provided by capital participations, enhanced by attendant hidden reserves, has promoted the amenability of universal banks to risk in the extension of credit.

Criticism of the financial and personnel interrelationships between universal banks and industrial enterprises has been the subject of earlier discussions of the German banking system. Histories of German banking describe an “industrial kinship” between banks and companies based on the fact that German enterprises were not self-financed like their Anglo-Saxon counterparts, but dependent upon the universal banks as efficient assemblers of capital. This characterization is fully justified: the “industrial kinship” was clearly a necessity given the prevailing conditions.

Standards for evaluating this relationship between banks and industry have changed as criticism of bank activity (e.g., in speculative securities dealings) has grown, and as theoretical writings have pointed out the possibilities occasioned by the “industrial kinship” for expansion of bank power and influence. The problem with current criticism of the industrial and commercial interests of the universal banks is that it presumes that past relationships have been carried over to today’s altered legal, sociological, and economic milieu without modification. Such criticism considers neither the narrowed range for excessive exercise of bank power resulting from increased competition nor the concrete patterns of favorable bank behavior that have developed with respect to capital participation policy. Furthermore, current criticism does not give sufficient weight to the macroeconomically significant functions performed by the banks. If one assumes that bank activity should be restricted to furnishing services that concern capital transactions and maintenance of accounts, then the existence of capital participations in industrial and commercial enterprises represents an alien phenomenon. The assertion that bank capital participation has nothing to do with credit transaction functions, however, cannot be maintained. Sufficiently close connections can and do exist between the capital shareholdings of the banks and their other banking tasks to justify including capital participations realistically among the list of proper banking responsibilities.

Opinions of the propriety of bank capital participations are a function of the particular economic context; they have no claim to a greater general validity. For example, during the speculative promotion period in German history (there was extensive founding of enterprises during the 1870’s), bank participation was vital to rising enterprises, but this influence declined with the growth of the capacity of the enterprises to generate capital themselves. The increasing financial indepen-
dence of industry, through the development of both suitable liquidity policies and alternate financial sources, vastly undercut this ability of banks to influence industrial financing unilaterally. The present capital shareholdings of banks are thus to be viewed not as instruments for domination of enterprises, but rather as aspects of market policy that do not interfere with competition.

The allegation that universal banks will attempt to secure a monopoly position through capital participations in order to force unfavorable terms upon enterprises is not supportable. If the terms demanded by a bank depart from market norms, then the competitive position of the enterprises will be affected, its profitability will be impaired, the market value of its capital will decrease and its own equity position in the enterprise will deteriorate. Banks will eschew short-term profit growth resulting from this type of conduct, since the exercise of any influence that weakens the position of the enterprise in the market will always endanger the credits the bank has extended to it. On the other hand, bank counselling, as house bank or through board influence, that increases the market value of the enterprise's capital cannot be objectionable. Thus, the assumption that capital interests are automatically unfair and anti-competitive cannot be maintained in light of conditions that exist in the real world.

Other motives besides the desire to stabilize profits must be considered in an examination of capital participation. Universal banks have often been forced to take over blocks of stock in order to rescue enterprises in distress; in many cases participations have been acquired at the request of the relevant enterprises or of large individual stockholders. Universal banks are also able to perform a helpful role in encouraging beneficial industrial concentration through mergers or cooperative endeavors. These bank participations are further useful in the case where it is necessary to maintain the independence of the enterprise against influence by a third party, or to prevent outside or foreign participation in the event of reorganizations, inheritance disputes and the like. As a rule, capital participations in these cases are perceived as simply temporary, limited "transitional situations", as the reshuffling of bank portfolios indicates.

The long-term capital interests found in the possession of the universal banks, which frequently originated as involuntary or unplanned participations on the occasion of reorganizations, debt conversions, etc., have quite often become basic profit centers. The divestiture of these profitable holdings would diminish business opportunities and the earning power of individual banks. Prior volume to risk ratios would no longer be justified and the banks would be forced to curtail the growth oriented policy that has heretofore produced numerous new and important economic developments. The microeconomically directed bank actions of seeking profitability through risk spreading thus serve to fulfill macroeconomic goals as well.

It is true that bank concentration could increase beyond the desirable level where structural weaknesses are eliminated to a point of macroeconomic danger. Such a concentration is, of course, harmful to competition and is not advocated here. It is merely argued that attempts to place arbitrary limits on the extent of
bank equity (such as the five percent limit advocated in 1976 by the Monopolies Commission) are based more on general antitrust philosophies than on sensible economic or regulatory policies.

B. Proxy exercise

The corporation law grants to every shareholder of a joint stock company the right to participate in general meetings as an exercise of shareholder rights. Universal banks often represent stockholders in these meetings [9], in which the banks exercise the voting rights of shares they do not own but merely hold in custody and administer for customers. The capital represented in this manner usually constitutes the major portion of the total share capital represented in the general meetings of the enterprises. Bank proxy voting is necessary because of financial, time, and capacity considerations since, given the large number of shareholders in the public joint stock companies today, one hundred percent attendance at general meetings is not only unrealistic but unworkable.

Practical experience shows, moreover, that the average middle or small shareholder is neither interested in, nor in the position to personally exercise his voting rights. This situation cannot be altered through an increased orientation of the corporation law toward the rights of individual shareholders or by an elimination of third party proxy exercise. For this reason, German banks mediate, subject to detailed legal provisions, between essentially passive shareholders and the managements of enterprises in the general stockholders’ meetings. Shareholders, often owning only minimal amounts of securities, authorize the bank administering their deposit to exercise their right to vote in general meetings. This authorization is limited according to the regulations of the corporation law as to duration and other aspects. Further, in their own general meetings, banks are allowed to exercise this voting right only to the extent that the shareholder has made explicit instructions with regard to individual questions. This right of instruction may be traced to the beginning of the twentieth century when, although participation in general meetings was generally limited to large shareholders, the presence of original capital of less than twenty-five percent was no rarity.

Any method of voting through an agent is subject to criticism unless the small shareholders can be persuaded to play an active role and unless the heterogeneous parties thus articulate their interests in the general meeting. This criticism assumes technical qualifications that in reality do not exist among the majority of shareholders. As pointed out above, disinterest and lack of expertise are fundamental shareholder characteristics with which every proxy voting system must deal. The German universal banks have increasingly attempted in recent years to make the small- and middle-sized shareholders aware of their own direct interest in the general shareholder meetings of the joint stock companies. In fact, German banks have been sending large quantities of information concerning the general meetings to shareholders every year for a long time.
In view of these facts, it is questionable whether there actually exists a sphere of uncontrolled power that urgently requires reform. It must be conceded that up to now the small shareholder has not satisfied his legally intended role. However, the present attitude of the shareholder with respect to abstaining from the exercise of voting rights is not necessarily irrevocable; it is possibly subject to alteration. Thus, reinforced efforts at education of shareholders towards increased utilization of their power to give voting instructions could reverse this situation. In addition, if small shareholders were also encouraged to contribute new conceptual input, a large step would be taken toward the legally mandated expansion of their potential for control and influence. Banks would then become mere transmitters of voters' decisions, not makers of those decisions. This development might mark a more appropriate direction for reform of shareholder voting methods than the adoption of the American system in the German context.

The present outlook of many universal banks is explained by their increasing interest in a high turnover business, as shown by the advertising directed at the "little man" with his checking account and his savings and securities deposits. Indeed, banks project this type of business as another primary source of expansion, in addition to their large industrial customer business. Therefore in a situation of conflict between large public corporations as large customers of the universal banks on the one side and individual shareholders as small customers on the other, the universal banks cannot afford to unreservedly favor the corporations if they want to win or retain the trust of the small customer. This has been proven true in various general shareholders' meetings in recent times. Critical reformers nevertheless contend that stock voting rights should not be left to the banks in the previously "uncontrolled" form.

C. Interlocking board membership

In addition to financial relationship, the personnel interlockings on supervisory boards, management boards, and advisory bodies between the universal banks and enterprises of industry and commerce are also criticized as sources of excess bank power. Here too, criticism stems from the assumption that the possibility of influencing the other party, and the exercise of this possibility, would de facto lead to a short-circuiting of competition among banks. It is additionally contended that bank capital participations will further reduce competition between large and small banks through the development of so-called house bank monopoly.

Actual opportunities for the bank represented on a board of directors to exercise influence are in fact provided for by legal provisions respecting the powers of the board of directors. Critics still complain that, by virtue of this position, banks gain insight into underlying data respecting business relationships that is not accessible to the public. It is necessary to remember that the framers of the corporate law assigned meaningful powers to the board of directors; their basic intent was to create an experienced and efficient control organ. It is precisely their expertise which
makes bank representatives particularly suited to the performance of this function.

Moreover, certain banks are represented on industrial boards of directors by only a single representative. Thus, since no member of the board can make a decision by himself when several representatives of different institutions share in the supervisory function, the power potential of an individual director shrinks markedly.

The mandate of the universal bank representatives in upper level management may be justified by their expertise and experience. Thus, the desire of industrial and commercial enterprises for bank cooperation in financial policy planning is commonplace. Bank concern with risk and the advisory role in the formulation of enterprise financial policy make personal interlockings on the board of directors advantageous to both sides. Furthermore, the inclusion of knowledgeable bank representatives on the board of directors often results in an increase in the credit worthiness of the enterprise. The directorships held by the universal banks are therefore not merely a result of the criticized proxy voting rights. Yet critics nevertheless call for further curtailment of bank directorships.

It is also difficult to conceive of a manipulation influence on the part of the universal banks in light of the degree of regulation and the increasing autonomy of boards of directors of the joint stock companies in industry and commerce. The balance of bargaining power between enterprises and banks have, in comparison with the "speculative period" in German history, notably shifted in favor of the enterprises as the latter have decisively increased their financial independence. In the fields of investment and financing as well as credit financing, industries are now able to play off banks against one another. This independence plus the advantages that bank presence on boards provides for enterprises indicate that the universal banks would be awarded their seats on enterprise boards even absent their shareholdings and proxy voting rights.

D. Underwriting activities

The power of both private and public universal banks is manifested for some critics by their representation in nearly all private securities issuing consortia as well as in public debt placements. Yet the beneficial role played by banks in the service of optimal mobilization and utilization of capital in underwriting transactions is also clearly visible. Banks are prominent in these areas for the following reasons:

(i) Universal banks have large financial resources which make them indispensable to issuers.
(ii) Universal banks offer economic consultation services to securities issuers which help to avoid negative impacts on the sensitive German capital market.
(iii) Universal banks possess an extensive distribution system in their nationwide and closely-knit network of branches; thus even small investors in all sections of the Federal Republic can be reached, with the result that the success of an issuance is generally assured.
(iv) Universal banks make available their "issuing credit" *i.e.* their reputations with the general public, in order to guarantee the success of the issue, the quality of the securities, and the orderly administration of the issuance.

(v) Universal bank assumption of issues presents a source of monetary capital immediately available to issuers that allows for risk to be shifted from the issuers onto the banks.

(vi) Universal banks also fulfill the subsequent administrative responsibilities as well as other tasks related to the circulation of new issues.

Universal banks bear a considerable risk by purchasing excess portions of issuances in many cases since unplaced securities cannot be returned to the issuer. Financial institutions of less capacity are unable to perform this macroeconomically valuable service to the same extent. In the second stage of the issuing process, the distribution of the securities among the public, the universal banks operate to identify those customers who have a view toward long-term investment. With their broad financial bases, the banks are not dependent upon immediate sales in the largest possible lots with a subsequent frequent turnover; they are thus able to proceed carefully in the interest of the capital market and the small- and middle-sized investors. Particularly in the sale of bonds, the universal banks can, because of their expansive network of branches and their thorough familiarity with a broad range of customers, insure that it is primarily long-term investors and not speculators who purchase the securities.

If a deterioration in the capital market creates difficulties in placing the securities within the planned sales period, the universal bank is contractually obligated to keep the unplaced securities itself, paying full value to the issuer. In this case, the universal bank becomes for the time being the final transferee. Thus, an issuing transaction which was essentially meant to consist of pure *mediation* between capital supply and capital demand produces an unplanned *credit transaction.* If a financially powerful universal bank were not available to bear this burden, the economy and the investors would not be protected against a serious capital market disturbance.

In many countries securities are frequently bought in blocks by institutional investors such as pension funds and insurance companies. Because of the particular capital market structure in the Federal Republic, however, the sale of securities must be directed to broad segments of the private public. The expansive distribution network of the universal banks, enlarged particularly after the 1958 repeal of the "examination of economic necessity" rule for new branches, is thus indispensable to adequate placement of an issue. This system provides an advantage over centrally located specialized securities banks which cannot reach the same range and quantity of the population as the universal banks without establishing a similar network. As the cost and revenue problems of American brokers have recently shown, widespread branching of specialized banks is unlikely.

It is further questionable whether specialized securities banks could assume
liability for prospectuses in accord with the stock exchange law. They depend on quick and remunerative turnover in their single-base business, and the pressure thus created could present an impediment to the undertaking of a careful investigation in connection with the issue and the assumption of liability for the prospectus. The broad mass of the small, relatively uninformed capital investors would thereby be disadvantaged.

In most issuances there will have been an extensive business relationship between the universal bank as house bank and the issuer of securities before the issue. Real advantages for both issuers and securities purchasers, rather than detrimental conflicts of interest, result from this relationship. When the universal bank functions as house bank of the issuer, its duties are not limited to keeping accounts, but often also encompass representation on the board of directors of the enterprise in question. It is obvious that the house bank will also handle the execution of upcoming issuances, since a special relationship of trust will have evolved from the comprehensive involvement of the bank in the customer's business. The bank will thus be afforded continuous insight into the economic situation and prospects of its credit and issuing customers. It is this "insider knowledge", in a positive sense, on the part of the bank that provides information essential to sound industrial financing and helps to avoid the special risks and potential dangers of involuntary long term capital investments.

The issuing business of the universal banks usually begins with counselling issuers with respect to the determination of the conditions of the issue. In this connection the seasonally and cyclically conditioned situation of the money and capital markets, the investment habits of the public, and the needs of the issuers need to be taken into consideration in order to lay the groundwork for smooth placement. Thus, because of their wide-ranging experience, their extensive business relationships, and the amount of resources at their disposal, the universal banks' cooperation is indispensable to the issuing enterprises. A bank voice in the formulation of the issuance conditions is also required because if they are eventually required to accept the securities for their own account or to grant credit, they will become involved in risk to such an extent that a failure of the issue would not only tarnish their reputation but also strain their liquidity. The existence of a bank say in corporate decision making is thus not an attempted "power play", but rather a legitimate requirement serving the interest of the depositor-customers and the stability of the credit industry.

An issue of industrial bonds and stocks is only successfully completed when an orderly market has been formed for the paper and an orderly stock price has been guaranteed. The universal banks serve the function of carefully watching the quotations of securities that they have recently issued, in order to avoid undesirable disruptions of the quotations and smooth out sudden and severe change fluctuations.

In sum, the large banks in issuing consortia do not play the role of instruments for the exercise of power, but rather of providers of normal services in the interest of the issuing industrial enterprises and issuing public authorities on one hand and investors on the other.
In opposition, critics take the position that universal banks are not concerned with promotion of the securities market and that their counselling influence is more obstructive than conducive to the attainment of capital market policy aims and socio-political goals. They argue that (1) the credit business based on deposit accounts is more profitable than the securities issuance and brokerage businesses, and (2) there is a trade-off between credit and issuing operations on one side, and deposit and securities operations on the other, in which the promotion of one type of business can only be made at the expense of the other. The opinion that there is a connection, based on biased financial advice, between the business policy aims of the universal banks and the behavior of potential issuers and investors stems from misconceived assumptions and hypotheses, rather than from an analysis of the actual behavior of the banks.

It is necessary to ask whether the current situation of the German securities market, often characterized as deficient in equity financing and in the percentage of household investment in securities, is the result of bank policies or of other influences. It is not clear that universal bank investment counselling is primarily directed towards financial advice that most favors their own economic goals without considering the interests of the investing customer. The competition of the market exercises a strong restraining influence since misconduct by an advising bank would result in the loss of customers to competitors.

Criticism of financial counselling of large customers is also problematic. Because of their size, enterprises capable of making a securities issue often require extensive administration with special staff positions for the preparation of financing decisions. This internal corporate staff will, as a rule, rely upon counselling by the universal banks and will seek to utilize bank familiarity with the current capital market situation. This bank information, however, enters into a complex financing calculation only as additional, subsidiary information along with a mass of other corporate and external data. Large enterprises generally possess a strong negotiating position vis-à-vis the competing universal banks and will thus in practice not allow themselves to be influenced to act inconsistently with their financial plans.

The assumption that universal banks are intent on substituting credit for security financing is particularly misconceived. Rather, there is a complementary relationship between these two forms. Since adequate enterprise capital is a prerequisite to a sound credit transaction, banks have a strong interest as creditors in seeing that a proper debt to equity ratio is maintained by debtor corporations. If this balance is not attainable through self-financing in light of given macroeconomic data, then the banks are induced to encourage recipients of their credit to strengthen their capital bases through an increase in share capital. The assumption that universal banks attempt, through exerting influence on the potential issuing enterprises, to reduce the percentage of stock issues in order to maximize long-term credit operations is thus not plausible. This is especially true since universal banks, by consolidating bank credit through stock issues by the recipients of their credit, are able to realize gains from the issuing operation.
Universal banks are also strongly interested in the maintenance of a functioning securities market as a means of securing their own liquidity, since profit maximization is not only restricted by risk aversion, but by the banks' need to maintain payment capabilities at all times. Universal banks enjoy a significant advantage in the maintenance of efficient liquidity by being able to combine securities operations with other bank services and thereby to mobilize cash when needed.

The view that because of profit considerations banks favor credit over issuing transactions presents the question of whether the capital needs of German enterprises have been sufficiently and appropriately met. In response, it is necessary to note that the German economy has relied upon the banking system with good results ever since the beginning of industrial development in the nineteenth century. Particularly, whenever other banking groups were unable to meet customer demands, the economy has depended upon the universal banks. In addition, the great reconstruction accomplishments and economic progress after the last war would in all likelihood not have been realized as quickly without the universal banks. Finally, there is also statistical evidence to refute the assertion that financing in the Federal Republic is composed of too much bank credit and not enough securities.

Certainly the universal banks, as well as other banking groups, concentrate on the development of individual branches of business in response to the forces of supply and demand in the market economy system with consequent fluctuations in the priorities given to individual services. There is no fundamental preference, however, for savings and credit operations over the securities business. A large universal bank that offers enterprises a broad choice of credit and issuing transactions, and makes available to individual customers varied deposit and investment possibilities, creates more of a balance than a conflict between savings and investment.

E. Credit supply decisions

Critics of the universal system point out that it is not only as counsellors, but also as creditors, that banks are able to exercise undue influence. It is argued that because of their ability to grant or withhold credit universal banks are accorded an excessive and uncontrolled influence over the investment decisions of industrial and commercial enterprises, and consequently over the development of the entire production process. Yet credit decisions made by banks in the normal course of business are merely designed to select the most credit worthy and profitable transactions according to the selection principles of a market oriented economic order. Moreover, bank decisions regarding the extension of credit reflect the decisions mandated by the Banking Act (KWG) as part of regulation designed to protect the credit system; for example, credit institutions are expressly required by bank supervisory authorities to enforce disclosure by recipients of credit. Finally, there are safeguards against improper credit decisions in a competitive banking system such as Germany's since any industrial borrower with sufficient credit worthiness can
turn to a broad choice of private and public banks as alternative to a rejection. This is especially true in times of high bank liquidity.

F. Interference with central bank policy

The allegation is also raised that because of their great capital strength, universal banks are in a dangerous position to counteract the German Federal Bank's regulatory measures regarding monetary policy. The response is that since the floating of the Deutsche Mark against the dollar and most other currencies the central issuing bank has been placed in an adequate position to implement its domestic monetary policy. Given a restrictive central monetary policy, banks will not be able to resist reductions in credit supply for long. In the event that an overall expansion of credit is desirable it is of course possible that the banks, despite reduced refinancing costs by the central bank, might not immediately reduce the credit costs to their customers in order to increase profits; but it is questionable whether, given competition, such a course can be maintained for long. In addition, the macroeconomic responsibility of the banks has a high profile in the public eye today, and the fear of public rebuke encourages bank conformity to central policies.

In this fundamental discussion concerning the possibilities and limits of regulatory measures regarding monetary policy by the central bank, questions must be asked concerning the quantitative and qualitative policy instruments generally deemed necessary, as well as the extent of the autonomy of the German Federal Bank as against the government. This economic policy debate, which from time to time flares up in the Federal Republic, is however far more complex than the theme dealt with in this article [10].

7. Toward the meaning of fundamental economic and social policy concepts within the framework of the discussion concerning the "power of the (universal) banks"

In the final analysis, the most prominent feature of the universal banking system in the Federal Republic is its microeconomic operational efficiency which simultaneously leads to credit system stability, and thus makes a valuable macroeconomic contribution. On the other hand, the system certainly contains the potential for conflict situations that could work to the detriment of customers. Many of these situations are, of course, also found in other banking systems. In Germany they are adequately corrected by competition.

Principles of the market economy demand that new and better answers to these problems be continually sought. In the Federal Republic these answers come from a variety of perspectives. Some criticism of the banks attempts to master problems within the context of the existing economic and political order. On the other hand socialist theoreticians, a minority group, call for socialization of the banks (especially the large banks) in order to make the credit system serve "societal" rather
than only "profit oriented" goals. At the same time Marxist theoreticians seek similar ends through nationalization. Demands for nationalization or socialization of the banking sector and the concept that banks abuse their power form the backdrop of many economic and political discussions. Conducted in the press, on radio and television, among scholars, and above all by political groups of varying color, these discussions are especially characterized by a mix of emotion-laden terms such as "bankocracy", "dominion of finance capital", and similar verbal symbols.

Critics calling for bank nationalization are distinguishable according to whether they envisage retention of the present economic system or demand a basic change in the system. Arguments of the former group emphasize "defects" in the existing universal banking system, as epitomized by the undesirable power position of the universal banks. It cannot be overlooked, however, that arguments are asserted by some critics only to conceal their real goal, since argumentation that is directed only against the power of the banks appears to be more readily received among the general public than that calling for system altering nationalization.

The second group of critics is openly in favor of altering the system. For them, nationalization of the credit system is the most important stepping stone toward transformation to a centrally planned (socialist) economic system. Their position is that non-optimal resource allocation by the free market mechanism and a credit system run on the basis of decentralized, business oriented decision-making attains purely profit oriented instead of "societal" goals, while nationalization of the banks with a centralized distribution of resources according to an over-arching central economic plan could better fulfill real "social" needs. These critics do not pay attention to arguments involving improvements of the present system, and thus ignore the phenomenon of competition which limits the abuse of bank power. They also overlook legal norms and supervisory organs as well as public controls, especially those exercised by the press, which comprise counterforces refuting the wholesale charge of omnipotent bank power.

The call of socialist theoreticians for socialization of banks and other large enterprises reflects the wish for elimination of the profit oriented control of credit as a fundamental element of the market economic order. Conversion to so-called "societal property" is supposed to replace the "anarchy of the market" with conscious, societal shaping of the production and distribution processes; that is to say, microeconomic "irrationality" is to be dispelled by macroeconomic "rational" planning.

These political demands for socialization of banks and other private property turn on the fundamental question of whether the investment decisions important for economic and social progress may best be made individually or collectively. Experience has clearly shown, however, that economic activities based upon a microeconomic and decentralized decision making system exhibit great elasticity and flexibility. A system of opposing enterprises in competition with each other creates not only continual improvement and increase in production, but also provides a control mechanism that curtails and rolls back the potential growth of
power. Given the active competition which is a prerequisite to a functioning market economy, the decision as to the correctness of an investment will ultimately be made by the market as a whole.

Advocates of bank socialization or nationalization intend to draw the banking sector into structuring the economy and society through a master plan. This principle holds true despite varied emphasis in individual designs for economic and societal master plans. The complex problem directly addressed by the term “investment control” is thus closely related to the bank nationalization question [11]. It is often in this context that the postulate of bank socialization or nationalization introduced from scholarly and political quarters fits. Influence of the investment structure through the banking sector will in any case be sought via control of credit. In a hitherto market oriented economic system, bank socialization will simply be seen as the instrument with whose help direct control of investments would be realized through imposition of credit control measures.

Notes

[1] For a full exposition see Büschgen, Das Universalbankensystem (Frankfurt, 1971).
[6] For details in connection with this, see Hopt, op. cit. supra n. 5.
[8] The concept of “finance capital” can be traced back to the Austrian Marxist theoretician Hilferding, who explained the origin of finance capital through changes in the circulation of capital, which in his view lead to monopolization of bank capital and eventually systematic bank influence over production. While Lenin, in the framework of his theory of imperialism, grasped the concept of finance capital in a similar way as a fusing or coalescing of banks with industry, a number of contemporary Marxist-Leninist theoreticians believe that the Federal Republic has already passed beyond the phase of finance capital. In their view, finance capital stands much less at the center of a turbulent development than does the government itself with its intervention in economic policy. This doctrine of “state monopoly capitalism” reduces the complex reality of Western industrial states to a common denominator, i.e., that the institutions and policies of such states as the Federal Republic of Germany are controlled totally by the power of private capital.
[9] In the Federal Republic, such voting rights are exercised not only by banks but also by other third parties, especially small shareholders’ associations.
[10] See Büschgen, Die Frage der “Macht der Banken” im Spiegel wirtschafts- und gesell-

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