HOUSE OF LORDS

Revised transcript of evidence taken before

The Select Committee on the European Union

Financial Affairs Sub-Committee

Inquiry on

COMPLETING EUROPE'S ECONOMIC AND MONETARY UNION

Evidence Session No. 7 *Heard in Public* *Questions 82 - 91*

TUESDAY 26 JANUARY 2016

2.10 pm

Witnesses: Markus Ferber MEP and Kay Swinburne MEP

Members present

Baroness Falkner of Margravine (Chairman)
Lord Butler of Brockwell
Lord Davies of Stamford
Lord Haskins
Earl of Lindsay
Lord McFall of Alcluith
Lord Shutt of Greetland

Examination of Witnesses

Markus Ferber MEP, Vice-Chair, ECON (DE, EPP) and **Kay Swinburne MEP**, ECON Member (UK, ECR)

Q82 The Chairman: Can I welcome you, Ms Swinburne? Thank you for agreeing to give evidence to this inquiry into completing Europe's economic and monetary union. As you know, this session is on the record and we will take a verbatim transcript of proceedings, which will be published in due course. You will of course have the opportunity to correct any minor errors or misunderstandings. I wonder if I might kick off. We are slightly pressed for time, so we thought that Mr Ferber could join our discussion when he arrives. I wonder whether you could give us your assessment of the Five Presidents' Report and the actions introduced in the shorter term by the European Commission in its document of 21 October. In doing so, I wonder if you could also cover the long-term sustainability of the euro in your response.

Kay Swinburne: That is no problem at all. Thank you for the invitation. It is good to come back. It is the second time I have given evidence to you in Brussels, along with a couple of times in the House of Lords itself, which shows that you are coming from both sides. It is nice to see you and for a Committee to take an interest in what we do here. It is nice that the UK engages. I can tell you that you are the House that engages, as opposed to the other one, which is a little more difficult to get to talk about some of the issues we deal with here.

In terms of the work here, I am able to talk from the perspective of being a co-ordinator on one of the political groups. The European Conservatives and Reformists Group is now the third largest in the Parliament. We have a significant number of members on the ECON committee. I can talk both collectively for them as a group but also individually for me as a British Conservative Member, where my perspective is probably a little more about how we make sure that what the eurozone does, and what the non-eurozone members get affected by, is clear and distinct. That is not always clear within the documents that are produced.

A particular example of that would be the Five Presidents' Report. The Five Presidents' Report is very clearly aimed only at the eurozone. It is clearly a eurozone document; it is clearly about the EMU and what actions they have to take, but often it interchanges "Europe" with "the eurozone". Some of the language is a little problematic at times, and it should be a lot more carefully used. More than that, because it was quite roughly put together in terms of that language, it is now potentially being misused. Certainly, in the ECON committee, it is referred to in the context of "the 28" quite often, which causes us some frustration. If we get sloppy in allowing this to be used for single-market purposes rather than specifically the eurozone, it could be problematic going forward. It is a slight criticism, to put it into context.

The issue for me is that the Five Presidents' Report is just that: it is five individual men, in this case, who have sat down and written a report. It is not a democratically accounted for document. The individuals concerned may have had a mandate from their individual institutions by being a president, but they did not have a mandate to write this report. It is very clear, from the Parliament's perspective, that what President Schulz has written here is what President Schulz felt, not what the Parliament thinks.

Actually, that causes me some concern. It is a democratically elected house and for it not to have come before us, before it was given as the Parliament's view, is particularly problematic. Even though I agree with much of the content of the document and the aims and ambitions for the stability of the eurozone, the way in which it has been undertaken leaves a lot to be desired. Sadly, the democratic house is the one that has the biggest democratic deficit in getting to what has been put into it. Markus Ferber may have a slightly different take on it, but it concerns me that that is the case.

The Chairman: I can see Mr Ferber has arrived. Mr Ferber, join us here. I am sorry to interrupt you, Ms Swinburne. Do continue.

Kay Swinburne: My biggest issue in the way it has been constructed is that five individuals and their teams have constructed it and brought it together. But, if it were a Commission document, as we would normally get a draft from the Commission, it would have to have been impact-assessed and it would have to have had a cost-benefit analysis to it. You would have to have done all the risk assessments on it.

As it is five presidents acting in their capacity as presidents, it has had none of those things done to it. If we have to take this as a document, I question whether it has the legitimacy that we might want a document to have.

Lord Haskins: Why did they do it that way?

Kay Swinburne: It was for speed: they felt it was important that this came out quickly. It was important for them to have a united front. If you had to take it through the Parliament, with 750-odd Members, I suspect that united front would not have been quite so united. That would be my interpretation.

Lord Haskins: Is the Parliament quite divided about it?

Kay Swinburne: The Parliament is divided about it, not just along national lines but along political lines. We have a socialist President right now and he has a particular view, which may or may not be shared by others. I suspect that Mr Ferber here will have some views, given that he is a fellow countrymen and in a different political party.

Markus Ferber: But I am not a socialist.

Kay Swinburne: Yes. There are some weaknesses here and, therefore, it is unfortunate that they took this route. A Commission document has the legitimacy of the treaties to bring forward initiatives and then for us to work in a democratic way on them. For me, that would have been stronger.

The Chairman: Could I stop you there to pick up something you have said? The way we look at it, it seems that the Five Presidents' Report is a road map; it is a general overview of the direction of travel. When and if this is translated into specific measures, of course at that point there will be impact assessments, will there not, when it becomes legislation?

Kay Swinburne: Yes, on individual pieces of legislation.

The Chairman: In that sense, your concern about impact assessments will be dealt with further down the road, will it not?

Kay Swinburne: Yes, but it is a very difficult way to go if you have already decided the direction without having any form of impact assessment as to the direction of travel you are aiming in. I would have liked those to have been at least tested before they set the very definite direction of travel.

Q83 The Chairman: Mr Ferber, good afternoon. I am Kishwer Falkner, Chairman of this Committee and its inquiry into deepening economic and monetary union. The question we had started on with Ms Swinburne was an overall assessment of the report and whether you think the follow-up paper of 21 October has significant things it says or omissions. Also, could you give us an overview of whether you believe this points towards the right things we need for the long-term sustainability of the euro?

Markus Ferber: First, thanks for the question. Secondly, I am sorry for being late, but I had a so-called shadow meeting on the European Semester and I had quite a similar fight, which was a right-left issue, on how the economy can be improved and how macroeconomic imbalances can be reduced. You can imagine the left is asking for more state, more state and more state, and I am coming from the other side, the right side, which is asking for more responsibility for member states to adjust their systems. That is why it was not possible for me to leave in time. I am sorry about that.

On the concrete issue, to be honest, this so-called five Presidents' report is something that is in the sky. Of course, those five presidents have responsibility, but none of them ever asked their structures. Mr Schulz never asked the Parliament; Dijsselbloem never asked ECOFIN; Juncker never asked the commissioners; Draghi never asked anyone. That is known. It is in his mandate that he is not obliged to do so. Tusk did not ask the Heads of State. But now it is in the world. There are these lovely procedures in Brussels—I am sorry for saying this—whereby, if something is born, it is like Christmas Eve: everyone says, "Wow, a new baby is here", but no one knows how to deal with it. That is one of those challenges.

To give you one idea, when we had responsible Commissioner Hill in our committee presenting the EDIS, the deposit insurance scheme, I asked him what had changed since the hearing when he said that in 2019 he would make some proposals according to the existing legislation. He said, "Well, we have the Five Presidents' Report". So it is alive. It is not recommunicated to any of those five bodies represented by those five presidents, but it has an impact, and that is one of those crucial issues about how things sometimes develop here. Therefore, for me it is a study or a paper—we have a lot of them, from economic structures, trade unions or whomever—but it is up to us as politicians at the end of the day to go to conclusions.

Therefore, it is good that the Parliament and Council, as co-legislators, can do whatever they want beyond the Five Presidents' Report. That is our obligation. For us, it means that, on the EDIS, which is the only concrete legislative proposal for the moment, we will stick to what has been agreed. That means that member states first have to establish deposit guarantee schemes, and then we will take a look at that.

Q84 Lord Shutt of Greetland: You have both had a similar tale, in a way. You are concerned that this report has not evolved from democracy. However, it says that democracy and legitimacy have to be one of the four pillars of their report and how it goes forward. If it is important, how is that happening? Do you see that working well? What is the balance between the European Parliament and the national Parliaments? What about the ins and the outs, as far as the euro is concerned? Are we going to have two Parliaments or a little section of the Parliament that just deals with this issue? How do you see this?

***Kay Swinburne*:** The ECON committee has already discussed at length in the last mandate whether it was legitimate for non-eurozone members to have an equivalent vote on the committee on eurozone matters. It was debated at length whether we would go down the President Schulz route of establishing a separate committee for the eurozone, which would exclude non-members of the eurozone from being full members of that committee. The committee voted to exclude that as a possibility, and it was decided fairly strongly that it should all be done within the mandate of the ECON committee as a whole; that no member should ever be excluded from being a participant in any matter concerning the European Parliament; and that to discriminate in any way would be inappropriate.

That decision was taken in the last mandate and was supported by the whole plenary. I would hope that that idea has been squashed once and for all within the European Parliament. There was the intention of creating this two-tier system, which was rejected by all political groups, unless your recollection is any different.

Lord Shutt of Greetland: Is that because the thinking is that the outs will be in tomorrow or the day after?

Kay Swinburne: The issue is that the vast majority, bar two countries, already have an obligation to join as and when their criteria meet the requirements, and they already follow all the rules of the EMU in order to be potential future members, so to exclude that group would have been inappropriate. But it was also felt that to create a special circumstance for those two countries that have an opt-out from using the currency would be inappropriate.

It is very much in that line of discussion where our Prime Minister in the UK is currently negotiating: to make sure we have this ability to have more than one currency recognised. If two countries have a permanent opt-out, you cannot always refer to just a single currency. You will always have to have arrangements that include those who do not use the euro as the currency of their choice.

Q85 Lord Haskins: Coming back to the first question, you did not answer the question we are really interested in: is the EMU sustainable in the long term? If it is, does the Five Presidents' Report help in any way to make it sustainable?

Markus Ferber: It is more a political issue than a question on the content. In the German Parliament, we sometimes have the same discussion as ECON had in the last period as to whether a European Parliament representing all 28 member states, and not only those 19 joining the monetary union, has the right to decide. It is not yet an official proposal, but I always have this discussion with my colleagues in the national Parliament in Germany, for example.

On the other hand, if you look at the treaties, in the EMU, the Council or the Eurogroup decides unanimously and the Parliament has only the right to give an opinion. If you speak about this democratic approach, all the things that are linked only to European monetary union are legitimised by national Parliaments, not by us.

For example, the European stability mechanism was never an issue in our committee; it was never an issue in the European Parliament. It was an issue in 19 national Parliaments. It is the Deutscher Bundestag which agreed on the ESM, never the European Parliament. If you look at the treaties, what is a European responsibility and what is a national responsibility is clearly defined, especially on those things that are fully, 100%, linked to the European monetary union.

On the other hand, even before the British Prime Minister brought up this point, we tried to deal with it in the way that those general rulings that have an impact not only on the monetary union but on the single market as a whole should be done as a single-market issue, where we have full legal rights—that is, the European Parliament, together with the Council. Of course, that applies to 28 member states, whether they are ins, pre-ins, opt-outs or whatever, or even if they do not know whether they will become a member of the European Union. There are a lot of possibilities.

Our approach was always not to have this distinction between the ins and the outs, but to say what is of importance for the single market. To come back to the actual proposal, of course a deposit guarantee scheme on a national level, with national responsibility, is needed in the single market, not an insurance scheme. Therefore, whether it is of benefit for the EMU or not, it has to be done as there is a need for the single market. That is a good approach. The Council did not always follow it, but in the main files we treated it as a single-market issue for all 28 member states.

Kay Swinburne: The very direct question is: is the EMU sustainable? Yes, I think it is, because it is a political project above all else. Where there is political will and the intent to maintain it and keep it, it will be there. We have seen over the last few years that, when it gets very difficult, people find solutions and are prepared to take moves they might not unless circumstances are against them.

We are going to see that time and time again, because, ultimately, this was not an economic construct; this was a political project from the very outset. It is recognised as such here. None of us would start with a clean sheet of paper and devise what we have currently. We all know that. Everybody who has participated in any of the discussions here knows that. But, yes, it is sustainable, because of the politics behind it.

Lord Haskins: It took the 2008 crisis to make politicians concentrate on the failures of their original attempts.

Kay Swinburne: There are not many national politicians who, without the financial crisis, would have taken some the moves they did. It focused people's minds as to what was important and what they wanted to see continue. Ultimately, the politics of it were that they wanted anybody who was an existing member of the eurozone to be maintained as a eurozone member.

Q86 The Chairman: Mr Ferber, do you believe that it was merely, or principally, a political issue rather than an economic one?

Markus Ferber: Of course, you have to come from the birthday, which was the Maastricht Treaty, and the negotiations on the Maastricht Treaty started in the late 1980s. Coming from Germany, of course it was the time of unification, although there never was an official link, to be honest. Chancellor Kohl and the Finance Minister Theo Waigel—he is a good friend of mine; he comes from the same region as I come from—always said that there was never an obligation for Germany to deliver the Deutschmark on a European level. However, if you consider the mood of the late 1980s, it sought to construct a political union, which the Maastricht Treaty failed to do, and a monetary union, in which it did not fail. From birth, it was a political concept, and its birthday is the Maastricht Treaty. This part of the treaty has never been changed by all the other treaties later on. That is the first point.

Secondly, the decisions were taken from 2010 onwards after the bankruptcy of Greece. It was not the financial crisis; it was the single-market issue. We did a lot of legislation, but, starting from 2010 onwards, when Greece was bankrupt and we had the decision to keep it in or throw it out, it was visible that it was a political concept where member states are granting things they never would have agreed to in a treaty, to be honest.

Coming from Germany, although we are one of the beneficiaries of the single currency, we would never agree a treaty which says, at the end, we have a bail-in procedure—although it is said that there is no bail-in. We would never have agreed to spend €22 billion from the German budget to guarantee a stability mechanism that gives credits or loans to other eurozone states and all this stuff that has been established.

Therefore, I fully agree with what Kay said: it is a political concept. If there is a need for it, euro member states agree to deliver what they would never have delivered voluntarily. I think it is sustainable, because they know what to do and they did what was necessary.

The Chairman: And they will do whatever it takes from now on.

Markus Ferber: This wording came in a phase when member states had already agreed to €500 billion in the ESM. It was clear that no national Parliament of these 19 was willing to grant more money, but, on the other hand, there was still some pressure on the euro via Greece. It was the European Central Bank that then made a statement, saying, "If the states are not able to deliver more, we are able to deliver more—whatever it takes".

You have to see it together with the EFSM and the EFSF, the first stability mechanism in 2010, the European stability mechanism, and then the last bazooka. That was the time the markets asked for a bazooka. I am sorry for using this word; it was not invented by me. It came from the financial world. The bazooka was created by the ECB. "Whatever it takes" is the bazooka. We have €500 billion safe, and whatever it takes above that the European Central Bank is ready to deliver. See it in this context, please. Do not see it as standalone.

Q87 Lord Davies of Stamford: How successful has the European Semester been so far in enforcing greater budgetary discipline and contributing to the reduction of risk and the stabilisation of the eurozone?

Markus Ferber: To be honest, we have not been very successful in the European Semester, because the European Semester tries, with the country-specific recommendations, to ask member states, especially in the macroeconomic area, to change things that they have decided. These did not fall from heaven. There was a decision from national Parliaments to do it this way or that way. Now there come these country-specific recommendations, saying, "You are doing this wrong". What is the normal reaction of all member states? They say, "We are not doing it wrong. You do not understand us". They do not change their policies. That is one of the main problems.

The second problem—now I have to speak politically—is that we have a commissioner from France who was Finance Minister in France in a period when France should have established reforms and did not. If you look at the actual economic forecast from the European Commission, it is really blaming France for not doing any reforms. Surprisingly, we have a French commissioner, who campaigned for the French president—he was the leader of the campaign and then he was Finance Minister—who is not putting pressure on the most crucial country. The crucial ones are not Greece or Cyprus. The most crucial one is France and number two is Italy.

As they are large member states, as they are founders of the European Union and as you need them for a lot of other problems, the Commission is not fulfilling its obligations. In this game, the Commission is the referee, and the referee has to give a yellow or a red card: "You are doing wrong". That is how we changed the stability and growth pact. Under this revised qualified majority, the referee says, “You should get yellow”, and then the Council can say, “No, this time it is not a yellow card”. The old rule was that the Council says, “We are giving you a yellow card or a red card”.

We changed that, and now the referee is not going into his pocket and pulling out the yellow card, or even the red, for France: “Stop this and this”. If the referee fails, you have a problem. That is the main problem I have. If Mr Juncker says, “We are a political Commission, so we decide on political circumstances”, it cannot play the role of a referee, because the referee has to be neutral and stick to the rulings. Therefore, we have to invent something. Germany is thinking about how, for example, structures that have already been established—such as this independent economic advice, which is a part of the Commission—can be strengthened. We need an independent structure that is able to give a yellow card or a red card. That is the main problem we see at the moment: the Commission is not fulfilling its role.

The process as a whole is something we could develop in a way that—as you asked about the European Semester—really allows us to make bad developments visible as early as possible. The idea of the semester is to make problems visible before they create a mess. The old stability and growth pact said, “The member states do their budgets and after the year we look at what happened”. In Greece, as we learned, they did whatever they wanted to do and it had nothing to do with the rulings, but we saw it too late.

Therefore, we need an independent structure that says, “You are doing it right. You are doing it wrong”. That is the problem I see at the moment: the Commission is not fulfilling this obligation.

Lord Davies of Stamford: The Commission has responded to that line of questioning or criticism, first, by bringing forward the whole process and intervening earlier in the annual cycle and, secondly, by suggesting the creation of this European Fiscal Board, which would be independent of the Commission in my understanding. Does that meet your requirements or not? Is it sufficient?

***Markus Ferber*:** No.

Lord Davies of Stamford: If not, do you think we should go further? If so, how much further should we go and in what direction?

Kay Swinburne: The Parliament proposed bringing the timings forward. It came from the Parliament, not the Commission.

Markus Ferber: Yes, but the problem is about what is going to happen at which stage. The European Semester idea is to check, even in the long run, before a problem occurs, whether they are on the way to creating a problem. Therefore, we have to think whether these country-specific recommendations are really the right tool. It is about the competence of the member states to adjust their systems.

Lord Davies of Stamford: What would the right tool be? That is what I am trying to get out of you. How would you do it better? You have made a lot of very trenchant criticisms.

Markus Ferber: To give you another idea, which I do not support, some member states are now asking for fiscal capacity, which means asking for additional money from Europe or the eurozone to create a eurozone budget. I fully disagree with that; Germany disagrees with that concept, but we will have discussions in the house as well.

Lord Davies of Stamford: Do you have any concrete proposals?

Markus Ferber: Yes, a concrete proposal is to say, "You have to do something in your state that has a volume of whatever". For example, France might say, "We need a volume of about €40 billion a year". The response might be, "But it is your decision, as the French Republic, with your national competences, as to how you will organise that to achieve this volume at the end". That would be more concrete—because you can really check it—than these country-specific recommendations. For example, every year in Germany we are told we have to change our vocational training; on the other hand, we have the lowest youth unemployment. I do not know why we have to change it. I am sorry, but the Commission is not able to give me an explanation for that, to put it the other way around.

The Chairman: Mr Ferber, I am advised that I need to reiterate to you, as you might have missed that section, that we are on the record.

Markus Ferber: Yes, I know that.

The Chairman: I very much appreciate your candidness. We are getting a good picture of the debate.

Markus Ferber: I know that.

The Chairman: I am very glad we are here, but I am told I just have to let you know that.

Markus Ferber: I have it directly in front of me.

The Chairman: Yes, indeed.

Markus Ferber: Do not worry.

The Chairman: Ms Swinburne, do you agree with most of that?

Kay Swinburne: I am slightly less harsh than Mr Ferber. The initial semester analysis, for the first couple of years, has been poor. I think it has been recognised and there have been moves to improve and to beef up the teams involved on the ground, going into each member state. I understand the quality of the individual assessors who produce the country-specific reports is improving. In certain areas, I have feedback from experts, particularly economists, saying they think there is an improvement in those who are coming to discuss and have dialogue. There is more of a willingness to understand the underlying issues, rather than just the superficial statements and statistics they can gather.

As we know, in the UK we always have the issue about housing. We know we have a shortage of housing. Reiterating it in every country-specific report does not help. There seems to be some form of criticism of every action we take to try to improve the situation. That also does not help. To now have a level of expertise going in is a little better; that is, not just talking about the absolute number of houses required, but looking at the underlying factors that are limiting it, realising where the limitations are and, therefore, maybe being less critical and more constructive in their remarks on other areas.

There has been a strengthening in the process; there has been a beefing-up of the teams; the expertise has improved. It is going to be a while before we see that come through as improved quality in the output. I suspect the problem with these is that we see the output only every year. If they do not have it quite right the first time they try, it is another year before we see the output again. It is a difficult thing to be too critical, given that we know they have made some changes, and they needed to make them. I am with Markus Ferber here that they needed to make them, but I am a little more cautious that maybe they have some of it a little better than they did.

Q88 Lord McFall of Alcluith: Kay, you mentioned earlier that when things get difficult we see political movement. The European Parliamentary Research Service has shown that few country-specific recommendations are followed. How big a problem is this for the credibility of the whole governance process?

Kay Swinburne: It is a problem, and it goes back to what I have just said: they were not specific enough in the early days of the semester.

Lord McFall of Alcluith: What do we need to do now?

Kay Swinburne: What has happened is that they have improved the quality of the economists and the people going in to do the country-specific visits. I understand the dialogue is of a much better calibre and far more granular than it previously was. Therefore, I would hope that means the next CSRs coming out will be far more relevant to the market they are referring to. That would be my hope. If they do not have it right, they have to go back to the drawing board and start again. The metrics they were using were not appropriate, and I think they have gone and revisited those. I just hope what they are now proposing is going to work this time around.

Lord McFall of Alcluith: Are you as optimistic as that, Mr Ferber?

Markus Ferber: I am an optimist by birth. I hope I can keep that, even working here. I have been here for more than 20 years as a Member of the Parliament.

Seriously, yes, this is the right way to improve it. On the other hand, we have to take care that, with this more granular approach, we are not judging too many competences of member states. Macroeconomic policy is still in the hands of the member states, and that has to be taken into account. We have different ways of financing social security. You have a tax finance system and we have a contribution finance system, with all the implications coming out of that. You want to keep your system and we want to keep our system. You would never agree if Brussels was asking you to change it; we would never agree. But, inside the system, maybe you can make some adjustments.

Sometimes it is like the process of a company asking one of the Big Four to give them advice. They know what to do, but they need pressure from outside to do it. We should deal with the European Semester like that. You know you have some imbalances, you need to do something, and you take that outside advice showing that you have to do it. It is not about saying, "Why the hell is the Commission dealing with our problems?" That way, you will do it right, as with the external advice a company asks for from outside, although they already know what has to be done.

Lord McFall of Alcluith: Both of you seem to give your evidence as if you are outside the process, commentating on it. I am interested in what you could do as parliamentarians, what the Parliament could do to get a grip on it and take some ownership of this, rather than waiting for things to happen and then, four years later, hey presto, we have not moved. We have to be more granular.

Kay Swinburne: Part of the reason changes have happened is because the Parliament, through the ECON committee, does an own-initiative report every year. There are two annual own-initiative reports, one on the AGS, the annual growth survey, and the other on the semester. We have an annual report on both of those, where we have a rapporteur and a full negotiating team, who put together a report. They are often critical, depending on who the rapporteur is and whether the political meaning comes out. Those get done on an annual basis. That is our opportunity to basically look at that year, particularly the country-specific reporting, and say, "Is it relevant? Is it having an effect? Is it granular enough?" We have been putting pressure on through that process.

We also have various things we do, including the inter-parliamentary meetings, which are coming up now, where we as the committee will sit with our parliamentarian colleagues from national Parliaments to discuss key topics. Certainly, AGS and semester are always key topics on that agenda, and they will always be key talking points within the debates we have in that inter-parliamentary space. There are some big things we are taking part in.

Do we have a direct role? No. We have a scrutiny role, which we are trying to engage in. When it comes to co-legislation arrangements, we obviously help set these up, but we are now in a role where the annual report is probably the main instrument we have. At any point, though, we could do an own-initiative report, if we felt there needed to be more drastic action, where we would, as a committee, come to the position of calling on the Commission to alter course. At the moment, I do not think there is much appetite. There is more of a feeling from the centre and left of the house that this needs to be given time to be seen to be working before we are too critical of it.

Q89 Lord McFall of Alcluith: The European Deposit Insurance Scheme was briefly mentioned there. I know Germany says treaty change is necessary in order to implement greater risk-sharing plans, but how confident or otherwise are you that we can get a solution to this problem and break the negative feedback loop present between sovereigns and their banks?

Markus Ferber: If you look at the existing directive, only half the member states have implemented it, although the implementation date was July last year. If you carefully read what has been agreed, at the end of the day, when all 28 member states have proper systems in place, fully equipped, fully financed, then we can discuss an insurance mechanism. The Commission is now proposing that those that have already established national systems should stop paying into the national system and start financing a new structure, and the others that have not yet done anything should do the same.

That is not appropriate. I am fully in line, as is Germany, with the idea that was agreed in the last period: to say that every member state starts and, if they have well-equipped systems, then we can base a reinsurance system on that. The other thing is, if you really want money to be transferred from one system to another, according to our German understanding, it is a bail-in procedure, which can only be done unanimously, not with a qualified majority in the Council. That is what Germany will ask for, and we will even go to the court.

Lord McFall of Alcluith: It seems a perfect negative feedback loop, because the information is that the recommendations under the European Semester are poor. That has been acknowledged. But it has fallen since the European Semester's inception. Given that background, you are saying, "Only half of the members have signed up. Wait until we have the perfect day, when everyone is signed up. Then we are going to make some movement." It is a yellow-brick road approach to it, is it not?

Kay Swinburne: They have all signed up. It is just that they have not actually implemented it. They are signed up. They have committed to doing so.

Lord Haskins: That is one thing.

Lord McFall of Alcluith: There seems to be a clause in here that we are waiting to get a perfect state, if you do not mind me saying that.

Markus Ferber: What is a perfect state?

Lord McFall of Alcluith: You are going to hang back, because you do not see it coming soon.

Kay Swinburne: The Commission should now be enforcing the implementation. It has the mechanism by which to do so. Banking union is three pillars. It is not just the deposit guarantee scheme.

Lord McFall of Alcluith: I understand that.

Kay Swinburne: We have not yet had time to really absorb the big link between the sovereign and funding of the banks. The supervisor was key to all this. With the SSM, and with the ECB taking that key role, we should not underestimate how completely and utterly transformational that is, how important it was for the system that it happened and how much resistance there was from individual member states to losing it, for the very reason you outline, in terms of breaking that link. That was seen as the crucial point of breaking that link: the single supervisor. We have that established. It is working reasonably well. In terms of scrutiny, we hear from colleagues who sit on various panels scrutinising it that it seems to be working very effectively right now. There is room for improvement, but it is working effectively as a new organisation.

The SRM is also now functional. That whole resolution mechanism is the next tool for any of those banks that do not make it through. If this all fails, you then need the deposit guarantee scheme. To look at it in isolation may be a little unfair, because these have been two big pillars. It has taken a huge amount of political sign-up to get this far. Actually, if they both work, we will not need a deposit guarantee scheme; we are not going to get the failing institutions because we will have already had the early indicators and then the intervention by the ECB through the SSM.

Lord McFall of Alcluith: It is a bit of a rosy perspective. That is why I have focused on Markus. Germany is the big issue here. Markus, how far down the line are we talking about this being up and running with the 28 fully oiled? Will it be, say, five years or seven years?

Markus Ferber: The plan was for it to be by the end of this century—I mean decade, sorry—by 2020. 2019 was the date to check whether the systems are properly functioning, but, as

Kay said, the deposit guarantee scheme is one pillar, and there are three pillars on which the banking union is founded.

Lord McFall of Alcluith: Do you see the German veto prevailing? That is my last question.

Markus Ferber: First, we have to clarify whether there is a veto possibility. If you have a qualified majority, you cannot veto if you are alone. Our estimation for the moment is we have only one or two small member states that are with us, which is not a blocking minority. In that case, we will go to the court and the court will decide whether it is a single-market issue with qualified majority or a bail-in issue with unanimity among the Council. Do not ask me what the outcome will be.

The Chairman: Lord Davies, did you want to come in on this point?

Lord Davies of Stamford: Yes. I am very concerned by what I think Markus has just told us. Perhaps colleagues already knew, but I did not. Germany is going to insist that, before any drawing is made on an eventual reinsurance fund for retail deposit insurance, there should be unanimity; in other words, there should be an individual veto. That seems inexplicable to me, unless the intention is to sabotage the whole project, because the whole purpose of this reinsurance scheme and the mutualisation is to establish credibility in normal circumstances, so you do not have people much more worried about placing a deposit in Romania than in Germany and you therefore do not have a higher cost of capital in the more problematic member states or weaker member states, which would be perverse.

Markus Ferber: Yes, but it is easy to resolve.

Lord Davies of Stamford: Let me finish, please.

The Chairman: Mr Ferber, as you answer, I am conscious of the time. Could you just give us a very brief answer? Then I want to move on.

Markus Ferber: If there is a change of the Commission proposal, there will be a change of the German position. I do not see the need for this proposal. That means we should come back to what has been agreed, which is the German position that member states create these deposit guarantee schemes nationally for their system.

Lord Davies of Stamford: Markus, do you accept that if there is an individual veto by one country the whole scheme has no credibility, because in a crisis people would say, “Well, the Germans will veto this, so therefore our bank deposit is not actually being backed by the European Union as a whole; our bank deposit merely depends upon the solvency of our national Government”? So you are back to square one.

Markus Ferber: While nothing is agreed, the existing directive is in force. Nothing is written down; the existing directive is in force. I am asking member states like the Netherlands, where they are not implementing it, to do so.

The Chairman: Thank you. If there is anything more or you have any other ideas on that one, we would be delighted if you would write to us.

Q90 Lord Butler of Brockwell: Could I come on to European capital markets union? Is that possibly a more realistic route towards completing the union? As a possible alternative to some of the others, would it be a more realistic route towards achieving either the banking union or the fiscal union?

Kay Swinburne: For starters, I do not see the CMU project as being a eurozone project; I see it as a project of the single market. It is very much the 28, not however many members may be in the eurozone at that particular point in time. Fundamentally, no, I would not agree with that. However, there are many things here. From the regulatory reaction we have had since 2007–08, in terms of capital being held by our banks and the way in which we have now instructed them on a global basis to hold more capital and therefore, for the stability of the system, taken some of the liquidity out of it, it has become apparent that Europe was over-reliant on bank lending, particularly within its SME sector and its medium-sized sector. We need to find more diverse alternative streams of funding.

For me, the crux of capital markets union is finding out how we make capital markets funding relevant to all 28 countries. It is easy to sit in the UK, with the City of London there as a beacon of capital markets, and think that everybody understands why capital markets funding is important. Other member states do not have advanced capital markets; many of them do not have any funding streams other than basic stock exchange listing and would never think to use a corporate bond issuance or any other mechanism to get funding into their real economy. It is important that we understand that, for the 28 to feel the relevance, we have to put systems in place to help them understand what they might actually take part in.

We are looking at some very innovative platforms occurring in places such as Estonia and elsewhere, where they do not have a traditional culture of capital markets. They are now looking at things like private-placement platforms, crowdfunding and other peer-to-peer platforms, and various fixed-income products that can be used across platforms electronically. There are some fascinating advances happening. CMU should be there to facilitate it; it should be there to stimulate it. It should get people thinking about what they can do as an alternative to an over-reliance on the banking sector for all types of funding going forward. If we free up some of those large growth companies and larger entities that need to raise hundreds of millions of pounds, or euros, from bank balance sheets and bank lending, we should then have more capacity in the bank loan book for the SME sector and those smaller companies, for which it may not be ever appropriate to go to the capital markets, but which need that source of funds to come. This is about rebalancing the way in which we finance the European growth strategy. It is important that we see a way forward on that for the 28.

Markus Ferber: CMU is—and this is what the Parliament asked for from the very beginning—a project for all member states. It is a single-market issue. It has nothing to do with European monetary union; it is nothing to do with the euro. It should create a single market for all these financial needs we have.

To give you an easy example, as a German working here, I am not allowed to buy a house with my German bank, but I will never find a Belgian bank to finance my house. As I am with a local bank, they say that outside this area they do not do financing, as they do not know anything about the circumstances in Belgium or the legal situation. However, for the Belgian banks, as my income goes to my German bank, they will not finance me because they do not have any information on my income. This is to give you an easy example, not to mention financing companies, especially those that do not have access to the financial markets for the moment, which is a crucial thing.

Lord Davies of Stamford: Would the proposed directive deal with that problem specifically?

Markus Ferber: I hope so. I do not think so, though.

Kay Swinburne: The CMU is a strategy, which will be implemented through various directives and regulations.

Markus Ferber: The CMU is an issue for 28 member states, so it is really a single-market issue. We do not have a single market in the financial world as the United States is a fully integrated financial market. We do not have that, and we need it, on a European level, not a euro level.

The Chairman: Mr Ferber, would you accept that it is also very helpful to the eurozone?

Markus Ferber: No, it is not a eurozone issue.

The Chairman: But it facilitates the embedding of economic and monetary union.

Markus Ferber: No. Kay made some remarks and I may add something. A well-developed financial market like the UK market will benefit more from access to the continental model than the continental model itself will benefit from access to other markets, to be honest.

Q91 Earl of Lindsay: Can I ask you both what you think full fiscal union or fiscal union will mean in practice? How important will that practice be and how will it operate? Will it involve a full transfer union if it is properly to support the EMU in the long term? What sort of oversight and democratic accountability could be exercised to link its practice with the European people?

Markus Ferber: I am not in favour of the concept of fiscal union.

The Chairman: Please tell us what your reservations are, briefly.

Markus Ferber: Your second part already tries to solve a problem I do not want to create.

Earl of Lindsay: Please explain.

Markus Ferber: I am sorry, but I cannot answer the second part as it is not my concept. Therefore, I am really a fan of the US system. Every level—local, regional, state and federal—has its obligations and its finance tools to fulfil the obligations. This system would create a European mess. Coming from a country like Germany, we have so-called Länderfinanzausgleich. I cannot translate this word. It is the exchange of money between the 16 Länder, which weakens the strong and strengthens the weak. Transferring this to the European level is an unacceptable concept for me. I appreciate the approach in which you have responsibilities on a European level, on a national level, on a regional level and on a local level. You have to give each structure its access to fulfil these obligations. The fiscal union creates a mess of responsibility, which means that, in the end, no one wants to pay but everybody wants to get the money. I do not like that system.

The Chairman: Ms Swinburne, did you have any closing remarks in that regard?

Kay Swinburne: Certainly talking to my colleagues in Parliament, we are not yet politically close to fiscal union acceptance. There is a lot of resistance to it. As the pressure is easing in terms of us returning to a slightly more normal situation with regards to the economy, the incentives will disappear. It will take the next crisis for us to get closer to any more fiscal union. That is my personal view. Interestingly, in the Five Presidents' Report, they had three descriptors of what it is not. They said it is not a permanent transfer between countries; it should not undermine incentives for sound fiscal policymaking; and it is not an instrument for crisis management.

Markus Ferber: But they did not say what it is.

Kay Swinburne: They did not say what it is, and that is the critical point here. Nobody knows what would be politically acceptable. If I had three economists in a room, I would have at least four different answers as to what it should be. We are back to the original problem of when the euro was constructed and the EMU was devised. Nobody really knows what the endgame is. We are continuously pushing at the envelope to find out what is acceptable at any particular point in time for people to have a more stable macroeconomic environment.

Earl of Lindsay: You do not see this going very far very fast, then.

Kay Swinburne: As you have seen over time, it goes very slowly when there is no crisis. When a crisis of one kind or another appears, there seems to be an increased speed of progress.

Markus Ferber: We have to take care that there is democratic legitimacy as well as responsibility if you are not able to spend the money. If that is broken—and this is my concern with a fiscal union—you are doing something really wrong. I do not see how Germany could agree on a treaty change in a direction that would allow systems such as the Länderfinanzausgleich.

Kay Swinburne: I would also say that this is not specific to Germany. There are many other countries that have severe reservations.

Markus Ferber: I know Germany best. I am sorry about that.

The Chairman: Thank you. We are slightly over time, so I have to bring this session to a conclusion. Thank you. That concludes the public part of the meeting. The Committee will meet in private from now on.