

# **BANK STATE AID IN THE FINANCIAL CRISIS**

## **FRAGMENTATION OR LEVEL PLAYING FIELD?**

### **A CEPS TASK FORCE REPORT**

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This report is based on discussions in a CEPS Task Force on Bank State Aid in the Financial Crisis, which was initiated by the Centre for European Policy Studies (CEPS), an independent policy research institute in Brussels. The members of the Task Force met four times between April 2009 and April 2010.

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# EXECUTIVE SUMMARY

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The financial crisis has posed an enormous challenge for the EU's state aid regime. Conceived to ensure a level playing field in the single market, the scheme also had to show that it could be adapted to exceptional circumstances. The size and nature of the aid, the number of the schemes and the complexity of the cases that had to be examined and approved were overwhelming. Although some high-profile cases of bank state aid had been dealt with by the European Commission in the past, never in the EU's half-century of history had the European Commission dealt with so many cases in such a short period of time. The approach followed during this period will thus continue to influence policy-making for a long time to come.

During the crisis, 20 national schemes of state aid to the financial sector and over 40 cases of individual banks were dealt with by the European Commission. At the height of the crisis, the effectively committed aid amounted to some 13% of the GDP of the EU. The final amount should be lower, however, as the biggest part of aid was granted in guarantees of bank liabilities, which disappear as soon as the guarantee is withdrawn, provided the financial system stabilises.

During 2008-09, the European Commission gave guidance to the private sector about its policy in applying state aid rules to the financial sector. The EU published four Communications, but it remains an open question whether this was the correct way to proceed, and how closely this policy was applied in practice. Considering the approach taken in specific state aid cases, it seems that the policy followed was more ad hoc. Some general principles were followed, including new conditions that had not been applied before, but it seems that the end result, certainly at European level, is a more uneven playing field. Some member states' banks were in better shape when the crisis hit, but some states were also better prepared to respond to the crisis and to make their state aid schemes compatible with EU rules. Different forms of restructuring packages were thus not necessarily only bank-specific, but also country-specific.

The legal provisions of the EU framework to assess state aid are unique. The EU is the only international entity with real powers to assess aid and its distortions to competition and trade, and to enforce remedies,

but its framework is limited to aid given by EU member states. Beyond that, the EU needs to rely on international agreements, most importantly the WTO's General Agreement on Trade in Services (GATS), which are much weaker than the existing provisions in the EU, and without having developed any case law so far.

This report is a distillation of the discussions held within the CEPS Task Force on Bank State Aid in the Financial Crisis. The report puts forward the following nine recommendations.

## **Recommendations**

1. A comprehensive view is needed on the role played by state aid during the financial crisis. The financial system was rescued thanks to the concerted efforts of governments, central banks and international authorities. But coordination needs to be enhanced inside the European Commission and with the member states, as the crisis has provoked a number of responses, of which state aid is only one. A bigger role could have been played by the EU Council and the European Parliament in coordinating the response, and in ensuring a more homogeneous policy, in establishing a special procedure for this unprecedented situation.
2. A higher level of awareness is needed within the member states of the application of the EU's state aid policies. An *ex-post* analysis seems to indicate that some member states were more aware of the state aid rules than others in the design of the bank rescue packages, resulting in a more uneven playing field after than before the crisis.
3. As the recovery was the result of a joint effort between states, central banks and the EU authorities, the exit strategy should also be carefully planned among these actors. As far as possible, the exit strategies should also be coordinated with the overall economic recovery strategies of member states. This is particularly true for state aid policy.
4. Cross-border coordination of the reduction of state aid support measures should be mainly pursued for those elements that are most distorting, i.e. different forms and degrees of support for bank debt. However, considering that the quality of the guarantor and size of the problem differs considerably across EU member states, and continues

to differ as the economic circumstances differ, a more pronounced coordination may be very difficult to achieve.

5. Greater openness is needed in state aid processes. A broader involvement of stakeholders in the consultation on the general policy of state aid and in specific cases would be useful. At the moment, there is no genuine and systematic consultation at EU level.
6. The EU should continue to analyse the impact of the aid and its various measures on the level playing field. An overall *ex-post* assessment of the crisis, of the state aid given to the financial sector, and of the EU's policy response is therefore needed. Following Treaty Art. 108.1, the Commission has a duty to monitor the implementation of its decisions.
7. There is an uneven playing field at the international level, with the European Commission scrutinising aid by the member states to European banks, while nothing comparable exists elsewhere. A framework is in place at the WTO level, but it is very rudimentary compared to the EU scheme, and leaves huge scope for carve-outs. EU banks may thus also be disadvantaged internationally by the tight EU regime.
8. At the global level, the London and Pittsburgh G-20 summits stated the importance of "cooperative and coordinated exit strategies". However, given the above, this seems very difficult to implement in practice. A mechanism is needed to facilitate multilateral coordination of exit strategies, which permits adjustment in the interest of fair competition. One international organisation should be mandated to act.
9. In the future, a European crisis management and resolution framework should be considered in order to deal with banks in trouble, but any proposed resolution or authority must integrate and clearly specify the EU's state aid rules and objectives of proportionality, necessity and focus. The involvement of the European Systemic Risk Board (ESRB) and European Banking Authority (EBA) in such a new framework would be essential.