General Economic Principles of State Aid in the Financial Sector

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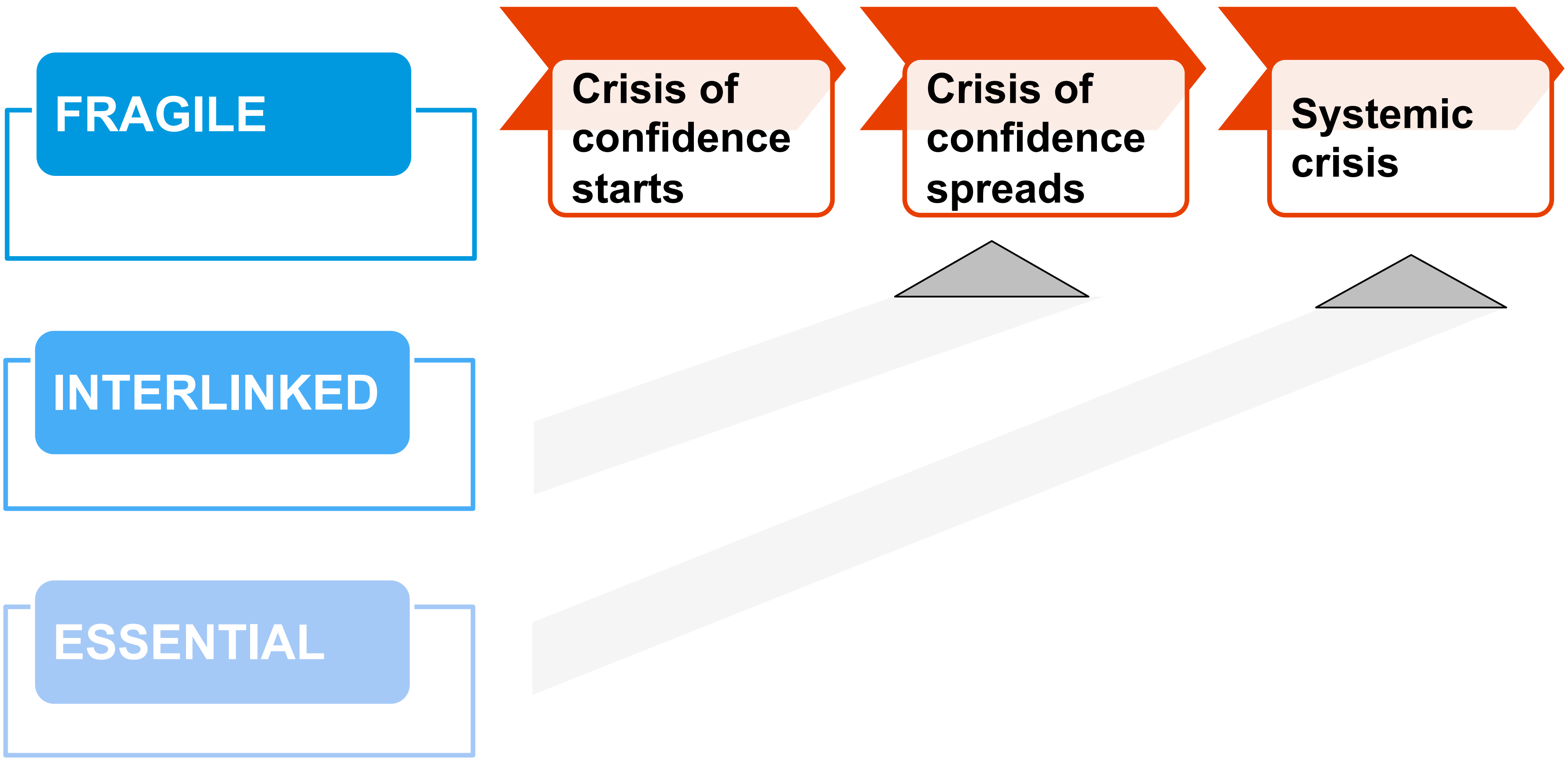
The characteristics of financial markets



Implications for State Aid

FRAGILE

INTERLINKED

ESSENTIAL

State aid is efficient

- State aid brings the market back to “normal” conditions
- Unlike traditional R&R aid which prevents normal market developments (exit)

Limited distortions of competition

- When banks are bailed out, most competitors benefit
- Unlike traditional R&R aid where competitors’ exit benefits undertakings

Aid is expected – moral hazard is rife

- The expectations of bail-outs for ‘too big to fail’ institution is unavoidable
- However, it incentivizes risky behaviour and should be offset

State Aid and Financial Stability

Competition and financial stability: friends or foes?

FRIENDS	FOES
Less competition, higher interest rates, more risk-taking in the real economy	Less competition, higher profits, higher capital buffers
More concentration, more ‘too big to fail’, more moral hazard	More competition, riskier behaviour
	More concentrated system easier to monitor

State aid and financial stability

R&R AID IN ‘NORMAL’ MARKETS	R&R AID IN FINANCIAL MARKETS
State aid expands output in markets often plagued by excessive capacity	Financial crises mean that liquidity (money supply) has dried up
Asset sales “compensate” the aid’s effects	Asset sales deepen the financial crisis

Thank you

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