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Public aid, level playing field and the role of banks

Corporates and SMEs all over the world have suffered from the lockdown and the drop in demand. Bold support measures have been adopted by many governments, which postponed payment difficulties, but a wave of bankruptcies and non-performing loans seems difficult to avoid. It is crucial in this context to ensure the viability of solvent firms that face temporary problems and/or an increase in debt as a result of the pandemic.

In Europe there were significant differences in the degree and modality of support of national governments, some of which relied more on credits with partial public guarantee whereas others used direct aid to a greater extent. Indeed, different problems require different solutions, but variation in national approaches across Europe seem to reflect more the willingness to use the fiscal space of each country than the size and nature of the problems. Viable firms with temporary liquidity problems and/or debt or capital constraints may need a combination of public aid, fiscal incentives for the injection of fresh money and debt restructuring.

Non-viable firms require an efficient and quick resolution framework that facilitates a fresh start. The latter requires in many European countries improvements in the insolvency framework, making it swifter and more efficient.

In Spain several measures have been adopted in this regard in February 2021: (i) a new direct aid line of €7bn will facilitate the repayment of fixed costs and debts of the most affected sectors; (ii) a €1bn fund will be used to recapitalize SMEs, on top of another €10 bn line approved a few months earlier for bigger firms and (iii) €3bn will be destined to restructuring financial debts with public guarantees (via term extension, conversion into equity loans and, as a last resort, direct grants to reduce loan principal). Regarding the latter a voluntary code of good practices will be agreed by financial entities. These measures are welcome, although perhaps they are late and too timid compared to other EU countries.

Banks have a key role to play in distinguishing solvent from insolvent firms, in particular in countries where the average size of firms is small and previous knowledge of the firm becomes crucial. But direct support measures should come from the government. Banks will always have skin in the game as a result of the previous lending relationship with the affected companies. Incentives should be designed carefully for all the parties involved to play their role. In this process it is particularly important to avoid that a potential corporate crisis is compounded by a banking crisis that would exacerbate the exit problems.

Financial regulation has been relaxed to a certain extent to facilitate an anti-cyclical role of bank lending. The degree of effectiveness of the different measures adopted has been uneven, but in any case, this relaxation is by definition temporary, which reinforces the case for direct public support measures to compensate for the eventual return to normality of financial regulation, which should in any case be calibrated carefully by regulators and supervisors.

European institutions acted decisively and boldly in the early stages of the crisis, especially with the Next Generation EU funds. Now that the funds are beginning to flow to the recipient countries, we need to make sure that the additional measures adopted by national governments are harmonized to the extent necessary to ensure a preservation of the level playing field in the single market. And governments, banks, corporates and SMEs need to cooperate in a constructive way to create the conditions for a robust recovery.