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## **New CEPR report assesses competition and regulatory policy responses to the financial crisis**

### **Bailing out the Banks: Reconciling Stability and Competition**

*Thorsten Beck, Diane Coyle, Mathias Dewatripont, Xavier Freixas and Paul Seabright*

The continuing crisis has been exceptional in its intensity and global reach. It started out as a financial crisis and it became an all-out economic crisis, requiring a wide range of globally-coordinated policy responses: monetary and fiscal as well as regulatory responses, not to mention steps to avoid the trap of protectionism. Interventions by governments throughout Europe in favour of weak and failing banks have raised many concerns on the implications of these bailouts for competition and stimulated debate on the necessary regulatory reforms to deal better in the future with such wide-spread need for intervention.

A new CEPR report, *Bailing out the Banks: Reconciling Stability and Competition*, assesses two related aspects of the policy response to the unprecedented financial crisis, competition policy and financial regulation. It addresses both the effectiveness of the response to the current crisis, and the lessons that can be drawn in order to reduce the likelihood of future crises.

### **Competition policy**

The links between competition policy and banking stability are central to assessing the crisis policy response, and in particular the effectiveness of state aid control. There have been two contrasting views of the relationship between competition and stability - one is that stability is such an urgent issue in the crisis context that it overrides competition concerns, while the alternative view is that intervention to restore financial stability will lead to massive distortions of competition in the banking sector, and so competition rules should be applied even more vigorously than usual.

The authors endorse neither of these points of view, and conclude that competition policy is indeed more important than ever in times of crisis, but that the competition rules appropriate to the banking sector are different from those that apply in other sectors. This is because bailing out one bank in an episode of crisis *helps* its competitors, and state aid rules should reflect this characteristic. While the authors acknowledge that European competition authorities have tried to strike a balance between the insistence on competition concerns and the need for urgent action to respond to the financial crisis, they stress that there should be a thorough competitive assessment of the banking sector following the recent bailouts. The fact that aid to individual banks has sector-wide competition implications means that a competition assessment conducted on a case-by-case basis is not sufficient.

### **Implications for regulation**

While acknowledging that the European Banking Authority (EBA) proposal and Bank Crisis Management (BCM) Communication constitute a step forward in the design of a post-crisis financial regulatory regime that better coordinates supervision in Europe, the authors identify three areas of concern.

- First, the key issue in terms of efficiency is the need to define a European bankruptcy regime, which is only vaguely invoked at the end of the BCM Communication.
- Second, the issue of burden sharing also mentioned in the BCM Communication will be a permanent source of disagreements among countries precisely because the European bankruptcy regime has not been harmonised.
- Third, the EBA proposal pursues two objectives at the same time: European consistency and integration on the one hand, and the creation of a new post-crisis financial regulation on the other. Although they are not incompatible, there is a risk that, as the European economies emerge from the crisis, the first objective ends up dominating the second and regulatory reform is postponed until the next crisis.

Critical among the report's series of recommendations for regulatory reform, with regard to both financial stability and competition implications, is the call for a strengthening of competences at the European level, beyond coordination mechanisms.  
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### **Contact**

CEPR Press and Publications Manager Anil Shamdasani, tel. +44 (0)20 7183 8809, email [ashamdasani@cepr.org](mailto:ashamdasani@cepr.org).

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