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**Working Paper**

# Public savings banks as transformative agents for an eco-social future? Towards a sustainable savings and investment union

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# Public Savings Banks as Transformative Agents for an Eco-Social Future?

## Towards a Sustainable Savings and Investment Union

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# Abstract

The paper explores whether and how public savings banks can be transformed into meaningful agents of change for a more sustainable financial system. It outlines concrete elements of an ambitious transition program. We take as context the efforts to further integrate European financial markets within the framework of the so-called Savings and Investment Union (SIU). The paper highlights the (potentially productive) tensions between a strategy for sustainable finance that relies on capital markets and an approach that emphasizes the role of organizations, in particular (public) banks and related institutions (regulation). It identifies potential complementarities between the two approaches and emphasizes the role of civil society and unions in reinforcing sustainable development.

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# 1. Introduction

Financing the transition to a socially and ecologically sustainable economy has been much more challenging than many experts had expected. In spite of massive attempts to de-risk investments, ("private") sustainable finance (SF) has neither provided the necessary financial resources nor facilitated the structural changes required to achieve rapid decarbonization of economies, let alone sustainable development in the broader sense. Even considering hybrid and public sources, the financial sector has failed to fund mitigation and adaptation sufficiently. Efforts to address the ongoing loss in biodiversity and the challenges posed by other planetary boundaries are severely underfunded. Estimates indicate a financing gap of at least 4.4 trillion US dollars each year between 2024 and 2030 for climate mitigation and adaptation alone, in order to avoid the worst impacts of climate change (Climate Policy Initiative 2025). The "biodiversity financing gap" is put at 700-900 billion US dollars per year (largely based on the estimates in Deutz et al. 2020). The cost of solving other ecological problems, let alone achieving a "just and fair" transition, are largely unknown, but underfunding is widespread, also and in particular with respect to the social dimension (Kulkarni et al. 2022).

Where SF has materialized, its actual impact has been, at best, mixed. While SF has the potential to reduce environmental degradation (Ahsan Iqbal et al. 2025), it can also have unintended consequences, contribute to rebound effects, and lead to a financialization of nature that is seen critical by many stakeholders of sustainable development (Smith 2022). From a social and political point of view, the type of policies aimed at redirecting financial flows towards environmentally sustainable business practices and lifestyles has resulted in significant social conflicts. In conjunction with the lack of redistributive elements, they have contributed to the so called "Greenlash", an increasing resistance against a consequential "greening" of the economy (Panarello 2021).

Public savings banks (PSBs) have long stood at the sidelines of these developments. More recently, and in line with general trends in the industry, they have increased their efforts (Klüh and Naji 2025), perhaps even relative to private commercial banks (Jozef and Kramer 2025). The effects of these changes on balance sheets and business practices have been limited, however (Knoll et al.; Flögel and Hejnová 2024). This stands in sharp contrast to the role of other public banks, in particular development banks (Mocanu and Thiemann 2025). It also appears to be inconsistent with the public purpose of these institutions, and contradicts parts of academic literature, which has recently emphasized the transformative potential of public banking (Marois 2021, 2022).

This paper explores whether and how PSBs can be transformed into meaningful agents of change for a more sustainable financial system. To address this question, we take a specifically European stance, analyzing it in the context of efforts to further integrate European financial markets within the framework of the so-called Capital Markets Union (CMU) and, more recently, the Savings and Investment Union (SIU). We chose this backdrop for two reasons. First, it allows us to highlight the (potentially productive) tensions between a SF strategy that strongly relies on capital markets and an approach that emphasizes the role of organizations, in particular (public) banks, actors engaged in constructing a sustainable future (such as CSOs and unions), and related eco-social institutions (regulation). Second, it offers us a way to think about potential complementarities between the two approaches.

We proceed as follows. Section 2 provides the context of the debate, with special emphasis on CMU and SIU and its potential effects on local banks. In section 3, we examine the current and potential role of PSBs in the eco-social transformation. In section 4, we therefore look at potential transition paths. One way to strengthen the public and ecological mandate would be to interact more intensively with civil society stakeholders and trade unions. We outline the prerequisites for such collaboration and find reasons to believe that the interaction between civil society actors and PSBs could be a promising starting point for a more dynamic transformation of the financial industry. In section 5, we offer recommendations for reforming PSBs and propose complementary organizations and institutions. Section 6 concludes.

## 2. The European Sustainable Finance Agenda and Local Banking

Attempts to address the ecological crisis have been grounded in a strong belief in market mechanisms and private initiative. The guiding idea was to price carbon and other environmental externalities, which would subsequently alter asset prices and risk assessments, facilitating a transfer of financial resources from brown to green sectors. However, it soon became evident that this foundational idea was misaligned with the maturity and risk profiles of the investments necessary for meaningful environmental progress (Aguila et al. 2026). Furthermore, governments recognized that fully internalizing ecological damages into prices would be neither socially nor politically sustainable. To mitigate uncertainty and address the long-term nature of green investments, the public sector has increasingly opted for supporting these private investments by "de-risking" them through public guarantees, primarily using programs of public development and promotional banks. Somewhat paradoxically, these public interventions have reinforced and even cemented the role of private capital markets in the transformation, as they have relied on types of financial engineering following their respective logics (Clifton et al. 2014; Mertens and Thiemann 2019). This is similar to other areas of intervention. In particular, governments have chosen to take a more proactive role in regulating the disclosure, measurement, and management of ecological financial risks, as well as in defining what constitutes sustainable investment. Both the European Union's (EU) Green Deal and Germany's SF Strategy (Deutsche Bundesregierung 2021; European Commission; European Commission 2018) primarily rely on measures financed by private capital. The fundamental idea is that financial investors would choose to invest sustainably if they were aware of the sustainability of certain financial products and the associated entrepreneurial activities. They would act out of self-interest, as brown investments are expected to lose value due to becoming "stranded assets" (Carney 2015).

When these measures failed to muster sufficient resources, calls for a substantial increase in public funding intensified, both to support further de-risking initiatives and to directly fund public works aimed at addressing ecological challenges (Agora Energiewende 2024; Mack and Findeisen 2023; Deutsche Energie-Agentur 2024). To align them more consistently with the objectives of the European Green Deal (EGD), the EU adopted "green frameworks" for several of its programs, including NextGenerationEU, InvestEU, the Just Transition Fund, Horizon Europe, and the European Structural and Investment Funds. While these measures did increase the available funding for the transformation, the overall number of resources still falls short of the

estimated needs (see above). Moreover, recent political developments have led to strong resistance against green policies. Consequently, public sector financial commitments to the transformation are being reduced, and the rather strict rules for reporting and transparency have been watered down.

Calls to revive the original idea of a market-based transformation have intensified – most recently through the initiative known as the SIU. The SIU represents an evolution and rebranding of the EU's CMU (Howarth and Quaglia 2026). Its stated goal is to strengthen the EU's fragmented capital markets by mobilizing capital from household savings. Retail investors should have easy access to capital markets, while small and medium-sized enterprises (SMEs) and innovative startups should benefit from improved financing opportunities. A key instrument for facilitating Europe-wide investment is the harmonization of regulatory frameworks, the supervision of capital markets, and the revitalization of the EU securitization market. Additionally, citizens should be provided with investment education. The CMU itself was introduced in 2014, with a view to complete the banking union, promote growth, and mobilize investments in European companies and infrastructure (European Commission 2015) . It was taken up by the Draghi report, that is based on the assertion that, "to unlock private capital, the EU must build a genuine Capital Markets Union (CMU) supported by a stronger pension system" (Draghi 2024). The CMU is based on the observation that European capital markets are relatively small, especially compared to the United States. This is seen as a challenge for corporate financing, especially for innovative startups (Draghi 2024; European Commission). The initiative identifies a key problem in the large amount of savings that remain "idly" on the balance sheets of credit institutions with conservative and locally biased lending policies. Therefore, the CMU aims at establishing a single European capital market, that would partially redirect these funds. The market for banking transactions—specifically those segments dominated by smaller local institutions, such as cooperative and PSBs – would be streamlined to enhance market capitalization. Additionally, the initiative seeks to attract capital from outside the EU and stabilize the financial system through a broader "range of financing sources" (European Commission). An EU securitization market is expected to facilitate the bundling of loans, enabling banks to transfer risks to capital markets, issue new loans, and provide SMEs with access to market capital. To this end, investor rights, insolvency and tax laws, and related areas are supposed to be standardized, enabling citizens to invest their savings in a pan-European personal pension as a form of private pension provision. The Draghi Report specifically addresses the low market capitalization resulting from European pay-as-you-go pension systems, as well as comparatively low public spending (Draghi 2024)[1].

Could such attempts to deepen and broaden EU capital markets be successful in closing the financing gap for the transition? The existing stock of savings in the EU indeed appears to be underemployed (Arnal 2026) , underinvested in green and overinvested in ecologically harmful activities (Nerlich et al. 2025). Therefore, leveraging capital markets to drive the transformation appears to be a logical approach. However, numerous doubts persist regarding the actual effects

[1] The Draghi report sees a need for increased investment to facilitate the energy transition, which is projected to require €450 trillion per year by 2030. This investment is outlined in an infrastructure package that also allocates substantial funds for digitalization (€150 trillion), defense and security (€50 trillion), and enhancing productivity through breakthrough innovation (€100-150 trillion). These initiatives are intended to be financed through the issuance of common safe assets Draghi 2024

and potential side effects of this strategy. On broader level, concerns have been raised (Cooiman 2023; Sturn and Klüh 2021; Klüh 2022) regarding the lack of policy coordination among the institutions of a "weak de-risking state" (Gabor and Braun 2025), especially given the necessity for public standard-setting and coordinated fiscal, monetary, industrial, and supervisory policies. In particular, a weak de-risking state employing a capital-market-based strategy risks causing distributional effects that it cannot rectify. Moreover, the financial resources required to provide sufficient de-risking could easily exceed the fiscal capacities of many governments. Additionally, there is growing concern that the level of carbon pricing necessary to stimulate sustainable capital market dynamics will face significant social resistance. Finally, greening capital markets requires extensive documentation and reporting to reliably distinguish between sustainable and non-sustainable projects. However, such documentation is increasingly perceived as burdensome, particularly for SMEs. On top, documentation requirements do not inherently lead to environmentally friendly investments, especially when fossil investments remain profitable and companies lack viable sustainable business models. Finally, there are doubts about the CMU/SIU constituting a suitable political framework for the transformation. Actors from the environmental sphere question its main objectives align with their ecological ambitions (Gabor and Braun 2025). Despite these concerns, Green parties and other environmental stakeholders have supported the initiative, hoping to incorporate as many ecological considerations as possible. CMU has been discursively framed as a common good, with green causes being a central element of this construction (Aguila et al. 2026).

Actors from bank-based financial systems fear that the CMU/SIU could transform the financial system in a way that poses threats to their existence (Deutscher Sparkassen- und Giroverband 2025, 2015). Respective concerns are mirrored in the academic literature (Allen et al. 2019; Gischer et al. 2018) and can be summarized in five main points. First, it is debatable whether the anticipated outflow of funds from the banking sector to the financial markets is truly beneficial for the eco-social transformation. Such a shift would further concentrate the power of globally oriented financial investors, which is already significant today. Investments through funds have resulted in the emergence of oligopolies among major asset managers such as BlackRock, Vanguard, and State Street (Becker 2024). Whether innovative clean technology companies are ultimately promoted, as hoped, depends on the decisions made by private fund managers. However, relying on these decisions is inherently risky. For instance, BlackRock has been distancing itself from ESG products and other SF initiatives since 2024, largely due to political and economic pressures from the Trump administration.

Second, while capital markets may exhibit greater dynamism, they have also been prone to periods of substantial volatility. The eco-social transformation, however, is likely to be better managed within a context of economic stability, especially since citizens and entrepreneurs must cope with the repercussions of multiple crises, such as the coronavirus pandemic, the conflict in Ukraine, geopolitical tensions, local flooding disasters, forest fires, droughts, and the rise of autocracy. Even proponents of CMU acknowledge the stability risks associated with it (Véron and Wolff 2015). The Commission itself acknowledges that securitization – a central instrument of the CMU – was one of the primary causes of the 2007-2008 economic and financial crisis, underscoring the necessity for enhanced supervision and regulation (Draghi 2024). Moreover, financial and economic experts argue that the type of risk sharing associated with the CMU does not necessarily enhance the stability of financial markets; when risks can be transferred, there is often

less attention paid to defaults (Schäfer 2016; Becker 2024; Gabrisch 2016). Schäfer (2016) argues that direct investment by savers, at the expense of bank deposits, can trigger bank runs during emergencies. Finally, there is a risk to financial stability when large pools of capital are directed toward selected green technologies on a large scale. The resulting concentration risks could lead to bubbles and the synchronization of financial and economic crises (Becker 2024).

Third, it is important to recognize that the eco-social transformation is not solely the responsibility of a few innovative companies. The more challenging task lies in dismantling existing polluting business models and converting current companies to sustainable practices. This transition may be facilitated by the financial and banking sector, which has long-standing relationships with these companies. These relationships enable banks to support the transition even if they do not generate substantial short-term returns. According to surveys, SMEs prefer bank financing over capital market financing (Schäfer 2016): If companies do not receive loans, it may be because banks' equity being tied up in non-performing loans. Liberalizing these rules could be detrimental to credit quality. Other authors argue that the German banking system is better suited to the structure of SMEs than a capital market-based system (Greitens 2023; Becker 2024). It is particularly problematic if the decision to lend ultimately rests with the owners of large fund companies, as this weakens the negotiating position of SMEs compared to local banks. The drawbacks of economies of scale must also be considered. This system requires standardization and fosters a "professional distance" that allows stakeholders to ignore the consequences of questionable investments.

Fourth, there are distributional concerns: basing SF on capital markets may require socializing a substantial portion of investment risks (through de-risking) while privatizing profits. This approach could transform sustainability into a source of capital income for wealthier segments of the population. Some analysts contend that this redistributive aspect is at odds with the reality that, up to now, affluent households have contributed disproportionately to environmental problems through their investment and consumption behaviors, but have not sufficiently supported initiatives aimed at tackling these issues (Chancel and Rehm 2023; Chancel et al. 2025). Consequently, benefiting these households through the CMU could not only be questioned on grounds of fairness but may also provoke political resistance against the sustainability transformation.

Fifth and finally, ecological limits demonstrate that economic efficiency in the private sector is not an end in itself. Low costs and increased competition incentivize a profit-driven logic that externalizes environmental costs. Green infrastructure projects, as well as the sustainable transformation of the overall economy and its entities, possess characteristics of public goods. However, capital markets primarily operate according to the logic of the private sector. Many projects essential for a green transformation are not sufficiently profitable within this framework, and among those that are, many fail to meet the risk profiles and time horizons required by various types of investors in capital markets (Aguila et al. 2025).

## 3. Could PSBs become Eco-Social Transformation Banks?

As outlined in the previous section, CMU/SIU could have a detrimental impact on an alternative infrastructure for SF: local and regional banks. These banks, often structured as cooperative or

PSBs, are frequently perceived as outdated and slow. However, they possess several characteristics that make them compelling candidates for the role of financial agents in transformative finance: They maintain long-standing relationships with a significant portion of the real economy and are embedded in regional networks similar to those utilized in transformational projects aimed at addressing "wicked problems" through collaboration and stakeholder engagement. Their business models focus less on pure quantification but on relationships. Additionally, their missions typically extend beyond the short-term profit focus characteristic of capital markets, emphasizing either "public value" or "membership value." Furthermore, they exhibit governance models that could potentially serve as foundations for the democratization of finance.

In this section, we discuss whether regional and local SBs can fulfill this potential. Can they serve as a viable alternative to a green transformation driven by the expansion and deepening of capital markets? Is it worthwhile to "save the savings" from the CMU/SIU in terms of sustainability transformation? To address these questions, we focus on German PSBs ("Sparkassen"), as a case study. Their future is not only of academic interest but also significant in its own right, as the SBs Finance Group (SBFG) and its associated partners constitute one of the largest financial services providers in Europe and are therefore expected to play a pivotal role in the green transformation. The group comprises 343 SBs with approximately 10,500 branches and a business volume of €3,320 billion (Sparkassen-Finanzgruppe 2026). Impairing this group would not only have a significant impact on the German economy and the European financial system but also substantially reduce the diversity of the financial system, as it represents one of the last bastions of public banking worldwide.

Public Sector Banks possess several characteristics that position them as effective agents for driving significant sustainability transformations. Most notably, they are not obligated to generate profits, allowing them to finance projects that might otherwise not be feasible financially ("bankable"). Their primary purpose is to fulfill missions defined by federal or state laws. Typically, these missions include providing standard banking services to the regions or municipalities that sponsor these institutions, along with offering general support to these municipalities. However, nothing prevents lawmakers from explicitly incorporating climate policy or sustainability goals into their mandates. For example, the legal mandate of the SBs in the state of Baden-Württemberg is to:

> "...ensure that all segments of the population, the business community—particularly small and medium-sized enterprises—and the public sector have adequate and sufficient access to financial and credit services, including in rural areas. In doing so, they support local governments in fulfilling their responsibilities in the economic, regional policy, social, and cultural spheres, as well as in climate protection and adaptation to the unavoidable consequences of climate change" (Landtag von Baden-Württemberg)

Combining an ecological mandate with reduced profit margins would substantially expand the range of green projects that could be funded through loans and other instruments that PSBs can offer as, in principle, universal banks. Redirecting fiscal resources from capital markets which are used for de-risking, to PSBs would further strengthen respective capacities.

The potential effects of de-risking PSBs' ecological activities illustrate a second characteristic that makes these entities well-suited for financing the green transition: PSBs are known to socialize not only losses but also profits. This may increase acceptance of both their ability to both

generate and absorb losses through investments in sustainable development. De-risking PSBs' green activities would keep public funds within the public sector, avoid undesired distributional effects, and might even produce desired ones. Effectively, it would serve as a way to subsidize municipalities, which bear the brunt of climate mitigation and adaptation costs and are very often severely underfunded. Moreover, the client base of PSBs is, on average, less wealthy and less risk-tolerant than that of private financial institutions (Becker and Walter 2024). Consequently, even an "internal" use of the extra profits resulting from de-risking could be seen to cause desirable forms of redistribution. These elements of redistribution are crucial given the needs of political and fiscal fairness that underpin the social acceptance of eco-social transformation. Highlighting them would also enable a fundamental reorientation on public debates about finance in general, and SF in particular. It would conceive finance as an inherently fiscal (and ultimately social and more democratic) domain involving significant forms of redistribution – a possible "financial future" largely absent from political discourse, except for a brief period following the 2007–2009 financial crisis. Furthermore, it would advance a reframing of financial systems that emphasizes their circuitous nature, as described by (Chiapello and Violle 2025). As argued by (Knoll et al.), such a reframing may be necessary to bring finance "down to earth", as the realization of sustainability transformation on the ground requires financial infrastructures that transcend typical boundaries between the private and the public spheres, as well as between the real and the financial economy.

A third characteristic of PSBs that could facilitate a transformative role is their governance structure. It features elements of both democratic and technocratic governance, combined with a certain type of managerialism: Strategic decisions are taken by a supervisory board or administrative council ("Verwaltungsrat"), which primarily consists of staff representatives, local politicians, and, in some cases, members of civil society (mainly from the business community). The CEO, as head of the management team, and the mayor or district administrator ("Landrat") as head of the Verwaltungsrat, typically work closely together to provide strategic guidance. In principle, this combination of democratic control and administrative and technical effectiveness can be considered as a crucial prerequisite for a sustainable transformation of the economy (Klüh 2021). If taken seriously, this approach could ensure that the rationalities that characterize democratic politics are integrated in a way that ensures a certain degree of policy effectiveness, or instrumental rationality. A supervisory board committed to eco-social goals could readily reformulate the bank's strategy and refocus it on financing sustainable development, within the broader legal framework established by law. Obviously, the flip side of this argument is that a change in political majorities could represent a major blow to PSBs green ambitions. However, proponents of a democratic transition must accept that majorities can shift. However, organizations and institutions that are better equipped to address the challenges of the eco-social transition and that prioritize fairness are more likely to gain broad majority support. Moreover, the long-term nature of PSBs' engagement with their clients, coupled with the fact that PSBs act not only politically but also in line with good credit risk management practices, should prevent excessively volatile behavior. In fact, the reluctance of PSBs to seriously engage with green issues is at least partly an expression of the long-term nature of their relationships with business clients (Flögel et al. 2024) and the fear of jeopardizing these relationships by pushing sustainability concerns too far (Klüh et al. 2025). If the board of directors or other parts of the organization

are systematically composed of stakeholders (as we suggest in section 5) who advocate for sustainability goals, they could serve as a corrective force.

A fourth characteristic of PSBs that enables them to be transformative is the high degree of trust and reputation they enjoy (Gärtner 2003). This reputation spans both a very diverse range of political and social milieus, as well as different societal systems. PSBs have a long history and extensive experience in assisting their regions with managing large-scale structural changes. They have evolved from being relationship lenders, possessing a profound understanding of and commitment to their local economies and financial circuits. Additionally, PSBs bring an interesting cultural element to the table in sustainability transformations. They are known to be rather conservative and "down to earth". At the margin, they tend to adhere more to the logic of local rootedness than to the logics of growth, accumulation, and globalization. Unlike ethical banks or environmental banks, they do not preach to the already converted; rather, they engage a clientele that has had limited exposure to eco-social transformation.

A fifth and final characteristic of PSBs that positions them as potential transformative agents is their close proximity to businesses and their intimate knowledge of the economic structures within their regions. Empirical evidence shows that a high headquarter-to-branch proximity increases the probability of innovation financing and relationship lending (Alessandrini et al. 2009). This proximity allows PSBs to "gain climate-relevant (soft) information, appropriately assess climate impacts, and support local clients in their transition to climate neutrality" (Flögel et al. 2024). This advantage may be particularly beneficial in supporting the transformations of those SMEs whose business models are not centered on sustainability. These SMEs constitute by far the largest segment of the real economy. Moreover, their transformation very often displays characteristics of wicked problems that require actor networks similar to those in which PSBs are engaged. PSBs may have significant incentives to serve as transformation guides for SMEs. Financing the transition to sustainability could enable them to reclaim some of the relationship business that market-based finance has taken from them.

One might contend that, although PSBs display certain characteristics that might be conducive to a transformative role, they are too specialized and small to serve as a viable alternative to the highly scalable instruments offered by capital markets. However, this perspective underestimates their collective size, interconnectedness, and current role. Through their presence at all levels of government, PSBs appear well-positioned to combine the ability to scale solutions with a willingness to engage in governance networks that are often associated with solving the wicked problems associated with transformation. At the same time, they have created a blend of highly localized elements and a dense national "network of networks", with potential global reach through their Landesbanken (regional public banks) and other equity interests. Unlike many other initiatives labeled as serving the common good, PSBs are both local and scalable. In Germany, they constitute the largest financial group, accounting for nearly half of the overall banking system.

Against this backdrop, it is tempting to assume that the infrastructure and value system of PSBs could serve as a robust vehicle for bringing capital "down to earth" (Knoll et al. 2025). Indeed, PSBs have garnered substantial interest worldwide, as they appear to be a robust and sizeable alternative to the logics of "financialization" (Marois 2021; Emunds et al. 2022) or capitalism dominated by Big Tech (Durand and Baud 2024; Klinge et al. 2023). Such models often come at the

expense of real economy sectors, including manufacturing, social welfare, and, more recently, ecological sustainability. With their unique structure and emphasis on local community development, they are viewed by some as a potential antidote to this trend. Their local focus, public ownership, and non-profit orientation create a model that is less likely to encourage speculative practices.

Regrettably, the actual eco-social performance of PSBs has been, at best, mixed. In their present form, German PSBs are unlikely to serve as agents of change for sustainability. In fact, they have often lagged in the sustainability transformation, struggling to translate their public mandate for regional development into effective policies that promote environmental sustainability. Sustainability rankings conducted by civil society organizations have consistently indicated that the majority of German banks have made minimal efforts toward sustainability. Although PSBs have recently intensified their efforts (see above), their sustainability efforts still lag behind those of dedicated ecological and ethical banks (see below). The first round of green asset ratio publications, which measure the proportion of assets financing activities aligned with the EU Taxonomy, reveal that only a very small fraction of PSBs' assets is expected to have a positive impact on climate mitigation. These rations typically range from zero to one percent, slightly below those of larger banks. In line with the general "greenlash", PSBs may be tempted to even scale down their ambitions.

What prevents PSBs from becoming more active agents of change? Our previous (Sturn and Klüh 2021; Klüh et al. 2025),along with other studies (Flögel and Hejnová 2024), suggests that PSBs are caught in a complex constellation of structural, institutional, cultural, and politico-economic restrictions and incentive structures that compel them to set other priorities. The core issue, however, is that PSBs have been increasingly pressured to focus on profitability and legal mandates. In recent decades, stakeholders and supervisors have pressured them to prioritize profits in order to compete with private banks. The motivations behind these pressures are multifaceted. Notably, pressures from the EU, combined with the desire to expand capital markets, deregionalize finance and support financial modernization, have played a crucial role. In particular, the EU has compelled PSBs to dismantle the system of public guarantees that previously ensured low refinancing costs. These pressures are further intensified by local demands: PSBs are increasingly expected to intervene when regional development is hampered by municipalities' fiscal problems. This support rarely takes the form of direct dividend payouts to municipalities – which remain a contentious issue – but rather through stakeholders' expectation that PSBs expand their balance sheets via lending. This, in turn, necessitates generating profits that can be retained to strengthen the capital buffers required for such lending. Regulatory pressures stemming from Basel II and III have exacerbated the problem, as these frameworks seldom account for the small size and unique nature of PSBs.

The pressures to increase profitability and meet expectations to become more market-oriented and competitive have led to fundamental changes in the management and governance of PSBs. Achieving high profitability in an environment of shrinking margins from traditional lending activities has made it increasingly important to generate non-interest income through sales commissions. To this end, institutions have recruited numerous specialists to enhance their sales forces and marketing initiatives. Many top managers view themselves as change agents, with their primary task being to create organizations focused on increasing sales. They perceive sustainability as a concern that is relevant only insofar as it can boost sales and commissions. At

the same time, EU pressures to abolish PSBs altogether have fostered a "circle-the-wagons-mentality", leading to a resistance against "everything that comes from Brussels". Partly, sustainability concerns are even seen as another attempt to weaken existing business models. This resistance has been reinforced by PSBs' tendency to take regulatory interventions very seriously. Many PSBs are driven (and often overwhelmed) by regulatory concerns. The more sustainability has become a statutory obligation without clear integration into business models and organizational cultures, the less it is seen as a promising foundation for organizational development. This attitude aligns with the political orientation of many actors within SBFG. Historically, PSBs have been characterized by either a conservative Christian-democratic or a social-democratic tradition, depending on local and regional political orientations. Both traditions tend to position themselves in partial opposition to environmental causes. Even in the years when the Green Party won several elections and gained an increasing share of votes in administrative councils, the PSBs' rather careful approach to eco-social topics did not change decisively. To understand this reluctance, it is important to note that, although PSBs governance structures are formally democratic, they are rather hierarchical in practice. Decision-making is informally dominated by the CEO, who primarily coordinates with the director of the supervisory board. The latter is typically the mayor or chief district administrator (Landrat). Moreover, a complex network of multi-level governance – where decentralized entities both exercise control over and are controlled by central entities – ensures that the strategic focus on profits and a narrow interpretation of mandates is usually maintained, while pressure for change is attenuated.

When weighing their substantial potential against their actual behavior, an obvious conclusion emerges: PSBs could play a decisive role in the sustainability transformation, particularly when compared to approaches based on capital markets. However, achieving this would require substantial institutional and organizational changes. How could such change come about? Modern societies operate through the interplay of three main governance forms: markets, the state, and civil society (Jessop 2022). To date, the interaction between these spheres has failed to redirect financial flows toward sustainable ends, as actors advocating for sustainability have been unable to overcome those driven by market or established logic. Vested interests aiming to preserve the status quo have proven to be very strong, as evidenced by the current "Greenlash" in the EU and beyond. Moreover, PSBs themselves are known to be politically well-connected and skeptical of major changes to their role, structure, and governance. Given these challenges, any proposal to make finance more sustainable must include a theory of change that identifies the types of actors capable of initiating transformative dynamics and overcoming resistance to transformation. Consequently, the subsequent analysis will focus on the interactions between civil society organizations, trade unions, and PSBs, particularly within the German context, their focus on sustainability, and these actors' perspectives on PSBs and their potential.

## 4. Civil Society and Union Perspectives on PSBs

Civil society organizations and trade unions represent a vital, yet frequently underappreciated, corrective mechanism capable of reinforcing eco-social principles within PSBs and finance in a broader sense. Although the term "civil society" is often employed as a generic label or a fallback explanation in the absence of alternative political change theories, studies have demonstrated

that the modest advancements achieved in eco-social transformation have been significantly shaped by these actors (Parks 2025). Civil society groups and labor unions possess legitimacy, interpretive authority, and mobilization capacity. Their significance lies in their distinctive ability to catalyze transformative processes and to surmount the inertia that impedes change within markets and formal political institutions. Organizations within civil society involved in SF engage with private sector actors by producing rankings and reports, providing advisory services, and participating in shareholder activism and 'naming and shaming.' They also collaborate with policymakers and the public sector by acting as watchdogs, monitoring implementation processes and litigation, advising policymakers, and engaging in lobbying and political campaigns (ibid.). Additionally, civil society actors reach out to citizens through media and educational initiatives, as well as direct action (ibid.). Transitioning the economy toward sustainability is a complex endeavor that requires collective competence. Citizens – particularly workers[2] – who often passively observe transformation processes rather than actively shaping them could contribute their cognitive and social skills, along with a willingness to embrace failure during the experimental process before achieving success. The extensive structural changes required, coupled with the mobilization of substantial financial resources, will be difficult to realize without adequate political pressure and broad social consensus regarding the objectives, scope, and strategies to be pursued.

## 4.1 Civil Society and Social Reform Approaches to Banking Reform

SF initiatives rarely emphasize banking reforms. Historically, the idea of systematically utilizing public-sector banks to advance social, democratic, and environmental goals is not particularly new. The SBs and cooperative movement, which originated in Germany in the 19th century, initially had a strong social reformist component. As self-help organizations, these institutions aimed to provide access to financial services – particularly for poorer segments of the population, such as craftsmen and farmers – who were denied such access by the private banks of the time (Gubitzer 1989). A fundamental reform of the financial system and the expansion of public banking were central to the concept of "Economic Democracy: Its Nature, Path, and Goal" (Aarons et al. 1928), developed in 1928 by a group of authors led by Fritz Naphtali. In this study, the authors criticize that capital has "accumulated in banks and other institutions" and is "reintroduced into the economy without any economic planning." Instead, they advocate for a planned allocation of capital in the interest of the public economy. To this end, central banks should influence the distribution of capital, the public banking sector should be expanded, and public-interest entities (e.g., in the area of housing finance) should be established, corresponding to capital formation by the state (Aarons et al. 1928). However, these plans were never implemented.

Following the financial crisis that erupted in 2008, concepts of economic democracy aimed at fundamentally restructuring the financial sector were revisited. In addition to expanding the public banking sector, proposals included the socialization of systemically important banks, strict re-regulation of the financial sector (such as banning or severely restricting shadow banks and hedge funds, expanding liability for financial actors, and providing preferential lending for

[2] The category of workers refers to those who earn a living through wage income and includes employees.

certain types of investments), the establishment of "public financial councils," the strengthening of alternative banking forms, and regional investment management (Detje and Sauer 2018). Although scholars and intellectuals close to civil society and trade unions have embraced these concepts and further developed them – for example, in proposals for public banks or the International Network for Democratic Economic Planning (INDEP) or scholars work on democratic banks (Marois 2021; McCarthy 2025)– civil society and trade union circles tend to focus on measures and policies that are less systemic in nature but can be pragmatically implemented and integrated into the political process. Initiatives on ethical investment and SF fall within this spectrum.

From the 1970s onward, eco-social financing in Germany was primarily provided by environmental and ethical banks (Ötsch et al. 2025). Concurrently, initiatives on SF and ethical investment that had emerged from civil society were institutionalized at the United Nations level. Later initiatives within the UN framework, such as the UN Global Compact, involved civil society actors and social partners; however, the agenda was largely set by the financial sector and businesses, with civil society and trade union actors lacking equal standing (Ötsch et al. 2025). This also applies to the European High-Level Expert Group (HLEG) and the German government's SF Advisory Board, which has been operational since 2019. Nevertheless, civil society and trade union actors have exerted some influence on SF, and ideas regarding the role of the PSB sector have emerged, which we will explore in due course. However, in the field of SF, civil society and trade union actors have not yet adopted a unified position (Ötsch 2024, 2026). Some of these actors have been selectively involved in policy processes related to SF and, as a "financialized civil society", have either embraced the framing of financial actors (Cerrato and Ferrando 2020; Tischer and Ferrando 2024) or demonstrated a cooperative stance (Kern et al. 2026). In contrast, other segments of civil society and trade unions have regarded such initiatives as largely ineffective (Ötsch 2024, 2026). Environmental organizations, in particular, engage minimally with financing issues, which can be attributed, among other factors, to a lack of influence (Kern et al. 2026). Trade union actors tend to hold coordinated positions but have so far participated cautiously in SF processes. However, they actively engage in shaping the eco-social transformation, provided their participation rights allow it.

## 4.2 Civil Society and Labor Union Actors in Germany and their Role in PSBs

In Germany, civil society organizations and trade unions engage with broad segments of society that, under previous policies related to the financing and shaping of the eco-social transition, were primarily addressed in their roles as consumers or, where applicable, as entrepreneurs or investors. The four largest environmental organizations – NABU, BUND, Greenpeace, and WWF – collectively have approximately three million members and supporters (Mez 2021) . The umbrella organization Deutscher Naturschutzring (DNR), which encompasses German nature, animal, and environmental protection groups, represents 99 organizations and reaches over 11 million people (DNR 2025). Additionally, informally organized movements such as Fridays for Future play a significant role in environmental advocacy. In comparison, only 1.2 million people were members of political parties represented in the Bundestag at the end of 2021 (Deutscher Gewerkschaftsbund 2024). Specialized NGOs and think tanks – including Climate & Company, Germanwatch, Facing Finance, Fair Finance, and urgewald – alongside development

organizations such as Oxfam, Südwind, and Erlassjahr/Eurodad, as well as welfare associations like the Paritätischer Wohlfahrtsverband, church groups, ethical banks, and organizations including Finanzwende, Attac, Economy for the Common Good (Gemeinwohlökonomie), and the plural economics movement – critically examine financial and economic systems. These organizations possess the capacity to interpret and mobilize issues related to financing eco-social transformation.

In 2023, German trade unions represent nearly six million employees (DGB 2024). They play a crucial role in the transformation process by advocating for diverse groups of workers, possessing insider knowledge of economic processes, and having extensive experience in complex negotiation and mobilization efforts. Co-determination rights are primarily exercised at the company level by works councils, which are typically composed of union members and serve as intermediaries between the workforce and management (Ötsch and Bartelheimer 2026). Unions are also represented on the supervisory boards of larger companies. Additionally, IG Metall has negotiated "agreements for the future," through which unions can set goals for product and process innovations related to digitalization, the energy transition, and the mobility transition; however, these agreements are intended only to guide discussions and are not legally binding (Ötsch and Bartelheimer 2026). Furthermore, unions have engaged in social alliances with civil society actors involved in the eco-social transformation and have been able to mobilize more effectively in certain areas, such as public transportation (Autor*innenkollektiv Climate-Labour.Turn 2023). In Germany, labor unions are represented on the supervisory bodies of banks if the latter meet certain size or legal structure requirements (Müller-Jentsch 2018). This representation occurs on the supervisory board (for corporations such as AG or GmbH) or on the board of directors (for public-law institutions such as PSBs). For major private banks such as Deutsche Bank and Commerzbank, as well as the central institutions of the cooperative sector like DZ Bank, which are organized as stock corporations (AG) or limited liability companies (GmbH), the standard German co-determination laws apply. In contrast, PSBs and state banks are subject to special legal regulations because they are public-law entities owned by municipalities, counties, or federal states. Due to their ownership by local governments, German PSBs have a close relationship with local politics, a connection that is unique within Europe (Véron and Markgraf 2018). This link is reflected in the fact that most seats on the administrative boards ("Verwaltungsrat," the public-sector counterpart to supervisory boards) of German PSBs are appointed by local governing bodies (city councils and county councils). These seats are typically given to local politicians or knowledgeable citizens, often members of the local business elite. This practice is frequently described as a politicized form of corporate governance, although board members often hesitate to engage in strategic discussions, focusing instead on compliance issues. Trade unions have representation on the administrative boards of PSBs, as stipulated by the respective SBs laws of the federal states. These boards generally consist of two-thirds of municipal representatives (mayors and county commissioners who are members of district and municipal councils) and one-third employee representatives elected by the workforce, as stipulated by law. The supervisory boards of the Landesbanken exhibit a heterogeneous composition. Alongside representatives from the sponsoring states, frequently finance ministers, and members of the regional SBs associations, these boards also incorporate representatives of employees and labor unions. Alongside other members, they advise the management board and participate in strategic decision-making, as well as in specific tasks outlined in the respective PSB constitutions.

## 4.3 Interactions Between Civil Society, Labor Union Actors, and PSBs

As our studies (Ötsch 2025a, 2024, 2025b; Ötsch et al. 2025) have shown, financial issues played a relatively minor role in the activities of CSOs focused on environmental issues. The financial crisis, coupled with issues such as greenwashing, has led to a predominantly negative perception of the financial sector among wide segments of society. Within this context, finance is frequently regarded by civil society actors – especially environmental CSOs – as more of a challenge than a remedy. Nevertheless, this viewpoint may cause these actors to overlook the potential of finance as a constructive instrument. Conversely, CSOs involved in financial matters often refrain from engaging with SF, as discourse on the subject has been predominantly influenced by conventional finance paradigms and restricted to a limited framework centered on environmental economics and SF.

Trade unions primarily advocate quality employment in the banking sector, oppose branch closures, and support the provision of comprehensive financial services. They show greater interest in development banks, especially those connected to industrial policies and high-road strategies, where union representatives hold positions on boards of directors. Union representatives attribute their reluctance to become more actively involved in CSR processes to limited participation rights, which exclude them from having a say in matters such as corporate sales or investment decisions (Krieger 2011; Ötsch and Bartelheimer 2026). Although German law adopts a stakeholder approach for corporations, this is increasingly being supplanted by a management culture focused on shareholder value, prioritizing the interests of owners over the common good. This shift occurs despite the German Corporate Governance Code's requirement that the board of directors must achieve "value creation … while taking into account the interests of shareholders, its employees, and other groups associated with the company (stakeholders)" (Krieger 2011). In addition to issues related to management culture, other challenges include the ambiguous definition of sustainability, limited opportunities for members of supervisory and administrative boards to prioritize sustainability on the agenda and participate in related decision-making, and, notably, conflicts of interest between profit generation and social responsibility (ibid.). Consequently, employees in the banking sector face contradictory expectations: they are normatively expected to act sustainably, and report accordingly yet simultaneously must meet sales and profit targets (ibid.). Another drawback is that sustainability criteria are not integrated into executive compensation. As a result, dividends are prioritized over long-term sustainable investments, which union representatives advocate for. Therefore, these stakeholders should be empowered.

Consequently, there have recently been few intersections between civil society, unions, and finance to promote SF. Banks have also been reluctant to engage with civil society actors. However, our interviews with public sector banks (Klüh and Naji 2025) indicate that this is changing. Recently, civil society has been increasingly recognized as a valuable source of information and motivation. While smaller PSBs are often hesitant to engage with eco-social actors, their central organizations, such as regional public banks (Landesbanken) and DEKA, consult regularly with these actors. According to one senior banker:

> "Well, we're currently engaged in a proactive dialogue with five NGOs, and we're actively reaching out to them—we're not just waiting for a poster to somehow appear at our office.... On Monday, we had another conversation with them, with the head of our corporate communications department, about current issues, off the record..."

Although PSBs and commercial banks are not the primary focus of CSOs and trade unions in Germany, activities related to SF are present within this sector. Specialized NGOs conduct and publish investigations that critically examine banking practices, analyze financial market and banking regulations, and evaluate monetary, economic, fiscal, and environmental policies. Additionally, there are campaigns promoting divestment and investment with an eco-social focus, watchdog activities, and constructive proposals and action guidelines directed at banks and regulators. Particularly prominent in the public eye are sustainability rankings of banks, as well as publications and efforts to disseminate knowledge.

The WWF Bank Rating (Hafner et al. 2020)[3] evaluates the 14 largest German banks based on governance criteria – specifically strategy, governance, monitoring, and reporting – as well as the sustainability of both the banks' own assets and those of their clients. This assessment includes private loans, corporate loans, securities issuances, mortgages, and building loans (Hafner et al. 2020). None of the banks surveyed achieved the top two levels – "visionary" or "pioneer". The highest-ranked banks were placed in the third tier; they offer niche products in the area of sustainability but neither drive innovation nor cover all product areas. Banks at the lowest level "hardly have sustainability on their radar (Hafner et al. 2020). Overall, banks are failing to integrate sustainability into their core business. However, some banks exclude financing for particularly environmentally harmful projects, such as coal-fired power generation or fracking (ibid.: 47). The WWF criticizes the surveyed banks for failing to systematically assess climate and sustainability risks, noting that "the effects of their financing and investment decisions on climate, the environment, and sustainable development are largely non-transparent" (ibid.: 65). The overall conclusion indicates "that the largest German banks ... are far from exploiting their potential for achieving the Paris climate targets and the SDGs..." (ibid.: 64).

Studies by various civil society actors show little difference between commercial and public banks from a sustainability perspective (Facing Finance and urgewald; Facing Finance 2024; urgewald 2019; Hafner et al. 2020). The banks ranked positively by NGOs are primarily environmental, ethical, and church-affiliated institutions, namely GLS, EthikBank, Tomorrow, Kirche und Diakonie, and Triodos (Facing Finance 2024; urgewald 2019). CSOs criticize the sustainability efforts of PSBs in several ways. First, they are concerned about greenwashing and deceptive marketing practices. Marketing financial products as "green" without ensuring they have a genuine positive environmental impact is seen as a problem that regularly occurs. The NGO Finanzwende reports that PSBs and cooperative banks engage in greenwashing by issuing ESG certificates that differ little from standard products (Schultz and Senn 2023). A detailed investigation into the "green" certificates offered by PSBs concluded that they constitute a "Mogelpackung" (deceptive packaging), as the funds raised are not earmarked for sustainable purposes

[3] The WWF withdrew its 2021 follow-up study due to allegations of greenwashing related to the collaboration between Deutsche Bank subsid-iary DWS and the environmental organization, as well as undisclosed conflicts of interest (Ondarza et al. 2024).

and the underlying sustainability criteria are lax, allowing investments in companies such as Shell and TotalEnergies (ibid.). This practice allegedly misleads customers and undermines the credibility of SF (ibid.). Second, PSBs are accused of continuing to invest in harmful industries. CSOs criticize the SBs group's fund manager, Deka Investment, and the associated Landesbanken for financing controversial sectors, including the coal and arms industries (urgewald 2019). Third, they perceive a lack of transparency and demand that PSBs report more openly on their investment and lending policies, expecting them to proactively disclose both their direct and indirect holdings (Fossil Free Lüneburg 2020). Fourth, PSB representatives are accused of lobbying against the public interest. The sector's powerful lobbying apparatus, composed of PSB managers and local politicians, are seen as obstacles to change. These networks supposedly protect their own profits and work to weaken financial regulations, rather than advance the common good (Eberhardt 2024). Overall, while acknowledging that PSBs are locally embedded and serve a broad customer base, civil society's assessment is that they have a long way to go to achieve a comprehensive sustainable business model (urgewald 2019).

On the other hand, CSOs offer various constructive suggestions on how to transform PSBs. They recognize and emphasize that these institutions have the potential to contribute positively to the eco-social transformation. Unlike niche ethical banks, PSBs serve a broad customer base of approximately 50 million people. This gives them a unique opportunity to scale up sustainability efforts, motivate less engaged clients to participate in sustainability initiatives, and increase the impact of SF. Gerhard Schick from the NGO Finanzwende argues that the extensive network of SBs, with total assets amounting to €1.2 trillion, has the potential to promote sustainability initiatives on a large scale (Däuper et al. 2021; Schick 2019). In his view, the German Banking Act should require PSBs to document their adherence to climate targets and other relevant sustainability policies within their business practices. Furthermore, the financial supervisory authority should be responsible for monitoring compliance with these requirements (Schick 2019). This approach would encourage business practices that include providing expert sustainability advice, offering green products across all categories of financial services (such as funds, certificates, covered bonds, Pfandbriefe, green bonds, and insurance policies), integrating sustainability considerations into their own securities accounts, assessing ecological risks when issuing loans, and preparing an accessible common good balance sheet (ibid.).

Several civil society organizations, including the 350.org movement, Fossil Free, Fridays for Future, and others, are urging the Regional Banks Association of Lower Saxony PSBs to establish clear investment and lending guidelines for their members. These guidelines should prohibit investments in fossil fuels, the military, and other environmentally harmful or socially detrimental projects, while promoting financing that adheres to positive environmental and social criteria (Fossil Free Lüneburg 2020). PSBs are also being called upon to increase transparency regarding the use of customer funds and to exert influence on their regional Landesbank (ibid.). Furthermore, elected officials from local governments involved with PSBs are encouraged to implement explicit exclusion policies against unsustainable investments and to advocate for positive standards in sustainable financing. Municipal representatives should advocate for divestment, support local climate protection initiatives, and develop sustainable savings options for residents (Fossil Free Lüneburg 2020).

CSOs recognize opportunities for PSBs to act but simultaneously highlight several obstacles. These challenges include, on one hand, the pressure to generate returns in competition with

private banks, and on the other hand, uncertainty regarding the interpretation of the public interest mandate – whether it pertains to promoting economic growth or to a broader public interest that encompasses eco-social goals, along with the associated conflicts of interest. These obstacles are as systemic as the unbalanced governance structures, which, while allowing selective participation by certain political and labor stakeholders, fail to ensure systematic representation of actors advocating for eco-social interests. Consequently, appeals to the ethical and moral conduct of PSB representatives are insufficient. The systematic restructuring of PSBs into transformation banks requires changes not only at the micro level – involving individual SBs, their staff, and their customers – but also at the meso level, which includes the regional and national context, including political decisions, regulations, and policies enacted by governing bodies. Furthermore, changes take place at the macro level, especially within the European context, involving its regulatory framework along with monetary and fiscal policies.

# 5. A Multi-Level Framework for PSB Transformation

The preceding analysis has demonstrated that PSBs possess distinctive institutional and organizational characteristics that can facilitate eco-social transformation. Their public mandate, democratic governance structures, their business models focused on long-term relationships, and their strong local roots stand in contrast to the capital-market-oriented logic of the CMU/SIU. The latter risks privatizing profits while socializing risks, especially in the context of a "weak de-risking state" (Gabor and Braun 2025). However, as outlined in Section 3, the transformative potential of PSBs remains largely untapped. They are constrained by an institutional environment characterized by profitability pressures, conservative organizational cultures, and hierarchical governance structures. As outlined in section 4, eco-social CSOs and unions are hardly involved. However, realizing this potential would require radical reforms based on the analysis presented in the previous sections. A coherent policy framework operating at the European, national, and local levels would be necessary to overcome barriers to such radical reforms. The following sub-sections outline a concrete set of policies for each of these levels.

## 5.1 European Level: A "Green Public Banking Union (GPBU)"

The CMU/SIU's current emphasis on deepening capital markets risks undermining the bank-based, decentralized financial systems that are essential for locally rooted transformation. Therefore, we propose the establishment of a Green Public Banking Union (GPBU) at the European level to complement it. Such a GPBU needs to be embedded in a broader reform agenda based on three principles.

1. **Strengthen risk-sharing and mobilize idle resources in line with a strongly bank-based financial systems:** The legitimate concerns that motivate the creation of a CMU/SIU (namely, the desire to enhance risk sharing among EMU members and to mobilize idle resources currently sitting on banks' balance sheets) should be implemented in a manner consistent with the needs of a bank-based financial system.

2. **Establish new forms of regional, decentralized finance:** The tendency of capital markets to reinforce processes of standardization, centralization, and globalization should be attenuated by

explicitly supporting existing and setting up new forms of regional, decentralized finance. A sustainable SIU would not only safeguard local cooperative and SBs; it would feature specific measures to strengthen the role of local, community-focused financial institutions relative to global capital markets, for example by providing fiscal resources for regions and municipalities outside Germany that would like to create PSBs.

3. **Systematically develop public infrastructures for eco-social transformation**: The European financial system should be conceived as public infrastructure with private elements (and not vice versa), explicitly aimed at achieving social, ecological and economic sustainability.

One way to implement these principles is to complement the two existing integration projects – the unfinished "banking union" and the CMU/SIU – with a "Green Public Banking Union" (GPBU). Such a union would enhance the diversity of the banking landscape in Europe and strengthen cooperation among public financial institutions. Instead of perceiving local cooperative and SBs as outdated models, their role as drivers of sustainable development would be acknowledged. Concrete measures to characterize such a GPBU could be developed on the basis of a critical analysis of existing proposals. Both banking associations and other observers have already brought forward respective proposals (BVR 2024; Deutscher Sparkassen- und Giroverband 2025; Arampatzi et al. 2025; Machado 2026).

The objectives of the GPBUs would be threefold. First, it would aim at protecting institutional diversity, sending a strong signal to PSBs and cooperative banks that the EU has finally recognized they are not an outdated model to be dismantled, but a vehicle for a consequential transformation of the European economy. Second, it would foster stronger cooperation among the numerous public and semi-public entities that characterize the European financial system, including purpose-driven banks, insurance companies, asset managers, development and promotional banks, central banks, and regulatory agencies. In particular, GPBU would support building platforms to facilitate cross-border collaboration among public and cooperative banks in financing transformation projects. Third, the GPBU would finally achieve a degree of proportionality in regulation that is consistent with a truly diverse financial system. In particular, regulations would be designed and applied in a differentiated manner, to avoid overburdening smaller, less complex institutions. This may involve exemptions or simplified regulations; for example, with respect to capital requirements, reporting procedures or risk measurement. In exchange for such proportionality, local banks would need to commit to preserve and when necessary, top up their capital buffers and implement a consequential greening of their balance sheets.

New rules would be introduced to ensure a significant greening of balance sheets and investment strategies, supplementing existing prudential requirements. Financial and climate-related disclosure regulations serve as an initial step in revealing the climate impacts of banking, finance, and the underlying economic activities. To reduce investments in fossil fuels, a combination of green incentives, penalties for brown assets, and the directed allocation of financial flows aimed at mitigating environmental impacts is necessary. For instance, the regulatory framework could set both quantitative and qualitative targets for green asset ratios (GAR), such as varying GAR paths for different sectors and regions, aligned with European and national goals to cut greenhouse gas emissions by 2050. Conversely, "brown assets" – like loans to coal, oil, and gas companies or unsustainable projects – would carry higher risk weights on banks' balance

sheets. These targets would be mandatory, based on the premise that they are essential to achieving legally mandated carbon neutrality.

The revision of the regulatory framework for public and cooperative banks would need to be embedded in a broader rewiring of the financial system. Alongside banking regulations, this would involve a further strengthening of development and promotional banks, and adjustments to the macro-financial framework, including with respect to monetary and fiscal policies. In particular, the ECB would be recognized as an element of the public banking sphere, providing further incentives to encourage lending to sustainable sectors and discourage investments harmful to the climate (Kedward et al. 2024; Ötsch et al. 2025). EU public funds could be directed specifically to bolster the capital of transition banks. More generally, European fiscal policy would be reconceived to facilitate progress toward ecological transition, while also addressing other public interest goals, such as medium- and long-term employment and training forecasts in specific regions. Instead of primarily de-risking private investments through capital markets, the EU would thus strengthen public institutions that can socialize profits and adopt a long-term perspective focused on the public good. A European Safe Asset could provide an important anchor for such a program.

## 5.2 The National and Regional Dimension: A New Set of Rules

Reforms at both the national and state levels are essential to position PSBs as leaders in the eco-social transformation. Key measures would include amending PSBs legislation, reforming the supervisory structures of German Sparkassen, integrating PSBs into interconnected financial circuits, and "translating" political initiatives for eco-social transformation into economic and financial products, alongside the coordinated promotion of such solutions. A reform can be organized around three sets of measures.

First, a revision of the public mandate. A legal redefinition of PSBs' mandate would represent the key lever and basis of any reform. References to regional development would be complemented by explicit eco-social objectives. The case of Baden-Württemberg, which has incorporated climate protection into its SBs legislation, represents a first step on which further steps could build on. Drawing on proposals from academic discourse, the mandate should empower PSBs to assume a "market-shaping" role rather than merely addressing market failures (Mazzucato 2016). This entails making strategic, long-term investments in sectors that remain too uncertain for private financing but are essential for regional transformation.

Second, democratization of governance arrangements and strengthening of accountability. Supervisory and administrative boards would serve as forums that bring together individuals and organizations with complementary expertise essential for eco-social transformation. They could enhance the legitimacy of public-sector banks and the projects they finance. This would also introduce a corrective to current hierarchical supervisory and administrative boards, which tend to focus on short-term economic returns and regulatory compliance. In addition to representatives from local politics, the business community and the workforce, seats on these boards should be allocated to qualified representatives of organized civil society (including environmental and social organizations) and unions, and independent scholars with expertise in sustainable development. The role of representatives from municipal parliaments, civil society, and unions on supervisory boards should be clearly defined and strengthened, shifting their function from

mere oversight to strategic contributions. Sparkassen laws should explicitly mandate the involvement of sustainability experts and require documentation of their participation in strategy development. Additionally, existing accountability mechanisms should be adapted. Specifically, reporting measures concerning public purpose would need to be enhanced. Moreover, audits by dedicated auditor units integrated within regional associations and auditing firms should be complemented with more public oversight. To this end, the existing "savings banks supervisors" at the state level need to be toughened up. Currently, they play a merely cosmetic role. Lawmakers and associations should collaboratively establish a distinct reporting framework for PSBs and their corporate clients that both simplifies and strengthens sustainability reporting.

Third, a better integration of PSBs in interconnected financial networks. Changing PSB-laws would fundamentally redefine their role within Germany's broader political economy. Consequently, federal policymakers would need to develop a comprehensive policy framework to facilitate a smooth transition and to leverage the new possibilities. To this end, Sparkassen and their partners could be conceived as integral components of interconnected local, regional, national, and potentially supranational financial circuits. These circuits encompass a diverse array of private and public institutions and systematically address the fiscal dimensions of finance. As an organization and institution that unites stakeholders with diverse skills and potential, institutionalizes eco-social logics, and connects financial networks, a complementary "Eco-social Future Fund" (EFF) could be envisioned, as outlined below. Furthermore, federal policymakers must clearly articulate their expectations for the evolving public banking sector and outline their planned support. To this end, promotional banks, such as Kreditanstalt für Wiederaufbau (KfW) and its state-based partners, should be empowered and encouraged to collaborate more directly with PSBs. At the same time, social security providers, regulators, and supervisors should work together to establish rules for sustainable retirement savings, particularly in the context of current initiatives to create new capital market-based products (Altersvorsorgedepots). Instead of investing in ETFs that indirectly finance fossil fuel assets and non-democratic asset owners (e.g., those in Big Tech), citizens would finance the local eco-social transformation and benefit from the gains of this transition.

## 5.3 The Local Dimension: Diversifying Eco-social Actor Networks

There are also untapped opportunities at the local level to advance eco-social transformation and enhance legitimacy. Above all, Sparkassen should embed sustainability into their core business. To achieve this, they must transform organizational structures and cultures to actively integrate into local eco-social governance networks. This requires making sustainability a fundamental principle in hiring, employee development, and corporate culture. To achieve this, Sparkassen should finance more ambitious local sustainability projects, such as community solar power initiatives, eco-friendly housing projects, and sustainable public transportation systems. This effort requires partnerships with local governments, particularly regarding municipal green projects, as well as increased collaboration with environmental and social NGOs and unions. The existing culture of social philanthropy – supporting social, sports, and cultural associations – within PSBs provides a strong foundation in terms of work and coordination practices to engage with these new types of actors. By integrating sustainability into their core operations, PSBs would not only significantly promote environmental and social well-being while continuing to

fulfill their traditional mission of supporting local communities but also embark on a process of sustainable organizational development. However, this would necessitate substantial changes to the legal and regulatory framework. A transformative mission requires new and innovative financial instruments and business models. Therefore, in collaboration with local eco-social stakeholders, it is essential to develop innovative legal structures and financial products, and business models.

As universal banks, Sparkassen should leverage their full range of services. Possible options include, (i.) The targeted issuance of "regional green bonds" to finance specific projects, such as the expansion of public transit or the energy-efficient renovation of municipal buildings; (ii.) the introduction of sustainability-linked loans for SMEs, where interest rates are linked to the achievement of specific sustainability goals; (iii.) the use of blended finance models: In collaboration with national development banks, PSBs can leverage public funds to mobilize private investment for higher-risk projects; (iv.) Finance sustainable projects with low profitability, either locally or at an aggregated level — which may involve accepting planned losses locally if they are offset on a larger scale. By doing so, PSBs would provide a form of public banking service that supports the eco-social transformation.

Finally, as members of financial circuits, PSBs must substantially revise their hiring, training, and leadership principles. Knowledge of these new ecosystems should be integrated not only at the board level but also among the staff and management of PSBs. Human resource policies, aligned with targeted training, would foster new competencies within PSBs, enabling them to address issues related to asset allocation, ecosystems, and climate. In some respects, this integration will bring clarity to controversial cases involving loans for fossil fuel-intensive or polluting activities.

## 5.4 The Global Dimension

A potential critique of our proposal could be that its local focus risks neglecting the global dimension of the current polycrisis. In particular, organizing sustainable finance locally might imply that resources that would achieve the highest eco-social impact in the Global South are fenced and hold captive in the Global North. Interestingly, the very institutions that are the focus or our approach have long-established structures that establish links between the two spheres. To address the potential reduction of available funding for the Global South, local North-South transformation partnerships could be established through the EFF and PSBs, building on these existing initiatives already implemented by PSBs and cooperative banks.

## 5.5 Complementary Institutions

The preceding reform proposals would go a long way in establishing sustainable PSBs. In conjunction with the creation of a GPBU, they would represent an important step towards establishing a transformative banking sector. However, the financial dimension of the eco-social transformation cannot be carried out on the back of banks alone. Complementary institutions would be necessary to create financial circuits that are able to achieve climate neutrality and an economy consistent with planetary boundaries. These complementary institutions would organize the funds, services and financing solutions that are outside the realm of banks. In particular, they

would ensure that enough private and public funding is available for hybrid financial solutions that are consistent with the long-term nature, complexity and risk profiles of many eco-social investment needs[4]. Additionally, these institutions must confront the challenges posed by increasing inequality and the obstruction of environmental initiatives by a small cohort of ultra-wealthy individuals (Conway and Oreskes 2014).

We illustrate this point by providing a sketch of such a complementary new institution: an Eco-Social Future Fund (EFF). In the EFF, public funds and private savings would be pooled to finance ecological and social investments, in particular the very long-term risky projects that do not yield immediate returns. The new fund would primarily manage long-term capital investments and provide expertise on how to reach a sustainable economy – ranging from business models and technological issues to regional development as well as social and democratic governance. More concretely, the fund would receive public seed funding, savings from citizen investors, and a polluter-pays fee (see below). An option still to be discussed is linking the EFF to the central bank and financing suitable projects (while taking inflationary risks into account) through money creation. The EFF would then serve as a provider of "patient capital" enabling long-term investments with high upfront costs and uncertain returns – investments that are too risky for private actors but generate significant social value. In addition, it would connect, empower, and strengthen eco-social stakeholders – particularly from an organizational perspective – who advocate for sustainability goals, while also facilitating progressive financing for the transition.

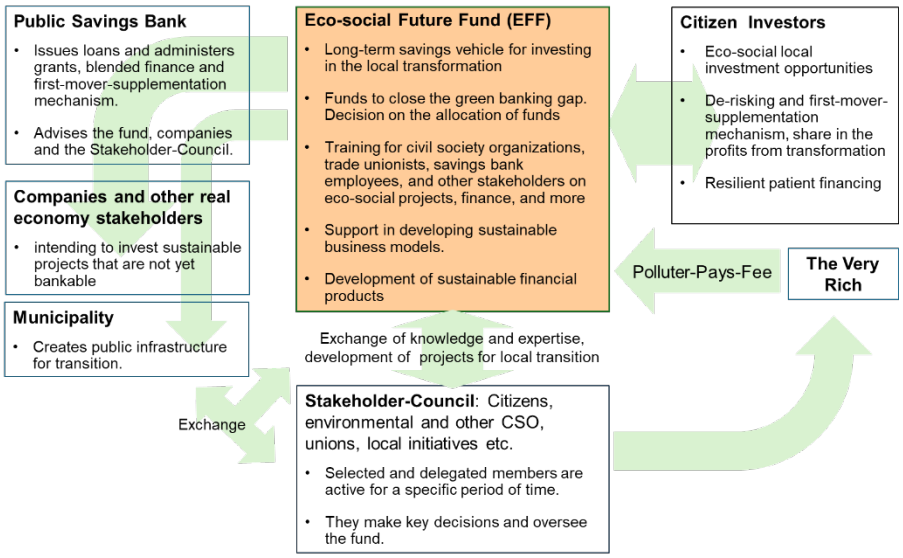


**Figure 1: Eco-social Future Fund**

The capital of the EFF is primarily used to finance those projects of the local eco-social transformation that do not belong on bank balance sheets. This allows citizens to invest their savings in the local transformation. The difficulty that green investments are riskier and less profitable in the initial phase is offset by a de-risking and topping-up mechanism, funded by the polluter-

[4] In the existing system, these solutions are mainly devised by development and promotional banks with their own budget (see Becker 2024 for a proposal for localizing the respective activities).

pays levy, which cushions the difference and the risk compared to conventional investments. In this way, citizens who invest sustainably are not economically penalized but instead participate in the profits of the transformation. The municipality, companies with sustainable business models or those aiming to become sustainable, as well as citizens or other organizations, can apply for financing. The fund could also offer educational programs for citizens, civil society, trade unions, politically engaged individuals, and local businesses on relevant issues of the local transformation. In terms of administration and governance, PSBs could handle the processing and administration of transactions and provide basic management services. To ensure democratic accountability, a stakeholder council composed of delegated representatives from environmental and other civil society organizations, unions, and the local economy would be established. making important decisions regarding project selection, investment orientation, and the educational offerings.

Institutions such as the EFF highlight two crucial elements for transformative change in the financial system (Klüh and Sturn 2025; Klüh 2025; Sturn and Klüh 2021) : the transformation cannot be conceived without considering both fiscal frameworks and distributional conflicts – two aspects largely absent from the discourse on SF. The mission of the EFF – to finance eco-social projects that are not immediately profitable – requires integrating public funds into hybrid solutions. However, these funds should be available in the long term, and the burdens should be distributed fairly.  Research on acceptance has shown that perceptions of fairness (Bergquist et al. 2022; Evensen et al. 2018; Jagers et al. 2017), along with participation (Syme et al. 2006), are crucial for garnering political support for environmental measures.

Against this backdrop, it would be logical to finance part of the costs of the transition by drawing on the capital of particularly wealthy individuals. This approach is supported not only by rising inequalities and their resulting negative societal consequences (Piketty 2013; Wilkinson and Pickett 2010), but also by the fact that the ultra-wealthy consume a disproportionately large share of environmental resources (Chancel et al. 2025; Chancel 2022) . One way to integrate distributive concerns with the green transformation of European capital markets and financial institutions is to apply the polluter-pays principle to finance the eco-social transformation (Ötsch et al. 2025). Portions of the proceeds from inheritance taxes or an ecological tax reform (Klüh et al. 2025) could be used to provide equity for sustainable projects. For instance, revenues from a polluter-pays tax targeting the wealthiest individuals and their investments in fossil assets could be partially allocated to fund the EFF.

# 6. Conclusion and Outlook

PSBs are at a crossroads. Their public mandate and local roots position them as natural key players in eco-social transformation. However, institutional barriers and a narrow focus on profitability hinder their ability to realize this potential. A purely capital market-driven strategy, such as that promoted by the CMU/SIU, risks further undermining this potential and may exacerbate social inequalities while eroding public acceptance of change. To enhance sustainability, our theory of change for PSBs links actors with an eco-social agenda to organizations and institutions that support this mission. The proposals outlined in this paper – including the conception

of a Green Public Banking Union (GPBU), the redefinition of the public mandate, the democratization of governance, and the creation of an EFF – are, in the spirit of radical reformism, deliberately more far-reaching than typical incremental adjustments. We believe that the dual crisis – the urgent need for eco-social transformation and the declining legitimacy of representative democratic institutions – no longer permits minor corrections. Instead, it demands comprehensive yet concrete proposals that restore citizens' control over key social processes. Our approach seeks to restore finance to its fundamental role of serving society by anchoring it locally, ensuring its democratic legitimacy, and aligning it with clear eco-social objectives. We recognize that many aspects outlined here – from specific mechanisms for taxing climate-damaging wealth to the detailed structure of transformation councils – require further in-depth discussion. Nevertheless, we are confident that the general direction proposed is correct: strengthening decentralized, public, and democratically controlled financial institutions is a crucial and previously overlooked foundation for a just and sustainable future. By directing resources into interconnected initiatives, this approach could enhance acceptance of the transformation, foster a stronger sense of identification among actors with the process, and strengthen the democratic legitimacy of the transformation.

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