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How to Avoid Anticompetitive Effects of State Interventions in Times of Financial Crisis

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Abstract

In the course of financial crises, state interventions often are a necessary evil. This paper addresses the possible consequences of state interventions on the competitive level playing field among market participants and their international repercussions. It discusses special challenges for competition policies linked with such interventions and tackles the question of what safeguards are necessary to avoid distortions of competition caused by bailouts or support measures of governments. By identifying possible universal eligibility criteria for governmental crisis interventions based on the paradigm of the EU state aid regime, the article depicts regulatory perspectives and argues for further regulatory steps at an international level.

I. Introduction

During the recent months, the disruptions in the global financial markets have prompted governments all over the world to launch extensive bailout programs for troubled financial institutions, along with other monetary and fiscal policy initiatives, in order to avert greater damage to their domestic financial markets and economies. Whether the measures taken by governments target specific financial institutions or constitute actual "rescue packages" or "guarantee schemes", they generally encompass some sort of state aid or subsidy to the financial sector. The U.S. Federal Government has extensively intervened into the U.S. financial market by adopting the Troubled Assets Relief Program under the Emergency Economic Stabilization Act and by pursuing an extremely lavish monetary policy. But also EU Member States and Asian countries, such as Japan, the Republic of Korea, and Kazakhstan, have had to take measures in order to stabilize their financial systems. Since most Asian funds are intermedi-

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ated through Western financial markets, Asian countries have as well been affected by the global financial crisis, which originally had its roots in the U.S. subprime mortgage market.

The effects of these manifold state interventions are not yet measurable in detail; however, if some market participants benefit from such bailout measures to the detriment of others, distortions of competition among financial institutions may be caused. State backing, for instance, allows specific financial institutions to gather deposits at the expense of other, "independent" institutions, leading to a situation which clearly interferes with the competitive level playing field.

Anticompetitive effects of state interventions are, however, not limited to the institutional level, but also increasingly encroach on the macro-level, distorting international capital flows and financial intermediation. On 9 February 2009, the Director-General of the WTO, Pascal Lamy, presented his report on recent trade-related developments associated with the financial and economic crisis in which he warned against "the introduction of any new measure that closes off market access or distorts competition".[1] The Final Declaration of the Summit on Financial Markets and the World Economy held on 15 November 2008 by the Group of Twenty (G-20) emphasized that the reforms and actions taken to mitigate the global financial crisis had to be "grounded in a commitment to free market principles", and generally rejected protectionism despite the present times of uncertainty.[2] This statement has been repeated many times ever since, especially by the G-7 Finance Ministers and Central Bank Governors in early 2009 as well as most recently by the G-8 Finance Ministers.[3]

Nevertheless, under the impression of the severity and perpetuity of the financial crisis and not least due to the increasing political pressure from their voters, governments feel constrained to protect domestic businesses and jobs from the effects of the global financial and economic decline. State measures in the financial sector (as well as in other sectors) are, thus, often accompanied by more or less explicit political requests to primarily lend to domestic banks on the interbank market, to favour credits to local businesses and to support domestic jobs in turn. As a result, banks have started retracting foreign lending and (re-)focusing on their home market activities. This development – The Economist has fittingly called it "return

1 Pascal Lamy, 'We must remain extremely vigilant' (Speech given at an informal meeting of the Trade Policy Review Body, 9 February 2009), http://www.wto.org/english/news_e/news09_e/tpr_09feb09_e.htm (visited 29 June 2009).

2 G-20, 'Declaration of the Summit on Financial Markets and the World Economy' (Washington DC, 15 November 2008), http://www.g8.utoronto.ca/g20/2008-leaders-declaration-081115.html (visited 29 June 2009).

3 See G-8, 'Statement of G-8 Finance Ministers' (Lecce, Italy, 13 June 2009), http://www.treas.gov/press/releases/tg171.htm (visited 29 June 2009).

of economic nationalism"[4] – threatens the achievement of open financial markets. To avoid distortions to competition and trade in financial services, common eligibility criteria need to be defined, around which the governments may build their rescue packages. Instead of improved regional cooperation, having been practiced in the European Union as well as in Asia,[5] state interventions thus must be internationally coordinated and put on a multilateral basis, especially with regard to major cross-border financial institutions.

II. Are State Interventions Anticompetitive?

A. State as Market Participant

Although not thoroughly undisputed, the current international economic system is based on the model of free markets, whose historical and theoretical background is particularly associated with the oeuvre *Wealth of Nations* by *Adam Smith*, published in 1776.[6] The notion of free markets implies special emphasis on the economic mechanisms that are to be held free from market interventions. According to *Smith*, the welfare of society is coupled with what he referred to as a "progressive state". Such state is based on a "laissez faire" policy, ensuring a broad scope for the development of an open economy by granting its individuals a free hand regarding the setting of market parameters, such as price formation and the functioning of competitive structures. The role of the state, according to *Smith*, is thus to be seen in the protection and support of ideal market conditions as well as in countervailing potentially damaging tendencies in free markets in support of the public welfare. *Smith*, however, supported the regulation of the banking sector as well as the control of the interest rate,[7] realizing that financial stability constitutes a premise to social security.

Such a limited role of the state and a strong focus on market mechanisms have been readopted by various modern economic theories. However, despite the objections against the state as a market participant, the assumption that public welfare can be achieved without governmental intervention, solely based on a self-regulative market (allegorically referred to as an "invisible hand"), has proved to be rather illusionary. This has particularly been reflected in the development of different conceptions and theories on competition and antitrust enforce-

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4 *The Economist*, 7 February 2009, at 9-10.

5 See generally Asian Development Bank, *Emerging Asian Regionalism: A Partnership for Shared Prosperity* (Mandaluyong City, Phil.: Asian Development Bank, 2008).

6 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (edited by Edwin Cannan), (Chicago: University of Chicago Press, 1976).

7 Smith, above n 6, Volume I, at 342-345, 350, 379-380.

ment.[8] Given that regulations, subsidies, and public-sector undertakings are acknowledged realities within today's modern economies and financial markets, there are only few scholars and politicians that still advocate such radical position.

Despite general concerns accompanying state activities in free markets, it is thus widely recognized that there does remain room for regulation and intervention in a market-oriented economic system. This is all the more the case with regard to financial crises, in which it amounts to a responsibility of governments to secure their own status and importance with a sound economic system, ultimately ensuring employment, real income for their citizens, and economic stability. Therefore, the question cannot be framed as *whether* states are in the position to adopt regulatory measures, but as *under which circumstances* and *how* such state interventions are viable and justified. In this context, it is particularly problematic that states occupy the role otherwise played by the market by determining who the "winners" and the "loosers" should be: Instead of letting market mechanisms "reward" and "punish" the market participants, the governments have assumed responsibility for deciding in an administrative process, which market participants they are willing to support and which ones they prefer to drop.[9] Obviously, state interventions in times of financial crises may have considerable anti-competitive effects.

B. Competition Policy and State Interventions in the Financial Sector

The issue of competition within the banking sector is different from that in many other sectors.[10] Since the liberalization process, financial institutions compete with each other in terms of cost minimization and allocative efficiency. However, competition in the financial sector is inherently imperfect, especially due to asymmetric information and low customer mobility. While the banking business to a great extent rests upon confidence, the typically central competition parameters, in particular the price, seem to be less important than in other, industrial sectors.

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8 See generally Rolf H. Weber, *Wirtschaftsregulierung in wettbewerbspolitischen Ausnahmebereichen* (Baden-Baden: Nomos Verlagsgesellschaft, 1986).

9 See also Rolf H. Weber and Mirina Grosz, Governments' Interventions into the Real Economy under the WTO Law Revisited: New Tendencies of Governmental Support of the Automobile Industry, *Journal of World Trade* (forthcoming).

10 It is at least difficult to determine the degree of competition within the financial sector empirically; see OECD Report, 'Competition and the Financial Crisis', http://www.oecd.org/dataoecd/52/24/42538399.pdf (visited 29 June 2009), at 7-8.

Therefore, there are special characteristics of financial markets that may justify a different treatment of the banking sector in terms of competition policies. Most importantly, the banking business is based on confidence among all involved parties, i.e., of customers towards their bank and between banks lending money to each other on the interbank market. Accordingly, banks are vulnerable to instability, for example in the form of bank runs, since confidence is of a fragile nature; it is rather easy to loose, but difficult to regain.

Furthermore, the risk of contagion is much higher in the banking sector than in other industries. This means that, due to the direct and indirect linkages existing in the financial sector, the failure of a major bank is likely to lead to the failure of numerous other financial institutions. Within the last years, independencies between international financial institutions have increased substantially, especially through the growing interbank market and the increasingly sophisticated payment systems, but also due to linkages between banks' portfolios. A crisis caused by financial distress of one important market participant can, thus, relatively easily become systemic, affecting the whole financial system and eventually also the real economy.[11] In the banking sector, the balance between competition and stability is thus delicate, which does not mean that stability concerns should completely override competition considerations. The question is rather how governmental measures aimed to maintain or recover financial stability can be designed in a way that avoids anticompetitive implications.

C. Possible Anticompetitive Effects of State Interventions

Since September 2008, the current financial crisis has prompted a great number of states all over the world to intervene in their financial markets. Extent and scope of the support have been substantially different among countries. The main forms of emergency measures taken by states included (1) liquidity support through collateralized lending, (2) public guarantees of deposits and other liabilities, (3) recapitalization and (4) purchases of illiquid or non-performing assets. These measures are by nature distortive at the market participants level; however, they may also create distortions in international capital flows and intermediation.[12]

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[11] Ibid, at 4-6.

[12] See also Stijn Claessens, 'The Financial Crisis and Financial Nationalism' (Joint World Bank-CEPR Conference, 26-27 May 2009), http://www.cepr.org/meets/ltm/2407/Claessens.pdf (visited 29 June 2009), at 4-6.

1. Among Market Participants

In market-oriented economies, it is a natural and logical process that under-performing undertakings disappear from the market. Under "normal" circumstances, state interventions in order to bailout certain entities are thus highly undesired, i.e., unproductive undertakings, although non-competitive, should not be artificially kept alive with public funds. However, under extreme circumstances, such as financial crises, governments may be forced to intervene in financial markets to prevent the financial system, and eventually the economy as a whole, from further damage. Besides being undesired *per se* in the abovementioned sense, such state interventions naturally have negative consequences for the competitive level playing field among market participants in a number of ways.

First, the most obvious and direct effect of governmental support measures is that they may privilege the beneficiary financial institutions to the detriment of other (domestic or foreign) banks operating without public funding. While beneficiary banks are induced to expand their deposit volume, the "independent" banks may find their deposits base eroded. Furthermore, if governments renounce an adequate interest rate for liquidity provided to beneficiary financial institutions, they put all other banks in a significantly less competitive position. Economic studies have, for instance, documented that banks which do not enjoy public support are prompted to adjust their risk-taking in reaction to shrinking profitability due to the public support of competing banks.[13] Therefore, financial institutions seeking capital or liquidity on the market are often punished compared to their competitors receiving public funding. Secondly, state support granted to domestic financial institutions can have anticompetitive effects on banks domiciled in other states. If domestic banks, for example, have access to capital at considerably lower costs than competitors abroad, their competitive position on the international level may be enhanced unjustifiably. Thirdly, state interventions may give an undue advantage to distressed or less-performing banks compared to banks which are fundamentally sound and better-performing. Indeed, what distinguishes state interventions in times of financial crisis from bailouts of financial institutions under "normal" circumstances obviously is their scope of application.

The current financial crisis, one the one hand, revealed weaknesses within certain banks' strategic and organizational structure, thus exacerbating problems that had already

[13] Hendrik Hakenes and Isabel Schnabel, 'Banks without Parachutes – Competitive Effects of Government Bail-out Policies', MPI Collective Goods Research Paper No. 2004/12 (2004).

existed before the turmoil started. On the other hand, however, the crisis equally affected substantially sound and thriving financial institutions, whose problems inherently originated from the general and exceptional market conditions. From a competition perspective, the bailing out of financial institutions characterized by endogenous problems stemming, for instance, from inefficiency or excessive risk-taking is more problematic than the support of institutions with mostly exogenous difficulties. In other words, if state support applies to all financial institutions without an appropriate degree of differentiation according to their risk profiles, the competitive level playing field is distorted considerably.

Apart from these immediate anticompetitive effects, state interventions can also have indirect influences on the competitive level playing field among market participants. In the course of the current financial crisis, a number of banks having been backed with public funds started expanding their commercial conduct to the detriment of competing institutions. Exploiting their preferential situation, they attempted to (re-)gain market share from generally better-performing competitors. A prominent example of such behavior is the Swiss bank UBS, which has been accused by competing banks of canvassing customers with dumping prices after having received governmental support in the amount of approximately 40 billion USD.[14]

2. International Repercussions

Possible anticompetitive effects of national bailout policies are, however, not limited to the level playing field among market participants. While state interventions, in the first instance, help individual financial institutions to cope with the implications of the crisis, they also sustain the financial sector as a whole. The more major banks are supported with public funds and financial stability is promoted the faster will the particular market recover from turmoil. Governments are, of course, highly interested in maintaining or even strengthening the importance of their domestic financial markets during the crisis compared to competing markets all over the world. Extensive backing of financial institutions by one state can, therefore, create difficulties for the economies of other states which do not intend to introduce such measures.

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[14] The maximum support that would have been granted amounted up to 59 billion USD, encompassing a direct injection of government money in the form of mandatory convertible notes of approximately 5 billion USD and a fund, created by the Swiss National Bank (SNB), that enabled UBS to transfer toxic assets worth up to 60 billion USD from its balance sheet; the so-called "SNB StabFund" was initially planned to be capitalized with 6 billion USD of equity capital provided by UBS, leaving a residual amount of 54 billion USD to the SNB. However, on 10 February 2009, the SNB announced that it would absorb toxic assets from UBS in the amount of "only" 39.1 billion USD, of which UBS itself would finance 10% (SNB Communication, *SNB stabilisation fund – reduced UBS asset transfer*, 10 February 2009, http://www.snb.ch/en/mmr/reference/pre_20090210/source/pre_20090210.en.pdf (visited 29 June 2009).

Public funding by particular states can also provoke other governments to provide even more public funds to the domestic banking sector. In other words, especially among states with highly developed financial sectors, national crisis interventions may initiate a subsidy race. Such race, however, can prompt governments to support domestic financial institutions without assessing their competitive capacity and viability in the long run. Often such race entails protectionist measures. States may, for example, (explicitly or implicitly) obligate beneficiary banks to focus their "remaining" lending activities on the domestic market.

National bailout policies can also result in a general shift of market powers. Many states are financially not in a position to afford extensive recovery plans for their financial sectors and have to accept that even some of their major domestic banks may go bankrupt during financial crises.[15] To a certain extent, these inequalities can be mitigated by funds granted to developing countries by the International Monetary Fund (IMF). However, these funds do not nearly compensate for extensive financial support provided by other states to their domestic markets. The examples of Mexico and Argentina show that it can take years to (re-)establish financial markets having been devastated by a financial crisis.[16] Given these inequalities, richer countries may actually "profit" from financial turmoil as competition from "developing" financial markets will – at least in the medium term – most likely be reduced in the aftermath of a crisis.

In sum, while the need for state interventions in times of financial turmoil or crisis is rather undisputed, such interventions do create distortions, not only among market participants but also internationally, leading to various anticompetitive effects. However, state interventions can also have beneficial effects on overall competition as they prevent the smaller financial institutions from going bankrupt and disappearing from the market, hence leaving the field to only a few major and systemically relevant banks.[17] The same is true for the international level since governmental support from one state to its domestic banks can help stabi-

[15] Most developing countries „lack fiscal space to implement countercyclical measures to combat the effects of the crisis and spur recovery", United Nations, 'Draft outcome document of the Conference on the World Financial and Economic Crisis and its Impact on Development', New York, 24-26 June 2009, http://www.un.org/ga/search/view_doc.asp?symbol=A/CONF.214/3&Lang=E (visited 29 June 2009), para 14.

[16] However, other lenders – such as South Korea, which received IMF funds during the Asian financial crisis and notably has been the biggest IMF lender in comparison with its quota so far – have been able to repay their funds rather expeditiously.

[17] See Christian Koenig, ''Instant State Aid Law' in a Financial Crisis, State of Emergency or Turmoil', 4/2008 *European State Aid Law Quarterly* 627 (2008), at 628.

lize other states' financial systems and thus enhance international financial stability.[18] Which effects – the anticompetitive or the pro-competitive – prevail depends at least in part on how government support is provided across market participants and financial markets.

III. Specific Challenges for Competition Policies

The current financial crisis has revealed a number of specific challenges for national competition authorities. Although these challenges are in their core not completely new, their intensity and weight has increased substantially in the course of the crisis, and they have thus become focal points of interest. Yet, despite their current actuality, these challenges are not of a short term nature, posing an intrinsic threat to effective and appropriate competition policies. Regulators should hence not neglect them as soon as the crisis abates, but rather seek to find solutions to handle them in the long run.

A. Proper Assessment of Banks' Risk Profile

Financial crises usually have market-wide implications, almost equally affecting fundamentally sound and previously distressed financial institutions and necessitating extensive governmental support. However, from a competition perspective, state interventions should not *treat* all financial institutions equally, but clearly distinguish between banks that have come under liquidity pressure due to general market disruptions and those that are characterized by endogenous deficiencies simply having been enhanced by the turmoil. Most of banks' deficiencies stem from undue risk-taking, for example, by investing in high-risk financial products while holding an excessive financial leverage. In these cases, a far-reaching restructuring may be needed since otherwise state support will vanish into thin air and only promote inefficient structures, strongly distorting the competitive level playing field. Moreover, the price for public funds granted to banks should correspond to the level of their particular risk profile. In other words, without an appropriate distinction between beneficiary financial institutions according to their risk profiles, inefficient banks are likely to be unduly favored in the context of state support measures compared to their competitors which are generally better-performing.

Yet in order to be able to make the necessary differentiation, states have to properly assess banks' overall soundness and risk profiles. Since time pressure for action during financial crises is intense and governments under considerable strain already, this is not an easy

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[18] Claessens, above n 12, at 2, 8.

task. Furthermore, the necessary transparency is often lacking as financial institutions are inherently reluctant to provide the rather delicate information to government officials. After most states had taken their initial support decisions more or less ad hoc at the beginning of the current crisis, the U.S. government as well as the EU Member States (on a consolidated basis) started performing such assessment of banks' status as turmoil persisted. These so-called stress tests were geared to measure banks' financial situation *after* they had already received public funds, though, and thus rather conduced to the determination of states' exit strategies than their decision whether and under what conditions financial support should be granted. However, it is not unimaginable to implement some sort of stress test at an earlier stage of crises or even on a regular basis.

B. Increased State Ownership

During the current financial crisis, governmental support schemes have in part reached such massive dimensions that they have factually entailed the nationalization of a number of banks. Some states have even issued new legislation clearing the way for public conservatorship of distressed financial institutions and the disappropriation of shareholders.[19] While it may be necessary and even appropriate to partly or fully nationalize near-to-fail financial institutions for a short time, increased public ownership of banks may distort financial intermediation in a potentially substantial and long-lasting way.[20] Notably, nationalization generally is considered the *ultima ratio* of all possible governmental support measures, only being taken if the particular bank cannot be saved from failure in any other way. Seen from this perspective, it is astounding that national competition authorities have not criticized increasing state ownership within the current crisis more explicitly.[21]

To minimize anticompetitive effects of nationalizations, states should limit their role in day-to-day operational details of the supported financial institutions while being their stakeholder. In the longer run, it is important that states having nationalized certain financial institutions develop appropriate exit strategies that limit the time in which there are potential distortions to competition.[22] Since nationalized banks – contrary to those simply receiving

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[19] E.g., some of the new provisions in U.K.'s Banking Act 2009, 2009 Chapter 1.
[20] Claessens, above n 12, at 5.
[21] For the reticence of the European Commission see Rolf H. Weber/Seraina Gruenewald, 'Finanzkrise und Wirtschaftspolitik: Herausforderungen für das Europäische Wettbewerbsrecht', 11 Zeitschrift für Europarecht (2009), 58-67, at 65-66.
[22] See OECD Report, above n 10, at 24.

capital or other special aids – in general cannot decide on their own to redeem state investments, governments particularly need to ensure that public stakes are sold again as soon as systemic concerns are not present any more.

C. Problem of "Too Big to Fail"

While state interventions entail certain immediate anticompetitive effects, they, more importantly, also interfere with the competitive level playing field in the longer run. In the course of the current financial crisis, governments all over the world were forced to decide which financial institutions they consider systemically relevant and thus inevitable to be rescued. Many major financial institutions have proved to be "too big to fail" or "too connected to fail" without severely disrupting financial stability. Until financial turmoil began in 2008, most governments had pursued a policy of "constructive ambiguity", seeking to keep it a secret to the market which banks, if at all, they would rescue in the case of a financial crisis. Given that governments worldwide have spent a total sum of approximately 10'000 trillion dollars in order to bailout major banks, this policy is obviously not credible any more. As a consequence, several financial institutions obtained – virtually over night – a factual government guarantee, which allows creditors and shareholders of such institutions to anticipate that their risk of the bank going bankrupt is, in fact, inexistent.

Although this development may not yet have an influence on the reliability of systemically relevant banks as long as turmoil endures, the governmental guarantee for such banks is most likely to distort competition in the long run. To tackle this problem, scholars have suggested various strategies. Some have warned from applying bankruptcy law too cautiously as negative implications could be cushioned by a well-organized restructuring process, allowing the bank to continue most of its business during bankruptcy procedure.[23] Others have advocated for a "Super Chapter 11", based on the U.S. bankruptcy regime "Chapter 11", which would only apply to systemically relevant financial institutions and involve specific mechanisms, avoiding any spill-over effects that could endanger financial stability. A more radical solution would be to give an *a priori* regulatory limit to banks' size, which would trigger, when reached, a split-up or asset stripping of the bank.[24] Furthermore, measures to com-

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[23] See Lindgren, Carl-Johan, *Pitfalls in Managing Closures of Financial Institutions*, in Honohan, Patrick & Luc Laeven (eds), *Systemic Financial Crises—Containment and Resolution* (Cambridge, U.K.: Cambridge University Press, 2005), 76-108, at 77.

[24] This measure was, amongst others, proposed by the designated new president of the Swiss National Bank, Philipp Hildebrand, see, e.g., *NZZ am Sonntag*, 21 June 2009, 38.

pensate the competitive advantages of systemically relevant banks have been proposed. Such measures include insurance schemes or the implementation of a fund, self-financed by systemically relevant banks, which pays for the losses of those banks in the case of a systemic crisis.

Whereas compensatory measures mitigate the problem of "too big to fail" financially, they do not actually solve it. To combat anticompetitive implications of state interventions, *ex ante* expectations of creditors in terms of bailouts have to be reduced. For the current financial crisis, most governments have probably not had (politically) justifiable alternatives to bailing out systemically relevant institutions; they could only make a difference by taking the most neutral measures in terms of effects on competition. After the crisis, the question of how to counteract the problem of "too big to fail", however, will have to be tackled by regulators all over the world.

D. Rescue Mergers

With a view to the issue of "too big to fail", the "rescue mergers" having been performed since the outbreak of the crisis – mostly backed by public funds – are rather problematic. Numerous countries have reduced their legal requirements for mergers with failing financial institutions on the grounds that such mergers are for the public benefit due to the financial crisis. The fact that the absorbing banks in most cases have had to be "persuaded" to agree to the merger by generously sponsoring it with public funds demonstrates clearly that such mergers are completely contrary to unbiased market mechanisms. For the short term, rescue mergers can save governments from major bank failures, which may produce higher costs than funds are spent for the performance of the merger. However, state-backed mergers may implement anticompetitive structures that persist long after the market has recovered from the crisis. Furthermore, mergers of major financial institutions only produce bigger bank giants, which are even more likely to constitute a systemic threat to the financial system. Given these facts, it seems paradox that governments spend money to consolidate financial institutions during times of financial crisis, while simultaneously combating the problem of more and more bank conglomerates becoming too big or too complex to fail.[25]

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[25] See Weber/Gruenewald, above n 21, at 65.

IV. Regulatory Perspectives

A. Global Solutions for a Global Problem

The current financial crisis has demonstrated clearly that financial stability is not an issue of national focus. The failure of a major cross-border bank, such as Lehman Brothers, not only entails negative implications for its host country but for the entire international financial system. The same is true for the bailout of a financial institution engaged in cross-border business, as it could have substantial spill-over effects on competitors, other sectors and other states. Furthermore, states will most likely not impose stringent restrictions upon themselves with regard to interventions in times of financial crisis if other states do not follow suit and consider similar criteria for financial support to their domestic markets. Due to the increasing integration of the global financial system, it is – although a step into the right direction – not enough to take measures in order to address anticompetitive effects of state interventions at a national level. There obviously is a need for multilateral mechanisms.[26] For a global problem, global solutions have to be found.

B. International Eligibility Criteria

It is not a simple task to find regulatory eligibility criteria for state interventions at an international level as most states will not be willing to yield a considerable part of their sovereignty to a global instance. In the context of financial emergency situations, states' negative attitude towards international guidelines, restricting interventions within their domestic markets, is likely to be even more distinct. However, in order to prevent state interventions in times of financial crisis from negatively influencing the competitive level playing field, certain basic provisions have to be determined and applied internationally.

In identifying international criteria state interventions have to fulfill, the state aid regime of the European Union may act as a paradigm. Although heavily influenced by economic policies of the member states in the course of the current financial crisis,[27] the EU state aid system has managed to provide for more or less comprehensive and generally accepted standards in terms of states' emergency interventions in financial markets.[28] Certainly, these

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[26] See also Claessens, above n 12, at 11-15.
[27] See Weber/Gruenewald, above n 21, at 67.
[28] Communication from the Commission on the application of state aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis ("Banking Communication"), 25 October 2008, 2008 O.J. (C 270) 8; Communication from the Commission on the recapitalization of financial

standards, aimed to help realize the Single European Market, cannot be adopted one-to-one at an international level; however, they could provide a starting point.

1. Non-Discrimination

Most importantly, governments have to take their decision whether to support a financial institution during a financial crisis based on *non-discriminatory* and *objective* criteria. The role the bank plays in the particular banking system should be the primary factor in the decision-making process. In contrast, the bank's (foreign) nationality or home country must not influence governments' determination whether to support or drop a particular bank. Only by strictly prohibiting the application of such discriminatory criteria, governments can be prevented from "returning to economic nationalism". This may not be easy to get accepted politically; however, to assess financial institutions based on their importance within the market and not on their nationality is the only way of applying bailout policies objectively and economically. However, discrimination should not only be eliminated in terms of the decision whether to support a particular bank but also with regard to possible protectionist conditions accompanying such support.

2. Proportionality

Furthermore, state interventions must be *proportionate* with regard to their content and duration. After all, state interventions are aimed to provide survival support for distressed financial institutions, not more. Whenever possible, governmental emergency measures should thus be based on regular market conditions. In case financial institutions are recapitalized, the price of the shares purchased by the state should be determined according to market prices. For credits granted by the government, financial institutions should be obliged to pay an arm's length interest rate, encompassing an appropriate surcharge for those risks private creditors are not willing to take.

Proportionality also implies that state interventions are limited in time. While it would be unreasonable (and probably impossible) to determine a fix maximum duration for all state interventions at an international level, it is vital to ensure that the governmental commitments end as soon as the beneficiary banks start recovering. Broadly speaking, the sooner financial

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institutions in the current financial crisis: Limitation of aid to the minimum necessary and safeguards against undue distortions of competition, 15 January 2009, 2009 O.J. (C10) 3; Communication from the Commission on the treatment of impaired assets in the Community banking sector, 26 March 2009, 2009 O.J. (C 72) 1; see also Koenig, above n 17, at 627.

institutions can perform without state aids again the better it is. Therefore, it can be reasonable to link state interventions with certain drawbacks for the beneficiary banks, such as restrictions on executive compensation and dividend distribution. Such measures will most likely incentivize financial institutions to withdraw from governmental support as soon as it is not needed any more. The U.S. example, where a number of banks – and lately also the insurance company AIG – are anxious to repay public funds received during the current financial crisis, demonstrates rather clearly that strict conditions for recipients of capital from the government can have this effect.

3. Minimization of Negative Spill-Over Effects

As far as the design of state interventions is concerned, governments should aim to minimize negative spill-over effects on competitors. Beneficiary banks must be prevented from potentially abusing their preferential position due to public funds granted to them, e.g., by extensively depress prices or canvass customers and investors. Therefore, states need to provide for certain safeguards keeping publicly funded financial institutions from expanding aggressively to the detriment of (domestic and foreign) competitors that do not rely on state aid. Such safeguards may include, for example, limitations to the size of the bank's balance sheet, obligations to use profits primarily for the establishment of adequate equity capital, or market share ceilings.

Furthermore, state interventions should be linked with the prohibition of commercial conduct that would be irreconcilable with the purpose of the support measure. Such inappropriate commercial conduct could for instance be seen in the provision of extensive compensation to executives having contributed to the banks financial distress and in marketing or advertising that directly relates to the state support.[29] While governments should beware of dictating prices to supported banks, they have to signalize decidedly that unfair competition rules are applied rigorously to those institutions exploiting state support to depress prices. In case of non-compliance with these behavioral constraints, states must provide for appropriate enforcement measures, such as the revocation of the state support.

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[29] Banking Communication, above n 28, para 27.

V. Conclusion

In the course of financial crises, state interventions often are a necessary evil. With financial support to major, systemically relevant banks, financial turmoil can often be mitigated and kept under control. Besides the various negative effects such state interventions may have on the competitive level playing field, it should not be ignored that the prevention of oligopolization of financial markets – caused by the elimination of numerous financial institutions within a specific market – is vital to competition and contestability. However, state interventions in the current financial crisis have led to many distortions, directly among market participants and indirectly by disrupting international financial intermediation and capital flow. Furthermore, there have been clear signs of protectionism as governments often have a bias towards domestic banks and lending to domestic businesses. While governmental support in times of financial crisis to some extent is inherently anticompetitive, some of its negative spill-over effects on competition among market participants and its repercussions on other countries depend on how such measures are designed and under which conditions they are granted. Given the increasing integration of international financial markets, anticompetitive effects of state interventions in times of financial crisis are an issue of global importance. Indeed, regional approaches, such as the state aid system within the European Union, are a step into the right direction; yet eventually, global solutions have to be found. Based on the paradigm of the EU state aid regime, this article has proposed primary international eligibility criteria for state interventions: Governmental support in times of financial crisis should be (1) non-discriminatorily and objectively granted, (2) proportionate with a view to their scope and time limitation, and (3) designed in a way that minimizes negative spill-over effects.