



HOUSE OF LORDS

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Witness: Commissioner Valdis Dombrovskis

Members present

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

Examination of Witness

Commissioner Valdis Dombrovskis, Vice-President for the Euro and Social Dialogue, European Commission

Q158 The Chairman: Vice-President Dombrovskis, thank you so much for seeing us and agreeing to give evidence to us today for our 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.

Commissioner, given your pivotal role in this area, how do you see the proposals in the Five Presidents' Report contributing to strengthening the euro and its long-term sustainability?

Valdis Dombrovskis: First, good afternoon, my Lords. Welcome to Brussels. Thank you for your interest in Europe's economic and monetary union. I will start with a short introduction and then will be available for your questions.

Indeed, it must be noted that a lot has been done to strengthen Europe's economic and monetary union since the crisis to put it on a more solid footing, to make it more resilient, but it is also clear that economic and monetary union is not complete and more needs to be done. This is one of the key areas on which the European Commission intends to work in the coming months and years. The Five Presidents' Report, which was published last year, presents a vision and a road map for how to complete economic and monetary union by 2025 in two stages. It is an ambitious yet realistic approach, and the stage-based approach basically differentiates between those steps that can be implemented without delay within the existing framework and others that will require more time. In essence, we believe that this gives a clear direction to the evolution of economic and monetary union, and will be important in renewing and strengthening confidence in Europe's economy and single currency.

To outline some of the work done since the crisis, fiscal and macroeconomic surveillance has been substantially strengthened, and we hope that in future it will better prevent crises through sound fiscal and structural policies. In the case of shocks, member states would need to be

able to absorb those shocks internally. Resilient labour markets, flexible product markets and sufficient fiscal buffers would allow automatic stabilisers to play their full role and help to stabilise the economy. Some larger shocks may need to be shared within the economic and monetary union, both in the public and private sectors, and the Five Presidents' Report provides some guidance as to how this can take place through institutional strengthening, setting up the euro-area fiscal stabilisation function, and advancing financial sectors through the banking union and capital markets union. We believe that this also enables us to reduce the need for public sector risk-sharing.

On 21 October, the Commission put forward a package of initiatives to follow up the Five Presidents' Report, focusing on stage 1. While developing and working on those proposals, we recognised that the future of economic and monetary union is important for all EU member states, whether ins, outs or pre-ins. Everything for the euro area therefore needs to be done transparently and through an inclusive process involving, wherever possible, all 28 member states, especially proposals that have direct links to the EU internal market. Those proposals would be open to all willing member states to join. To increase the democratic legitimacy of EU economic governance, the European Commission will ensure frequent engagement with the European Parliament and national parliaments. That is being done, primarily, and we intend to do so increasingly through the European Semester, which is the main instrument of our economic policy co-ordination.

Moving to the second stage of the Five Presidents' Report requires thorough preparation and we need to shape a consensus among member states on the way forward. We are now launching a wide public consultation on the second stage of the Five Presidents' Report, and we intend to create an expert group in mid-2016 which will further explore the outcomes of the consultations and preconditions and proposals for longer-term action. We intend that the outcome of this debate and the work of the expert groups will feed in to the Commission's White Paper, which we intend to present in spring 2017, where we will outline more detailed proposals for stage 2 of the Five Presidents' Report.

Thank you very much. I will stop the introduction here. I am ready for your questions.

Q159 The Chairman: Thank you. You mentioned the consultation and the expert group that you are about to establish. Are you able to give us an idea of the main elements that you expect to come out in that White Paper?

Valdis Dombrovskis: As you know, the Five Presidents' Report is divided into two stages. Stage 1 is until mid-2017 and stage 2, with more far-reaching proposals, is from mid-2017, with a view to complete the work by 2025 at the latest. This consultation and this expert

group would concentrate on the proposals outlined in the Five Presidents' Report for the second stage. I have already mentioned, for example, the euro-area fiscal stabilisation function and euro-area treasury, and ways to make the process of convergence more legally binding. One of the main ideas of the Five Presidents' Report is how to restart the process of convergence within economic and monetary union, which has unfortunately stalled since the crisis, and how to make sure this is convergence towards best practice and best performance.

The Chairman: In broad brush, as you have mentioned, they are quite ambitious, and you have said that you expect the White Paper to come out in spring 2017. We accept that there are going to be two big political events in the same year, the German and French elections. Do you expect the White Paper to be on time, or might it be delayed until the completion of those quite significant elections?

Valdis Dombrovskis: We are not currently adjusting our plans or work with a view to different elections, because in a union of 28 countries you always have elections of one kind or another in some of the countries. This timeline is already outlined in the Five Presidents' Report and we intend to, wherever possible, stick with this timeline.

Q160 Lord Haskins: In dealing with these issues, you are going to have to reconcile different interests across the 28. I will name three. There are the different aspirations or the different realities between the ins and the outs. There are the different surpluses and deficits that sovereign states are running. For example, the Germans are running a big surplus. Everybody talks about deficits, but nobody talks about surpluses. Surpluses can be as big a problem as deficits in dealing with the issue. There are also the different labour market behaviours across the 28. To make the single market and the euro work effectively, these somehow have to be much more in harmony than they are at present. How is the Commission going to deal with those types of issues? There are many more.

Valdis Dombrovskis: Of course, when deepening the EMU, we will need to address a number of questions, and already in this year's European Semester we are taking the approach of paying more attention to the euro area's aggregate economic and fiscal performance. This is one of the reasons we advanced the publication of the euro-area recommendations and published them together with the results of the annual growth survey in November, contrary to previous years when they were published together with country-specific recommendations. This was done exactly with a view to allow for better discussions on appropriate euro-area aggregate economic and fiscal positions, and to reflect this thinking in country-specific recommendations for euro-area member states.

Indeed, you mentioned surplus as a form of macroeconomic imbalance and that is exactly what is being recognised by the macroeconomic imbalance procedure. Large and persistent current account surpluses, for example, are also seen as macroeconomic imbalance. That is why countries such as Germany and the Netherlands, for example, are also in the macroeconomic imbalance procedure and, among other things, have been advised to stimulate investment and the demand sides of their economies. Of course, they recognise that there are two sides of the coin.

On the labour markets, I would emphasise that labour markets are more directly linked with the EU internal market, so it is not limited to the euro area. From that point of view, this is something that needs to be dealt with at the EU 28 level, especially taking into account that free movement of labour is one of the four fundamental freedoms of the European Union.

The Chairman: Could I follow up on that? You have mentioned Germany and that running a current account surplus constitutes as much of an imbalance as having a deficit. How do you put it into effect? Do you put in a penalty? Is it a penalty or exhortation? How do you get the Germans to deal with that problem?

Valdis Dombrovskis: Regarding our macroeconomic surveillance, as you know we have a macroeconomic imbalance procedure where we assess different member states' performance and whether or not they have macroeconomic imbalances. In the case of excessive macroeconomic imbalances there is also a possibility to put member states in an excessive imbalance procedure, which foresees a more intrusive surveillance process. It must be said that it has not been done so far and Germany has not been found to have excessive imbalances. If Germany is found to have imbalances requiring decisive policy action, the ways to address this imbalance are addressed in a country report and in a country-specific recommendation to Germany.

When I was mentioning those recommendations to stimulate investment and to look at the demand side of the economy, this is exactly what is reflected in country-specific recommendations—but, as the name suggests, those are recommendations, not orders. We see a way to improve the implementation of country-specific recommendations, because it has been, generally speaking, relatively weak. We see that we can improve the implementation through more engagement with member states through more dialogue, so reaching more common understanding on what challenges we are facing. Indeed, we see that all the European Semester-related documents are also increasingly becoming part of the national policy debate. The surveillance process is gaining strength and prominence in member states'

discussions. As I was mentioning in the case of excessive imbalances, there are also mechanisms for more intrusive surveillance.

Lord Haskins: But in this context, this seems to some of us to be crucial to this working. The failure of EMU the first time was that the stability pact was partly ignored by large numbers of countries, including France and Germany, and the Commission did not have the power or the will to do much about it. What is going to be different this time around to make sure that these sorts of disciplines are enforced?

Valdis Dombrovskis: A number of things have been done since the crisis to strengthen economic and fiscal governance. The creation of the whole European Semester cycle is an outcome of this development. We know that a number of new legislations have been adopted, including the so-called six-pack and two-pack regulations, and basically the macroeconomic governance framework is shifting from where it was before to correct some gross policy mistakes and towards more preventive surveillance.

There is quite tight fiscal surveillance, not only in the corrective arm of the stability and growth pact or in the excessive deficit procedure but also in the preventive arm. Member states are required to reach their medium-term budgetary objectives, which are defined as structural budget deficits not exceeding 0.5% of GDP or, in some cases, where member states have low and sustainable public debt, up to 1% of GDP. There are possible actions that can be taken in both the corrective arm and the preventive arm of the stability and growth pact to make sure that member states are complying with the requirements. All in all, this regular annual surveillance is having an impact on the member states, and average budget deficits and, by now, average public debt in the euro area are declining.

We still have substantial issues with public debt, because it is still around 90% of GDP in both the EU 28 and the euro area, whereas in the treaty 60% of GDP is seen as a safe level. We continue to work especially with those countries that have excessive deficits and high public debt levels, and that is why we are continuing to have fiscally responsible policies as one of our three economic policy priorities.

Lord Haskins: I certainly think that the semester approach is very good and very satisfactory. One of the witnesses we have seen said that Ministers from member states come here and engage with them and find them very interesting, and, when they go home, they throw them away.

Valdis Dombrovskis: I would not agree with that assessment. We see member states correcting their fiscal behaviour and often doing so on the advice of the European Commission. Clearly, the European Semester process is having an impact on member states'

fiscal behaviour. I could get into specific examples from our experience or the previous Commission's experience with this fiscal and macroeconomic governance, but it is probably not exactly the topic of today's inquiry. In the assessment of the Commission, however, we are seeing a clear impact on member states' behaviour.

The Chairman: You say that, Commissioner, but we constantly come up against, for example, Italy telling you it is not going to conform, as France did for several years. How will you get Germany's Mr Schäuble to change his policies through just a dialogue from Brussels?

Valdis Dombrovskis: Those three countries are in different procedures. Let us go through those briefly. France is in excessive deficit. Indeed, it has been granted an extension on the deadline to correct its excessive deficit. There have been quite serious debates on this.

The Chairman: Italy?

Valdis Dombrovskis: Let me finish with France, and then I will move to Italy and Germany.

Of course, it also came with conditions. France had to deliver additional fiscal effort last year and has to meet its budget deficit targets this year and next to correct its excessive deficit. It must be said that France clearly met by a margin its budget deficit target last year. It presented a budgetary plan aiming to meet its fiscal target this year. There is also a clear commitment made in public statements from the French Government to correct its excessive deficit as foreseen in 2017.

There is one problem with the French approach: they are concentrating on meeting the nominal targets. Of course, in excessive deficit procedures, that is the first thing you look at. At the same time, however, they are falling short in terms of the required structural effort. Indeed, they will have to make more structural effort in the 2017 budget to meet France's 2017 budget deficit target. As the excessive deficit procedure is designed, as long as member states are meeting their nominal targets, we are not discussing the stepping up of the excessive deficit procedure.

Italy's budget deficit is also on a declining trajectory. However, it must be said that Italy has come with additional requests for the use of flexibility clauses in the stability and growth pact. We have been making it clear in our opinion on Italy's draft budgetary plans that we will returning to assessment of those requests in the spring, but of course those clauses in the stability and growth pact come with certain conditions. In terms of the investment clause, Italy will have to demonstrate what additional EU co-financed investment it is undertaking. In the case of the structural reform clause, it will have to demonstrate what major new structural reforms, on top of those for which Italy already asked for flexibility in last year's budget, it is undertaking. In both cases, Italy will have to demonstrate how, after the temporary deviation

from its fiscal path, it will speed up its adjustment in the coming years, because that is what is outlined in the Commission's communication on making the best use of the flexibility within the existing rules of the stability and growth pact.

There was an additional request on the refugee crisis. The refugee crisis approach, which has been communicated to the member states—and it applies not only to Italy—is that it will be evaluated *ex post* on a case-by-case basis, assessing what additional significant expenditure member states are facing on top of what they had been spending in previous years. Then it will be recognised according to the stability and growth pact clause about unusual events beyond government control. We are expecting to return to the discussions on Italy's budget in the spring, and I do not expect very easy discussions.

On Germany, on the fiscal side it must be noted that Germany is found to be in compliance with the stability and growth pact, both with regard to deficit and debt rules. In the case of Germany, we are assessing its macroeconomic imbalances, namely its large current account surplus, and advising it to use some of its fiscal space to stimulate investment and the demand side of its economy. Germany has responded already throughout the previous year with several additional investment packages for both central and local government, as well as with contributions through the development banks, through the KfW, to the Investment Plan for Europe or Juncker investment plan. We will also be reassessing Germany's performance this year, because Germany is also one of the countries for which we are doing an in-depth survey.

Q161 Lord Shutt of Greetland: We have come from the UK, and you will have spotted that we are not members of the euro. What assessment have you made of the impact upon the UK of the Five Presidents' Report? Indeed, do you think that other non-euro states have aligned interests with each other and, in particular, with the UK?

Valdis Dombrovskis: First, on the impact on the UK, stronger economic and monetary union is in the interests of both euro-area and non-euro-area member states. This is incidentally also the opinion publicly expressed by the UK Government. We understand that different member states are in different situations. As I mentioned, we have ins, outs and pre-ins, so it is important, when we undertake initiatives to strengthen economic and monetary union, that we do it in a way that is open and transparent to non-euro-area countries while preserving the integrity of the internal market. As I was outlining as a principle, initiatives related to the EU internal market should be dealt with at the level of EU 28, because it is in the interests of all member states. So far, it must be said that the UK has played a very constructive role in our discussions on deepening the EMU. There has been constructive UK support, for example, on creation of the banking union, the single supervisory mechanism and the single resolution

mechanism, and those issues were discussed and decided by all EU member states. Banking union is one of those examples where an initiative that is primarily there for the euro-area countries is open to non-euro-area countries.

On whether non-euro-area member states have some aligned interests, yes, they do, in the sense of the EU internal market preserving its integrity. But then we must recognise that member states have different traditions, histories and political systems, so there may be different positions in different situations. Also, member states have different positions vis-à-vis the euro area. We know that all new EU member states are legally bound to join the euro area. There are no deadlines or enforcement mechanisms associated with this, but still it is a treaty obligation, whereas countries like the UK or Denmark have opt-outs. Even then, the UK has a floating rate and Denmark is part of exchange rate mechanism II. It is pegging its currency to the euro. There are different situations, but one can agree that all member states are interested in financial stability and economic growth. We believe that non-euro member states are interested in a strong and stable euro, as indeed euro-area countries are interested in stable currencies in non-euro-area countries.

Q162 Lord McFall of Alcluith: Commissioner, you mentioned that the European Semester is the main instrument of economic policy. If we look at the financial crisis commencing in 2008, we see that eurozone real demand is roughly 3.5% lower than it was in the fourth quarter of 2008. How effective do you think the European Semester has been and will be in driving reform in eurozone and non-eurozone member states' macroeconomic imbalances and fiscal policies? Should the system put more pressure on creditor countries? If it should, what type of pressure should be put on them and is there a realistic means of doing so?

Valdis Dombrovskis: There are quite a few questions. First, the financial crisis indeed had a strong negative impact on Europe's economy, but this negative impact was not limited to the eurozone. Indeed, most EU countries were experiencing financial and economic difficulties.

A lot of important steps have been taken since then to strengthen economic and monetary union, and already now we have an economic and monetary union that is more resilient and able to withstand economic shocks. As I mentioned, this fiscal and macroeconomic policy co-ordination cycle, the European Semester, has been concretely introduced since the crisis, so economic and fiscal surveillance has been strengthened quite substantially. The European Stability Mechanism has been created to help euro-area member states with financial difficulties, and it has been outlined that this comes with a strict policy and reform conditionality.

The banking union has been created both to reduce the risks in the banking system and to ensure that taxpayers are not first in line to pay for banking system mistakes, and the European Central Bank is using its monetary policy tools to their full potential and is now pursuing a common monetary policy. Indeed, we have already seen this stronger, more resilient economic and monetary union during the recent Greek crisis. It was a very turbulent and eventful first half of the last year, yet we saw very little in the way of spillover effects on other euro-area member states and the stability of the euro area was not questioned. This was different from what we saw in 2010 and 2011, when we saw problems in one country triggering problems in other countries.

You mentioned some of the macroeconomic data. It is true that Europe and the euro area are still recovering from this financial and economic crisis. Our economic policy priorities, which are outlined in the annual growth survey, are exactly meant to strengthen this recovery and overcome the negative consequences of the crisis. That is why this year we basically built on the existing economic policy priorities of facilitating and promoting investment, including the Investment Plan for Europe, through having a focus on structural reforms to modernise and strengthen the competitiveness of our economies while still pursuing fiscally responsible policies. We believe that by pursuing those priorities we can strengthen the economic recovery and job creation in Europe and the euro area.

To come specifically to the question of structural reforms, this is one of the key questions. Something that is, by the way, often emphasised by the European Central Bank when discussing quantitative easing or other measures is that you cannot solve structural problems in the economy with monetary policy tools alone. It is necessary for structural reforms to be done at both EU and member-state level. In terms of strengthening the recovery at EU level, we are concentrating mainly on completing the EU internal market, especially in areas like services, energy or the digital single market. At member-state level, different member states are facing different problems, but some of the recurring issues are questions related to: well-functioning labour markets, so finding the right balance between flexibility and security, using the concept of flexicurity; the long-term sustainability of social and pension systems, given the ageing population; the functioning of goods and services markets; and, in some cases, opening up closed professions. There are different issues in different member states, and that is what we are outlining in our annual analysis in our country reports, and that is what we are pinpointing in our country-specific recommendations.

Lord McFall of Alcluith: You mentioned the country reports. You were Prime Minister of Latvia at the beginning of the financial crisis and had to face that crisis as Prime Minister. I

have to say that you did that very successfully. Were there any recommendations emanating from Brussels at that time that were any help to you?

Valdis Dombrovskis: With regard to that experience in Latvia—we are moving away from the topic of today's discussion—in 2008 Latvia was severely affected by the global financial and economic crisis. Due to a number of domestic factors before the crisis, like an overheating economy, macroeconomic imbalances and a worsening structural fiscal balance, Latvia was one of the hardest hit countries in 2008 and 2009. In 2008 Latvia had also applied for an international loan programme to the European Commission, the IMF and several bilateral lenders. The policy conditionality of this programme was outlined in the relevant documents, like the memorandum of understanding with the European Commission, letters of intent with the International Monetary Fund—and, of course, we had been in a process of intense discussions with the lenders. At the end of the day, we managed to reach an agreement and strategy that allowed Latvia to recover quite quickly. In the second half of 2010, Latvia was back to year-on-year growth, and in the following years it was one of the fastest-growing EU economies.

One of the important elements in this—here one can make some comparisons, for example, with the Greek experience—was that in Latvia we had a front-loaded programme, meaning that we had already done the bulk of the adjustment and structural reforms during the crisis, especially in 2009. Of course, it was a very difficult adjustment, but it allowed us to regain financial stability quickly, which allowed us to return quickly to economic growth.

Greece was following a different strategy; it was trying to delay that adjustment, basically using the Keynesian argument that fiscal adjustment, austerity, is bad for economic growth—which is no doubt true, but the point was that by postponing the adjustment Greece was also postponing the return to financial stability. Without financial stability, it was not able to return to economic growth. From that point of view, we saw that the result was a deeper and more protracted recession and the need for adjustment not becoming smaller but bigger. In terms of fiscal adjustment in percentages of GDP, by now Greece has now done more than Latvia did during the crisis years, but it is getting much less credit for that.

Lord Davies of Stamford: Why?

Valdis Dombrovskis: Because we saw this protracted recession, and because we saw a certain loss of confidence in the Greek economy from the creditor side and the investor side. Eventually Greece had to do more, but it is a fact that the public perception was that somehow not enough was being done. Also, we saw in 2014 that Greece was back to economic growth. It had quite good job creation. It was delivering on fiscal targets. It was tapping financial

markets. We were discussing with the Greek Government at the time how, with the help of some kind of precautionary programme, Greece would return to market financing. Political developments led it elsewhere, and while at the beginning of last year our forecast was 2.5% growth for Greece, now we know there was hardly any growth at all last year. Once again, we clearly see this link between financial stability and economic growth. Greece lost financial stability once again in the first half of 2015, to the extent that it had to close down its banks, and it had a heavy negative effect on economic growth.

Of course, it also showed the other side of the coin. If Greece keeps its programme on track and successfully concludes the first programme review, which is basically starting now, there is a good chance that the Greek economy will be able to recover quite quickly. We saw in 2014 that the fundamental preconditions for economic recovery are there. By restoring financial stability and confidence, Greece can get back to growth quite quickly, and one can expect some positive surprises on the economic growth side.

Lord Davies of Stamford: Is no bailout or debt forgiveness required, in your view?

Valdis Dombrovskis: As you know, Greece is now in its third programme. There is an agreement that is also reflected in euro group conclusions that the question of Greek debt conditionality will be addressed after successful completion of the first review. Greece's creditors and other eurozone countries are ready to address this question and look at and address debt conditionality while excluding a nominal haircut. That is the current state of play.

Q163 Lord Haskins: Commissioner, coming back to the five Presidents' letter, written by five very distinguished people, it has not been properly tested in the consultation process. Nevertheless, our impression, I think, is that it has been reasonably well received—as far as it goes. The problem is that there is no beef with this proposal up to 2017. The problems arrive thereafter. We have picked up evidence that there will be quite severe opposition particularly to structural reform in certain labour markets and, to an extent, to financial discipline. Within the Commission, being an EU institution, there are different voices coming out. How do you propose to work your way through, on the one hand, getting the Commission to speak with one voice—this is in phase 2—and then getting the Parliament to speak with one voice, and finally getting the Council to speak with one voice? Can you see your way through that?

Valdis Dombrovskis: To come back to the Five Presidents' Report, I mentioned that it has an ambitious yet realistic approach. By “realistic approach”, I mean exactly that there are different opinions among different member states and different stakeholders about what is the best way forward. Regarding stage 1 of the Five Presidents' Report, it has all in all been

received relatively well. In December the European Council tasked the Council with following up on the initiatives in the first stage of the Five Presidents' Report quickly. The Dutch presidency has quite ambitious plans for this and I hope there is going to be good progress during the Dutch presidency. That is the first stage.

On the second stage, when I mentioned the process of public consultation, this is exactly with a view to building a consensus on the way forward. Clearly, we are aware there are different views and different assessments. That is why we are having this process of public consultation. We will be engaging closely with the member states and an expert group will take an in-depth look at the proposals and the outcomes of those consultations.

But one thing seems to be emerging already: on the one hand, there is a demand for more solidarity, risk-sharing and mutualisation, while on the other there is a demand for more control and more sovereignty-sharing, if you like. If we are going to deepen economic and monetary union, those two elements, risk-sharing and sovereignty-sharing, will have to go hand in hand. The more we engage in risk-sharing, the more important it is that all member states involved in those mechanisms follow the same rules. That is why we will need to find a balanced approach between those two tendencies.

Lord Haskins: But we have been told that there is not much space, under present treaty arrangements, to carry out the next phase of structural reform. We are almost certainly going to face treaty change in phase 2, are we not?

Valdis Dombrovskis: That is certainly possible. That is also recognised in the Five Presidents' Report: that those more far-reaching proposals outlined in stage 2 may require treaty change.

Lord Haskins: Are you are confident we can win that argument?

Valdis Dombrovskis: If we look at some of the proposals in stage 2, they seem to go beyond the scope of the current treaty. In this case, the Commission has to be ready to propose relevant treaty changes and justify them.

Q164 Lord Davies of Stamford: Mr Vice-President, you have been giving us an upbeat message and things appear to be going positively in the European Semester, in Greece, and so on. What about your progress on banking union? Are you optimistic that there will be agreement on a mutualised retail deposit reinsurance system such as has been proposed, despite the very well-known opposition of a rather large and important country in the Union?

Valdis Dombrovskis: First, I have one factual comment on the European Semester and Greece. It must be noted that Greece and Cyprus are not subject to the normal governance procedures of the European Semester. Those are programme countries, which means that their governance is done through the programme documents.

Lord Davies of Stamford: I said you were bullish about the European Semester programme and about Greece, not the two together. I did not suggest that.

Valdis Dombrovskis: Okay—very good. Sorry for that. To move to the actual question on the banking union, a lot of work has been done already. The single supervisory mechanism is in place. The single resolution mechanism is in place. The single resolution fund has started to work. Agreement was reached at the end of last year for bridge financing for a single resolution fund, so we are able to move forward. But when the banking union was created, there had already been discussions on its third element, which is a European deposit insurance scheme. This is exactly what the European Commission is now putting on the table. We have filed a legislative proposal on the creation of a European deposit insurance scheme using a gradual approach and starting with a system of reinsurance. It is clear that this proposal has received a mixed welcome. Some member states very much favour this proposal and are willing to move forward; some are more hesitant or reluctant.

Lord Davies of Stamford: The Dutch presidency has taken it up, which must be encouraging.

Valdis Dombrovskis: Exactly. The Dutch presidency is taking it up, and Germany's argument is on the question of sequencing, about which I have been in extensive discussions with Finance Minister Schäuble. Before we engage in additional risk-sharing, we need measures to reduce risks. We will need to discuss the exact sequencing. In any case, we are proposing, alongside our legislative proposal on a European deposit insurance scheme, to take and assess measures to reduce risks in our banking systems. To avoid moral hazard and so on, it is important that member states implement existing agreements, meaning the bank recovery and resolution directive and the deposit guarantee schemes directive, and this is exactly a precondition that we put in our proposal: only those member states that had done their homework, so to speak, by transposing the directives and had fully funded national deposit guarantee schemes, to the extent prescribed by the directive, will be eligible for the European deposit insurance scheme. I believe there are a number of elements in our package that help to address the concerns raised by Germany and several other countries.

The Chairman: Commissioner, how are you doing for time?

Valdis Dombrovskis: Time is running out, gradually.

The Chairman: Do you have 10 minutes more, potentially?

Valdis Dombrovskis: My agenda seems to be busy.

The Chairman: We were under the understanding that you would be with us until 4.30 pm.

Valdis Dombrovskis: Our programme says 4 pm.

The Chairman: I see.

Valdis Dombrovskis: Let us stick with 4.15 pm—so we have seven minutes—and be efficient.

The Chairman: In that case, Lord Davies, do you want to pick up on fiscal union? We see that as quite important.

Q165 Lord Davies of Stamford: Yes, I would. Mr Vice-President, there are three basic views about fiscal union, as I understand it. First, there are the hardliners, the disciplinarians, who think that all that needs to be done is a very telling and tough structural reform programme, and very tough limits on fiscal deficits and sanctions and so forth, and that is the end of the story. Then there are those very generous-minded people concerned with solidarity and other concerns, who think we should have a full transfer union, rather as individual member states currently have. Those in the third category think a full transfer union is not necessary—or indeed desirable, probably—because it would create dependency syndrome. It is necessary to have the public sector contribute to the stabilisation process by developing some stabilisers to use in the case of asymmetric shocks. For that purpose, a number of ideas have been put forward, including one that we heard about this morning from Bruegel, about a reinsurance fund to reinsure national unemployment funds against cyclical unemployment increases. Another suggestion made by the Ghent Financial Law Institute is for an EU-based mini IMF working on similar conditionality principles, providing liquidity when it is required in a crisis and so forth. What do you think of those proposals? What are their merits? What are their chances of being adopted? Do you have any ideas for developing a mechanism so that there would be some public sector contribution to stabilisation in the event of asymmetric shocks?

Valdis Dombrovskis: First, on the question of fiscal union, according to the understanding outlined in the Five Presidents' Report, fiscal union will have both elements you have mentioned: a sound fiscal and macroeconomic governance framework, ensuring that member states follow the same rules, and potentially moving towards more joint decision-making at the EMU level. It would also imply a euro-area fiscal stabilisation function to help deal with large asymmetric shocks. Both elements will need to be in place.

On how exactly this fiscal stabilisation function should be made, we know that this issue is still being debated. For example, the Five Presidents' Report mentioned the European Fund for Strategic Investment as a possibility. Of course, we cannot just copy and paste the fund as it is, because its decision-making is non-political. Projects are evaluated based on their merits and so on. But the idea that you use investment as a fiscal instrument to deal with asymmetric shocks is a very valid one. An idea mentioned in the four Presidents' report was this EU-wide,

or euro-area-wide, unemployment guarantee scheme. At this stage, this proposal has not been evaluated much more deeply. Part of the broad consultation process and the work of the expert group will be to assess the most relevant methods of fiscal stabilisation.

You mentioned this European IMF. This certainly is not a scientific comparison, but we have the European Stability Mechanism exactly to assist euro-area member states in financial difficulties. From that point of view, a big step has already been taken.

Q166 The Chairman: In the concluding two minutes, I might just go to governance. Do you see the existence of the eurozone being more formally reflected in the institutions? For example, do you foresee a eurozone parliament? How do you see the interests of non-eurozone countries being protected?

Valdis Dombrovskis: With regard to the institutional settings, we see this being part of stage 2 of the Five Presidents' Report. For example, there could be more functions for the president and possibly permanent president of the euro group. Normally, from the Commission's point of view, we are not going deeply into discussing the working methods in other EU institutions, so this question should still primarily be addressed to our colleagues in the Council. Regarding the European Parliament, as President Juncker has outlined, we already have a European Parliament, and this can also act as a parliament for the eurozone, adjusting its working practices. From our side and that of the Five Presidents' Report, we do not see proposals for setting up another euro-area parliament. We think the European Parliament can play this role, addressing the concerns of euro-area countries and providing democratic oversight of the euro-area policies.

The Chairman: Commissioner, thank you so much. This concludes our meeting. You have been very generous with your time and we very much appreciate your having taken the time to discuss this very important matter with us.

Valdis Dombrovskis: My Lords, thank you very much for your visit and for your interest in those economic and monetary union developments. As I said, part of our agenda of deepening the EMU also means deeper engagement with European and national parliaments.