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State Aid in the European Union Competition Policy in the Context of the Financial Crisis

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Abstract: The main subject of the paper is the issue of granting state aid discussed from the point of view of the most important changes in the European Union competition policy as a result of the global financial crisis. The author makes a review of state aid related to the financial crisis in the European Community. The article includes a detailed description of reasons for the economic interventions which has been designed and taken by the Member States in the form of various schemes, plans and objectives. The directions of the main changes in the structure of state aid granted to the financial institutions in absolute and relative terms are shown. It was essential to notice the significant European Commission's role ensuring that large support schemes for the financial sector will be implemented in compliance with the state aid rules and do not create undue distortions of competition. The paper contains numerous legal materials, including primary and secondary legislation, as well as European case law. The author also relied on the literature and articles on the notified state aid connected with the financial services sector and banking crisis.

Introduction

Financial services sector is one of the most fundamental to economic growth and development in all advanced economies. Financial services including banking, savings and investment, insurance, debt and equity financing constitute a nation's economic engine by fulfilling three essential functions in the economy (*The UK financial services sector...* 2005, pp. 1–3):

– On the one hand, these services provide financial intermediation functions between savers and investors who are looking for security and growth, on

the other hand, consumers and entrepreneurs receive access to credit and capital[1];
- Financial services sector is a mechanism to manage risks effectively and efficiently by way of insurance and increasingly sophisticated derivatives[2];
- It provides practical solutions for money to be managed, transferred and received quickly and reliably[3].

Government intervention in financial services sector and state protection of national banks are one of the most problematical issues discussed in economic policy. While some view these measures as highly protectionist against the underlying principles of the European Union, others motivated with the implications of recent global financial crisis argue that these interventionist policies might be part of the solution. Considering the peculiarities of the financial services sector, the importance of that sector for the national economy in general and the probability of having systemic crises emanating from the financial difficulty of large lending institutions, it is very difficult for any government to resist calls for assistance from those institutions (Kocoglu 2009, p. 7).

Although protecting less competitive credit institutions[4] should result in distortion of competition, theoretically, there might be some situations where market does not function properly or when the failures of such institutions would have more damaging effects on the economy (*Directive 2000/28/EC*... p. 37). In such a case, a carefully designed and well targeted state aid can support business development and even make the financial markets more efficient by eliminating certain obstacles that market forces are not able to tackle on their own (Nicolaides & Kekelekis 2004, pp. 578–583). Thus, state aid rules constitute an important part of the European Union competition policy.

This paper aims at examining the state aid provisions discussed in the light of recent changes in the European competition policy as a result of the global financial crisis. For that purpose, the legal framework for state aid rules in general as

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[1] This intermediation is crucial for allocating capital to the most profitable investments, ensuring a mechanism for saving, raising productivity, increasing competitiveness of the nation in the global economy.

[2] These tools help private citizens and businesses cope with diverse global risks and uncertainties.

[3] This is a vital requirement for commercial activities, participation in the international trade and investment.

[4] Credit institution is: (a) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; (b) an electronic money institution within the meaning of Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit and prudential supervision of the business of electronic money institutions. For simplicity, credit institutions can be assumed to mean banks.

mentioned in article 107(1) of the TFEU[5] (*Consolidated versions...* 2010) will be presented. Following that analysis, the paper will be focused on the derogations of state aid prohibition as laid down in articles 107(2) and 107(3)(b) and (c) of the TFEU, which are the most important provisions within the context of the recent financial crisis. It entails the necessity to introduce common instruments of state aid used in the financial services sector. What is also illustrated are the implications of the recent banking crisis by providing an analysis of the European Commission's response in the context of its exclusive competence in the state aid control policy to evaluate the compatibility of large support schemes for the financial sector granted by Member States with the rules of the European competition law. Therefore, in the second part of the paper the magnitude, structure and directions of state aid measures used in the EU-27[6] and adopted by the European Commission during the time of financial crisis were presented.

Overview of state aid rules in the European Union

State aid as defined under article 107(1) of the TFEU is a form of any state intervention used by a Member State or through State resources to promote a certain economic activity. It implies that certain economic sectors or the production of certain goods are treated more favourably than others and thus distorts competition because it discriminates between companies that receive assistance and those that do not (*Consolidated versions...* 2010, p. 121). Therefore, the TFEU in its article 107(1) generally prohibits state aid as being incompatible with the internal market unless it is justified by reasons of general economic development (*EU competition policy...* 2004, p. 15).

Lack of direct guidance in the Treaty as to what constitutes state aid suggests broad interpretation (Craig & de Burca 2008, p.1087) and could be intentional, since if Member States had known the exact scope of the notion of aid they would have easily devised new measures which would have not satisfied all the requirements of this notion (Schina 1987, p. 13). Furthermore, a definition might limit the scope of the relevant articles if other forms of illegal aid will be introduced in the future (Kocoglu 2009, p 9). Conversely, lack of a definition lets the European Courts to interpret the notion in a broad and flexible way. The European Commission has provided an illustrative but not exhaustive list of the types of aids. Accordingly, direct subsides, tax exemptions, preferential interest rates, favourable loan terms and exemptions from monetary charges are the major types of state aid. The European Court of Justice, while defining the concept of aid, does not make a distinction between measures having the posi-

[5] Treaty on the Functioning of the European Union.
[6] EU-27 includes all Member States which acceded to the EU until the end of 2007.

tive benefits to the undertaking such as direct subsidies and measures decreasing the charges an undertaking would normally bear under normal market conditions such as tax exemptions, a reduction in social security contributions or applying preferential rate for the supply of goods and services. According to the European Court of Justice, these two groups of measures have the same effect and should both be included in the concept of aid.

State aid rules in the European Union apply only to measures which satisfy all of the criteria listed in article 107(1) of the TFEU, and in particular (*Vademecum...* 2008, pp. 6–7):

– Transfer of state resources. State aid rules cover only the measures involving a transfer of state resources including national, regional or local authorities, public banks and foundations, etc. Furthermore, the aid does not necessarily need to be granted by the state itself. It may also be granted by a private or public intermediate body appointed by the state. The latter could apply to the cases where a private bank is given the responsibility to manage a state-funded small and medium-sized enterprises aid scheme.
– Economic advantage. The aid should constitute an economic advantage that the undertaking would not have received in the normal course of business. Less obvious examples of transactions satisfying this condition are given below: a firm buys or rents publicly owned land at less than the market price; a company sells land to the state at a price higher than the market price; a company enjoys privileged access to infrastructure without paying a fee; an enterprise obtains risk capital from the state on terms which are more favourable than it would obtain from a private investor, etc.
– Selectivity. State aid must be selective and thus affect the balance between certain firms and their competitors. 'Selectivity' is what differentiates state aid from so-called 'general measures' (namely measures which apply without distinction across the board to all firms in all economic sectors in a Member State, e.g. most nation-wide fiscal measures). A scheme is considered 'selective' if the authorities administering the scheme enjoy a degree of discretionary power (Bacon 1997, p. 270). The selectivity criterion is also satisfied if the scheme applies to only part of the territory of a Member State (this is the case for all regional and sectoral aid schemes)[7].
– Effect on competition and trade. Aid must have a potential effect on competition and trade between Member States. It is sufficient if it can be shown that the beneficiary is involved in an economic activity and that it operates in a market in which there is trade between Member States.

[7] The interpretation of the concept of selectivity has been fine-tuned over the years following various European Commission decisions and Court rulings. Details of the most important cases can be found on the European Commission website and in recent Annual Competition Reports (*State aid scoreboard...* 2008, p. 12).

The nature of the beneficiary is not relevant in this context (even a non-profit organization can engage in economic activities). The European Commission has taken the view that small amounts of aid (de minimis aid) do not have a potential effect on competition and trade between Member States. It therefore considers that such aid falls outside the scope of article 107(1) of the TFEU.

According to article 107(1) of the TFEU, the aid measures that satisfy all the criteria outlined above are, in principle, incompatible with the common market. However, the principle of incompatibility does not amount to a full-scale prohibition if the European Commission authorizes it. Articles 107(2) and 107(3) of the TFEU specify a number of cases in which state aid could be considered acceptable (the so-called ‘exemptions’[8]).

Article 107(2) of the TFEU provides that certain aid is automatically compatible with the common market: a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned; b) aid to alleviate the damage caused by natural disasters or exceptional occurrences; c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

Additionally, article 107(3) of the TFEU encompasses some further exemptions but of a discretionary nature: a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; c) aid to facilitate the development of certain economic activities or of certain economic areas; d) aid to promote culture and heritage conservation; e) such other categories of aid as may be specified by decision of the Council on a proposal from the European Commission.

Taking into account the above-mentioned criteria, we can distinguish three major state aid categories:

– Regional aid. It provides a basis for the acceptance of state aid measures aimed at tackling regional problems. The list of regions qualifying for this exemption is decided by the European Commission, but on a proposal by Member States. Member States can use national criteria to justify their proposal.

[8] The existence of these exemptions also justifies the vetting of planned state aid measures by the European Commission, as foreseen in article 108 of the TFEU. This article provides that Member States must notify to the European Commission any plan to grant state aid before putting such plan into effect. It also gives the European Commission the power to decide whether the proposed aid measure qualifies for exemption or whether the state concerned shall abolish or alter such aid.

– Horizontal aid. Horizontal or cross-industry rules set out the European Commission's position on particular categories of aid which are aimed at tackling problems which may arise in any industry and region (e.g. aid for climate change and environmental protection; aid for research, development and innovation; aid for the rescue and restructuring of firms in difficulty; aid for small and medium-seized enterprises; aid to employment; training aid; aid for risk capital; and aid for services of general economic interest).
– Sectoral aid. The European Commission has also adopted sectoral or industry-specific rules, defining its approach to state aid in particular industries. These currently include the sectors of audiovisual production, broadcasting, coal, electricity, postal services, shipbuilding, steel and synthetic fibres industry, agriculture, forestry, fisheries, aquaculture. Sector-specific state aid rules apply also in the transport sectors (including rail, air, inland waterways and maritime transport).

Trends and patterns of statea aid expenditure in the European Union

The global financial crisis which hit Europe was the greatest in its severity since the Great Depression and left a profound mark on the European economy. In the lead-up to the financial crisis, the European Union had been experiencing steady economic growth per annum. Budget deficits came down to an average of 0.8% of GDP in 2007. Unemployment fell and stood at a long-time low of 7% EU-wide in 2008. The financial crisis abruptly brought an end to the steady GDP growth, low levels of state aid[9] and decreasing budget deficits (*Communication*... 14.10.2009).

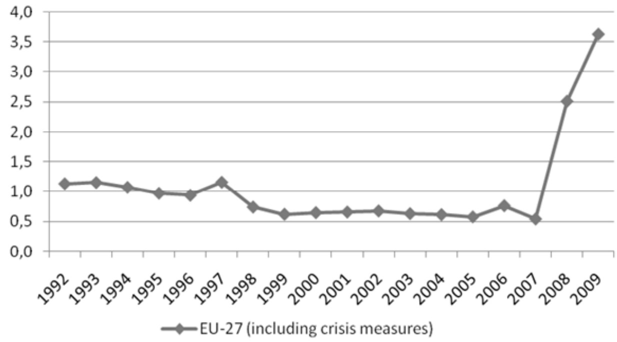
Looking at the trend from a long-term perspective, the overall level of state aid in the 1980s was in the region of 2% of GDP, fell then to just below 1% in the 1990s and came down to around 0.5-0.6% of GDP in the years 2003-2007. Due to the response to the financial crisis, the overall EU-27 aid level increased significantly (*State aid scoreboard...* 2010, p. 4). The total state aid[10] granted by the Member States in 2009 amounted to € 427.2 billion or 3.6% of EU-27 GDP (Figure 1.). Out of this total, € 353.9 billion (3% of EU-27 GDP) related to crisis

[9] This decline in state aid expenditure can be explained in part by the work that began in the mid 1980s to make effective state aid control a key component of the Single Market Programme. It is also the result of a general recognition that a high volume of state aid not only hindered an efficient allocation of resources but also rendered the economy as a whole less competitive.

[10] The total covers aid to manufacturing, services, coal, agriculture, fisheries and part of the transport sector but excludes, due to the lack of comparable data, aid to the railway sector and aid for compensation for services of general economic interest.

measures reported by Member States. If the crisis measures are excluded, the total state aid amounted to around € 73.2 billion in 2009 (0.6% of EU-27 GDP).

Figure 1. Trend in the overall level of aid as % of GDP, EU-27, all measures, 1992–2009



Source: own study based on data from Directorate General for Competition, European Commission.

Though increasing again in that year as compared with the previous year, it is still within the average of the past ten years. This seems to indicate that first Member States continued to maintain state aid discipline (when crisis aid is excluded); and second, the strict aid discipline in the years prior to the crisis can be seen as an important contribution that made a swift, substantial and targeted response to the crisis possible without undermining the overall consensus that state aid should be used in a cautious, considered way where it is necessary to achieve a commonly accepted objective while being proportionate to that objective (*State aid scoreboard...* 2010, p. 5).

In absolute terms, the five largest grantors account for € 39.8 billion (68.2%) of total aid. Germany accounted for € 15.3 billion (26.3%) of total aid, followed by France (€ 11.7 billion; 20.1%), Spain (€ 4.9 billion; 8.4%), Italy (€ 4.6 billion; 7.9%) and the United Kingdom (€ 3.3 billion; 5.5%). A completely different picture emerges when looking at aid as % of GDP: Malta granted aid representing 1.7% of GDP, followed by Hungary (1.0%), Portugal and Denmark (each 0.9%) and Sweden (0.8%).

It is recalled that state aid for horizontal objectives, which is aid not granted to specific sectors, is usually considered as being better suited to address market failures and thus less distortive than sectoral ad hoc aid. Research and Development and Innovation (R&D&I), safeguarding the environment including energy saving and renewable energies, support to small and medium-sized enterprises, employment creation, the promotion of training and aid for regional economic development to support territorial cohesion are the most prominent horizontal objectives pursued using state aid.

On this basis, the aid earmarked for horizontal objectives amounted in 2009 to € 48.7 billion and accounted for roughly 84% of the total aid to industry and services. It can be compared with much lower levels in 2004 (74%) and in the mid-90's (50%). The three main objectives pursued by Member States in 2009 were regional aid (24%), aid assessed under the environmental aid guidelines (23%)[11] and aid for R&D&I (18%). The underlying trend confirms the upward move on aid oriented towards horizontal objectives. However, when looking at the number of Member States directing 90% or more of their aid to industry and services to horizontal objectives of common interest, a decrease was identified. In 2009, 15 Member States were granting 90% or more of aid earmarked for horizontal objectives compared to 17 in 2008 and 2007 (*State aid scoreboard...* 2008, p. 30).

The European Commission and the member states' response to the financial crisis in the field of state aid

State aid was one of the main instruments in helping to battle the financial crisis. The situation deteriorated sharply after the collapse of Lehman Brothers in September 2008. Poorly performing assets, severe rating downgrades, a poor earnings outlook and markets players' uncertainty about exposure to impaired assets disrupted the normal functioning of interbank markets. Those main factors led to serious difficulties in accessing liquidity and banks' reluctance to lend to each other and to the real economy. Moreover, market participants also started requiring capitalization ratios far in excess of the minimum statutory capital requirements. The result was considerable solvency problems for a number of financial institutions.

The crisis has prompted action on many levels – national governments, the European Central Bank (ECB) and the European Commission. All have been working closely together to protect savings, ensure financial stability, maintain a flow of affordable credit for business and households and put in place a better system of governance for the future[12]. The Member States and the European Commission's first responses to the crisis included the unprecedented recourse to article 107(3)(b) of the TFEU in the course of just a few months adopted the

[11] Two distinct groups of cases fall in the category environmental aid and energy saving: The first group of cases pursues a direct benefit to environment. The second group comprises reductions or exemption from environmental taxes.

[12] In this process, state aid control as an integral part of the EU's competition policy plays a central role. Since the beginning of the crisis, the European Commission's interventions have contributed positively to maintaining financial stability while preserving incentives for appropriate risk taking and competition in the future. In the absence of a comprehensive pan-European supervisory, regulatory and legal framework for the financial sector, state aid policy

'Banking Communication' (*Communication...*5.10.2008, pp. 8–14), the 'Recapitalisation Communication' (*Communication...*15.1.2009, pp. 2–10), the 'Impaired Assets Communication' (*Communication...* 26.3.2009, p. 1) and the 'Return to Viability Communication' (*Communication...* 19.8.2009, pp. 9–20). That decisive coordination of Member States' actions allowed them to address the severe liquidity shortages which had led spreads on interbank markets to increase exponentially in the wake of the crisis and helped calm down the markets and ease deleveraging banks' capital base and cleaning impaired assets from the financial institutions balance sheets.

The controlled framework for aid to remedy the serious disturbance in the economy of the Member States has been part of state aid rules since the entry into force of the Establishing European Community Treaty in 1958 and with one exception the provision related to the article 107(3)(b) of the TFEU has so far not been applied, not even during the recession phases in the 1970s and early 1980s.

In the period between 1 October 2008 and 1 October 2010, the European Commission took more than 200 decisions in the financial services sector based on article 107(3)(b) of the TFEU. These decisions authorised, amended or prolonged 41 schemes and addressed with individual decisions the situation in more than 40 financial institutions. The financial crisis called for wide-ranging action with the European Commission authorising financial crisis measures in the field of state aid in 22 Member States except Bulgaria, the Czech Republic, Estonia, Malta and Romania.

The maximum volume of the European Commission-approved measures including schemes and ad hoc interventions amount to € 4588.90 billion or 39% of the EU-27 GDP for 2009 (Table 1.). The total volume approved for schemes (€ 3478.96 billion) was considerably higher than for individual financial institutions (€ 1109.94 billion). The large amounts of support approved under schemes can be explained by the fact that some Member States adopted blanket guarantee schemes which covered all their banks' debt. In terms of aid instruments used, the greatest bulk was approved as guarantees including schemes and ad hoc interventions representing € 3485.25 billion (30% of the EU-27 GDP for 2009) or 76% of all aid approved for the financial sector. € 546.08 billion (4.5% of GDP) was approved as recapitalisation measures, followed by € 401.79 billion (3.3% of GDP) for impaired assets interventions. The volume of liquidity instruments approved was € 155.77 billion (1.3% of GDP).

provided the framework to allow swift implementation of national measures in a coordinated manner while ensuring the integrity of the Single Market.

Table 1. Maximum approved volumes, nominal amount and state aid element, € billion

Types of support measures	Approved volume 2008-2010	Actual use i.e. nominal amount 2009	State aid element 2009	Total crisis state aid granted as a % of GDP
Schemes	3 478.96	727.38	180.91	1,53
- for guarantees	3 026.28	612.59	77.33	0.60
- for recapitalisation measures	348.64	95.15	95.15	0.80
- for asset relief interventions	62.17	1.40	1.40	0.01
- for liquidity measures other than guarantee schemes	41.87	18.23	8.60	0.05
Ad hoc interventions in favour of individual financial institutions	1 109.94	379.16	170.76	1.44
- for guarantees	458.97	214.30	50.81	0.40
- for recapitalisation measures	197.44	46.36	44.49	0.30
- for asset relief interventions	339.63	108.38	73.87	0.60
- for liquidity measures other than guarantees	113.90	11.11	1.50	0.01
TOTAL	4 588.90	1 106.54	351.68	2.90

Source: own study based on data from Directorate General for Competition, European Commission.

It appears that Member States relied principally on guarantee measures which had a stabilising effect on the financial sector without weighing heavily on the public finances, as opposed to more interventionist instruments such as recapitalisations or the cleaning of impaired assets. In addition, 68% of the approved aid relates to just five of the Member States (the United Kingdom, Ireland, Denmark, Germany and France), with overall substantive differences of approved volumes in individual Member States (Table 2.). The maximum volume approved by the European Commission in the United Kingdom is € 850.30 billion (or 18.5% of the EU-27 total amount), followed by Ireland – € 723.31 billion (15.8%), Denmark – € 599.66 billion (13.1%), Germany – € 592.23 billion (12.9%), France – € 351.10 billion (7,7%), Spain – € 334.27 billion (7.3%), Belgium – € 328.59 billion (7.2%), Netherlands – € 323.60 billion (7.1%), Sweden – € 161.56 billion (3.5%) to less than 2% of the EU-27 total amount in Austria, Greece, Finland, Portugal, Italy, Slovenia, Luxembourg, Hungary, Poland, Latvia, Slovakia, Cyprus and Lithuania.

In addition to the schemes approved under the Banking and Recapitalisation Communications, some Member States have adopted ad hoc interventions in favour of individual financial institutions amounting to the total volume of around € 380 billion. For example, individual measures were taken in favour of *Dexia*, *Fortis*, *KBC*, *Ethias Group* and *Parex Banka Latvia* due to the lack of general schemes available at the moment when the banks entered into difficulties. Similarly, the recapitalisation interventions in favour of *Anglo Irish Bank*, *ING*, *Aegon*, *SNS Reaal/New*, *Carnegie Investment Bank* and *Bank of Ireland* were needed in the absence of recapitalisation schemes in the relevant Member States. Conversely, *Kaupthing Bank*, *Bayern LB* and *Nord/LB* did not fall under the scope of the respective guarantee schemes while the guarantee granted to *IKB*, although it was in line with the German support scheme for financial institutions, required individual notification because the bank was under restructuring. The individual intervention for the *Sicherungseinrichtungsgesellschaft Deutscher Banken* was also justified because the eligibility conditions of the scheme in place in Germany were not fulfilled by this financial institution (*State aid scoreboard*... 2009, p. 21).

With the financial crisis deepening during 2008, financial institutions were deleveraging and becoming significantly more risk-averse than in previous years. Companies started to experience difficulties with access to credit. As part of its response, the European Commission adopted in January 2009 the so-called 'Temporary Framework' (*Temporary Community framework*... 2009, pp. 1–15) to give Member States additional possibilities to address the effects of the credit squeeze on the real economy.

Between 17 December 2008 and 1 October 2010, the European Commission authorised 73 schemes under the 'Temporary Framework' (*State aid scoreboard*... 2010, p. 56):

– 23 schemes for aid up to € 500 000 per company proposed by Bulgaria, the Czech Republic, Germany, Estonia, Ireland, Greece, Spain, France, Italy, Latvia, Lithuania, Luxembourg, Hungary, Malta, the Netherlands, Austria, Poland, Portugal, Romania, Slovenia, Slovakia, Finland and the United Kingdom;
– 18 guarantee measures in Belgium, Germany, Greece, Spain, France, Italy, Latvia, Luxembourg, Hungary, Romania, Slovenia, Finland, Sweden and the United Kingdom;
– 8 schemes for subsidised loan interests, in the Czech Republic, Germany, Greece, France, Italy, Hungary and the United Kingdom;
– 5 schemes offering reduced interest loans to businesses investing in the production of green products, in Germany, Spain, France, Italy and the United Kingdom;
– 6 risk-capital schemes in Belgium, Germany, France, Italy and Austria;
– 13 export-credit schemes, in Belgium, Denmark, Germany, France, Latvia, Lithuania, Luxembourg, Hungary, the Netherlands, Austria, Slovenia, Finland and Sweden.

It is observed that the situation in the financial sector has improved. First, in 2009 banks used favourable market conditions to restore their capital position. That development allowed many of the larger banks to increase their Tier-1 capital ratio to above 10%, although smaller banks still have not regained the capi-

Table 2. Approved amounts, actual use and expenditure per Member State, all schemes and ad hoc measures, € billion

Member State	Approved amounts 2008-2010	Actual use 2008	State aid element 2008	Actual use 2009	State aid element 2009	State aid element as a % of national GDP
United Kingdom	850.30	182.34	62.28	282.41	119.91	7.65
Ireland	723.31	0.34	0.03	11.29	11.03	6.74
Denmark	599.66	586.22	56.48	14.44	8.03	3.60
Germany	592.23	192.07	51.08	262.68	100.00	4.15
France	351.10	81.37	25.59	129.48	26.75	1.40
Spain	334.27	99.35	0.94	60.31	7.32	0.70
Netherlands	323.60	17.03	14.04	75.00	9.70	1.70
Belgium	328.59	55.86	21.47	120.43	32.29	9.57
Sweden	161.56	1.29	0.34	79.39	8.50	2.90
Austria	91.70	10.79	0.99	30.94	9.35	3.37
Greece	78.00	0.00	0.00	25.12	12.18	5.13
Finland	54.00	0.12	0.00	0.00	0.00	not used
Portugal	20.45	4.76	0.52	0.65	0.07	0.04
Italy	20.00	0.00	0.00	4.05	4.05	0.27
Slovenia	12.00	0.00	0.00	2.00	0.20	0.57
Luxembourg	11.59	3.98	2.78	2.72	0.88	2.33
Hungary	10.33	0.00	0.00	2.57	0.35	0.38
Poland	9.24	0.00	0.00	0.00	0.00	not used
Latvia	8.78	0.94	0.94	0.86	0.86	4.62
Slovakia	3.46	0.00	0.00	0.00	0.00	not used
Cyprus	3.00	0.00	0.00	2.23	0.23	1.36
Lithuania	1.74	0.00	0.00	0.00	0.00	used in 2010
TOTAL	4 588.90	1 236.47	237.48	1 106.54	351.68	-----

Source: Directorate General for Competition, European Commission.

talization they had before autumn 2008. Second, the banking sector had a rather strong performance in terms of earnings and profit throughout 2009. Finally, financial asset prices recovered, contributing to the good results on the earnings side. Admittedly, this was in part fuelled by record lows in central banks' interest rates, allowing low refinancing costs.

Another sign of the situation in interbank markets having improved is significantly lower reliance of the financial institutions on state guaranteed liabilities. According to the data available to the European Commission, guaranteed bonds constituted less than 5% of the total amount of banks' funding by the end of 2009, compared to more than 30% in January 2009. These positive signs led the European Commission, upon the recommendation from the Council to review some of the existing state aid guarantee schemes for existing and new debt (*Staff working paper*... 2010, p. 11).

Those positive signs must be accompanied by some caveats. The improvements mentioned are not felt equally across Europe with the financial institutions in the countries with sovereign debt issues being in a more difficult situation than those elsewhere in Europe. Next, the positive trends in capital ratios could possibly be offset by the fact that the extent of the impaired assets was never fully disclosed by the financial institutions, contributing to some degree of uncertainty. Next, the strong rebound in earnings and profits appears to be of a temporary nature and without sustained strong performance by the real economy it will not be sustainable in the long term. Therefore, further success in bringing the situation in the financial sector closer to market conditions depends on a number of factors including the strategies of the banks themselves.

Regardless of the turmoil over sovereign debt issues, discussions started on how to progressively reduce banks' reliance on state support. Demonstrable falling reliance on state guarantees in the banking sector called for action. The Ecofin Council welcomed the preliminary analysis of the European Commission's intention to introduce specific pre-requisites regarding the renewed provision of guarantees after 30 June 2010, which included the increase of the guarantee fees based on banks' creditworthiness. Those actions paved the way for bringing funding costs closer to market conditions and requiring a viability review for the banks still heavily reliant on government guarantees.

Another significant event was the second round of stress tests carried out by the Committee of European Banking Supervisors under the mandate from the Ecofin Council. The stress tests took into account various macro-economic parameters to assess banks' resilience to credit and market risks, in particular the exposure to sovereign debt and reliance on public support measures. It covered a sample of major cross-boarder banking groups representing over 60% of the European Union banking sector in terms of total assets (91 banks) using agreed baseline and adverse scenarios for 2010–2011. Under the adverse scenario, the total amount of impaired assets and trading losses would amount to € 566 billions, according to the tests results. Tier 1 capital ratio would fall from 10.3% in 2009 to 9.2% by the end of 2011 (compared to the regulatory minimum of 4% and to the threshold of 6% set up for that exercise). In the selected adverse conditions, seven banks would see their Tier 1 capital drop below the level of 6% taken as a benchmark for the test. They were Spanish *cajas*, *Hypo Real Estate* from Germany and Greece's *ATE* bank. As regards implications for state aid, nearly all of those banks (except a few *cajas*) were already undergoing restructuring pursuant to the European Union state aid rules. It is also important to mention that any future test would not automatically mean that granting state aid was required, as banks remain free to raise funding on the market (*State aid scoreboard*... 2010, p. 46).

On 22 September 2010, the European Parliament approved new rules on the revamped system of prudential supervision in the European Union. The reform will enable newly created supervisory institutions to spot systemic risks within the European banking system and contribute to avoiding a repetition of the financial crisis. In concrete terms, the new framework will reinforce financial stability, ensure the consistent application of basic technical rules, put in place an early warning system and effectively solve disagreements between financial supervisors. The framework will create new institutions, namely the European Systemic Risk Board and three new European Supervisory Authorities for the financial services sector: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). Each of the new authorities will be made up of the 27 national supervisors (*Communication from the Commission*… 20.10.2010).

Conclusions

After the break-down of the inter-bank lending in September 2008, Member States injected substantial amounts of state aid into the financial sector in order to prevent the collapse of banks in the European Union and with the aim of countering the systemic risk which many banks posed to the functioning of the financial markets.

The European Commission has been and will continue playing a key role in coordinating Member States' action with a view to maintaining a level playing field, preserving the integrity of the common market and fighting harmful protectionism. The European Commission will continue to monitor closely the situation in the market and review Member States' support measures in order to ensure that they are designed in a way to limit as much as possible competition distortions and to maintain the functioning of the single market. In addition, the European Commission has particularly emphasized that support measures must be designed considering the medium-to-long term perspective, in particular in the effort of swiftly returning to a competitive environment. Finally, the European Commission will support restructuring processes in the context of state aid monitoring.

A stable banking system is the key to provide the economy with liquidity, mainly in the form of credit. This is essential for business operations, but is particularly important for small and medium-sized enterprises with a view to ensuring new investments, especially in the technologies needed to achieve European objectives. The state aid rules in place before the recession also provided a good framework to tackle the impact of the financial crisis on the real economy, by targeting smart investments in favor of training, risk capital, environment protection and energy saving – and restricting the use and negative effects of rescue aid. Support measures to the financial sector and aid to the real economy were put in place by Member States to ease business's financing constraints. The massive injections of state aid which contributed to stabilizing the banking sector should eventually reap future dividends in the form of maintaining jobs and creating new ones and ensuring that many enterprises are able to stay in business because of continued access to finance.

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