State aid to Spain's banking sector in the EU context

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Numerous EU governments have provided solvency and liquidity support to their troubled banks throughout the crisis, resulting in higher public deficits. Given the challenges many European banking sectors are still facing, it is likely that additional losses from public bailout schemes will further impact fiscal balances in the coming years.

Many EU countries have had to provide support to their financial sectors in order to help them overcome the crisis. Between the contingent liabilities and capital injections, State aid to Europe's banks since the start of the crisis has come to almost 1.3 trillion euros, equivalent to 10% of EU-27 GDP. State aid measures have largely taken two forms –liquidity support through guarantees and financial asset purchases, and solvency support through direct capital injections. Several countries have already seen their public deficits increase as a result of bailing out their banking sectors. Additional risks taken on in the form of contingent liabilities may add further pressures to public accounts in the years to come. In Spain, while public aid was less than in some countries and in line with the EU average, the losses, and hence impact on the public deficit, have been bigger. Moreover, Spain's contingent liabilities are much higher than the European average. Hence, the economic recovery will be a key determinant factor in the ultimate losses incurred by the State, and thus by taxpayers, as a result of the public bank bailout.

Since the outbreak of the crisis that has come to be known as the "Great Recession" six years ago, governments in numerous countries have had to bail out their banks to help them overcome their liquidity and solvency problems. Initially, the closing of wholesale funding markets forced central banks to act as lenders of last resort, multiplying the size of their balance sheets by offering abundant liquidity at low interest rates. But governments also stepped in to help their troubled banking sectors, implementing liquidity measures, primarily through issuing guarantees and buying financial assets, which substantially increased risk in the form of contingent liabilities. Moreover, in some cases (such as Spain), governments acted as guarantors for bonds issued by their "bad banks", consequently assuming yet more risk.

Moreover, impairment and falling value of bank assets as a consequence of the crisis have affected institutions' solvency, forcing governments to inject capital into banks, further increasing public debt levels. In many cases, the public aid granted

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has helped absorb losses, which has had a negative impact on public deficits.

In the specific case of the European Union's banking sectors, during the crisis of 2007-2012, State aid in the form of capital reached a total of 673 billion euros, equivalent to 5.2% of the EU-27's GDP. And almost a quarter of this State aid has been written off, implying a cumulative increase in the public deficit of 1.2% of GDP. Given that, in addition to State aid provided as capital, governments have also assumed risks in the form of contingent liabilities to the equivalent of 4.6% of EU-27 GDP at the end of 2012, the possibility that the public deficit deriving from aid to the banking sector might increase in the future, with an even bigger bill for taxpayers, cannot be ruled out. Between the contingent liabilities and capital injections, State aid to Europe's banks since the start of the crisis has come to almost 1.3 trillion euros, equivalent to 10% of EU-27 GDP.

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Against this backdrop, this article sets out to analyse State aid to the Spanish banking sector in comparison with other banking sectors in the EU-27, using information from the European Commission (specifically, Eurostat) for the period 2007-2012. The information enables solvency aid to be analysed separately from other aid resulting in contingent liabilities (mainly liquidity support), and the effect that State aid to the banking sector has had on the public deficit. The breakdown of the data for each of the years of the crisis is extremely useful, as it allows us to analyse European governments' varying reactions, in terms of response time, as well as scale.

State aid to shore up banks' solvency

State aid to bolster banks' capital has been provided in the form of loans, asset purchases, and direct capital injections. As Exhibit 1a shows, for the EU-27's banking sectors, the total cumulative solvency aid to banking institutions over the period 2007-2012 was 673 billion euros. The countries of the euro area account for 78% of this total. Examining the results by country, Germany stands out, with a public capital injection of 285 billion euros. It is followed, although at a considerable distance, by the United Kingdom with an injection of 140 billion euros. The third country in terms of solvency aid is Spain, with 54 billion euros.

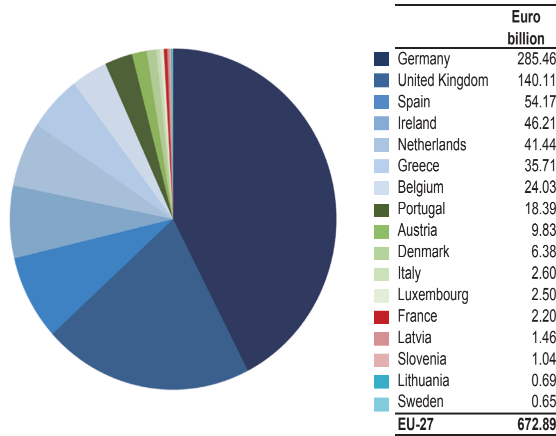
The scale of the aid granted is obviously determined by the size of the banking sector. For this reason, Exhibit 1b shows the ranking of the EU-27's banking sectors sorted by the amount of aid as a percentage of each country's GDP. One case that stands out is that of Ireland, where almost the whole banking sector went bankrupt, forcing the government to inject public funds equivalent to just over a quarter of the value of the economy (28.2% of GDP, to be precise). State aid to keep Greece's banks solvent was also significant, coming to 18.4% of GDP.

Of the EU-27's biggest countries, the injections of public capital into Germany's and the United Kingdom's banking sectors were largest, with percentages of GDP of 10.85% and 7.4%, respectively, as against an average value of 5.2% in the EU-27 and 5.5% in the euro area. Portugal (11.1%), the Netherlands (6.9%) and Belgium (6.4%) are also above the European average. In the case of Spanish banks, State aid in the form of capital represented 5.2% of GDP in 2012, in line with the EU-27 and slightly below the euro area averages. In the case of France and Italy, public capital injections were minor relative to the size of their economies.

Exhibit 1

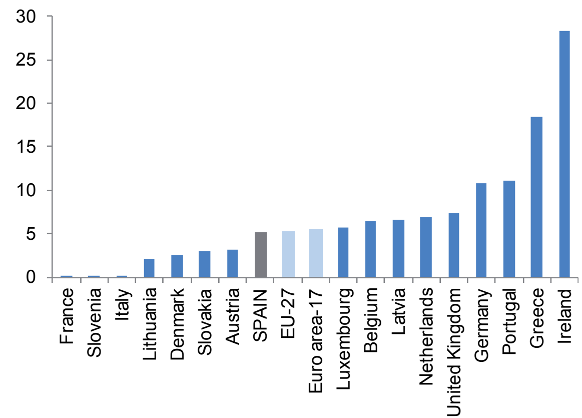
State aid to EU-27’s banks in the form of capital over the period 2007-2012

a) Distribution



	Euro billion
Germany	285.46
United Kingdom	140.11
Spain	54.17
Ireland	46.21
Netherlands	41.44
Greece	35.71
Belgium	24.03
Portugal	18.39
Austria	9.83
Denmark	6.38
Italy	2.60
Luxembourg	2.50
France	2.20
Latvia	1.46
Slovenia	1.04
Lithuania	0.69
Sweden	0.65
EU-27	672.89

b) Percentage of GDP



Source: European Commission and author’s calculations.

The breakdown by years offered by the European Commission makes it possible to analyse the different speeds at which the EU-27’s governments reacted to their banking sectors’ problems with public resources. Focusing on the Spanish case, the biggest percentage of aid granted in the form of capital was in 2012, when aid for a total of more than twice that in all the previous years was granted. By contrast, in the EU-27 as a whole, the bulk of the resources were mobilised between 2008 and 2011. By country, those that granted most aid to support banks’ solvency were also those that granted aid in the early years of the crisis, prior to 2010, as was the case in Germany, the United Kingdom, the Netherlands, and Ireland. Along with Greece and Portugal, Spain is the country, which has mobilised most resources since 2012 to solve its banks’ solvency problems.

Other exposures associated with public aid to the banks: Contingent liabilities

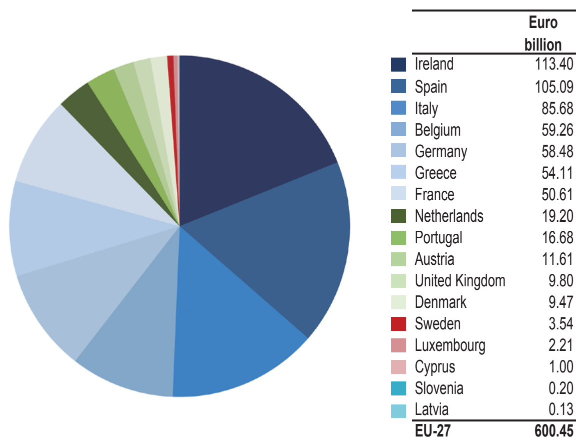
Between the outbreak of the crisis in mid-2007 and 2012 the European Central Bank multiplied its monetary base by 2.6 to meet financial institutions’ liquidity problems, above all with the two extraordinary auctions it ran at the end of 2011 and in early 2012, when it injected over a trillion euros into euro area countries. In addition to ECB liquidity support, European governments have also helped alleviate financial institutions’ liquidity problems in other ways, mainly by buying financial assets and granting guarantees to underwrite bank debt issues. These operations, although they produced income to the treasury in the short term from the commissions charged, led to the public sectors’ facing exposure to the possible loss in value of the assets or potential exercise of the guarantees given. This aid was therefore classified as a contingent liability. Bonds issued by bad banks backed by government guarantees, such as in the case of the SAREB in Spain, are also contingent liabilities.

As Exhibit 2 shows, for the EU-27 as a whole, the value of contingent liabilities existing at the end of 2012 was 600 billion euros. Three countries (Ireland, Spain and Italy) account for almost half the total. In Ireland the guarantees granted to the

Exhibit 2

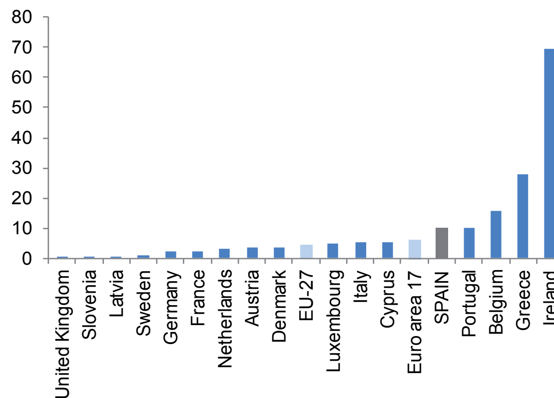
Contingent liabilities associated with banking sector aid in the EU-27

a) Distribution



	Euro billion
Ireland	113.40
Spain	105.09
Italy	85.68
Belgium	59.26
Germany	58.48
Greece	54.11
France	50.61
Netherlands	19.20
Portugal	16.68
Austria	11.61
United Kingdom	9.80
Denmark	9.47
Sweden	3.54
Luxembourg	2.21
Cyprus	1.00
Slovenia	0.20
Latvia	0.13
EU-27	600.45

b) Percentage of GDP



Source: European Commission and author's calculations.

banking sector by the government came to 352 billion euros in 2008, although at the end of 2012 the figure had dropped to 113 billion euros, of which 29 billion euros corresponded to guarantees for the bonds issued by the bad bank (NAMA). In Spain and Italy, the total contingent liabilities come to 105 billion euros and 86 billion euros, respectively.

As a percentage of GDP, the Irish government assumed the biggest risk by far in the form of guarantees to its banks, totalling almost 70% of GDP. At 28% of GDP, the aid granted by the Greek government is also substantial. In Spain the exposure assumed by the government from aid to the banks other than measures to shore up their solvency represents 10% of GDP in 2012, a percentage that is twice the EU-27 average. Contingent liabilities in 2012 increased by more than 60% on the previous year as a result of government guarantees underwriting the SAREB's debt issues used to purchase toxic real-estate assets from banks receiving public aid (referred to as Group 1 and 2 banks in the *Memorandum of Understanding* between Spain and the EU).

The impact on the public deficit of State aid to the banking sector

Public aid to the banking sector only represents a cost to taxpayers when it entails the recognition and assumption of losses. Similarly, it can produce a budgetary surplus if the income associated with the aid granted (for example, in the form of interest on loans granted or commissions charged for guarantees given) exceeds their cost. In the case of aid in the form of capital, in the short term, it can cause public deficits as losses are absorbed, although in the long term, it may help reduce the deficit if capital gains are made when the bank shareholdings are sold off.

Exhibit 3 shows the cumulative value of the net gains/losses for the period 2007-2012 generating public surpluses/deficits, and the percentage of 2012 GDP they represent. For the EU-27 as a whole, banking aid has meant an increase in the public deficit of 149 billion euros. In some countries (specifically, in six) the aid granted yielded net income. And in the other countries, in

which the aid increased the public deficit, three (Germany, Spain and Ireland) account for 81.5% of the total, with sums close to 40 billion euros in each country.

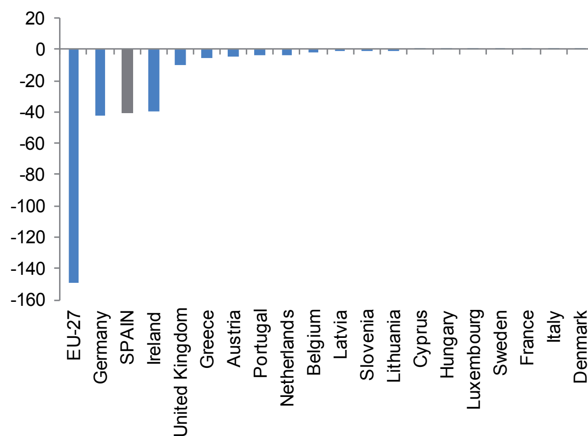
As a percentage of GDP, Ireland is by far the country that has faced the biggest bill for the bank bailout, as the cumulative recognised losses came to 24% of 2012 GDP. In the EU-27, Spain comes second in terms of the cost to taxpayers of its bank bailout, with losses equivalent to 3.8% of GDP (39.6 billion euros). In Greece and Portugal the impact of the aid on the public deficit came to 2.9% and 2.5% of GDP, respectively, while in Germany it was 1.6%. Consequently, although in countries such as Germany, the Netherlands, the United Kingdom, Portugal and Greece the public resources mobilised to inject capital into their banks exceeded those in Spain, towards the end of 2012 the percentage considered lost and hence the increase in the public deficit was less. In Germany, for example, public aid granted to shore up banks' solvency was substantial (10.8% of GDP), but the impact on the public deficit was just 1.6% of GDP. By contrast, in Spain the aid granted was half that of Germany (5.2% of GDP), but the losses realised and hence passed on to the public deficit were more than twice as big (3.8%) due to the fact that the bulk of the capital aid transferred was to absorb losses rather than taking the form of financial transactions, such as buying shares.

In Spain, the aid granted was half that of Germany (5.2% vs. 10.8% of GDP), but the losses realised and hence passed on to the public deficit are more than twice as big (3.8% vs. 1.6% of GDP) due to the fact that the bulk of the capital aid transferred was to absorb losses rather than taking the form of financial transactions, such as buying shares.

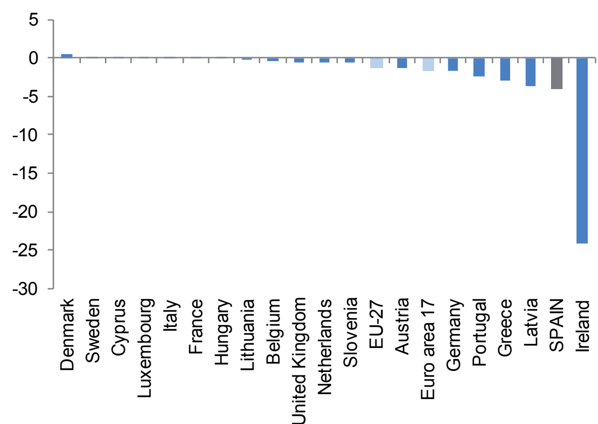
Exhibit 3

Cumulative impact from 2007 to 2012 of State aid to the banking sector on the public deficits of the EU-27

a) Euro billion



b) Percentage of 2012 GDP



Source: European Commission and author's calculations.

Disaggregated analysis of public aid to the Spanish banking sector and cost to taxpayers

In order to make the detailed analysis of the Spanish case that follows as compatible as possible with the European Commission's Eurostat statistics used above, the data reported below do not include aid which, although initially granted, has since been recovered. Similarly, aid initially granted by the Fund for Orderly Restructuring of the Banking Sector (FROB) which was subsequently assumed by the Deposit Guarantee Fund (FGD) is not included, because although it is considered public by the European Commission, the source of its funding is private.

As Table 1 shows, the aid granted by the FROB1 (in the form of a loan with the purchase of preference shares) came to 8,317 million euros. The initial figure was higher (9,674 million euros), but the aid of 977 million euros granted to Banca Civica which, following its absorption by Caixabank, was returned to the FROB in April 2013 has been discounted. Similarly, the 377 million aid to Unnim which was assumed by the FGD has been discounted.

In the case of the FROB2 (capital injection in the form of share purchases) the sum was 5,183 million euros. The initial figure was 5,751 million euros, from which the 568 million aid to Unnim subsequently assumed by the FGD has been discounted.

In the case of funds from the European Stability Mechanism (ESM), the figure is 39,078 million euros, which does not include the FROB's shareholding in the SAREB as it is not bank solvency aid.

With this breakdown, the final figure for public aid to the Spanish banking sector in the form of capital until 2012 (without including aid granted by the FGD) is 52,578 million euros. If we include the ESM funds used to set up the SAREB (2,192 million euros), the figure rises to 54,770 million euros, a figure very close to that which appears in the European Commission's statistics (54,169 million euros)[2].

Table 1

State aid to ensure the solvency and liquidity of the Spanish banking sector provided through 2012
Millions of euros

a) Capital injections		b) Contingent liabilities	
FROB 1	8,317	Guarantees on bank debt (until 09/07/13)	55,032
FROB 2	5,183	Covered bonds issued by the SAREB	46,600
ESM	39,078		
Total	52,578	Total	101,632
SAREB	2,192		
Total+SAREB	54,770		

Source: FROB and author's calculations.

[2] If we include the aid granted by the FGD and the aid from the FROB to Banca Civica for an amount of 977 million euros (which subsequently has been given back by Caixabank), the total aid is very much in line with the estimates provided by the Bank of Spain in its informative note published September 2nd, 2013, which is in the order of 61,366 million euros. Nevertheless, we must take into consideration that in this article, we have focused on the aid granted through the end of 2012 (given that the international comparisons, if on the basis of Eurostat data, can only be made through 2012). Meanwhile, the Bank of Spain also includes aid granted by the FGD and data for 2013, even though this figure does not deduce the 977 million euros of aid provided by the FROB to Banca Civica that have since been returned to the FROB.

Of the 52,578 million euros of State aid in the form of capital for the Spanish banks, four entities absorbed 93%: 22,424 million euros in the case of Bankia (42.6% of the total), 12,052 million euros in the case of Catalunyacaixa (22.9%), 9,052 million euros in NovaGaliciacaixa (17.2%) and 5,500 million euros in Banco de Valencia (10.5%).

In the case of contingent liabilities, between 2008 and 2012 the State granted guarantees underwriting bank debt of 108,329 million euros, of which more than half had been repaid by July 2013 (using the latest information from the Treasury). A Financial Assets Acquisition Fund (FAAF) was also created, which bought bank assets worth 19,341 million euros, since totally liquidated. Finally, the bonds issued by the SAREB to acquire assets transferred by banks that have received State aid (Groups 1 and 2) have a government guarantee of 46,600 million euros. Specifically, guaranteed bonds account for 92% of the SAREB's balance sheet of 50,653 million euros, the remaining 8% being equity (2% capital and 6% subordinated debt).

With these figures the total contingent liabilities outstanding on 09/07/2013 came to 55,032 million euros, which when added to the 46,600 million euros of debt backed by the SAREB, yields total contingent liabilities of 101,632 million euros, which is close to the figure of 105,093 million euros in the European Commission statistics on 31/12/2012.

According to the European Commission's calculations, the impact on the public deficit of State aid to the Spanish banking sector comes to 39,637 million euros. The figure is higher (43,479 million euros) in the case of capital injections to cover losses at Bankia (18,302 million euros), Catalunyacaixa (11,126 million euros), Novagaliciacaixa (7,601 million), Banco de Valencia (5,498 million) and Unnim (953 million). The inclusion of the aid to Unnim as public deficit (the loss was assumed by the FGD) is due to the fact that the European Commission considers the FGD to be part of the State. The net effect on the public deficit is less than the capital injections considered lost as a result of public income obtained from aid granted in the form of commissions or interest income.

If, rather than use European Commission data on solvency aid to Spanish banks computed as public deficit (capital transfers to absorb losses and not financial transactions in the form of share purchases of 43,479 million euros), the analysis is performed in terms of losses realised so far according to the FROB's annual accounts up to 2012, the sum comes to 36,197.1 million euros to the end of 2012. This aggregate figure corresponds to losses by Bankia (13,641 million euros), Catalunyacaixa (9,642 million euros), Novagaliciacaixa (6,649.4 million euros), Banco de Valencia (5,498.5 million euros), Ceiss (525 million euros) and BMN (241.25 million euros). Consequently, the difference from the European Commission's calculation for the period to 2012 is 7,281.9 million euros and is due in part to the bigger losses Eurostat ascribes to Bankia (4,661 million euros more), Catalunyacaixa (1,484 million euros more) and Novagaliciacaixa (951.57 million euros more), and the inclusion of Unimm's losses (953 million euros) in the public deficit. However, the European Commission has not included asset impairments at Ceiss and BMN in the public deficit, unlike its treatment by the FROB.

What share of the solvency aid has been lost? If we compare the data on aid granted with the recognised losses and focus on the four institutions absorbing the largest percentage of the aid granted, according to the European Commission's data, Bankia has lost 82%, Catalunyacaixa 92%, Novagaliciacaixa 84% and Banco de Valencia 100%. And according to the FROB's annual accounts, the percentage loss was 61% at Bankia, 80% at Catalunyacaixa, 73% at Novagaliciacaixa and 100% at Banco de Valencia. Consequently, in these four institutions, an average of 87% of the aid granted has been lost, according to the European Commission's calculations, and 72% according to those of the FROB.

Concluding remarks

Five messages clearly emerge from this analysis of State aid to the Spanish banking sector: 1) as a percentage of GDP, the solvency aid was of a value similar to the European average (5.2%) and less than that in countries such as the United Kingdom (7.4%) and Germany (10.8%) and a long way short of that in countries worst hit by the crisis (18.4% in Greece and 28.2% in Ireland); 2) the reaction to the crisis came later in Spain, as can be seen from the figures for the early years of the crisis (2007-2010), when compared with an injection of public capital of 5% of GDP in the EU-27, the resources mobilised in Spain represented exactly half that, at 2.5% of GDP. If public resources had been mobilised much earlier, as was the case in other countries (such as Germany, the United Kingdom and the Netherlands), the problems affecting part of the Spanish banking sector may have been resolved earlier. Nevertheless, previous consolidation efforts had to be undertaken to ensure public funds would be used efficiently; 3) State aid to the banking sector has had a much bigger effect on the public deficit than the EU-27 average, as cumulatively, it comes to 3.8% of 2012 GDP, compared with an EU-27 average of 1.15%. In fact, only the collapse of the Irish banking sector has had a bigger impact on the public deficit (24.1%); 4) in the case of State aid to ensure banks' solvency, the European Commission considers the loss to be 43,479 million euros (this therefore forming part of the public deficit), while the FROB puts a slightly lower figure on the asset impairment losses (36,197.1 million euros); and 5) apart from the capital aid, the risks assumed by the Spanish government through aid granted to the banks in the form of contingent liabilities (10% of GDP in 2012, in particular in the form of guarantees for bank debt and bonds issued by the SAREB) are much higher than the European average (4.7%).

In short, as in other countries, resolving the banking crisis in Spain has made it necessary to mobilise public resources, which has meant a burden for taxpayers. The public aid granted in the form of capital was less in Spain than in some other European countries, although its impact on the public deficit has been bigger. Nevertheless, given the problems other European banking sectors are still facing, it is likely that the public deficit from losses on aid to banks will increase in these countries over the coming years.

In the case of the Spanish banking sector, only time and the economic recovery will tell if the State aid to the banks will translate into further liabilities for taxpayers, as the value at which nationalised banks can be sold will depend on the recovery, as will the potential losses associated with the asset protections schemes granted by the FROB when auctioning off certain institutions, and the profitability of the SAREB's business plan, as the SAREB is part-owned by the FROB and its bonds are guaranteed by the State. In any event, the cost of the banking crisis is far higher than that assumed by taxpayers, as one has to add in the sums assumed by financial institutions that have written down their assets with charges against provisions (almost 250 billion euros since the crisis began) and by drawing on the Deposit Guarantee Fund (almost 21 billion euros counting losses assumed and others estimated on the asset protection schemes granted), and the losses faced by shareholders and holders of hybrid instruments (preference shares and subordinated debt), in this latter case initially estimated at almost 13 billion euros. Consequently, it is the banking sector and its owners who have assumed by far the largest share of the cost of the crisis, devoting a sum equivalent to over 25% of GDP which, had it not been for the crisis, they would mainly have devoted to strengthening their solvency, paying their shareholders, and setting aside funds for their community welfare activities.