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Forging a new Mittelstand Compromise:
Lobbying Strategies and Business Influence after the
Financial Crisis

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Abstract

How did business interests succeed in influencing the post-crisis financial sector reform agenda? The present article draws on a remarkable instance of lobbying success in the process of reforming the Capital Requirements Directive (CRD4-CRR), which regulates banking within the European Union. Business lobbyists from Germany, supported by representatives from other countries, obtained a more favourable regulatory treatment of bank lending to small- and medium-sized corporations (SMEs) compared to the stipulations of the internationally agreed upon Basel III framework. An in-depth study of the formation of this new so-called SME compromise shows that existing approaches, which either highlight the special role of business in shaping public policies or the constraining effects of increased political salience and the politicisation of an issue cannot account for the dynamics of business influence in the case in question. Whereas an inside evidence-based strategy of influence failed, lobbying was successful because business representatives actively increased the salience of the issue through an outside lobbying strategy.

Keywords

SME compromise, business influence, lobbying strategies, CRD4-CRR, Basel III, capital requirements, regulatory reform, financial crisis, banking regulation

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Eileen Keller

Max Weber Fellow, 2014-2015

Introduction

The most recent financial crisis, which required large-scale taxpayer support to distressed financial institutions, was a dramatic experience. Given the severity of the crisis, great expectations were set on post-crisis financial sector reforms. Some hoped that the crisis would put an end to financial regulation as low politics, decided upon primarily by independent regulatory agencies and specialized expert communities without direct democratic legitimacy and with a presumably excessively high and one-sided influence of the financial industry. In other words, many expected that the time for significant reform had come (e.g. Grant and Wilson 2012; Mayntz 2012). As the contours of post-crisis reforms became visible, however, concerns arose that regulatory achievements might not meet expectations, to the extent of “wasting a crisis” (Froud et al. 2010), that the pre-crisis trend of increasing complexity would continue (Porter 2014) and that change might be incremental and piecemeal rather than paradigmatic and all-encompassing (Moschella and Tsingou 2013).

From a theoretical point of view, potential for significant regulatory change is usually seen to depend on the effects of salience, the politicization of financial regulation and the broadening of the policy community involved – factors which have all proven relevant to the chances for business influence (Mitchell 1997; Blyth 2002; Culpepper 2011; Woll 2013). On the other hand, limited regulatory change and light financial regulation are frequently attributed to persistent business influence due to special business power, regulatory capture, close policy network regulators and financial industry representatives being embedded in global financial governance with an increasing role of private authority (Underhill and Zhang 2008; Baker 2010; Tsingou 2010).

The present article shows that the above-mentioned factors insufficiently account for the dynamics which underpin attempts at business influence in the post-crisis context. Whereas the first set of factors tends to overestimate the extent to which the interests of businesses and political decision-makers automatically overlap, the second risks underestimating the extent to which lobbying strategies can be adjusted to the political context (see Young 2013 on this latter aspect). This article draws on an in-depth study of the lobbying activities of German business federations in the context of the post-crisis banking reforms, both domestically and at the European level. Together with allies from other member states, business representatives succeeded surprisingly well in obtaining lower capital requirements for bank lending to smaller corporations compared to the stipulations in the internationally agreed upon Basel III framework.

Two strategies of influence were applied in order to obtain this so-called *Mittelstand* – or SME – compromise.¹ On the one hand, lobbyists targeted regulators’ technocratic approach to regulation with an evidence-based strategy. When applying this strategy, interest groups provide both empirical evidence and technical arguments in favour of their position in an attempt to persuade regulators that their demands are well founded. On the other hand, political decision-making is not only about implementing the best solution to a policy problem understood in a technocratic sense, but also about making value-based decisions with distributive implications that respond to the demands of the broader electorate. Hence, a second political strategy mobilized the business community and targeted parliamentarians and economic politicians, emphasizing the risk of unfairly punishing smaller corporations when it comes to bank lending. The influence on the policy-making process of this strategy is best conceptualized as exerting pressure by increasing the salience of an issue among important societal groups.

In the case of the post-crisis bank capital reforms for SME lending, the first strategy was not successful: both within Germany and at the European level regulators remained fiercely opposed to lowering the Basel III regulatory standards. They did not buy the arguments put forward by the business community and they presented empirical evidence that contradicted the claims made by the business representatives. The second strategy, by contrast, succeeded: banking lobbyists successfully expanded the conflict to the non-financial corporate sector and sought media attention. In this way

¹ The term ‘Mittelstand’ refers to small- and medium-sized, often family-owned, German corporations (SMEs) without any precise size limit.

they gained, inter alia, the support of the European Parliament, which made the SME compromise one of its core claims and a key political priority during the Trilogue negotiations.

The present article makes at least three contributions to the literature. First, it provides an in-depth case study on business lobbying in the post-crisis context and traces lobbying activities at different levels and in different policy venues. Second, it departs from access and exchange views of lobbying by focusing on influence strategies, persuasion and pressuring in particular, and on how they interact with different policy-making venues. Finally, the article provides empirical evidence on how business representatives use outside lobbying strategies, which so far have largely been associated in the literature with diffuse interests. More research on the ways business interests seek political influence through mobilization, mediatization and legitimization strategies is certainly desirable.

The remainder of the article is structured as follows. The next section discusses theoretical perspectives on lobbying activities and business influence. The subsequent section gives an overview of the bank capital reforms after the crisis and describes the details of the new so-called SME compromise. In a next step, the lobbying efforts to lower the capital requirements for SME lending are analysed, focusing on the activities of German business lobbyists, who were particularly active. The reasons for success and failure of lobbying in different political venues are traced next. The article concludes by summarizing and discussing the findings.

Perspectives on lobbying strategies and business influence

Broadly speaking, three approaches to the study of lobbying and business influence can be found in the literature. A first approach highlights the special role of the business community in shaping public policies through privileged access, structural power or capture. A second, more nuanced, approach emphasizes that the chances of business lobbying success are mediated by the salience of an issue, i.e. by how important an issue is for the broader electorate. A third thesis goes one step further and argues that business influence is even more circumscribed than the previous two approaches suggest, because so-called diffuse interests can actively manipulate the salience of an issue by using outside lobbying strategies. I suggest that this typology insufficiently accounts for the dynamics of business influence in the present case because business can also profit from mobilization-based strategies. In order to understand how business seeks influence in different political venues, it is useful to distinguish between an evidence-based and a political strategy. Whereas influence is achieved through successful attempts at persuasion in the first case, it is achieved through pressuring in the second.²

The “business wins all” thesis

The “business wins all” thesis starts from the assumption that business is a particularly powerful political actor. In the structural power literature, the particular strength of the business community is attributed to the dependence of the state on capital and investment decisions by private economic actors, which ultimately generate economic welfare. Politicians are considered to make business-friendly decisions when business representatives can credibly threaten to leave the political territory concerned and invest elsewhere (see Bernhagen and Bräuninger 2005, pp. 44 ff.; Lindblom 1977). In an influential recent contribution, Hacker and Pierson (2010) argue that the particular organizational strength of US business interests relative to other societal groups has led to an even higher concentration of political and economic power in the hands of a small elite.

A similar departure from pluralist views of policy-making and lobbying is also a characteristic of the literature on regulatory capture, whose central insight is that narrowly-defined business interests are particularly well placed to shape interventions in the economy by public authorities by influencing the content of regulations in their favour (Dal Bo 2006). Two reasons are generally stated for this (Stigler 1971). On the one hand, since costs and benefits are usually more concentrated for business

² I use the term influence premised on the assumption that the main purpose of lobbying is to have an impact on the policy-making process and to increase the chances of seeing a favourable policy outcome that would be less likely otherwise. In this contribution, the focus is not on measuring its precise impact, which is indeed difficult (Dür 2008), but on showing the mechanisms through which lobbying works and how different types of political decision-makers respond to different kinds of lobbying activities.

than for consumers or voters, collective action problems are more easily overcome. On the other hand, business actors are particularly resourceful financial actors and hence can “buy” political decision-makers. Business representatives capture political decision-makers when through their actions they “consistently or repeatedly” obtain political deals in their favour that intentionally diverge from a counterfactually-posed public interest (Carpenter and Moss 2014, pp. 13 ff.; Carpenter 2014, p. 58).

In the Stiglerian line of thinking, lobbying is conceptualized as an exchange of mutual favours between influential societal groups, mainly business representatives and political decision-makers (Hall and Deardorff 2006, p. 70). In these models, business obtains favourable regulatory stipulations in return for financial contributions or bribes (Dal Bo 2006). Works in this tradition on *legislative* lobbying have focused on the exchange of campaign contributions for votes (Welch 1974; Snyder 1990; Morton and Cameron 1992). Works on *administrative* lobbying have focused on capture through revolving doors, i.e. situations in which a favourable regulation is obtained in return for a well-paid post in the private sector (or an expectation or promise thereof) (Dal Bo 2006).

Empirical evidence, however, has increasingly shed doubt on the direct policy- or vote-buying effect of financial contributions or promises of future employment. If it exists at all, it seems to be rather weak (Hall and Wayman 1990, p. 798; Hall and Deardorff 2006, p. 70; Morton and Cameron 1992; Ansolabehere et al. 2003, pp. 112 ff.). Overall, interest groups spend much more money on other lobbying activities than on direct financial contributions (Figueiredo, Richer 2013, p. 5). In response to these shortcomings, a second view of business power has gained prominence which focuses on cognitive, cultural or social forms of capture. According to this second view, business representatives get what they want not primarily because they manage to overcome collective action problems more easily or because of the money that they have, but because of the networks they are embedded in and the worldviews that are shared within these networks.

This approach to regulatory capture holds that regulators enact business-friendly regulations not because it serves their narrowly-defined material self-interest, but because regulators think that what they do is the right thing to do (see Kwak 2014). The behaviour of regulators is influenced by those with whom they interact on a daily basis, and business power ultimately results from the predominant position of business in these networks relative to other societal groups. In the literature on lobbying, similar conceptualizations of business-regulator relations exist which highlight that lobbying is not necessarily about seeking influence in the sense of changing a legislator’s mind but assume that lobbyists and those they target with their activities want the same thing in the first place. Hall and Deardorff (2006), for example, conceptualize lobbying as a legislative subsidy which does not attempt to change a legislator’s preferences (or utility), but subsidizes her legislative activity by acting as a kind of ‘service bureau’. In this view, lobbyists simply provide support for policies that the political decision-maker concerned supported in the first place.

The transnational financial policy community has been characterized as a particularly closely tied club-like community where “financial policy becomes apolitical for those within the community, with regulators and supervisors becoming aligned with market participants” (Tsingou 2014, p. 4; for a critical view, see Young 2012). Given the highly technical character of financial regulation and the high salaries paid in the financial industry, independent public authority or expertise is particularly difficult to develop (also see McCarty 2014). Cognitive or cultural capture has also been widely stated as one of the reasons for the Great Recession and emphasized by some of the most outstanding commentators on the crisis, including Nobel prize winner Joseph Stiglitz, Citigroup’s chief economist Willem Buiter, and former executive chairman of the British Financial Services Authority Adair Turner (see Kwak 2014, p. 78 for an overview).

If cognitive capture is omnipresent, why did regulators not back up the demands of industry for lower regulatory stipulations on SME lending? There is good reason to assume that the cultural or cognitive influences, while undoubtedly being important concepts, may be less automatic than many of the capture accounts may lead us to think, especially in the post-crisis context.

The “quiet politics” thesis

A more nuanced thesis on business influence stipulates that business does not always have the best chances of winning. This more circumscribed thesis highlights the role of the electorate or the broader

public as a second constituency to which political decision-makers are usually responsive. Not only do politicians care about the health of the economy and business' big pockets, but also about what voters want. In political science, a broad literature has developed on the role of the median voter, electoral politics, and electoral vulnerability in shaping public policies (Mayhew 1974; Fenno 1978; Arnold 1990; Immergut and Abou-Chadi 2014). Common wisdom holds that politicians are more likely to respond to the concerns of the broader public the more important an issue is for the electorate. Neil Mitchel (1997) coined the term 'calculated heroism' for the moments when political decision-makers overcome the resistance of the business community.

Bringing together the special role of business interests and the sensitivity of politicians to the preferences of the electorate, Culpepper (2011) argues that business is most likely to be successful when the decision-making context is characterized by low political salience, i.e. when an issue is of "little immediate interest to most voters" (p. 4) as is the case of many rather technically-opaque policy fields. In such cases, a pattern of "quiet politics" prevails, where business tends to win because of its superior political resources, and expert knowledge in particular. When the public has little interest in a topic, politicians and reporters have few incentives to develop their own expertise and the voice of business has a good chance of prevailing (Culpepper 2011). By contrast, when an issue matters to the broader public the opposite is true and the chances of business lobbying success are low.

While highlighting an important aspect of the dynamics of business influence, the quiet politics thesis does not help us in elucidating the present case of business lobbying success. Clearly, in the aftermath of the financial crisis public attention to financial regulation was at its highest and, given the tremendous amounts of taxpayers' money spent on supporting failing financial institutions while the economic recession forced many people to tighten their belts, lowering regulatory prescriptions and siding with industry preferences by softening the standards for increased financial stability was an issue that could potentially count on election day. In other words, from a quiet politics perspective the chances for business success were probably the lowest they could get.

The "noisy politics" thesis

The noisy politics thesis goes even further, in that it holds that the salience of an issue is not always an exogenously given characteristic of the political context in which a specific policy debate takes place and which evolves in response to largely unforeseen and uncontrolled events. Rather, the salience of an issue among the broader public can be manipulated through so-called outside lobbying strategies. Outside lobbying aims at mobilizing people outside the policy community to achieve inside lobbying goals (Kollman 1998, p. 3). As Trumbull (2012) shows, so-called diffuse interests can overcome collective action problems and increase their chances of lobbying success by forming broader legitimacy coalitions that support a specific claim. Raising the importance attached to a specific issue through noisy politics, which may include media campaigns, protest activities, and grass roots mobilization among others, may lead to lobbying success, in some cases even against powerful business interests.

The importance of manipulating the salience of an issue as a political strategy can be traced back to Schattschneider (1975 [1960], p. 3), according to whom "the most important strategy of politics is concerned with the scope of conflict." Schattschneider developed a theory of politics characterized by the antagonistic tendencies of privatization vs. socialization of conflict, where dominant interests seek to keep a conflict private, i.e. avoid government involvement, whereas the weak "want to socialize conflict, i.e. involve more and more people in the conflict until the balance of forces is changed." (Schattschneider 1975 [1960], p. 40). As Kollman (1998, p. 9) highlights, it is often less the popularity of a policy that outside lobbying attempts to alter, but rather the relative importance that the public attaches to a specific issue.

In the lobbying literature, the importance of changing the scope of conflict has gained prominence with distinctions being made between access vs. voice (Beyers 2004) or inside vs. outside lobbying (Kollman 1998). 'Voice' as an outside lobbying strategy used to be strongly associated with the activities of interest groups that do not have the privileged direct access to policy-makers that many business associations have (Bouwen 2002; Eising 2007).

Business lobbying – quiet and noisy

Whereas noisy outside lobbying is mainly associated with diffuse interests, I show that it can also be used by business actors in certain circumstances. It was noisy politics rather than quiet inside lobbying strategies that led to the remarkable lobbying success on SME lending after the crisis. From early on, the bank lending coalition, composed of banking as well as corporate sector representatives, engaged in a dual political strategy of quiet *and* noisy politics. What may sound paradoxical at first glance is possible because the two rely on different mechanisms to achieve political influence (see Table 1).

Quiet politics often relies on an evidence-based strategy. This strategy seeks influence by providing empirical facts or expert knowledge on the potential favourable or otherwise policy implications of a given policy, and aims to convince a policy-maker that, given the implications of the proposal, it is in his own interest to modify a policy in the proposed way. When an evidence-based strategy is applied, influence is achieved through successful attempts at persuasion through arguing, based on empirical facts and expert knowledge. Arguing aims to shift a policy-maker’s position in one’s direction through a reassessment of his policy preferences in the light of the information provided by an interest group. In other words, lobbying aims to maximize the perceived interest overlap between the interest group and the policy-maker concerned through the strategic use of arguments (on lobbying as arguing, see Naurin 2007; Beyers 2008, pp. 1194–1200; on persuasion, see Hall and Deardorff 2006, p. 71). Evidence-based lobbying strategies are more likely to succeed the more a decision-maker is policy-seeking. They therefore usually target specialized regulatory agencies and characterize the interactions in knowledge-based expert communities.

Noisy politics, by contrast, focuses on the political or electoral consequences of a policy. Policy-making is not only about finding the best policy option for a given problem in a technocratic sense, but also about shaping the development of the political community towards political priorities and about responding to the demands of core political constituencies. A lobbying strategy which speaks to this aspect of policy-making often builds on claims of why a certain policy is desirable, unfair or on why a certain claim is legitimate. The aim of the political strategy is to convince the policy-maker that a specific policy demand is in line with central political constituencies, her core function or fundamental values that she represents. In this context, lobbyists increase their chances of lobbying success through pressuring by raising the salience of an issue among the members of a specific group, or among the broader public through media campaigns and other public events (Kollman 1998; Goldstein 1999; Hall and Reynolds 2012). Such a strategy is more likely to be successful the more a politician is seeking support.

Table 1. Lobbying strategies and influence

	<i>Content</i>	<i>Conflict dimension</i>	<i>Target</i>	<i>Mechanism for influence</i>
<i>Quiet politics</i> Evidence-based strategy	Provision of empirical evidence in favour of position	Evidence – counter-evidence	Policy-seeking decision-makers	Persuasion through arguing
<i>Noisy politics</i> Mobilization strategy	Based on legitimacy-driven arguments on value choices, justice, fairness, or (un)desirable consequences	Competing politically salient claims	Support-seeking decision-makers	Pressuring through mobilization and conflict expansion*

Source: Own elaboration. See running text for references. *Mobilization and conflict expansion are not the only ways political influence through pressuring can be achieved. Another mechanism is signalling. An interest group can, for instance, threaten to withdraw financial support from a project that is relevant for a political decision-maker or signal a refusal to cooperate in the future (on signalling, see Bernhagen and Bräuninger 2005).

To summarize, both the evidence-based and the mobilization strategy aim at gaining influence over the political process by changing the perceived returns of different policy options. In the first case,

influence is gained through persuasion; in the second case, influence is gained through pressuring. Interest groups draw on one or a combination of the two strategies depending on how they see the chances of influence being best achieved. Indeed, empirical evidence suggests that interest groups often combine lobbying strategies and that business representatives also use outside lobbying strategies (Baumgartner and Leech 1998, pp. 147 ff.; Hojnacki and Kimball 1999; Binderkrantz 2005; Victor 2007; Chalmers 2013). Working on a sample of 29 EU policies and 75 interest groups, Beyers (2004) even finds that outside media information strategies are slightly more frequently used by so-called specific interests, such as employer organizations and unions, compared to diffuse interests, especially NGOs.

Bank capital reforms after the crisis

Given the tremendous losses many banks incurred during the crisis, banking regulation was central to the post-crisis reform agenda. Part of the post-crisis consensus among politicians and regulators in the G20 countries was that the pre-crisis minimal regulatory capital requirements for banks were insufficient, both qualitatively and quantitatively (G20 2009, p. 2). Regulatory capital requirements define how much equity capital a bank has to hold against its business activities and they are one of the cornerstones (if not *the* cornerstone) of banking regulation. Sufficient equity capital puts banks in a position to bear unforeseen losses while living up to their other commitments, and they de-incentivize risk taking (Tarullo 2008, pp. 15 ff.). If a bank grants credit to a corporation, it has to finance this activity with a certain amount of equity capital. In simple terms, the amount depends on the riskiness of the borrower, the loan volume, and the minimal capital ratio as defined by the relevant banking regulation.

The internationally agreed upon reform of bank capital requirements which was adopted by the Basel Committee of central bankers as part of the so-called Basel III framework in December 2010 introduced stricter capital requirements for banks by defining additional capital charges and a more stringent and more restrictive definition of capital. Overall, the minimum capital ratio, including the newly-introduced capital conservation buffer, was raised by almost one third from 8% to 10.5%. In addition, capital charges were introduced to smoothen the business cycle and for systemically important financial institutions (SIFIs) (Basel Committee 2010).

The higher capital requirements and other tighter regulatory prescriptions were implemented with the aim of strengthening financial stability by making financial institutions more resilient in the case of economic and financial shocks. At the same time, however, with an increase in minimum capital levels the amount of equity capital required for each credit automatically increases, and all things being equal the overall volume of credit attributed with a given capital base decreases – a circumstance which can lead, as some feared, to a reduction in the supply of bank credit and higher borrowing costs for the non-financial sector. In the worst-case scenario, regulatory changes may affect overall economic development, especially during the transition phase when financial institutions are adjusting to the new standards.

In the face of these risks, doubts about the macroeconomic sustainability of the new regulatory requirements emerged. The *Institute of International Finance* (IIF), the global financial industry association, for example, argued that the impact assessment conducted by the Basel Committee underestimated the cost of the regulatory reforms. According to the IIF's own predictions, credit growth would decrease by 4.2% between 2011 and 2020 in the Euro area compared to the baseline scenario (IIF 2011, p. 54). Taken together, the cumulative effect of the reforms would lead to significant welfare losses, estimated at 3.2% lower GDP and 7.5 million job losses (IIF 2011, p. 10).

Against this backdrop, voices, especially from Germany, gained prominence with the beginning of the negotiations on the transposition of Basel III in the EU, emphasizing that the reform of the European capital requirements directive (CRD) should take certain distances from the Basel III text. In particular, business representatives asked for lower regulatory requirements than those stipulated by Basel III. Strikingly, these lobbying efforts resulted in the adoption of a new so-called SME compromise, which implements lower regulatory capital requirements for bank credit to smaller

corporations in Europe compared to Basel III.³ The new SME-compromise was among the most contested elements of the CRD4-CRR reform package and fiercely opposed the European Parliament against the Commission and the European Banking Authority (EBA). In order to understand this surprising business lobbying success under relatively unfavourable conditions, it is necessary to understand how lobbying strategies and decision-making in different policy venues interact.

Forging a new SME compromise

The demand for lower capital requirements for SME lending emerged in business circles in Germany, and was brought to the European post-crisis reform agenda together with similar-minded business groups from other countries, from Austria and Italy in particular, but also from France. The German savings and cooperative bank sectors, for which bank lending to smaller corporations is a major source of income, were particularly sensitive to the capital increases, but the supportive coalition grew steadily, including not only all German banking groups but also many employer organizations from the non-financial sector.

Substantively, the German business sector's evidence-based strategy built on the work of several German economists on the relative capital charges for different bank activities and related losses during the financial crisis. Based on a sample of 332 big banks, the economists had found that capital charges were, relatively speaking, more disadvantageous for credit risk – and hence bank lending – than for other bank activities, especially the financial market-related activities of the trading book (Erlebach et al. 2010; Berg et al. 2011).⁴ The results of the study began to circulate among banking and corporate sector organisations, and several business organisations referred to the study in their publications (e.g. vbw 2012, pp. 60–62; DSGV 2013, pp. 4–5). In line with the findings of the study, representatives of the employer organizations claimed that the Basel III higher capital requirements would 'penalize' credit risk, and hence bank lending, disproportionately (Die Familienunternehmer 2011, p. 2; BVMW 2011, p. 8). Besides the perceived distorted relationship between capital levels for trading and credit risk, attention also focused on the capital levels for credit risk as such. A study drawn up for the association of medium-sized enterprises, for instance, argued that the regulatory capital levels for SME credit risk under Basel II were too high compared with the factual losses that occurred, and therefore had to be lowered (BVMW 2011, pp. 5, 9-11, taken up by vbw 2012, pp. 59–68).

Based on these findings, several German federations from both the corporate and the banking sectors made suggestions on how the capital cost of credit risk could be reduced, thereby focusing on two aspects: a reduction in the risk weight applied to the credit risk of smaller corporations by up to 40% on the one hand, and an increase in the threshold for loan volumes and a corporation's annual turnover to which the special SME rules are applied on the other (BVMW 2010, pp. 6–7, 2011, p. 25; ZDH 2011, p. 8; BDI 2011, p. 3; vbw 2012, pp. preface, 79-80; interview 2013101814D).

Besides this focus on the very technical content of the regulation itself, business sector representatives highlighted the potential implications of the reforms in a language that was accessible to the broader public, and they made sure that the message was distributed and heard widely. Both the German banks and many employer organizations from the corporate sector were particularly attentive to the progress of the banking reforms and they developed their political mobilization-based strategy on the potential implications of the reforms very early on (Interview 2013101814D). In substance, two

³ In the EU, a corrective factor of 0.7619 offsets the increase in the capital ratio and maintains the regulatory capital cost for credit to smaller corporations at the pre-reform level (10.5% new capital ratio *0.7619 = 8% previous capital ratio; see EBA 2012, p. 19). The factor is applied if the exposure of the bank to a corporation does not exceed 1.5 million Euros and if the annual turnover is below 50 million.

⁴ According to their findings, unforeseen losses from credit risk during the crisis amounted to 24% of the capital banks have to hold against these risks for by far the largest fraction of credit institutions (90% quantile), whereas the losses related to the trading book amounted to 255% (!) of risk-weighted assets for most banks (90% quantile). The distorted relationship between the regulatory treatment of different asset risks even holds when taking into account post-crisis capital increases for trading book risks, introduced with Basel II.5 – even though the reform corrected for some distortions.

arguments about the undesirable implications of the regulatory reforms, whose main declared purpose was to strengthen financial sector resilience, were put forward.

On the one hand, business sector representatives reframed the issue of higher capital levels and other higher or new standards for banks as a much more fundamental choice about continental Europe's financing model regarding the special role of banks and bank lending that the regulatory reform might ultimately threaten. Supporting the present model was consequently reason enough to take a more critical stance on the reforms. In September 2009, for example, when the Basel Committee had just agreed on the very rough cornerstones of the Basel III reform, *AG Mittelstand*, a working group, which gathered representatives from the interest associations of the cooperative and savings bank sector as well as several associations from the corporate sector, published a joint appeal warning against the impact of the reforms on continental Europe's successful – as they emphasized – financing model (*AG Mittelstand* 2009).

On the other hand, banking sector representatives argued that the reforms were not simply an issue for the banks and about financial sector resilience but were of immediate concern to the non-financial sector, and ultimately an issue concerning macroeconomic development and economic welfare. Since higher capital costs would make bank lending more costly in terms of equity capital, and potentially scarcer, non-financial corporations would be 'punished' for faults that were committed in the financial sector – an implication that almost certainly would be judged unfair by the broader public. In the worst-case scenario, this could lead to lower economic growth and prolong the recession – a sensitive issue for politicians.

As previously mentioned, business sector representatives did not try to treat the issue as 'quiet politics'. In parallel with the institutionalized meetings between regulators and banks, business sector representatives sought the broader public from very early on. In this case, broadening to the public mainly meant increasing awareness of the potential effects of the banking reforms on the German corporate landscape and linking the conditions for bank lending to the outcome of the banking reforms. Each entrepreneur needed to know that it could be more difficult for her in the future to obtain a bank credit due to the reforms. The employer federations used various communication tools to this end: press releases, appeals in the specialized SME press, information brochures, presentations and briefings.⁵

The failure of the evidence-based strategy

Neither the technical argument about the distorted relationship between the capital charges applied to different types of financial risks nor the claim of an excessively conservative calibration of the risk weights applied to SME credit risk convinced the regulators and supervisors – neither in Germany nor at the European level. Domestically, regulators from the Ministry of Finance, the Bundesbank and BaFin, the financial oversight body – all involved in banking regulation and the supervision of financial institutions – asked for evidence for the claims made and insisted that the banks empirically prove the correctness of their claims with their own loan default data. After some negotiation, the German savings and cooperative banks finally agreed to provide data on their loan defaults and the Bundesbank made its own calculations. The results indeed indicated that the factual losses were somewhat lower than what the assumptions underlying the regulatory prescriptions would have led to expect, but the conclusions drawn from these results diverged. Whereas the Bundesbank, BaFin and the Ministry of Finance argued that the difference between the predicted and the factual losses did not justify the thesis of a wrong calibration of the risk weights – in particular when considering that the

⁵ The communication efforts can only be illustrated here. For appeals in the specialized press, see e.g. "Basel III: The Mittelstand foots the bill" in the Journal of the Crafts Sector from December 2010, <http://www.handwerksblatt.de/handwerk/basel-iii-die-zeche-zahlt-der-mittelstand-13406.html>; for an information brochure, see the joint publication of the association of private banks (bdb) and the chambers of industry and commerce (DIHK) on the consequences of Basel III for the German Mittelstand, available at <http://www.dihk.de/themenfelder/gruendungsfoerderung/unternehmensfinanzierung/-positionen/basel-iii>. The federation of the skilled crafts sector (ZDH) provided detailed information on the Basel Committee and Basel III on its homepage, <http://www.zdh.de/themen/wirtschaftsenergie-umwelt/finanzierung-basel-iii-sepa/basel-iii.html>, and most employer federations conducted impact studies on the effect of Basel III on the German Mittelstand.

calibration was intended to work worldwide – the banks and the corporate sector concluded that the risk weights needed to be lowered (interview 2013103019D). Overall, neither the Bundesbank, nor BaFin or the Ministry of Finance endorsed the claim politically during the European negotiations, emphasizing that it was not appropriate to modify individual risk weights unilaterally without taking the overall calibration of risk weights into account (interviews 2013092710D, 2013103018D, 2013103019D).

Lobbying efforts were not limited to the domestic level, and representatives from the corporate and banking sectors approached the European Commission and tried to convince its bureaucrats of a wrong calibration of the capital requirements (interview 2013101815D). However, the Commission was not receptive to the arguments either, and countered the claims arguing that SMEs had no reason to be concerned about the availability of bank credit after the regulatory reforms. On the contrary, the argument put forward in the Commission's impact assessment was that small- and medium-sized corporations, which depended the most on bank credit, were the primary beneficiaries of higher regulatory standards and a smoothed business cycle, because smaller corporations are usually more strongly exposed to credit-rationing effects during economic downturns (European Commission 2011a, p. 52). The European Commission made its own impact assessment of the new rules and concluded that *“the transition to stronger capital and liquidity standards is likely to have a limited impact on the aggregate output.”* (European Commission 2011a, p. 50; emphasis in the original).

In the light of these findings, the Commission was not willing to consider a modification of the risk weights immediately. All the Commission was committed to doing when drafting its reform proposal was to introduce a review clause on the regulatory treatment of SME credit risk based on a report to be made by the European Banking Authority (EBA) in the first two years after the implementation of CRD4-CRR (European Commission 2011c, p. 151). In addition, given the high salience of the issue, the Commission mandated the EBA to work on a report on whether or not a reduction by one third of the risk weight applied to SME credit risk was recommendable immediately (European Commission 2011b, pp. 12–13).

The EBA on its side was very reluctant and emphasized in its report to the European Commission that *“great caution should be exercised in altering the RWs [risk weights] or the threshold for SME Retail exposures to avoid any risk of jeopardising financial stability”* (EBA 2012, pp. 9; emphasis in the original) and considered the increase in the threshold for applying the SME compromise “arbitrary” (p. 38). The counter-arguments brought forward by the EBA emphasized that the financial structure of smaller corporations was less stable, default probabilities higher, and that their activity was more strongly affected by economic cycles than those of bigger corporations (EBA 2012, pp. 15, 26–29). In addition, the EBA questioned the direct link between regulatory standards and bank lending behaviour that business representatives were constantly highlighting, and was sceptical about whether the perceived funding gap indeed resulted from the supply of credit. The EBA's suggestion was that SME funding should preferably be supported through other channels, such as private equity, debt capital markets or public guarantees (EBA 2012).

To summarize, neither in Germany nor at the European level were the regulators and supervisors willing to take up the demands of business for a recalibration of SME credit risk weights, despite the technical arguments and empirical material put forward. Instead, the regulators both in Germany and at the European level relied on their own internal expertise, and developed counter-arguments to those brought forward by the business representatives. Regulatory capture, neither in the classic way nor in its cognitive or cultural variant shaped the regulators' or the supervisors' position.

The success of the mobilization strategy

One might expect that a request to lower regulatory standards for banks that was discredited by all the relevant banking regulation authorities both domestically and at the European level was politically dead, especially in the post-crisis context. However, it turned out that it was not. The lobbying efforts by the corporate and banking sector representatives were not limited to the regulatory and supervisory authorities, especially when it became clear that the regulators were not willing to modify the risk weights.

German lobbyists were also approaching parliamentarians in the German Bundestag, the Ministry for Economic affairs and the Chancellery – and they indeed found ears open to their demands. The German Bundestag adopted a joint resolution of all the parties except the leftist party asking the government, inter alia, to pay attention to the impact of the banking reforms on the real economy and the threat of a credit crunch when defending German interests in international and European negotiations (Deutscher Bundestag 2010, p. 1). In addition, a resolution by the Social Democratic parliamentary group explicitly asked for a more favourable regulatory treatment of SME credit risk (Deutscher Bundestag 2012, pp. 2, 3).

The issue was also taken up by the *Mittelstandsbeirat*, an advisory board to the Ministry for Economic Affairs on SME issues composed of individual entrepreneurs and experts on SME issues.⁶ In February 2011, the board issued a resolution on Basel III warning against the risk that the reform package could de-incentivize bank lending, and long-term funding in particular. The board recommended alleviating the negative affect of the Basel III higher capital requirements on corporate financing by lowering the risk weight for SME credit (BMW_i Mittelstandsbeirat 2011). The suggestion to reduce the risk weights was finally taken up and supported politically by the Ministry of Economic Affairs, despite the concerns expressed by the Finance Ministry, Bundesbank and BaFin. Representatives from the Ministry of Economic Affairs themselves went to Brussels to promote special SME rules in meetings with representatives from the European Parliament and the Commission (interview 2013120324D). Business lobbyists also approached the chancellery, and after several meetings with Angela Merkel's consultants gained her interest and, eventually, her political support for the issue (interview 2013101814D).

At the European level, it was the European Parliament that saved the SME compromise politically by making it one of its key demands during the Trilogue negotiations. In October 2010, the Austrian parliamentarian Othmar Karas from the European People's Party was nominated rapporteur for the CRD4-CRR reform package, and he was a decisive factor in shaping the Parliament's priorities during the negotiations. Karas involved the Parliament from very early on in the debates on banking reforms. In October 2010, the Parliament adopted a resolution which emphasized the need to take into account European distinctiveness regarding corporate financing, the impact of the reforms on economic growth, and the diversity of Europe's banking landscape more directly (European Parliament 2010, pp. 3, 4, 5, 6, points L, 5-8, 18, 26-27, 29). Karas, who represented the position of the Parliament most fiercely in public, emphasized over and over that the transposition of Basel III in Europe had to be sensitive to the particularities of the European diversified banking landscape and the role of banks in financing the real economy. Karas repeatedly emphasized in public that the CRD4-CRR should be both a “banking sector stabilizing and a real economy financing law” (Karas 2010, 2012; own translation).

In order to be heard by the Austrians, the German Association of the Skilled Crafts Sector (ZDH) and the German Industry and Commerce Association (DIHK) approached the Austrian Economic Chamber (WKÖ) and managed to arrange a high-level meeting on the issue with Karas and with two German deputies from the Committee for Economic and Monetary Affairs in September 2011 (DIHK et al. 2011). The European Parliament finally took the issue up. The Parliament's internally agreed upon draft of the CRD4-CRR, adopted in June 2012, lowered the capital requirements for SME lending (by suggesting a scaling factor of 0.7619) and expanded the scope of its application by increasing the threshold up to which the special SME rules were to be applied (European Parliament 2012). In addition, the Parliament introduced a stipulation on credit distribution, demanding that banks' lending decisions should be based on “customer specific information gleaned from a relationship with the customer and not available on standard credit scores and databases that can be bought in the market” (European Parliament 2012, pp. 126, art. 118-ca). The SME compromise became one of the EP's key priorities during the Trilogue negotiations and only survived politically thanks to the Parliament's fierce insistence on its inclusion in the final draft of the Capital Requirements Regulation.

⁶ See the BMW_i homepage: <http://bmwi.de/DE/Ministerium/beiraete,did=161990.html>, accessed on 14.03.2014.

Discussion

The previous sections have traced how a specific demand that was initially articulated by interest groups from the corporate and banking sectors in Germany found its way into one of the core pieces of legislation on the post-crisis banking reforms regarding one of the key elements, namely bank capital regulations. Even though lobbying efforts clearly played an important role during the policy-making process, it would be too far-fetched to conclude from the evidence that lobbying activities alone *caused* the Mittelstand compromise. Whereas lobbying failure can be shown easily, a lobbying success is always the result of a constellation of factors that produce a specific outcome. In the present case, supporting the SME compromise allowed parliamentarians to do something for the local economy back home. For the Ministry of Economic Affairs, supporting SME lending corresponded to one of its core functions, which is to maintain smooth lending conditions for the real economy. For the European Parliament, insisting on the SME compromise was a means of sharpening its own profile during the Trilogue negotiations. For all these political actors, however, the political returns for supporting the SME compromise were higher because the issue had become highly salient.

Three conclusions on how business lobbying activities seek to affect the policy-making process and increase the chances of a certain legislative outcome can be drawn from this case study. First, lobbyists can gain influence over the political decision-making process through different mechanisms. On the one hand, representatives from the corporate and banking sectors developed and put forward sophisticated technical arguments based on scientific output and backed with empirical evidence in an attempt to convince regulators of their demands. On the other hand, business representatives used an outside lobbying strategy and sought the attention of the media. By this means they put pressure on politicians. In this context, the impact of the regulatory reforms was framed as an attack on the predominant financing model and as an unfair punishment of the production sector. The findings also show that different types of political decision-makers are more or less receptive to different influence strategies. Whereas the above arguments on the unfair punishment of bank lending were well received by many parliamentarians, the regulators and supervisors were much less receptive to them.

Second, even in the highly complex field of banking regulation, where risks of cognitive capture are particularly high (McCarty 2014), business influence is far from automatic and interests do not naturally coincide as capture arguments suggest. The modus operandi in highly technical policy communities is best conceptualized as an exchange of arguments based on empirical evidence and challenged by counter-evidence; influence is gained through successful attempts at persuasion. The regulators were indeed sensitive to the demands brought forward by the corporations and banks, and scrutinized them thoroughly. Nevertheless, access did not translate into influence. The regulatory and supervisory authorities both in Germany and at the European level fended off the claims with strikingly similar counter-arguments and a strong emphasis on the beneficial effects of increased financial stability. The evidence-based strategy clearly failed.

Third, the potential for business to achieve lobbying success through an outside lobbying strategy should not be underestimated. Even if a political demand is highly technical – such as the modification of the risk weight applied to SME credit risk – its potential implications (more difficulties in obtaining bank lending and eventually lower economic growth) can be framed in a language that speaks to the broader public. This hints at a more general point about business influence in an age of media democracy: in an environment where access to information has become easier and easier and where communication can be diffused through ever more and ever diverse channels at an ever lower cost, corporations know that their image matters and that any negative press can have devastating consequences. “Whatever the potential benefits of lobbying for legislative ‘relief’”, Trumbull (2012, p. 18) highlights, “the potential cost of being targeted for subverting the general interest is often higher.” In response to this, business representatives have increasingly invested in their public image and reputation management through various corporate social responsibility activities. Seeking policy influence through privileged access may be less costly, but there is a potential downside if it is not backed by minimum levels of legitimacy.

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