



Ministerie van Financiën

## The state of public finances and its effect on crisis management

Public Hearing on 'The spread of the crisis'

14th January 2010



# 1. State of public finances is paramount

- Credibility of national authorities is essential for financial markets, in times of calm, during and in the aftermath of crises
- Two factors determine the credibility (room for manoeuvre) of national authorities in crisis situations:
  - Size and importance of financial institutions relative to,
  - State of public finances determines “fiscal capacity / room for manoeuvre”
- Indication of increasing size and importance of financial institutions:
  - As of 1990, 24 out of 25 largest banks in the world by assets had a balance sheet smaller than 25% of the host country’s GDP
  - Just before the crisis, as of 2007, 11 out of 25 largest banks had a balance sheet larger than 75% of the host country’s GDP
  - As of 1990, 10% of the working population were employed in financial services
  - As of today, 15% are employed in financial services



## 2. State of public finances and crisis management

- Before a crisis
  - Mitigate risk for the taxpayer by limiting risk of financial institutions
  - Run a healthy budget
  - Keywords: prevention and having a 'plan B'
- During a crisis
  - Therefore, stimulate private sector solutions, and if necessary: **spend public money wisely** as it affects room for manoeuvre in the short term, and confidence in authorities in the long term!
- After a crisis
  - Aim efforts at stimulating real economy, i.e. through supply of credit (ideally measures which gradually phase out)
  - Clean up bank balance sheets, and gradually restore national budget



## 3. Looking ahead

- Mitigate risk for the taxpayer
  - Reduce risk financial institutions and thereby moral hazard through better regulation
    - › Capital requirements, Supervisory Regime
  - Create possibilities for private sector solutions
    - › Address TBTF, Living Will
    - › Contingent Convertible Securities
- Return to a healthy national budget, Growth and Stability Pact
  - Credible budgetary exit strategies (Europe: Stability and Convergence Programmes)
    - › Enhance confidence; mitigate increase in long-term interest rates (debt service, crowding-out, default risk)
    - › Create fiscal room for manoeuvre to cope with the next crisis or downturn



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Thank you for your attention

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