Box 8

THE FISCAL IMPLICATIONS OF FINANCIAL SECTOR SUPPORT

Since the outbreak of the financial crisis in autumn 2008, most euro area countries have had to provide support to financial institutions, mostly by recapitalising distressed banks or providing guarantees on banks' liabilities.[1] This box provides an overview of the budgetary impact of financial sector support, which has regained importance since 2012. The box also looks at the

1 "The impact of government support to the banking sector on euro area public finances", *Monthly Bulletin*, ECB, Frankfurt am Main, July 2009.

Net impact of financial sector support on government deficit, debt and contingent liabilities in euro area countries (2008-12)

(as a percentage of GDP)

	General government balance					General government gross debt	Contingent liabilities
	2008	2009	2010	2011	2012	2008-12	2008-12
Belgium	0.0	0.0	0.1	0.1	-0.6	6.7	15.7
Germany	-0.1	-0.1	-1.3	0.0	-0.1	11.6	2.2
Ireland	…	-2.3	-20.2	-3.6	1.0	31.4	69.8
Greece	…	0.2	0.4	0.3	-4.0	14.5	27.9
Spain	0.0	0.1	0.1	-0.3	-3.6	5.1	6.5
France	0.0	0.1	0.1	0.0	-0.1	0.2	2.5
Italy	…	0.0	0.0	0.0	0.0	0.2	5.5
Cyprus	…	0.1	0.2	0.1	-0.2	10.0	5.6
Luxembourg	-0.1	-0.2	0.1	0.1	0.1	6.7	5.0
Netherlands	0.0	-0.4	-0.2	0.0	-0.1	6.9	3.2
Austria	0.0	0.0	-0.5	-0.1	-0.8	3.4	3.8
Portugal	0.0	0.0	-1.3	-0.5	-0.6	10.6	10.0
Slovenia	…	0.0	0.1	-0.6	-0.1	4.1	0.6
Euro area	**0.0**	**-0.1**	**-0.7**	**-0.1**	**-0.6**	**5.7**	**5.7**

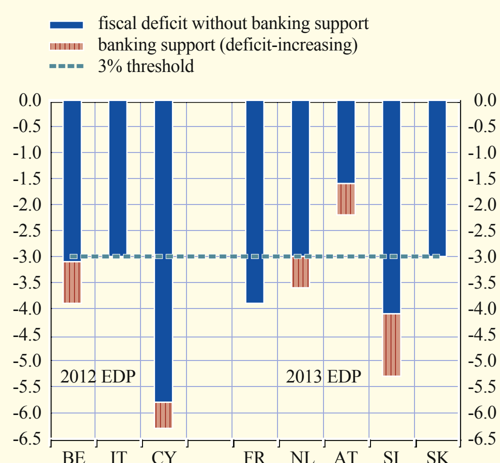
Source: Eurostat.
Notes: Between 2008 and 2012 no financial sector support was provided in Estonia, Malta, Slovakia or Finland. Empty cells indicate that no financial sector support was provided. Contingent liabilities reported only refer to state guarantees granted to banks.

treatment of financial sector support in the context of the reinforced Stability and Growth Pact (SGP), with a focus on the excessive deficit procedure (EDP).

From a statistical point of view, financial sector support (in the form of acquisition of shares in banks or loans, for example) has a direct impact on government gross debt. Likewise, redemption payments by the financial sector to the government lower the debt burden. State guarantees on banks' liabilities, however, affect neither government gross debt nor the fiscal deficit, but are recorded as contingent liabilities. Nevertheless, they pose a (in some countries considerable) risk to public finances if the guarantees need to be honoured, in which case they adversely affect both government debt and deficit levels. Financial sector support can also directly increase the fiscal deficit in the case of a capital transfer, i.e. a capital injection by the government that is not expected to yield a sufficient rate of return. The impact is considered temporary, as it only affects the deficit in the year of the transaction. In addition, public finances are affected indirectly by financial sector support, for example through interest payable on debt instruments issued by the government to finance its banking support. To derive the net impact of financial sector support on the government deficit, these expenditure items have to be offset against corresponding government revenue (mainly interest receivable on loans granted to financial institutions, dividends and fees receivable for guarantees).

General government balance in the respective EDP deadline year (2012-13)

(as a percentage of GDP)



Sources: European Commission's spring 2013 economic forecast and national sources.
Note: The chart only refers to the deficit-increasing financial sector support measures and their direct impact on the corresponding fiscal deficit in the year of the EDP deadline, thus either 2012 or 2013.

For the euro area as a whole, financial sector support in 2012 caused the fiscal deficit to increase by 0.6% of GDP (see the table), while the cumulated net impact on the government gross debt-to-GDP ratio (i.e. after taking account of redemptions) amounted to 5.7% of GDP for the period 2008 to 2012. The accumulated stock of contingent liabilities related to state guarantees granted to banks stood at 5.7% of GDP. However, support given to financial institutions and its budgetary implications varied considerably across countries in 2012: the net impact of financial sector support on the government deficit was particularly pronounced in Greece and Spain (approximately 4% of GDP) and, albeit to a lesser degree, in Belgium, Austria and Portugal. By contrast, in Ireland, the massive banking sector support provided mainly in 2010 had, via receivables, a positive net impact on public finances in 2012.

In the first few months of 2013, financial sector support continued to affect public finances in some euro area countries. For example, in the Netherlands, the nationalisation of SNS Reaal and the subsequent honouring of guarantees increased the 2013 fiscal deficit by 0.6% of GDP and the debt-to-GDP ratio by 1.6%, according to the government. In Slovenia, the fiscal deficit is expected to increase by 3.7% of GDP in 2013 as a result of support granted to financial institutions (including the additional measures recently announced by the authorities).

Given the importance of safeguarding financial stability and providing liquidity support, there is a need to recapitalise banks. Therefore, financial sector support should be treated differently from other public expenditure. For this reason, the corrective arm of the reinforced SGP provides the possibility to exclude financial sector support when calculating the "annual structural adjustment" efforts of a country – at least in the event that the support measures have a temporary direct impact on government budget balances.[2] Thus, in this case the respective countries do not necessarily need to compensate for the fiscal costs arising from financial sector support by taking additional consolidation measures. This might be particularly relevant in the context of the current debate about EDP deadline extensions (usually granted for one year). The prerequisites of an EDP deadline extension are: (a) an unexpected adverse economic event with major unfavourable consequences for government finances, and (b) the government having undertaken the required "effective action", using the country's "annual structural adjustment" efforts as a basis. However, financial sector support is not excluded when the question as to whether the EDP should be abrogated is assessed, because such assessment is based on the nominal (headline) deficit, which is not adjusted for financial sector support. Moreover, financial sector support is not excluded when assessing, under the preventive arm of the SGP, whether a country complies with the deficit and/or debt criterion.[3]

The partly sizeable impact of financial sector support will make it even more challenging for a number of euro area countries to correct their excessive headline deficits by the initial deadline. The chart shows the fiscal deficits of the countries with agreed EDP deadlines in 2012 and 2013 and the deficit-increasing impact of financial sector support in the respective EDP year. The figures suggest that in the case of the Netherlands, without the provision of financial sector support, the country could have met its EDP deadline in 2013. Most of the other countries with EDP deadlines in 2012 or 2013 would not have met the 3% threshold even if the fiscal costs of their financial sector support were disregarded. Thus, for those countries to comply with the agreed deadlines, considerably more fiscal consolidation efforts would have been necessary.

2 A similar approach has been taken in the context of EU/IMF adjustment programmes, where fiscal targets explicitly exclude the impact of financial sector support on the deficit.

3 However, the SGP foresees taking financial sector support into account as a "relevant factor" (Regulation (EC) No 1467/97, Article 2(3)) when assessing whether a country complies with the deficit and/or debt criterion.