Impediments to Financial Development in the Banking Sector: A Comparison of the Impact of Federalism in the United States and Germany

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STUDENT NOTE

IMPEDIMENTS TO FINANCIAL DEVELOPMENT IN THE BANKING SECTOR:
A COMPARISON OF THE IMPACT OF FEDERALISM IN THE UNITED STATES AND GERMANY

Khalil Nicholas Maalouf*

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I. INTRODUCTION

This Note examines how differences in U.S. and German variants of federalism have contributed to the formation and development of the dual banking system in the United States and the three-pillar banking system in Germany. Specifically, this Note considers the manner in which federalism has informed the respective banking systems' reactions to dynamic changes in the global banking industry and analyzes the role

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federalism has played in contributing to or impeding reform efforts in the United States and Germany.

U.S. federalism has limited the regulatory powers of the states in the field of banking considerably. This power dynamic provides the federal government with a trump when it chooses to accomplish system-wide reform, thus rendering consolidation of the U.S. banking system more achievable once a consensus is reached at the national level. The U.S. federal government's broad powers to legislate for and regulate the banking industry enable the federal government to create a facilitative framework for reform and, if need be, implement reforms to a point where the very suitability of the label—the dual banking system, which implies some sort of parity among federal and state regulatory bodies—is questionable. As a result, policies backed by a national consensus, as defined by a public choice or a public interest paradigm, are arguably effectuated in the United States with greater ease. Given the U.S. variant of federalism, reform of the regulatory scheme is dependent on the attainment of a government consensus at the federal level sufficient to pass new legislation or, at a minimum, to allow for the introduction of a new regulatory paradigm that would manifest itself through agency action.¹

In contrast, the German variant of federalism protects the institutional arrangement of the three-pillar banking system, the contours of which were heavily influenced by longstanding constituent state aims of achieving certain public policies.² Because the German system is not as malleable as its U.S. counterpart, the prospect of developing a more profit-efficient banking structure through greater consolidation is hampered. Notwithstanding reform efforts by private actors that are similar in intensity to those that have taken place in the United States, the extensive network of German subnational public-sector banks can still impede regulatory and structural reform of the banking system through reliance on extensive support from their public backers. As a result, the dominant

¹. For example, the national bank regulator's reading of the "closely related to banking" standard with respect to what kind of securities activities bank holding companies could engage in was significantly liberalized during the 1980s and 1990s in conjunction with a growing perception at the national level that the separation of banking and securities was not efficiency-enhancing. Chevron deference allowed the national bank regulator to act decisively to bring down this barrier in the banking system without having to go to Congress, where the regulator could encounter opposition to liberalization. See Jonathan R. Macey, Geoffrey P. Miller & Richard Scott Carnell, Banking Law and Regulation 443–44 (2001).

². Involvement of subnational entities in the banking industry, with the principal aim of offering the poor and the middle class a place to put their money, predates the postwar period. For example, forty-six percent of the 1,765 Sparkassen operating in Prussia in 1913 belonged to a city. Around twenty-three percent belonged to a county, and ten percent were either privately held or belonged to an association. Timothy W. Guinnane, Delegated Monitors, Large and Small: Germany's Banking System, 1800–1914, 40 J. Econ. Literature 73, 85 (2002).
Changes in the Global Banking Industry

Changes in the Global Banking Industry

position of the subnational public-sector pillar in Germany is maintained by virtue of its entrenched political status, a status that is perpetuated by the numerous disincentives at the grassroots and constituent state levels to enact far-reaching reforms of Germany's financial architecture. The very subnational governmental entities that would otherwise serve as the main avenues to effect change under Germany's constitutional scheme are arguably the entities most interested in maintaining the status quo. These constitutional protections provide some beneficiaries of the status quo banking system with veto power that they can wield against reform efforts aimed at changing the legal status and the market behavior of the subnational public-sector banks.

While the German federal government, or Bund, could introduce a framework that would, to an extent, facilitate efficiency-enhancing change to the banking system, the Bund is unable to serve as the effective implementer of reform by using its legislative and regulatory powers to rearrange market incentives to precipitate system-wide change and, ultimately, cross-pillar consolidation of the German banking system. In view of Germany's banking structure, and the constraints that its variant of federalism places on the manner in which the Bund is able to exercise its powers to legislate and regulate, the Bund faces more hurdles than its U.S. counterpart in forcing change on the banking field even if a nominal consensus is reached on the national level.

Unlike the United States, the achievement of structural reform of the German banking system would require reformers to persuade individual regional governments and their respective subunits to refrain from interfering in an area of the economy that these public entities directly influence, and from which they derive benefit. The current configuration of German bank regulation, which is embedded to a large extent at the superstructure level of the banking system—in addition to being effectuated through regulatory bodies that play a supervisory role over the entire banking system—is likely to remain largely unchanged for the foreseeable future. As such, the structure of the German banking system appears entrenched, a predicament illustrated by the formidable battle that reformers face in convincing subnational political entities to carry out reforms, given that many such reforms may be adverse to these subnational governments' economic interests even though they may be welfare enhancing at the national level.

The operations of banks in both the United States and Germany have been constrained by regulatory systems that further many of the same public policies. Such public policy goals include promoting safety and

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3. This analysis assumes that such a framework is not collectively blocked by the Länder by virtue of their power in the Bundesrat. See infra Section IV.B.
soundness in the banking sector, ensuring the effectiveness of monetary policy, preserving a degree of local control over the regional or local economy, promoting the supply of credit to all market segments, encouraging community reinvestment, and enhancing consumer protection. In the United States, these public policies are implemented to a greater extent by regulation of a supervisory nature, albeit they occasionally take a form that is structurally intrusive. In Germany, on the other hand, public policies are largely achieved in structurally intrusive ways, which in conjunction with the German variant of federalism give rise to banking institutions and practices that are largely shielded from reform due to the indirect constitutional protection they enjoy.

Part II of this Note provides background on the global consolidation trend in various banking markets. Part III discusses the impact of U.S.-styled federalism on the development of the U.S. banking system. Part IV discusses the role of the German variant of federalism on the development of the German banking system and argues that German federalism, in contrast to its U.S. counterpart, imposes constraints on the development of the German banking system by protecting subnational public-sector banks at the expense of other pillars of the banking system, in particular the commercial banking pillar. The competitive advantage that the public-sector banks enjoy, derived from both overt and subtle public backing—a practice entrenched by Germany’s variant of federalism—hampers the competitive position of banks in other pillars. As a result, the development of the German financial system, when using bank profitability as a proxy, is stymied in both a static and dynamic manner. Part V argues that U.S. constitutional constraints and


5. A salient example of how the U.S. and German banking systems promote public policies in different ways is the manner in which each system attempts to fulfill the goal of providing banking services to the poor. In the United States, banks are obligated to service low income and minority areas in order to obtain a satisfactory Community Reinvestment Act evaluation, a factor that bank regulators take into account when approving mergers with or acquisitions of other banks. See Michael S. Barr, Credit Where It Counts: The Community Reinvestment Act and Its Critics, 80 N.Y.U. L. Rev. 513, 517 (2005). In Germany, however, one of the very purposes of subnational public sector banks is to serve low income market segments. See Ulrich Immenga & Joachim Rudo, Unlimited Liability of State-Owned Banks Under the EC-Rules of State Aids 6 (1998).

6. In terms of total bank assets and liabilities, subnational public-sector banks comprise a substantial part of the German banking system and are accorded indirect constitutional protection. See infra Part IV.

7. The scope of this Note is limited to the consideration of the impact of federalism on the execution of efficiency-enhancing reforms that promote or facilitate consolidation of the banking sector in the United States and Germany. In the case of Germany, this Note focuses in particular on reform that would give rise to cross-pillar consolidation.
jurisprudential precedent show that a banking system similar to that of the three-pillar system could not develop in the United States.

II. BACKGROUND

Global banking markets, and the firms operating therein, have undergone significant restructuring over the last twenty years. By the 1990s, there was a growing appreciation worldwide that many of the public policy aims that justified a significant portion of banking regulation could be achieved via less structurally intrusive regulatory schemes. Technological advances, including improvements in communication, product standardization, and reductions in the cost of processing information, have equipped global banks to expand over geographies, giving rise to institutions that are able to translate economies of scale and scope into higher profits. Bank regulators across the globe have taken note of the utility of greater bank consolidation, viewing it as a principal means of achieving enhanced efficiencies within the banking sector.

Underlying this policy shift is the premise that by removing barriers to greater market concentration, dominant banks will be better positioned to conduct business with efficiently sized units, generating more profit from enhanced economies of scale and scope. As an illustration, consolidation tends to improve a banking market's cost-to-income ratio. The number of banks operating in a country influences this ratio because

8. A significant amount of regulation is geared toward preventing bank failure, a particularly bad externality that can impair the banking system, disrupt the payment system, hurt the real economy, and complicate monetary policy. Newer forms of regulation, such as functional regulation and self-regulation, attempt to prevent bank failure in a less intrusive manner. It is difficult, however, to quantify the success of these new regulatory measures. Nonetheless, the calls for deregulation were clearly perceptible by the late 1970s, and have since been a major theme among bank regulators. See Kenneth E. Scott, The Dual Banking System: A Model of Competition in Regulation, 30 Stan. L. Rev. 1, 48-49 (1977) ("Banking quite possibly is the most extensively regulated of all industries, and there is a growing body of opinion that much of the regulation is ineffectual, costly to the public and, in view of the existence of federal deposit insurance since 1933, redundant.").

9. In the United States, for example, the watershed moment occurred when the Treasury Department began talking about U.S. "superbanks" that would compete with comparable banks in Japan, Germany, the United Kingdom, and France. See Carl Felsenfeld, Banking Regulation in the United States 208 (2d ed. 2006). See also Reinhard Lahusen, Bank Performance in Europe: Great Progress Through Consolidation—Except in Germany, Deutsche Bank Res. EU Monitor, June 28, 2004, at 4 (noting also that over the past few years, many European countries have witnessed the emergence of large, influential, profitable banks operating in increasingly concentrated domestic banking markets).

10. Lahusen, supra note 9, at 5 ("Even though market structures are only one type of cause of lower financial results in comparison to other domestic banking systems)—alongside cyclical factors and the strategic orientation of the banks—the German banks would be considerably more successful if the peculiarities of the German system were brought into line with standard international practice.").
the ratio implicitly factors in, for example, the cost of operating head-
quarters facilities, which are more numerous in diffuse banking systems. Germany has the highest banking density in Europe, posting 3.1 banks per 100,000 inhabitants, which has a detrimental effect on the banking system's relative efficiency and profitability. In contrast, the United Kingdom has .6 banks per 100,000 inhabitants. In Germany, the top five banks control less than twenty percent of total domestic assets. In the United States, just three banking institutions hold twenty-five percent of the nation's domestic deposits. Furthermore, the German banking sector employs more people than the banking sectors of France and Italy combined. In terms of productivity, on average German banks trail U.S. banks by thirteen percent. As bank regulators in many of the large industrialized economies view greater consolidation in a more favorable light, regulators in profit-lagging banking systems are under pressure to take deliberate steps to facilitate market concentration, lest the banks operating under their jurisdiction fall behind in relative competitiveness.

III. THE IMPACT OF U.S.-STYLED FEDERALISM ON THE DEVELOPMENT OF THE BANKING SYSTEM

Scholarly literature has referred to the U.S. banking system as a dual banking system, a categorization that is a reflection of overlapping federal and state regulatory jurisdiction over members of the banking sector. Although the U.S. dual banking system may intimate a system of dual federalism, implying that banks operating within the jurisdiction of the United States are subject to two separate, equally powerful, and distinct juridical systems, such a portrayal does not appropriately describe the legal reality.
Commentators have remarked that while politicians on the federal level have tweaked aspects of the dual banking system, any dramatic change to its underpinnings has traditionally been blocked by its "sacred cow" status in the American political tradition. However, the power imbalance in favor of the federal government in light of the Commerce and Supremacy Clauses undermines the suitability of the dual banking system label. While the perception of the existence of a more equal dual banking system lends credibility and force to political safeguards for a variant of federalism that, depending on the strength of such safeguards, shifts regulatory power in the field of banking to the constituent states, the supremacy of federal regulatory powers nonetheless renders the dual banking system label somewhat artificial.

Due to U.S.-styled federalism, typified by its asymmetric distribution of federal-state powers, constitutional concerns with respect to preserving a state role in the realm of banking give way to efficiency-enhancing regulatory preferences once a national consensus is reached to take such a reform path.

To gain a better idea of how the dual banking system developed and to better understand its malleability in the hands of the U.S. version of federalism, Section A will analyze the development of U.S. banking regulation through the rubric of federalism. Section B will then analyze how the underlying asymmetric power dynamic of U.S.-styled federalism has contributed to consolidation of the banking system. Specifically, it will look at this phenomenon in the context of the relaxation of regional restrictions on banks, and the role that U.S. federalism played in paving the way for a more profit-efficient institutional banking arrangement.

18. See, e.g., Geoffrey P. Miller, The Future of the Dual Banking System, 53 Brook. L. Rev. 1, 1–2 (1987) ("Questioning the underlying premise of the dual banking system has traditionally been outside the borders of permissible political discourse.").
20. See, e.g., Scott, supra note 8, at 1 (1977) ("The dual banking system . . . is a vital national goal with roots deep in our constitutional history, and one of the very reasons why this country has achieved an economic growth unparalleled among the nations of the world.") (quoting F. Shelby Cullom, a representative of the National Association of Supervisors of State Banks).
21. See Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528, 548–554 (1985) (reasoning that the proper safeguards of federalism in preventing congressional overreach and, more specifically, preventing Congress exercise of its commerce powers, is in the very design of the federal government, by virtue of state indirect representation in the Senate, House of Representatives, and electoral college, thus obviating the need for the cultivation of a "sacred province of state activity").
A. The Development of U.S. Banking Regulation through the Rubric of Federalism

Unlike the Canadian Constitution Act\textsuperscript{22} and the German Grundgesetz,\textsuperscript{23} the U.S. Constitution does not explicitly grant the federal government powers over banking.\textsuperscript{24} However, the U.S. federal government may regulate banking through its Commerce and Supremacy Clause powers.\textsuperscript{25} Around the time of the drafting of the Constitution, state-chartered banks existed in Philadelphia, New York, and Boston.\textsuperscript{26} During the United States' formative years, a significant question was whether the federal government's constitutional powers were such that it could charter a national bank.

In the landmark case, \textit{McCulloch v. Maryland},\textsuperscript{27} the Supreme Court answered whether, and by what right, the federal government could establish a bank.\textsuperscript{28} Chief Justice Marshall, in interpreting the federal commerce power to prohibit Maryland from taxing the federally chartered central bank, sustained Congress' power to charter a national bank.\textsuperscript{29} Later, Justice Jackson wrote in \textit{Franklin National Bank of Franklin Square v. People of the State of New York}\textsuperscript{30} that ever since \textit{McCulloch v. Maryland}, "it has not been open to question that the Federal Government may constitutionally create and govern [national banks] within the states."\textsuperscript{31} Furthermore, the United States established this system of national banks as federal instrumentalities to perform various functions related to credit allocation, including "providing circulating medium and government credit, as well as financing commerce and acting as private depositaries."\textsuperscript{32} The ability of these banks to perform such functions depends on their capacity to attract private deposits.\textsuperscript{33} Justice Jackson stated "[t]hat these federal institutions may be at no disadvantage in competi-
tion with state-created institutions, the Federal Government has frequently expanded their functions and authority.\footnote{Id. (finding no indication that Congress intended to render the use of the term "savings" subject to local restrictions).}

For example, after the failure of the Bank of the United States and the subsequent turmoil of the free banking era, the federal government, led by Treasury Secretary Salmon P. Chase, sought to establish a federal free-banking regime through the issuance of federal charters.\footnote{EDWARD L. SYMONS, JR. & JAMES J. WHITE, BANKING LAW 22–23 (3d ed. 1991).} The federal free-banking regime was set out in the National Currency Act of 1863 and the National Bank Act of 1864, but to Secretary Chase’s dismay, few state banks converted to national charters, largely because federal regulators were stricter than state regulators.\footnote{Id. at 23.} In an effort to induce state banks to become nationally chartered banks, and thus switch chartering authorities, Congress imposed a ten percent tax on bank notes in 1865.\footnote{Id. (“The evidence suggests that it was the hope of Chase, if not of Congress as a whole, that the ten percent surcharge would force all state banks to refrain from issuing their own notes, seek national charters, and circulate a uniform national currency.”).} State banks unsuccessfully challenged the tax on constitutional grounds,\footnote{Veazie Bank v. Fenno, 75 U.S. 533 (1869) (upholding the constitutionality of the tax and the power of the federal government to regulate in a discriminatory manner). Ironically, Secretary Chase, the chief proponent of the tax, later wrote the opinion for the Supreme Court sustaining the legality of the tax. Id.} but they maintained their competitive advantage and independence from federal regulatory interference by developing the checking account, which provided state banks the means of avoiding the punitive features of the tax on bank notes.\footnote{SYMONS & WHITE, supra note 35, at 23–24.} State banks, however, have had to stay two steps ahead to preserve their competitive niche in the face of strong federal regulatory powers that frequently favor national banks over state banks. While agile state banks can occasionally exploit technological and product innovation ahead of their national counterparts, thus preserving a means for attaining a competitive advantage over nationally chartered banks, federal legislators and regulators can easily close these “loopholes” by either preempting the field or issuing competing regulations that level the playing field.\footnote{A state’s primary means of attempting to reestablish the semblance of parity with national banks comes through laws like “wild card” provisions that authorize state banks to conduct any business that national banks are permitted to conduct. Forty-four states have such statutes on the books. FELSENFELD, supra note 9, at 49. However, despite attempting to afford state banks many of the same powers that national banks enjoy, “wild card” provisions have a tendency to entrench the dominance of national bank laws. Id.}

To some extent, the manner in which the U.S. banking system developed has influenced the way politicians and commentators have viewed the rank and importance of federal and state banking regulators,
regardless of the theoretical underpinnings of federal dominance in this field. More specifically, because banks were originally exclusively chartered at the state level, there is a residual sentiment that states should continue to play an important role in bank regulation. However, regulatory arbitrage\(^4\) of the kind found in the U.S. market for corporate charters does not exist in the banking sector because the market for federal and state bank charters is not truly competitive.\(^2\)

The federal government, by virtue of the Supremacy Clause and its Commerce Clause powers, may preempt regulatory diversity or impose regulatory uniformity in the banking sector as it pleases.\(^4\) As a result, the extent to which states are able to exercise their regulatory powers, above and beyond their residual and limited police powers, is dependent on the explicit or implicit authorization of Congress. States may not regulate in an area if the judiciary deems the area occupied by Congress. Express preemption occurs if the intent of Congress is clear with respect to a given issue.\(^4\) Field preemption is implicated if congressional intent can be inferred from the design of the federal law.\(^4\) If a state law interferes with the policy the federal law advances, the federal law will preempt the state law.\(^4\) Also, congressional statutes will frequently offer federal regulators wide latitude to promulgate regulations that preempt state laws.\(^4\) In practice, in instances where the statute is ambiguous, Chevron deference provides federal regulators substantial latitude to clarify the meaning of the statute through subsequent regulation.\(^4\) Given the power-

\(^{41.}\) For the standard underlying true regulatory arbitrage, see Scott, supra note 8, at 13 ("If the differences in regulatory options available to a bank create significant differences in estimates of future earnings, the model predicts that banks will choose to convert to the most profitable option if the costs of conversion are less than the increase in present value generated by it.").


\(^{43.}\) Id. at 694 (stating that the federal government has preempted state regulation with respect to reserve requirements, investment banking services, and bank expansion into different product and geographic markets through holding companies).


\(^{45.}\) Id. at 153.

\(^{46.}\) Id.


\(^{48.}\) See Fid. Fed. Sav. & Loan Ass'n, 458 U.S. at 153 ("Even where Congress has not completely displaced state regulation in a specific area, state law is nullified . . . when compliance with both federal and state regulations is a physical impossibility.") (quotation omitted).

See also Andrew T. Reardon, Note, An Examination of Recent Preemption Issues in Banking Law, 90 IOWA L. REV. 347, 360 (2004) (remarking that in cases where the legislative delegation is implied rather than explicit, a "court may not substitute its own construction of a
ful trump that U.S. federalism allocates to the federal government, federal regulators have significant power over their state counterparts, undermining any notion of regulatory parity that the dual banking system's history may intimate.

This is not to say that the U.S. variant of federalism altogether forecloses the existence of regulatory arbitrage, as Congress does not always choose to occupy the field when regulating financial services. For example, implicit in the McCarran-Ferguson Act, the principal statute allocating to the states the power to regulate the insurance industry, is an anti-preemption rule stipulating that a federal statute will not preempt a state statute enacted "for the purpose of regulating the business of insurance," as long as the federal statute does not specifically relate to the business of insurance.

Over the course of the nineteenth and twentieth centuries, a major focus of bank legislation and regulation was to constrain competition through geographic and product segmentation for largely prudential reasons. In light of this regulatory approach, Congress permitted states to exercise their regulatory powers with respect to both state and national banks operating under their jurisdiction. As a result, banks had a degree of latitude in selecting their regulatory environment by deciding where to be regulated and under what regulatory authority to be chartered. The potential for regulatory arbitrage was considerable because jurisdictions had different rules and regulations on various banking activities. The preservation of regulatory distinctions in the field of banking is dependent on the federal government refraining from passing preemptive legislation. For example, when state banks were dropping out of the Federal Reserve System because of its reserve requirements, the federal government responded by enacting the Depository Institutions Deregulation and Monetary Control Act of 1980, thereby imposing federal reserve requirements on all banks.


\footnote{15 U.S.C. § 1012 (2000).}

\footnote{Id. § 1012(b) ("No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance.").}

\footnote{See First Nat'l Bank v. Missouri, 263 U.S. 640, 656 (1924) ("[N]ational banks are subject to the laws of a state in respect of their affairs, unless such laws interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies, or conflict with the paramount law of the United States.").}

\footnote{Butler & Macey, supra note 42, at 694.}

\footnote{Pub. L. No. 96-221, 94 Stat. 132 (1980).}

\footnote{See Butler & Macey, supra note 42, at 694–95.
Apart from Congress' preemption power, the federal government offers state banks a carrot in the form of federal deposit insurance to elicit their agreement to fall within its regulatory and supervisory umbrella without requiring state banks to switch chartering authorities.55 This insurance scheme is open to both federal and state banks, conditioned on the banks' acquiescence to submit to a broad range of federal regulation.56 Competitive forces pressure state banks to become members of the Federal Deposit Insurance Corporation (FDIC) because depositors overwhelmingly prefer FDIC protection in exchange for their deposits.57 Therefore, the federal government, through FDIC, can exert more regulatory pressure on state banks, even though Congress historically carved out the regulatory domain over state banks with state authorities in mind.

Since the adoption of the Seventeenth Amendment, states are unable to directly prevent an onslaught of federal legislation.58 Of particular relevance is that states are no longer able directly to shape legislation governing what national banks and state banks may do, and the extent to which state regulatory authorities must refrain from regulating national banks operating within their jurisdiction. When Congress chooses not to exercise its regulatory jurisdiction in the field of banking, it does so not because it is constitutionally constrained but rather out of deference to the states' traditional interest in regulating their local banking sectors.59

Due to federal supremacy in the field of banking, the dual banking system does not provide the level of competition its ideal suggests. The system, however, preserves regulatory competition because sufficient vertical competition, between federal and state regulators, and horizontal

55. Apart from paying the requisite insurance premium, state banks are subject to heightened federal regulatory scrutiny in return for insurance coverage. Many of these powers were incorporated into the Federal Reserve Act from the National Bank Act, subjecting state banks to national prohibitions such as "federal examination, interest rate ceilings on time and savings deposits, cease and desist authority, and approval power over domestic branches and merger acquisitions." Scott, supra note 8, at 6. If the federal government is on the hook for insurance, states could exercise their regulatory jurisdiction to attract banks looking to switch their charters. However, by federalizing much of the safety and soundness regulation (reserve and capital requirements), the moral hazard is mitigated and a race to the bottom is prevented.


57. See MACEY ET AL., supra note 1, at 107 (stating that although FDIC insurance is not required for state banks by law, practical business necessity demands that virtually all banks acquire it). In addition, for preexisting depositors, the transaction costs associated with switching from banks that do not provide FDIC insurance are relatively low, which puts pressure on banks to participate in the FDIC program if competing banks are also doing the same.

58. In relevant part, the Seventeenth Amendment states: "The Senate of the United States shall be composed of two Senators from each State, elected by the people thereof, for six years; and each Senator shall have one vote . . . ." U.S. CONST. amend. XVII.

competition, among state regulators, is injected into the dual banking system to promote regulatory arbitrage. At times, national regulators have even been alarmed by the extent of regulatory choice among federal and state regulators. As Federal Reserve Chairman Arthur Burns stated in 1974, "[t]he present regulatory system fosters what has sometimes been called 'competition in laxity.'... I need not explain to bankers the well-understood fact that regulatory agencies are sometimes played off against one another."

In defending their regulatory powers, states can occasionally rely on political safeguards of federalism. The significance of such safeguards varies over time and is in part a function of the relative strength of the banking lobby representing state banks, which is, in turn, dependent on whether firms and individuals believe themselves to be better off with a more geographically decentralized banking system where greater regulatory authority accrues to the individual states. When the political safeguards of federalism are strong in the banking industry, state regulatory powers are substantially shielded from the exercise of congressional preemption powers, and the opportunity for regulatory arbitrage and state-level experimentation is enhanced. The extent to which the political safeguards of federalism are in fact significant to the bank regulatory scheme, however, can be viewed through the prism of public choice theory. Once a national consensus is achieved that favors circumscribing states' use of their regulatory powers, the political safeguards of federalism weaken significantly. If one assumes that public choice resolutions at the national level produce the most efficacious outcome for the country as a whole, the ease with which political safeguards of federalism are set aside allows for welfare-enhancing regulatory evolution.

60. Banks still switch chartering authorities, and, surprisingly, they do so about equally in both directions from state to national and national to state, meaning that differences in regulation among states and federal regulatory authorities still matter. See Felsenberg, supra note 9, at 28 (citing the example of the National Bank of Commerce of Memphis, which gave up the national bank charter it had held since 1933, because by switching to a Tennessee state charter, it would enjoy lower examination fees and have easier access to regulators). In addition, there is competition at the extremes on the federal level. For example, if the Office of the Comptroller of the Currency regulates in a manner extremely adverse to commercial banks, these banks could decide to become thrifts and submit to the regulatory authority of the Office of Thrift Supervision. See generally id. at 29. In other words, if the cost of the regulation exceeds the benefits over time, the regulated entity may simply choose another regulator.

61. See Scott, supra note 8, at 12–13 (quoting Chairman Burns).

62. Alternatively, state banks can lobby Congress to legislate to obviate the impact of certain state regulations. This occurred with respect to the Gramm-Leach-Bliley Act of 1999, which provided that if an out-of-state bank establishes a branch in a state whose constitution limits interest rates, the relevant constitutional provision will automatically be preempted. 12 U.S.C. § 1831u(f) (2000).
B. How the Underlying Asymmetric Power Dynamic of U.S. Federalism Has Contributed to the Consolidation Trend

The underlying asymmetric power dynamic of U.S. federalism has contributed significantly to the consolidation trend within the banking sector in the United States. An illustration of this point is the manner in which the system of regional restrictions on banks was sufficiently relaxed to a point where such restrictions no longer significantly impeded market forces in deriving a markedly more profit-efficient institutional banking arrangement. Although the relaxation of regulatory barriers to consolidation has taken place in varying degrees, the liberalization of geographic limitations on Bank Holding Company (BHC) expansion is particularly salient because the ensuing dismantling of these restrictions and the subsequent passage into law of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 significantly reduced the barriers to consolidation of the banking industry.

The Douglas Amendment to the Bank Holding Company Act, enacted in 1956, limited acquisitions of banks by out-of-state BHCs to instances where the acquisition of the bank was specifically authorized by the laws of the state in which the acquired bank was located. Senator Paul Douglas of Illinois sought to frustrate interstate banking by “carry[ing] over into the field of holding companies the same provisions which already apply for branch banking under the McFadden Act.” States used the regulatory powers accorded to them by the amendment, particularly the option of not authorizing acquisitions by...

63. See Patrick Mulloy & Cynthia Lasker, The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994: Responding to Global Competition, 21 J. LEGIS. 255 (1995) (at the time of writing, Mr. Mulloy served as Chief International Counsel for the U.S. Senate Committee on Banking, Housing, and Urban Affairs and Ms. Lasker was a Legislative Assistant on the same committee).

64. See 12 U.S.C. § 1841(a)(1) (2000) (defining a bank holding company as any company “which has control over any bank or over any company that is or becomes a bank holding company”). Limitations on geographic restrictions on BHCs allows such holding entities to own state or national banks across the country, and served as the basis on which the Financial Holding Company (FHC), whose activities and geographic reach is unprecedented in the United States, was modeled. See generally MACEY ET AL., supra note 1, at 430–49.


66. See Mulloy & Lasker, supra note 63, at 255 (“This historic banking legislation allows the formation of larger banks with extensive interstate branch networks by eliminating many of the geographic restrictions currently placed on banks. This will result in a more efficient banking system in the United States which will ultimately enhance the competitiveness of U.S. banks and companies.”).


68. See FELSENFELD, supra note 9, at 156 (citing the Douglas Amendment, 102 CONG. REC. 6856 (1956)).
out-of-state holding companies, to protect their state banking sectors. This practice had the effect of confining an individual BHC to a single state and impeding the BHCs from expanding nationally.

However, not all states maintained this practice over time. In 1972, Maine adopted an “invitational” banking statute permitting out-of-state BHCs into Maine if the BHC was based in a state that reciprocated in kind. Such statutes had more symbolic effect than actual market effect. By the 1980s, however, states began to form regional interstate banking compacts that permitted out-of-state BHCs located in compact-participating states to acquire banks within the compact. While these compacts marked a clear trend toward a less encumbered nationwide banking system, states with sizeable financial services industries, such as New York, California, Illinois, and Texas, were often excluded from such compacts. Professors Kroszner and Strahan found that on the state level, deregulation occurred earlier in states with fewer and weaker small banks and where dominant state insurance sectors did not block reform.

Although states played a role in recalibrating the relative value of geographic restrictions in a dynamic manner—largely by changing the incentives on the state and regional levels—federal intervention was nonetheless needed to bring about more fundamental reforms to interstate banking if a truly nationwide banking system was to emerge.

By the 1990s, the political safeguards of federalism that existed when the Douglas Amendment was enacted were not as robust. Although liberalization measures of the kind enacted by Maine allowed states to serve as catalysts in the process toward achieving a national banking market, it is worth underscoring that it was Congress that gave the states discretion to enact “invitational” banking statutes and that had the power to revoke such discretion and establish a uniform framework permitting BHCs to expand nationally. In 1994, Congress passed the Riegle-Neal Act, which repealed the Douglas Amendment, permitted BHCs to acquire a bank in any state, paved the way for the emergence of full-fledged interstate banking, and “administered the quietus to all remaining state legislation barring such expansion.”

Many explanations have been offered for the emergence of a national consensus to liberalize state restrictions on interstate banking. It is fair to say that it came about by virtue of a coalescence of political fac-

69. See id.
70. See id. at 158.
72. For further elaboration on the effect of such incentives, see id.
73. MacEY ET AL., supra note 1, at 360.
tors and an evolving socioeconomic consciousness in the political, academic, and business realms of the merits of a regulatory paradigm that would allow for greater concentration in the banking system. These factors included concerns over whether a geographically dispersed banking structure really served the national interest.\(^7\) One author argued that the combination of national pride considerations relating to the perceived need to create large banks to compete internationally with similarly situated banks—and the fact that a number of states had already dismantled many of the geographic restrictions on interstate banking—was instrumental in the national decision not to impede the growth of larger banks, instead facilitating a national consolidation process.\(^7\)

One could also view the change through the prism of public choice and public interest theories of regulation. For example, consolidation could have occurred as a result of a clash and subsequent victory of larger, expansion-oriented banks—backed by the American Bankers Association and the Financial Services Round Table—over smaller banks, supported by trade groups like the Independent Community Bankers of America and the Savings and Community Bankers of America. Alternatively, Professors Kroszner and Strahan posit that innovations such as automatic teller machines, checkable money market mutual funds, and reductions in communication costs decreased the value of geographic restrictions because consumers could increasingly do business with distant banks nonetheless.\(^7\) In sum, the "marginal value of lobbying to repeal branching restrictions increased just as the relative value to the small banks of maintaining branching restrictions was declining."\(^7\) The authors also found that the very same variables mentioned above, which prompted deregulation on the state level, likewise prompted the deregulation campaign on the national level.\(^7\) In addition, deregulation of geographic restrictions reflected an incorporation of Chicago School economic theory into banking legislation, and more generally, the growing adoption of the view that the impact of bank consolidation on borrowers and bank customers would be positive.\(^7\)

\(^{74}\) See also Felsenfeld, supra note 9, at 161 (noting that in 1995, no American bank made the list of the top twenty-five largest banks in the world).

\(^{75}\) Felsenfeld, supra note 9, at 161–162 (positing that while Riegle-Neal was viewed as a victory to large banks, it was not seen as much of a loss to smaller banks that had been opposing liberalization of geographic restrictions because, "through gradual state action over a period of years and FIEAA, they saw the battle as already lost").

\(^{76}\) See Kroszner & Strahan, supra note 71, at 1460–61.

\(^{77}\) Id. at 1462.

\(^{78}\) See id. at 1438.

\(^{79}\) Compare Louis D. Brandeis, Other People's Money and How the Bankers Use It 111, 128 (1933) ("[B]oth the financial concentration and the combinations which they have served were, in the main, against the public interest . . . . [S]ize may, at least, become
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Congress structures the framework underlying regulatory arbitrage, permitting the states to experiment and serve as the catalysts for regulatory innovation in the U.S. banking system, up to the point that the federal government allows. Although states are limited in their ability to compete with the federal regulators as a chartering authority, in the sense that states do not want to provide too attractive a regulatory environment so as to induce preemption of their competitive advantage, states can nonetheless compete with each other where national banks are subject to state laws. Given the consolidation trend over the past thirty years, state regulatory regimes had the distinct opportunity to compete for the designation as the most efficient regulator. Where federal regulatory policy allows for diversity, states have served as laboratories for financial innovation through regulatory action.

In the United States, however, the lobbying efforts of the dominant banks seem to have won the day in the public arena. In reaction to this development, the U.S. variant of federalism allowed for a quick shift in regulation that facilitated the achievement of greater consolidation of the banking industry, and moreover, the rapid growth of expansion-oriented

noxious by reason of the means through which it was attained or the uses to which it is put. And it is size attained by combination, instead of natural growth, which has contributed so largely to our financial concentration . . . . [Laws should be enacted to] escape from that inefficiency which is attendant upon excessive size. But what is far more important, we shall, by such legislation, remove a potent factor in financial concentration. Decentralization will begin.”), and Peter L. Struck & Lewis Mandell, The Effect of Bank Deregulation on Small Business: A Note, 38 J. Fin. 1025, 1030 (1983) (suggesting that the credit needs of small businesses are less likely to be satisfied where the state allows banks to engage in wide geographic activities because the bank structure may circumscribe the level of local decisionmaking), with Allen B. Frankel & John D. Montgomery, Financial Structure: An International Perspective, 1991 Brookings Papers on Econ. Activity 257, 305 (1991) (“A product of the limits on the geographical diversification of U.S. banks is a much higher failure rate.”) (authors are members of the Board of Governors of the Federal Reserve Bank), and Rebecca S. Demsetz & Philip E. Strahan, Diversification, Size, and Risk at Bank Holding Companies, 29 J. Money, Credit & Banking 300, 312–13 (1997) (arguing that diversification provides an important motive for bank consolidation because diversified banks can leverage their diversification advantage to operate with lower capital ratios and pursue riskier activities), and Mitchell A. Petersen & Raghuram G. Rajan, Does Distance Still Matter? The Information Revolution in Small Business Lending, 57 J. Fin. 2533, 2534–35 (2002) (arguing that the growth in distance between small firms and their lenders and the growing impersonal nature of their relationship can be explained by technological change in the lending market; in the past small banks were needed to conduct strict ex ante screening, while today larger banks can effectively conduct frequent ex post screening and quick intervention) (Professor Rajan teaches at the University of Chicago Business School and is one of the leading proponents of “financial development” and financial deregulation), and W. Scott Frame, Aruna Srinivasan & Lynn Wooley, The Effect of Credit Scoring on Small-Business Lending, 33 J. Money, Credit & Banking 813, 823–24 (2001) (positing that advances in information technology reduce information costs and asymmetries between borrowers and lenders, developments that reduce the value of local lending relationships when newer methods of lending like credit scoring are taken into account).

80. See Macey et al., supra note 1, at 120.
banks. To foster regulatory uniformity, national bank regulators either have to convince Congress to change features of bank regulation that they do not find attractive, which is by no means an insurmountable obstacle, or they can act in a creative fashion by relying on *Chevron* deference. The ease with which regulatory uniformity is achieved in the United States once a national consensus exists is also distinguishable from efforts in Germany to reform the German banking system in a way that would promote static and dynamic profit efficiency through consolidation.

### IV. The Impact of German-Styled Federalism on the Development of the Banking System

The architectural underpinnings of the German banking system, to which the German *Grundgesetz* and the German variant of federalism afford strong protection, serve, in a functional manner, as the principal institutional arrangement that sets out to achieve many of the same public policy goals that influenced the development of the U.S. bank regulatory system. In light of structural and constitutional limitations, German federal legislative and regulatory powers in the field of banking are subordinated, in various respects, to the legislative and regulatory powers of the individual Länder and sub-Länder governments. The manner in which regulatory power is allocated provides these political subdivisions an effective veto over the imposition of a regulatory scheme that would have an overarching effect on the structure of the banking system to the disliking of these political subunits. The inability to achieve uniformity in regulatory approaches among the Länder, and more importantly between the Länder and the Bund, prevents a more consolidated market for banking services from emerging because actors advocating fundamental change to the German banking system cannot rely predominantly on their ability to influence central decisionmaking to effectuate their reform agenda. Despite the growing acceptance of a correlation between reform of the banking sector and an increase in economic welfare at the national level, champions of reform are relegated to assuming a decentralized lobbying approach. The efficacy of such a lobbying approach is constrained by the reality that suggested reforms may be perceived to run up against the interests of Germany’s constituent states and their respective political subdivisions.

The Länder and their subunits have the power to found and control public banking instrumentalities through which many public policies are
The manner and extent to which these public instrumentalities affect other market actors in the banking system, by allocating capital along regional and subregional lines, creates a market effect that does not exist in the United States. Consolidation of the banking system is more difficult to achieve in Germany because public policies have been ingrained into the structure of the banking system through the creation of subnational public-sector banks. While the scope of the subnational public-sector banks’ mandate is to some extent nebulous, and because these entities have been accorded de facto constitutional protection via their public backers, subnational public-sector banks working in tandem with their backers can fend off or water down proposed paradigmatic regulatory changes that might otherwise dislodge the public-sector banks from their coveted position as central actors in the banking system. A factor contributing to this impasse is the close alignment of the interests of the subnational banks and those of the decisionmakers—namely, Länder and municipal-level government officials—that could help authorize a move to bring fundamental change to the German banking system. For example, even if one assumes the achievement of consensus, however tenuous, on the national level in favor of changing the structurally intrusive ways in which public policies are realized in banking, the process of reform is nevertheless onerous because it must be embraced by the subnational backers of public banking instrumentalities in order to be effectuated. These government backers may be reluctant to conclude that such public policies, and the manner in which they are implemented, are outdated, and may prefer to maintain the current banking structure.

Given the coordination difficulties in achieving reform, fragmentation and segregation of sizeable segments of the German banking market prevent the realization of efficiency gains. Similarly, the lack of scale in the domestic retail banking operations of German commercial banks hampers their profitability, given the dominance of the subnational public-sector

81. IMMENGA & RUO, supra note 5, at 9–10.
82. See Guinnane, supra note 2, at 88–89.
83. IMMENGA & RUO, supra note 5, at 10 (“The public mandate of Landesbanken is ultimately not definable, but rather is subject to constant change.”).
84. See infra Section IV.B.
85. See infra Section IV.C.
86. See Lahusen, supra note 9, at 3–4.
87. BUNDESVERBAND DEUTSCHER BANKEN, BANKENVERBAND, BANKING SURVEY 2006 44 (2006), available at http://www.bankenbericht.de/pdf/2006/B_gesamt_engl.pdf [hereinafter BANKING SURVEY 2006] (“The relatively weak earnings power of German banks is the result mainly of structural problems on the German banking market, especially the fragmentation of the domestic banking sector and restraints on competition and distortions of competition due to the large public-sector share of the banking market.”). But see Jan Wagner, The Other German Struggle—Germany’s Political Battles May Be over but the War Over Reform of the
banks in the German banking market. In light of the relatively high density of banks in Germany, commentators have questioned whether the subnational banks still require the unique public-sector support to perform their capital-supply function and provide comprehensive services to the communities they have historically served. More broadly, the Bund’s exercise of regulatory powers over subnational public-sector banking is circumscribed to such an extent that the Länder and municipalities have become the principal entities capable of dislodging these banks from their protected position. Yet these political entities have the incentive to drag their feet in bringing about fundamental change to the banking structure.

To understand the depth to which German federalism allocates regulatory power in the field of banking in favor of the Länder and sub-Länder political subdivisions, it is necessary to look at the role of the subnational public-sector banks in the German banking market. Section A analyzes the salient structural features of the German banking market. Section B discusses the constitutional constraints on the manner in which reform of a type that would give rise to cross-pillar consolidation can be conducted. Finally, Section C analyzes the considerable resistance to change on the part of the Länder and their political subunits, giving rise to a formidable roadblock to consolidation of the banking market.

A. Structure of the German Banking System

The German banking system is frequently referred to as a three-pillar banking system because it consists of three distinct groups of banks: the subnational public-sector banks, the commercial banks, and the cooperative banks. The largest pillar in terms of total bank assets is the subnational public-sector banking group. This banking pillar includes roughly 600 local savings banks, known as Sparkassen, and thirteen regional banks called Landesbanken. The Sparkassen and the...
Landesbanken control about thirty-four percent of the German banking market; this figure, however, increases to forty-five percent when public special-purpose banks, mortgage banks, and building and loan associations are included. While the structure of this banking group is a reflection of the subdivisions of German federalism, with banking units at the Bund, the Land, and the municipal levels, individual municipalities and Länder exert substantial control over banks within their jurisdiction. The individual banks within the subnational public-sector pillar enjoy autonomy from one another, in light of their different ownership structure and restricted areas of operation.

In stark contrast to U.S. commercial banks and savings institutions, which are incorporated under private law as either for-profit or nonprofit entities, the vast majority of German subnational public-sector banks are incorporated under public law and are owned and controlled by Länder, municipalities, districts, and foundations that are in turn controlled by a mixture of the first three above-listed government subdivisions. The activities of the banks in the subnational public-sector pillar are limited by the Savings Bank Act of their respective Land, an act that generally focuses the banks' activities on helping out poorer and middle class segments of the economy, and lending to public authorities. Embedded in the Savings Bank Acts are geographic limitations, referred to collectively as the Regionalprinzip, which, by requiring Sparkassen to serve the public interest of their respective community, limit their operations such as branching to the geographic confines of the individual Sparkasse's controlling municipality. The types of activities in which these public-sector banks engage largely mirror those of the commercial banks, except that the subnational public-sector banks tend to serve as

93. Yet, if the banks were viewed as a whole, the combined entity, with three trillion euro in assets in 2000, would be considered the largest financial institution in the world. See Hackethal, supra note 13, at 81.
94. See IMMENGA & RUDE, supra note 5, at 5-7. Usury laws, which are designed to regulate the substantive fairness of the bargain under which credit is supplied, do not play such a large role in Germany because the nonprofit maximization and community focus of the banks ensure that interest rates will remain relatively low. This arrangement may, however, crowd out other market participants that would supply capital up until the usury law ceiling on interest rates.
95. See Hackethal, supra note 13, at 79 ("[T]o avoid competition between local savings banks, each institution is prohibited from operating outside its local area and encroaching upon its neighbours' territories.").
96. See Guinnane, supra note 2, at 88-89 (noting that at the outset of the twentieth century, Sparkassen transformed into full-scale universal banks on account of legislative changes that allowed this class of banks to offer checking accounts and underwrite and sell securities).
the *Hausbank* to the *Mittelstand*, whereas the commercial banks serve as the *Hausbank* to very large, often publicly traded companies. The second pillar is made up of the commercial banks, which include the likes of Deutsche Bank, Commerzbank, and Dresdner Bank. These banks are incorporated under private law and are generally structured as universal banks, providing a wide palette of banking services. The commercial banks control thirty-eight percent of the German banking market and operate throughout Germany. Members of this pillar have been the most vocal advocates for change to the banking system and likely would have the most to gain from cross-pillar consolidation.

The third pillar comprises the credit-cooperatives, which are divided into commercial credit associations, referred to as *Volksbanken*, and rural credit associations, known as the *Raiffeisenbanken*. This pillar has a twelve-percent share of the German banking market. Credit-cooperatives are incorporated as credit associations and can be compared to mutual savings banks in the United States, where in return for choosing to further a social mission, they enjoy nonprofit status. The banks in the credit-cooperative pillar are regulated under the Business and Trade Cooperatives Act of 1889. This pillar falls outside the scope of this Note because of its relatively low market share and because credit-cooperatives are controlled by their nominal owners and not by a level of government. Thus, the contours of German federalism are not implicated with respect to this pillar to the degree they are in the case of the subnational public-sector banks.

With regard to the subnational public-sector bank pillar, backing from *Länder* and municipalities provides the banks many advantages vis-à-vis their counterparts in the other pillars while also protecting these banks from potential *Bund* attempts to phase out such advantages. Subnational public-sector banks are insulated from market forces because they are not burdened by private shareholder pressure. Furthermore, subnational public-sector banks enjoy low dividend pay-out ratios, by virtue of their undemanding public owners. In addition, due to past direct and current

97. *Mittelstand* is the collective name for Germany's "traditional" small and medium-sized enterprise (SME) segment. The name does not necessarily correspond to the SME sector in the United States because very large, family owned enterprises are often characterized as members of the *Mittelstand*.


99. See Association of German Banks, *supra* note 92.

100. See *id*.

101. Gesetz betreffend die Erwerbs- und Wirtschaftsgenossenschaften [Business and Trade Cooperatives Act], May 1, 1889, RGBl. at 55.

102. Hackethal, *supra* note 13, at 83 (stating the number of members to whom profits are paid reached fifteen million).

indirect *Länder* backing, public-sector banks’ credit ratings are buttressed,\(^{104}\) providing the banks with a distinct advantage over their private sector counterparts in raising capital.

While subnational public-sector banks may acquire commercial banks, commercial banks may not acquire public-sector banks.\(^{105}\) Given their status of incorporation, public-sector banks are shielded from hostile acquisition, rendering them immune to short-term profit maximizing pressures of the sort that commercial banks face. This advantage may also translate into more stable relationships between these banks and their clients, an important advantage in banking generally. Given these distinct advantages, this market structure does not promote a level playing field in the German and the European market for banking services and hampers inter-pillar consolidation.

As a result of these advantages, the *Länder*, by supporting this banking arrangement, are causing certain externalities to be felt throughout Germany. Such externalities most acutely affect the commercial banks. By virtue of their public ownership status, subnational public-sector banks may be able to offer banking products at overly competitive rates, which allegedly hurt the profitability of commercial banks by squeezing margins to “unattractive levels.”\(^{106}\) The subnational public-sector banks are able to impose lower margins on their competition, and by increasing their market share,\(^{107}\) subnational

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104. Although the credit ratings of the *Landesbanken* have taken a hit since the rollback of explicit *Länder* guarantees as part of the Understanding About the Orientation of Legally Independent Special Credit Institutions in Germany between Mario Monti, Commissioner for Competition, and Caio Koch-Weser, State Secretary in the German Ministry of Finance, (reached on Mar. 1, 2002 in Brussels) [hereinafter Understanding between Monti and Koch-Weser], they are, however, higher than they would otherwise be if they were not affiliated with a Land. *See Finance and Economics: Deep Impact; German Landesbanks*. ECONOMIST, Nov. 29, 2003, at 109 (reporting that Fitch, a credit rating agency, will take into account implicit guarantees when issuing its ratings of *Landesbanken*).

105. *See Banking Survey 2006*, supra note 87, at 44.

106. *See id*. *See also* Hackethal, supra note 13, at 80. This negatively affects German banks internationally because they have to compete vis-à-vis other banks with strong home market operations. This makes German commercial banks more reliant on income from international operations, which tends to fluctuate dramatically. *See also* Marcus Walker, *Losing Interest: As Crisis Looms, Big German Banks Blame Tiny Rivals—Adding to Economic Malaise, Majors Cede Rich Market to State-Backed Lenders—When Profits Aren’t the Point*, WALL ST. J., Feb. 14, 2003, at A1 (providing anecdotal evidence of bank customers turning to Sparkassen for more affordable loans). Thomas Schwarzbauer, the head of a local Sparkasse detailed his lending philosophy: “My philosophy is: How would I feel about the bank’s decision if I was in the customer’s position.” *Id*.

107. Manfred Weber, *The German Banking Market: I. Structural Change*, DIE BANK: ZEITSCHRIFT FÜR BANKPOLITIK UND PRAXIS, July 2002, at 6, 11, available at http://www.die-bank.de/media/062002/its062002.pdf (demonstrating that *Landesbanken* have been expanding lending to domestic firms at the expense of the commercial banks. Since the early 1990s, the *Landesbank* market share in the corporate lending business has risen from 9.8% to 17.5%).
public-sector banks may crowd out commercial banks from important banking business.108

B. The Impact of the German Constitutional Structure on the Development of the Banking System

The German constitutional scheme, which provides the Länder considerable power and discretion in many fields in accordance with the system of “cooperative federalism,” offers substantial protection to the regulatory autonomy of the backers of the subnational public-sector banks. Because the formation of many public-sector banks predated the Grundgesetz, its provisions and protections largely mirror, at least in a functional way, past protections accorded to this segment of the banking sector.109 Article 74 of the Grundgesetz affords the Länder and the Bund concurrent legislative power in the realm of banking. Article 72 states that the Länder’s ability to exercise concurrent powers is dependent on the condition that “the Federation does not use its legislative power.”110 Since the field of banking is a concurrent power, the Bund can only act if it is supported by the Bundesrat, the council comprising the Länder representatives.111 The Bund can only enact regulation with respect to a field of concurrent legislation if such regulation is deemed necessary. Article 72(2) states:

The Federation has the right to legislate on these matters to the extent that a need for a Federal rule exists because (1) a matter cannot be effectively dealt with by the legislation of individual Länder, or (2) dealing with a matter by Land law might prejudice the interests of other Länder or of the entire community, or (3) the maintenance of legal or economic unity, especially the maintenance of uniformity of living conditions beyond the territory of a Land necessitates it.112

The Bund has not used these powers in contravention of the Länder’s role in regulating subnational public-sector banks, except in a perfunctory manner. For example, the Bund has enacted legislation con-

108. See Banking Survey 2004, supra note 88, at 11 (arguing that Landesbanken are able to offer loans “on conditions which do not even remotely reflect market realities”).
109. While the first savings bank was incorporated in 1801 in Göttingen, the Prussian Savings Act of 1838 circumscribed the legal independence of all 238 Prussian savings banks, placing control of the banks under the local governments in the areas of their respective operation. Hackethal, supra note 13, at 78.
110. Grundgesetz, May 23, 1949, art. 72.
111. See infra Section C. (discussing impediments to Bundesrat action due to disincentives affecting the Länder).
112. Grundgesetz, May 23, 1949, art. 72(2).
cerning banking supervision. Likewise, given the support of the public-sector banks at the Ländler level, it would be difficult to conceive of the Bund fitting such legislation into one of the three above listed categories, and then receiving Bundesrat support to legislate in a manner that is materially adverse to the integrity of the three-pillar banking system.

A cursory glance of these constitutional provisions might compel the erroneous conclusion that the Bund, assuming it had sufficient support from individual Ländler comprising the Bundesrat, could just impose on the subnational public-sector banks a new corporate form and mandate that they privatize. A somewhat similar approach occurred in Italy when the Italian government passed the "Ciampi Law" in 1999, which prohibited foundations from holding majority stakes in savings banks and provided tax incentives to smooth out the disposal process. An analogous approach would not produce a similar effect in Germany, however, because the German Constitution in Article 28(2) bestows on municipalities and counties the right of self-government, which affords these political subdivisions the discretion to establish savings banks in the form of public instrumentalities. As a result, subnational public-sector banks

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113. See Jens-Hinrich Binder, Regulatory Competition Between the Deposit Insurer and a Single Financial Regulator—The Case of Germany, 39 INT'L LAW. 3 (2005) (discussing federal regulatory authority of a supervisory and prudential nature over all three pillars of the banking system).

114. See Andrea Goldstein, Privatization in Italy 1993–2002: Goals, Institutions, Outcomes, and Outstanding Issues 27–28 (CESifo, Working Paper No. 912, 2003) (claiming that the loophole in the legislation is that foundations can still team up to control banking institutions).

115. See Grundgesetz, May 23, 1949, art. 28(2) ("The Communities must be guaranteed the right to regulate on their own responsibility all the affairs of the local community within the limits set by law. The associations of communities also have the right of self-government in accordance with the law within the limits of the functions given them by law.") (translation available at http://www.constitution.org/cons/germany.txt).

are shielded from legislation analogous to the Ciampi Law. Moreover, it would likely be politically difficult to garner the necessary two-thirds majority in both the Bundesrat and Bundestag to amend the constitution in a manner that would mollify the impact of the self-government provision of the German constitution as it applies to the subnational public-sector banks.\textsuperscript{117}

While the exercise of federal law and regulatory powers affects this pillar of the banking industry insofar as it performs a supervisory function, such exercise of regulatory powers cannot impact the legal structures of subnational public-sector banking instrumentalities or associations in a fundamental sense. Rather, \textit{Länder} law typically applies if such instrumentalities or associations perform a function of the \textit{Länder}, commune, or municipal level, which is certainly the case when each subnational public-sector bank is viewed individually.\textsuperscript{118}

German \textit{Länder} circumscribe the scope of the banking entities' activities through what is referred to as the Savings Bank Act, or \textit{Sparkassengesetz}. Generally, a Land's savings bank law limits the geographic operations of such banks, restricts their profit-orientation, and promotes the allocation of credit and banking services to the middle class and the poor.\textsuperscript{119} In September 1994, the German Federal Constitutional Court, relying on the self-governance provision of Article 28(2), confirmed the constitutionality of a Land's power to define such \textit{Sparkasse} functions.\textsuperscript{120}

\begin{itemize}
  \item Id. (parenthetical text omitted). \textsuperscript{117}
  \item See Grundgesetz, May 23, 1949, art. 79. \textsuperscript{118}
  \item See id. art. 72. Conversely, if an instrumentality or association fulfills a public function at the federal level, for example the Bundesbank, federal law would serve as the basis for its establishment. \textsuperscript{119}
  \item For a translation of the North Rhine-Westphalia Savings Bank Act, which is typical of other savings bank laws, see IMMENGA \& RUDO, supra note 5, at 6. \textsuperscript{120}
\end{itemize}

1) Savings banks are business enterprises of local authorities or local authority associations charged with the function of serving the credit needs of the people and the economy, and particular of the business sector and of their guarantor. (2) Savings banks strengthen competition in the credit business. They promote the people's sense for saving and their formation of wealth, as well as responsible behavior on the part of youth in financial matters. Savings banks contribute to the financing of debtor advisory services offered by consumers or debtor advisory bureaus; the guarantors determine the scope of distribution of these funds to the authorities of the advisory bureaus. The credit supply serves chiefly to provide credit to the middle class and weaker economic segments of the population. (3) The business of savings banks, subject to their public mandate, is to be conducted in accordance with general business principles. The realization of profit is not the main purpose of business operations.

\begin{itemize}
  \item Id. \textsuperscript{120}
  \item See id. at 9 (quoting Bundesverfassungsgericht [Federal Constitutional Court], Sept. 23, 1994). \textsuperscript{120}
\end{itemize}
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The Länder, acting as federal actors in the Bundesrat, could establish a facilitative framework that could offer incentives or remove certain obstacles to formal privatization of the Länder-level public-sector banks. For example, through the Bundesrat, the Länder could support changes to the German Banking Act (Kreditwesengesetz) that would allow privatized savings banks to use the label “savings bank.” However, the Bund would not be able to implement or even induce broad-based consolidation by mandating privatization because of the self-government rights accorded to municipalities and counties.

C. Lack of Interest in the Länder to Support Reform of the Three-Pillar System

Even if the Länder could, through the Bundesrat, collectively promote fundamental change to the underpinnings of the financial system, these constituent states lack the incentive to authorize such legislation. An individual Land does not have a strong incentive to effect change to the structure of the subnational public-sector banks operating within its regulatory jurisdiction. Even assuming for a moment that an individual Land decided to amend its Savings Bank Act to allow publicly backed banks to privatize, such an approach would constitute mere formal privatization. Material privatization, in which the public interest in the Sparkassen or Landesbanken is actually sold, would be necessary to create any significant market effect. A move to materially privatize these banks would be contingent on whether individual local jurisdictions

Irrespective of the legal independence of savings banks, they have remained, due to organizational interlacement, local institutions with whose help communities and administrative districts can fulfill part of their function of providing comprehensive public services. In particular, they are supposed to rouse and promote the people’s sense for saving, to provide them with opportunities to invest money securely, and to supply credit, with particular consideration for the middle class and weaker economic segments of the population.

Id.
121. Grundgesetz, May 23, 1949, art. 50.
122. See Kreditwesengesetz [Banking Act], Jan. 5, 2007, BGBl. I § 40. Notwithstanding the recent European Commission-Germany Agreement on Sparkassen stating that “Section 40 of the German Banking Act (Kreditwesengesetz) will be applied in a manner that does not infringe the provisions of the EC Treaty on the right of establishment (Articles 43 et seq.) and the movement of payments and capital (Articles 56 et seq.),” the agreement does not alter Section 40. Moreover, any Sparkasse that undergoes privatization is still subject to public service obligations, and whether future privatized Sparkassen can use the name will be determined on a case-by-case basis. See Press Release, European Commission (EC), Agreement on “Sparkasse” (Dec., 6, 2006); Banking: Deal Reached on Sparkassen Privatisation, EUR. REP., Dec. 7, 2006. These barriers, which could be alleviated through legislative changes to the German Banking Act, render an acquisition of a savings bank by a private bank less attractive, assuming that such an acquisition would be permitted in the first place.
decide that privatization of these banks is in their respective interest. In view of the coordination costs involved and the fact that localities might have serious reservations about selling their interest in the savings banks they control, the sheer amount of time and energy a privatization process would require constitutes the most prohibitive hurdle to material privatization, which in turn impedes any inter-pillar bank sector consolidation process.

A Land could do a lot to win favor among the commercial banks; for example, it could amend its savings bank law in a manner that benefits the private sector. However, unlike the case of individual U.S. states, a Land does not lose much by not catering to nonpublic-sector banks. Likewise, municipalities that back Sparkassen likely would not overwhelmingly support a privatization scheme because of the utility they derive from merely maintaining the status quo. Or, at a minimum, these political subdivisions may feel that they would be adversely affected by fundamental deviations from the existing banking arrangement, a sentiment that may dictate a preference for continuity. These preferences are significant not just at the Sparkassen level but also at the Landesbanken level because organizations of municipality-backed Sparkassen exert control in conjunction with the individual Länder governments on the respective Landesbanken within their control.123

In addition, given that commercial banks are already crowded out of a fair share of banking business, the threat of a commercial bank exiting a Land or, metaphorically, of commercial banks voting with their feet, is just not credible. Any banking business that would be lost on account of the exit of a commercial bank could arguably be compensated for by entry of the subnational public-sector bank to fill the gap, as the service that the respective banks provide are, more or less, substitutable.124 On the surface, such an outcome might be even more preferable for the Land, which would be the controlling entity of an expanding bank. Moreover, at the local level, the commercial banking industry is not well positioned to “capture,” or even cajole, the locality or Länder government. One exception might be the state of Hesse, given the number of

123. See Immenga & Rudo, supra note 5, at 9–10 (“In each state the founding body of the Landesbanken is, albeit in varying proportions, the respective state, the respective savings bank and transfer associations, and regional associations of corporate bodies.”).

124. HANNES SCHNEIDER & HANS-JÜRGEN HELBWIG, THE GERMAN BANKING SYSTEM 14 (1978) (“Contrary to what their name implies, [the subnational public-sector banks] more or less perform the same all-round services as private commercial banks, although with particular emphasis on their traditional activities, namely the acceptance of savings deposits and real estate lending business.”).
commercial banks housed in its largest city, Frankfurt, and the collective lobbying strength that these banks possess.  

While subnational public-sector banks are not allowed to grant local or Land authorities preferential treatment, these banks still serve the credit needs of their controlling authority.  

An International Monetary Fund report found that because control of Landesbanken is vested in public officials, there are cases where loans are not “strictly screened on the basis of creditworthiness.”  

Such a conclusion should not come as a surprise, given the ability of the founding entity, as the owner of the bank, to control who sits on the bank’s supervisory board.  

As a result, many politicians sit on supervisory boards of subnational public-sector banks. Such arrangements, however, may result in a misallocation of capital to the benefit of the Land’s local economy, but perhaps to the detriment of the national economy.

The subnational public-sector banks, in particular the Sparkassen, have played the role of the Hausbank for Germany’s sizeable small and medium-sized enterprise (SME) market segment, better known as the Mittelstand. Providing a steady flow of lending to the Mittelstand—something that the commercial banks have been accused of refraining from doing—strengthens support among the general population for the subnational public-sector banks because the Mittelstand is collectively a

125. The government of Hesse is planning on amending its Savings Bank Law to liberalize rules on who may buy subnational public-sector banks. Although this might be a first step toward privatization, the fact that prospective purchasers will be limited to members of the public-sector banking group shows that even in Hesse, the strength of the public-sector lobby and its supporters is very strong. See Anja Struve & Norbert Schwaldt, Hessen mischt den Sparkassensektor auf; Gesetz soll den Verkauf der Institute ermöglichen, DIE WELT, Mar. 30, 2006, at 12. Members of the commercial banking sector, however, believe that Hesse is not going far enough in promoting privatization. See Klaus-Peter Müller, President of the Ass’n of German Banks and Chairman of the Bd. of Managing Dirs., Commerzbank AG, Spring Press Conference: Stay Firmly on the Path of Reform (Mar. 15, 2006) (translation available at http://www.german-banks.com/html/15_press/press_00_060315.asp) ("[T]he planned legislation certainly falls short of the private banks’ expectations concerning the modernisation of the German market.").

126. IMMENGA & RUDO, supra note 5, at 8 (noting that savings banks allocate fifteen percent of their credit to public budgets). In 1993, public banks had a 52.7% market share of loans to public budgets. Id. at 3.


128. The executive board, which is charged with the management of the bank, reports to the supervisory board, two-thirds of which the founding entity selects. The founding entity is able to influence important credit decisions through the credit committee, which includes at least three supervisory board members. See Hackethal, supra note 13, at 79.

129. See id. at 95.

130. See id. (remarking that the large commercial banks are withdrawing from traditional commercial loan business, focusing on investment banking and commercial banking to large corporations).
major employer in individual Länder. The commercial banks assert, however, that this system leads to systemic underpricing of their lending arrangements with Mittelstand firms. Subnational public-sector banks may still be able to provide such firms with underpriced credit in light of their “unfair” ability to raise capital through implicit guarantees, irrespective of the fact that, after the EU agreement on the phaseout of guarantees, these public-sector-backed banks no longer derive explicit guarantees from the individual Land in the form of Anstaltslast (maintenance obligation) and Gewährträgerhaftung (liability obligation).

More overtly, subnational public-sector banks, particularly those at the Land level, participate in the organization of local economic solutions to preserve control over firms based in the backer’s jurisdiction. One illustrative example involved the sale by Allianz, a major German insurer, of a large equity stake in the Hamburg-based consumer goods manufacturer Beiersdorf. Shortly before the sale of the equity stake, the American consumer goods giant Proctor & Gamble not only showed strong interest in acquiring Allianz’s stake in the company, but also in acquiring the remaining outstanding shares of Beiersdorf, an outcome that would have enhanced shareholder welfare. However, an unofficial consortium led by Tchibo, a family controlled Hamburg-based coffee company and major shareholder in Beiersdorf, preempted Procter & Gamble’s purchase of the company by acquiring Allianz’s stake. As a result, German ownership of Beiersdorf was preserved. However, because Tchibo’s financing options were considerably limited relative to those of Procter & Gamble, and because Tchibo’s controlling family lacked the financial muscle to acquire all of Allianz’s stake, Tchibo’s controlling family had to participate in the organization of an informal consortium of stakeholders, the members of which would all share the same goal of consummating the deal to Tchibo’s favor, against the “outsider” Procter & Gamble. To facilitate this deal, Beiersdorf bought back 7.4% of the stake, and members of the traditional ownership coalition decided to acquire more of the stock than they had originally

131. See supra note 105 and accompanying text.
132. Understanding between Monti and Koch-Weser, supra note 104.
133. See Finance and Economics: Deep Impact: German Landesbanks, supra note 104 and accompanying text.
135. See Taylor & Ellison, supra note 134.
planned. Ultimately, however, Beiersdorf’s independence was secured by the Hamburger Gesellschaft für Vermögens- und Beteiligung (HGV), a holding company controlled by the city of Hamburg, which acquired a ten-percent stake in Beiersdorf. Interestingly, in devising a national solution, Hamburg’s finance senator worked “hand in hand” with Alexander Stuhlmann, the head of HSH Nordbank, a subnational public-sector bank. This illustration points to the role Landesbanken play in supporting the vestiges of German Industriepolitik. Even the mere expectation that they stand ready to organize local economic solutions provides this banking pillar with residual support at the Land level.

The opposition on the regional level to taking the initial steps necessary to change the German banking structure was recently illustrated by the difficulty in privatizing Sparkasse Hansestadt Stralsund, a savings bank located in the structurally weak eastern part of Germany. This incident shows that even where there is support among the savings bank owners at the municipal level, a regional government can step in and block the privatization scheme. In the Stralsund case, the regional government of Mecklenburg-Western Pomerania strongly opposed a sale, fearing that it would precipitate a piecemeal dismemberment of the Sparkassen Group by “cherry-picking” commercial banks.

In late 2003, the government of Stralsund expressed an interest in privatizing the local Sparkasse, the Sparkasse Hansestadt Stralsund. Due to the precedent-setting implications that would result if the Sparkasse were successfully privatized, an open and intense battle among numerous interest groups ensued. Commerzbank and the Swedish banking group SEB, in addition to other commercial banks, showed particular interest in acquiring the Stralsund Sparkasse. Still, notwithstanding the eagerness on the part of the local backers of the Stralsund Sparkasse to sell the bank, the regional government of Mecklenburg-Western Pomerania strongly opposed a sale, fearing the ramifications such a sale would have on the subnational public-sector banking pillar. Sigrid Keler, the Finance Minister of Mecklenburg-

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136. Id.
138. Id.
140. See Wagner, supra note 87, at 1.
142. Id. (reporting that Commerzbank lamented, “[i]t is a shame that the opportunity to consolidate across the ‘three pillars’ will not now happen in the foreseeable future.”).
Western Pomerania, made a pointed comment to the *Frankfurter Allgemeine Zeitung*, one of the most important German dailies:

The three-pillar model proved itself in Germany and is economically advantageous for the country. One only has to take a look at England for this to be recognized. The *Sparkassen*, which generate their income primarily in their respective regions based on the regional principle, play a large role in structurally weak regions such as Mecklenburg-Western Pomerania. The region of Stralsund, as pointed out by statements made by Mr. Ackermann [the CEO of Deutsche Bank] and Breuer [the former head of the supervisory board of Deutsche Bank], is of limited interest to the large banks [Deutsche Bank, Dresdner Bank, and Commerzbank].

A spokesman for Mr. Ringstorff, the prime minister of Mecklenburg-Western Pomerania added:

If we had let Stralsund’s Sparkasse be sold off to a private bank, that would have been the end of public banks in Germany . . . . The terrible thing about that is that the private banks, captive to capital markets, only buy *Sparkassen* that are profitable and have a big client base. They don’t care about remote areas, so those people and SMEs suffer.

This controversy was ultimately put to rest when the regional government of Mecklenburg-Western Pomerania passed a new law on the regulation of the *Sparkassen*, which more clearly vested decision-making power with respect to any future privatization scheme with the *Land* government. The enactment of the new law reflected the general opposition on the *Land* level to any rash moves that may serve as a precedent for more significant and encompassing privatization schemes. Keler made it clear that the Sparkasse Hansestadt Stralsund was not for sale:

The *Sparkasse* is incorporated under public law. The Hansestadt Stralsund is not the owner under private law; rather it is the founding entity. The rights of the founding entity are circum-

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144. Wagner, supra note 87, at 1.

scribed by the Savings Bank Act. The Savings Bank Act of Mecklenburg-Western Pomerania gives the founding entity the possibility of merging the Sparkasse with another Sparkasse. The Savings Bank Act does not allow the founding entity to sell the Sparkasse in whole or in part . . . . Also, the winding-up of the Sparkasse is clearly provided for in the Savings Bank Act. It is dependent on, among other things, approval by the [Land’s] finance minister and interior minister.146

Given the difficulty of effecting inter-pillar consolidation due to constraints related to the German variant of federalism, the German commercial banks circumvented the German political system by lodging a complaint with the European Commission in 1999 via the European Banking Federation, asserting that the state guarantees enjoyed by subnational public-sector banks constitute impermissible state aid.147 On March 1, 2002, Mario Monti, the European Union Commissioner for Competition, and Caio Koch-Weser, the German Minister of Finance, reached an agreement to phase out the maintenance and liability obligations, which provided public-sector banks a distinct advantage in raising capital.148 Underscoring the role that Länder play in EU policy, State Secretary Koch-Weser was joined by the finance ministers of North Rhine-Westphalia, Bavaria, Baden-Württemberg, and the president of the German Savings Bank trade association.149 Despite the unsuccessful privatization attempt in Stralsund, the growing importance of the European Union as a forum for evaluating behavior presumptively in violation of the EU internal free market or other treaty commitments was underscored by the city of Stralsund’s attempt to obtain EU intervention on the grounds that Mecklenburg-West Pomerania’s move to change the Savings Bank Law impeded the freedom of settlement and capital movement in the European Union.150 The role the European Union might play in the future in abolishing implicit guarantees to subnational public-sector banks remains an open question. German commercial banks may very well take the reform path that passes through Brussels to effectuate all-encompassing reform of the kind necessary to induce a significant

146. Id. (author’s translation).
147. See German Banks Lose State Backing, DEUTSCHE WELLE, July 19, 2005.
148. Understanding between Monti and Koch-Weser, supra note 104. Notwithstanding the agreement, the public-sector banks still have a foot up vis-à-vis their private-sector counterparts due to implicit guarantees.
inter-pillar consolidation process, as the prospects for convincing the Länder to adopt a reform agenda are remote.

V. U.S. Federalism Would Not Sustain a Three-Pillar Banking System

Unless the U.S. Congress steadfastly supported a scheme analogous to the banking system in Germany and explicitly manifested such intent by reducing it to writing in the form of legislation, U.S. courts would not uphold the state regulatory powers necessary to create and cultivate a three-pillar-styled banking system. Given the path dependency of the U.S. regulatory system and economy, any moves to establish a banking structure similar to that in Germany would be superseded by one underlying policy aim frequently articulated in U.S. jurisprudence: creating a national market unencumbered by protectionist state legislation and regulation. The pursuit of this theme is inherently incompatible with a banking system like that of Germany, where the free flow of capital among the constituent states is significantly encumbered. The Supreme Court's Dormant Commerce Clause jurisprudence as applied to the banking sector provides a sense of the opposition in the United States to such a scheme. Granted, such comparisons leave something to be desired because in Germany, the Länder, by virtue of the Savings Bank Act, restrict the purchases of public banks by private banks, rendering the point of contention one that revolves around a public-private dichotomy. In the United States, however, the focus of the relevant jurisprudence relates in pertinent part to states protecting private banking entities located in their state against banks located in other states. As the Court stated in Granholm v. Heald, "time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate 'differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.'" In the United States, Congress would have to permit such activity, and Congress would surely revoke its permission if it found, for example, that a hypothetical scheme analogous to the German three-pillar banking model was having an adverse effect on the national economy and impeded U.S. productivity vis-à-vis its international counterparts.

U.S. states have tried to prevent entry of national banks into certain banking areas. For example, Bankers Trust, a New York-based bank,
sought to establish an investment management subsidiary in Florida.\textsuperscript{153} The Florida legislature responded by enacting legislation that prohibited an out-of-state bank holding company from owning or controlling a business in Florida that sells investment advisory services, even though the Federal Reserve Board had deemed the provision of investment or financial advice as "closely related" to banking within the meaning of the Bank Holding Company Act of 1956.\textsuperscript{154} The Supreme Court, with Justice Blackmun writing for the majority, struck down the Florida legislation.\textsuperscript{155} Blackmun reasoned, "[t]he statute makes the out-of-state location of a bank holding company's principal operation an explicit barrier to the presence of an investment subsidiary within the State . . . . [I]t thus prevents competition in local markets by out-of-state firms with the kinds of resources and business interests that make them likely to attempt de novo entry."\textsuperscript{156} Notwithstanding Florida's interest in preventing economic concentration in high finance, protecting its residents from fraud, and "maximizing local control over locally based financial activities," Blackmun stated:

In almost any Commerce Clause case it would be possible for a State to argue that it has an interest in bolstering local ownership, or wealth, or control of business enterprise. Yet these arguments are at odds with the general principle that the Commerce Clause prohibits a State from using its regulatory power to protect its own citizens from outside competition.\textsuperscript{157} As long as Congress remained silent on the subject, the Dormant Commerce Clause would prevent Florida from establishing a regional banking system insulated from competition from bank holding companies from other states.

The Supreme Court similarly constrained the states in \textit{Northeast Bancorp, Inc. v. Board of Governors},\textsuperscript{158} in which Justice Rehnquist, writing for the majority, reasoned that "an individual State acting entirely on its own authority would run afoul of the Dormant Commerce Clause if it sought to comprehensively regulate acquisitions of local banks by out-of-state holding companies."\textsuperscript{159} Rehnquist distinguished the

\begin{thebibliography}{99}
\bibitem{154} \textit{Id.} at 30--32.
\bibitem{155} \textit{Id.} at 27--28.
\bibitem{156} \textit{Id.} at 39.
\bibitem{157} \textit{Id.} at 43--44.
\bibitem{158} 472 U.S. 159 (1985).
\bibitem{159} \textit{Id.} at 174 (distinguishing states acting in a categorical discriminatory manner on their own authority from states acting based on the authorization of Congress, as was the case with respect to the Douglas Amendment to the Bank Holding Company Act, rendering the
constitutional status of a state action that is discriminatory and based on its own authority from a similar state action that is based on authorization from Congress. These jurisprudential precedents, coupled with constitutional constraints, point to the legal difficulties in establishing an analog to the three-pillar banking system in the United States.

VI. CONCLUSION

The distinct variants of federalism in the United States and Germany lead to a different distribution of regulatory authority between the federal government and the constituent states. If the assumption that a certain degree of consolidation in the banking system is necessary to promote profit efficiency is valid, the U.S. regulatory system, given its less diffuse and federal government-biased form of federalism with respect to banking, is more malleable. As a result, the U.S. scheme of federalism sets the stage for dynamic change to bygone regulatory paradigms that deferred in large part to the regulatory preferences of U.S. constituent states. The scope of deference that existed was influenced by political safeguards of federalism rather than by constitutional stipulations. Although federal powers are constrained to a degree by political safeguards of federalism, such safeguards are relatively easy to overcome if the right bargain is struck at the federal level. As a result, market actors are better equipped to prod the establishment of a more profit-efficient structure in the United States, as long as their position is supported by a critical political mass at the federal level.

In the United States, real regulatory power is ultimately stored in the federal government. To the extent that interstate competition exists by virtue of the dual banking system, its effect is limited by federal regulatory powers and by national consensus, however tenuous. In Germany, by giving effect to public policies at the structural level, the vehicles through which such public policies are implemented, namely the subnational public-sector banks, enjoy a sense of permanence, and the three-pillar system is therefore more firmly entrenched. The varying degrees of protection afforded to the status quo banking structure by Germany's
variant of federalism give the status quo further permanence. The policy goals underlying geographic restrictions and the Regionalprinzip are very similar. In the United States, however, once a critical mass of opposition to these kinds of restrictions arose at the national level, it was easy to dismantle the regulations and forge a new market structure. This is not the case with respect to the Regionalprinzip, despite a comparable critical mass of academics, politicians, and private sector actors who oppose its underpinnings and advocate change. As a result, in the field of banking, the inflexibility of German federalism imposes a constraint on the profitability and efficiency of the commercial banking pillar and arguably the banking sector overall.