HOUSE OF LORDS

Revised transcript of evidence taken before

The Select Committee on the European Union

Economic and Financial Affairs and International Trade (Sub-Committee A)

Inquiry on

EURO AREA CRISIS

Evidence Session No. 2. *Heard in Public.* *Questions 18 - 29*

TUESDAY 11 OCTOBER 2011

11.55 am

Witness: Ms Sharon Bowles

Members present

Lord Harrison (Chairman)
Lord Hamilton of Epsom
Lord Haskins
Baroness Hooper
Lord Jordan
Baroness Maddock
Lord Marlesford
Lord Moser
Lord Vallance of Tummel
Lord Woolmer of Leeds

Examination of Witness

Witness: **Ms Sharon Bowles**, Member of the European Parliament (via video link)

Q18 The Chairman: I am extremely grateful to you for finding time to come and speak to the House of Lords Committee as it embarks on this very short inquiry into the euro crisis, a follow-up of our original one on economic governance. Are you able to hear me?

Sharon Bowles: I can indeed. Can you hear me?

The Chairman: Excellent, I am most grateful to you. I think you know the drill. We will be taking a transcript of this interview. We will be asking you to correct any such transcript. It is also going to be webcast, as I understand it. My colleagues are here all eager to ask questions, so perhaps I may start off. First of all, we have had the German Ambassador this morning. He answered questions on the same topic, and he responded at one point to say that the quality of the politicians we have now in Brussels ensures that the responsibilities so devolved on you have been rightly devolved on you. I thought I would pass on that piece of flattery immediately to you.

Would you care to comment on the meeting in Berlin on Sunday between Madame Merkel and President Sarkozy? What do you think might come out of that? Perhaps you would also like to expand further on what Mrs Merkel said: if the euro fails, Europe will fail. I would be most grateful if you have any thoughts with respect to Sunday's Berlin meeting. Thank you very much indeed.

Sharon Bowles: Thank you very much. With regard to Sunday's meeting, I think it is quite difficult because I was not there. I would very much like to have been a fly on the wall. I think initially perhaps there is disappointment that more was not forthcoming. I think everybody now realises they have to get a decent communication strategy together and come forward with a full package of measures to address the current situation, rather than do bits here and bits there. It is also still quite clear that there are differences between the approach that Germany wants and the approach that France wants for a variety of reasons, partly because of the Constitutional Court position in Germany, and I think France would do almost anything to try to make sure they do not lose their AAA rating. If they recapitalise the banks directly, I suppose they fear they will get a downgrade, whereas if they can do it via the EFSF or in a way that is not stigma causing, they can rescue their credit rating. Of course the German view would very much be that those countries that are in programmes by all means have resort one way or another to the rescue funds, but those that are not in programmes should themselves first expect to raise any capital from markets, and failing that from their taxpayers, before you go into using any of the mechanisms, although they can be used in a precautionary way. So that dilemma remains to be solved.

On the wider question of whether Europe will fail if the euro fails, I guess I also have fears that might be the case. If something that is potentially the biggest financial disaster they have faced cannot bring them around to get their act together and fix it, will those that were always a little half-hearted about some of the single market procedures find it within themselves to avoid the descent into populism and protectionism, which history shows us often follows on from financial crises anyway?

Q19 Lord Woolmer of Leeds: Good afternoon. There appear to be two or three urgent issues facing European leaders: dealing with the Greek crisis, dealing with the recapitalisation of banks, and ensuring that the big countries of Italy and Spain do not get into a "too big to fail" situation. What measures are your committee encouraging to address those problems? Do you believe it necessary for Greece to default in an orderly fashion? How do you think recapitalisation of banks can be resolved from a parliamentary position, recognising the difference, as you said, between the French and the German approaches?

Sharon Bowles: This is an area where in many respects we do not have any powers; all we can do is pass resolutions. In terms of dealing with the Greek crisis, from a very early stage the Parliament set up inquiries—this is going back to 2009—as soon as it was found out the figures were not quite as expected. Indeed the Parliament has had a long history of trying to make sure there is better recording. I think from then on there is a big litany of what we have asked for, which I could summarise as saying we wanted more, bigger, sooner, and a single communication—not having people contradict one another. I have not been gentle in my criticism to Ministers and to the Commission, and I have been even more robust when it has been in private.

I think now the situation is, as we have always said, that we have to shore up the banks first. We cannot have a solution if it goes as far as there being any more default or voluntary involvement of the private sector or some kind of structured procedure. We cannot have that until the banks are safe, because otherwise there will be contagion into other countries through the banking system. Indeed, of course, we will suffer greatly in the United Kingdom as well, even though we are not in the euro. The Parliament had actually wanted crisis resolution to be part of the European Stability Mechanism. We had a report saying what we expect should be in bank crisis resolution and how it should operate as well. Of course all of that has been delayed. The United Kingdom did not want things to proceed any faster than was coming out from the Financial Stability Board, whereas, I think relatively unanimously in the committee, we felt something needed to be done much sooner. It has not been; maybe now we are on the threshold of it being done. It needs to be something that is substantial. The mechanism, as I said, may vary from country to country, because some countries' banks will be able to go to the public markets and others will require intervention, so going back to the taxpayer again. Then the final category may need some precautionary intervention from the European Financial Stability Facility, which would then be allowed, or those that are in programmes sometimes already have assistance to the banks as part of their packages. It is not going to be one size fits all, but it is going to have to be comprehensive. Only then, when we have ring-fenced, if you like, the banks, can we contemplate going any further with anything to do with Greece. We need to avoid, as far as possible, something that is disorganised. But I greatly fear that everything is being left too late for that to actually be what we manage to achieve.

Q20 Lord Woolmer of Leeds: Thank you very much. You said that the recapitalisation of banks needs to be sorted out first before the resolution of the Greek situation. In practice, they have to come together, don't they? A decision has to be taken on the extent to which Greek debt has to be written down at the same time, because that is relevant to the degree of capitalisation. As you said, is it not the case that next time the Union acts it must act credibly? It would be a disaster if it got it wrong and markets simply did not believe the degree of write-down and the way in which banks were capitalised.

Sharon Bowles: Yes, I think that is correct. I just think that we are in an extremely dangerous situation and governments have not prepared the member states' electorates for what is necessary, so there is a schism between what I am sure many Ministers and leaders know is necessary at the European level and what they can actually get through their own Parliaments. Look at some of the troubles that have happened trying to get the 21 July measures through, one of the consequences of which is that the facilities available have been rendered even less flexible than they were in the first place. This is then a hindrance going forward. By not being ready, by not being prepared, we may not be able to avert a disaster unless they act more quickly. We are still in hock to elections. I am certain the fact that there is a presidential election coming along in December in France weighs as heavy as the financial crisis in some minds. The same has happened in Germany with their elections.

Q21 Lord Hamilton of Epsom: Our Chancellor of the Exchequer, George Osborne, has called for a fiscal union in the eurozone. Do you think this is ever going to happen, and in which case what form would this actually take? We have had the German Ambassador; he has ruled out any transfer union. He does not think the Germans should be involved in anything like that. He accepts that there are transfers happening already, but he does not seem to think that the eurozone going neutral is an option for the Germans. How is this all going to work out?

Sharon Bowles: I think it is going to have to be something that evolves, simply because there are these big obstacles; in the German mentality, they still care about it not being a transfer union. They have not really taken account of the fact that they have had a lot of transfer to them because of the favourable rate at which they joined the euro. They do not seem to think that they have had any part in the current circumstances, even though they were rather willing to lend to countries that then used that money to get themselves into more difficulties. It is very difficult if you start playing the blame game, because we have a lot of problems with macro-economic imbalances.

I think initially there will be progressively more convergence on taxation policies: there will be pressure for mechanisms such as the financial transaction tax as a way to earn; there will be pressure towards having the common corporate consolidated tax base. Almost everybody's favourite chestnut is going to come out. Some of these things are not going to solve the fundamental problem, so I think it is going to be long and hard. You only have to look at when we were trying to negotiate the pieces of legislation on economic governance, the so-called six pack; we had to battle on for another three months to get the French Government to agree to a change in the voting system so that it was more likely that the Council would make the decision and press the sanctions button. That is not really a very good example going forward, so unless there are some very big differences, I am not quite sure where they are going to manage to achieve enough to satisfy the desires for control that Germany would want. I think it is quite difficult.

There are ways forward with more powers for the eurozone to decide things among themselves, and that looks to me like it is going to be done on an inter-governmental basis rather than on any institutional basis. We have had a vote today; I have not yet been able to analyse it, because I have come straight here, trying to work out what it is we have just voted in the context of the European Central Bank and what the balance of the view in the committee is. I can tell you it is very tight on some of these forward-looking things where we have had tied votes. There are divisions; there will be big political divisions soon that we have to fix.

Q22 Lord Haskins: I would be interested in hearing your views on the eurobond, which seems from the outside to have something going for it in dealing with the immediate crisis, but of course the German Ambassador tells us that Germany is adamantly against going down that route at all. Where is that argument going?

Sharon Bowles: In the Parliament there is support for a eurobond that, I could say, is a future-oriented eurobond, following some of the proposals that have come out of organisations such as Bruegel and others, where there is a blue bond and a red bond. So you can pool together and have a eurobond while you are, if you like, in the good part of the Stability and Growth Pact and while your debts are under control. Then you get expelled and have to raise your own debt again if you exceed the thresholds of the Stability and Growth Pact. Again, that is a very good mechanism for when we reach sunny times again, but of course it is no use in helping us out of the present hole.

We have a kind of eurobond, I suppose, in the EFSF in one sense. If we are going to have anything that is of the now I guess it is going to be through a mechanism of that kind. We are expecting from the Commission a set of proposals on various alternative eurobond mechanisms, some of which require treaty change and some of which do not. This working document should be produced sometime soon, but I believe even that does not see eurobonds as something that is there and of the now; it is at best a medium-term solution. We are still stuck with the problem of recapitalising the banks and somehow stopping the contagion. It is a great shame that we cannot use the depth and the liquidity that there would be in a eurobond market for generalised cheaper borrowing, but if there were a common eurobond interest rate at the moment, would it be compared to the Bund or would it be higher? Unless it is the same I cannot see Germany wanting to go into it.

Q23 Lord Haskins: How do you deal with Greece paying 14%, Portugal 9%, Ireland 7% and the rest of us 2% or 3%? That is the real problem.

Sharon Bowles: That is the real problem because we did not have enough bond spreads earlier on. That is the problem we are still trying to solve. Obviously the idea is to have what is essentially a kind of limited eurobond in the European Financial Stability Facility that enables borrowing for the countries that are in programmes at a lower rate. But of course the facility is not large enough if you have to start encompassing some of the larger member states. Maybe it is large enough if you can get more bang for your buck out of it in other ways and use it as a partial precautionary measure. I am sure these things will be looked at. There may well be other measures that in extremis might be taken if an emergency is declared. Then of course the ECB might be able to do more. We have a problem if the ECB is not seen to be standing behind many of these things because it is not a fully fledged European Central Bank in the same way as in a country that is on its own.

Q24 Baroness Hooper: As between EU member countries and eurozone countries, do you see a danger that the current euro debt crisis will create a division, or perhaps I should say further division, between these two groups? What role would you and perhaps the European Parliament in general expect the United Kingdom to play in the euro area debt crisis?

Sharon Bowles: We have to hope that solutions are found and that we move forward where there is more eurozone governance and more fiscal unity, even if it is not initially a fully completed process. By definition, that means that the eurozone is going to be having even more discussions among itself over its budget and so forth. Therefore, there will be a bigger divide, I suppose, between those that are on the outside and those that are on the inside of those discussions. The Parliament has so far been pretty vehement about saying that as far as possible we want everything to be done through the Community method and through the 27 wherever feasible. The economic governance package in the legislation that we have just passed does do that. There are some places where you have to distinguish, and I suppose the treaty that set up the European Stability Mechanism also says that the single market has to be respected and adhered to. Even if they invent something for the eurozone, they cannot dispense with other aspects of the treaty. I think we also have a precedent in the six pack in terms of budgetary co-ordination and looking at spillovers, which means surely one must therefore consider what is the spillover from the eurozone into the non-eurozone. So we need to look for mechanisms for that.

As far as the UK is concerned, I wish that we had engaged more publicly. I do not know necessarily what went on behind the scenes, but I wish we had engaged more publicly before July instead of being on the ringside, because it was quite obvious that our banking structures and everything else would be at threat with a problem of Lehman proportions. Once the Chancellor did intervene, as far as the Parliament is concerned I have only heard positive remarks. Indeed, many people came up to me and said they were glad he had intervened, they wished he had done so earlier and they hoped he would continue to do so. The messages at different levels may have been different, but within the Parliament nobody has raised any criticism whatsoever. It is clear we have more market expertise in the United Kingdom, and I would like to see that being brought to bear with ideas.

It is quite difficult; I think we made some mistakes when the second Greek bail-out package was done. That was relatively hot on the heels of the package agreed for Portugal, which tapped into the budget mechanism, the European Financial Stability Mechanism. There was a lot of comment in the UK press about why we were contributing other than via the IMF, and of course we do have quite a lot of interest in Portugal. Partly as a consequence of that public outcry, with the second Greek bail-out we did not allow even a notional tapping of that budget fund. From the goodwill stakes, that was probably not what I would have chosen to do because it made us look more on the outside rather than on the inside trying to help. I think it would have brought goodwill and perhaps a bit more of a seat around the table if we had not forbade that, even for just a nominal amount.

Going forward we have to take very seriously that we are greatly affected by this crisis, and if we are doing a cost-benefit analysis of it, then surely we must take that into account in some way rather than pandering to a more simplistic approach of, "Well, it is nothing to do with us."

Q25 Baroness Maddock: You touched on fiscal integration in some of your comments earlier. I wonder if you could tell us what you think would be the implications for the United Kingdom if we have the eurozone moving much more towards fiscal integration.

Sharon Bowles: I am not sure that there is necessarily any direct effect. There might be a bit of a coercive effect that it might appear to be simpler to do similar kinds of things. The fear is more that, when they are in the room discussing how the eurozone wants to go forward, they might extend into areas that are beyond the fiscal. It is sometimes difficult to say where the dividing line is between what is fiscal and what is the rest. There would be probably some undermining of the voice and status of the United Kingdom unless the right kinds of safeguards are put in place for those countries that are not in the eurozone. If you are in a country that is obliged to join the eurozone, in a sense it is all the more remarkable, because they are going to have to take on board what are substantial changes that were not in the treaty when they signed up to it, but they are still going to be obliged to join the euro. So in a sense they are in an even more difficult position in some respects, and even more deserving of having a place at the table. This is something that is certainly going to be occupying my mind and that of many colleagues as to how we find the right balance there.

If I go back a little bit to the eurobond discussion, ultimately if there is some kind of eurobond then, with a very deep and liquid market, what would be the implications of that for gilts, in that it would be bigger and deeper than our market in gilts? This is very much long-term future; that might be something we will want to look at in terms of our future direction when we return to a stable state.

Q26 Lord Vallance of Tummel: I think you have answered most of my questions on the EFSF already—about the size of it and whether it should be leveraged or not—but one remaining question is what mechanism of scrutiny exists for the European Parliament to control the operations of the EFSF and does it impede swift action in a crisis?

Sharon Bowles: We do not have any mechanisms of scrutiny because it is essentially an off-treaty inter-governmental vehicle, so it is nothing to do with us. We have had before the committee the Chief Executive Officer, who has explained things to us, but we only have a goodwill basis on which we can ask them to come to a hearing and talk to us about it. We do not slow it down at all, but of course member states can slow it down. In passing the 21 July mechanisms through the Bundestag, there has been more shackling of the EFSF put in place. It is now less flexible than it was, and when we are going into this near-emergency/emergency situation it is far from helpful that we have many national Parliaments to deal with.

Q27 Lord Vallance of Tummel: Beyond all this fog, and there is a fog of complication here, there is a very simple dilemma: something has to give. Either there is some form of fiscal union with the potential for substantial transfers of funds between nation states or there will be sovereign debt defaults and at least a temporary exit of some countries from the eurozone. That risks contagion and can only be managed properly in a predetermined manner. I think what we have learnt this morning from the German Ambassador is that the chances of some form of fiscal union in the medium term and short term are zero. Therefore, if I am right, the dilemma is how you handle potential sovereign debt default. You have to get your minds around doing this in a predetermined fashion rather than having this come upon you in an uncontrolled way. Have I got it wrong?

Sharon Bowles: I think that is a reasonably accurate description, and therefore to manage whatever is a default event, we have to make sure the banks are in as robust a situation as possible to contain it. We are not going to avoid contagion, but we can stop it spreading in an uncontrolled way, which is why the crisis resolution in banks is a paramount factor. Unless we have that, we will have a disorganised default; there will be no hope of an organised default.

Q28 Lord Marlesford: Would you tell us how close an eye your committee keeps on the ECB? I am thinking particularly of its own solvency. We all know that in theory a central bank cannot become insolvent because it can just print money, but that is not something that the Germans, for example, would welcome with their history. The ECB has been buying the bonds of these troubled countries and has basically been paying for assets, and as soon as it has bought them on a mark-to-market basis they are worth a great deal less than it has paid. How much longer can it go on doing this or is it really a chimera—this view that the ECB can be this sort of *de facto* rescue mechanism? Do you keep an eye on it? Do you question the ECB about its real assets versus its theoretical liabilities?

Sharon Bowles: We do. We have a regular quarterly monetary dialogue, as it is called, with the President of the ECB. In fact the last one for Jean-Claude Trichet was last week—that is the last of 35. He also comes to the committee on other occasions when we ask him to. These are the kinds of questions we do ask. A lot of this information is published in an anonymised form. He will not tell us how many Italian bonds he has bought versus Spanish versus others, but we can get sort of collective numbers. As I said, these are published and the markets watch them quite a lot. I find myself in quite a difficult position here because I cannot see any solution that does not require the ECB being there at least in some form as an éminence grise, and if we probe too much we lose even that.

There are some things the ECB could do that it might never even contemplate doing. It could buy all the Greek debt and say, "You pay us 1% a year for the next 30 years," and technically that is not a loss on their books. Actually, if it is only €300 billion it is looking like a bit of a bargain, had they thought of doing that a little while ago. I am not saying that they would ever get agreement to do such activities, but there are activities that they might be able to do if an emergency situation were declared that they would not do in other circumstances. Only today we have had Trichet in committee, this time in his role as the Chair of the European Systemic Risk Board, and he has been explaining that he would like there to be maximum flexibility and maximisation of the EFSF, but they do not see that as something the ECB is going to be standing behind. My personal view is that ultimately it is the only institution that has the ability to act as fast as the markets; the other mechanisms do not. It has been the ECB that has been much more market-savvy and has had much more foresight. It has been pestering for a long time for the recapitalisation of banks and such measures, but we are all wise in hindsight and we can all point to the things we have been going on about for years. But I think they have already saved the euro, and I think they will have to play a bigger part if we are to get out of the situation, though quite what it is I do not know. Printing money is not necessarily the long-term solution, because underlying all of this we have overvalued asset problems and various other things that result from the fact that the Western world has been growing and living on debt in an unsustainable way. We have some even more fundamentals issues than just looking at countries that you might say have been overly profligate.

The Chairman: We have a last question from Lord Jordan. You have kindly consented to answer one on the financial transaction tax.

Q29 Lord Jordan: Is the proposal for the financial transaction tax popular in the European Parliament? What would be its main advantage and/or disadvantage and what, principally, should the revenues of a financial transaction tax be used to finance?

Sharon Bowles: This has been an ongoing story for more than two years now. It started off more like the Tobin tax idea—that one would do worthy works in developing countries. It has moved on to doing things to do with renewable energy. The Parliament was initially marginally against it, and it has now moved over to being I would say more than marginally in favour of it. The thing that provided the switch was anger at banks and wanting to get more money out of banks, and the fact that it could be used as a way to help pay down sovereign debt. It certainly is seen as a bit of a salvation at ministerial level by many member states—as something that they need.

The proposal that has come out does not indicate what the division should be. It says that some of the money would go to member states and some of it would go to the EU own resources, but as yet, because I think it was brought out in a hurry to try to get some maybe even calming of the markets, a lot of details remain to be ironed out. I think it is quite a difficult proposal, because some Members of the Parliament might even be a little bit disappointed in that it is done rather like a VAT so it is the end user that will be picking up the tab. I would be quite worried that there would be an impact on insurance companies and pensions and others. A few basis points when you are in more or less a zero-interest-rate environment is not an insignificant amount to take out of pension funds.

One thing that is interesting, and I did ask this of Commissioner Šemeta in a meeting we had with him, is whether it will follow the norms of port taxes and others in that the collecting country gets to keep 25% to 30% as an administrative fee, because it did occur to me that, if we were collecting a lot of this in London—were it to happen—we would possibly be in for a nice tidy sum from that administration fee.

Although the European Parliament has said that Europe should go it alone if need be, there is still very much a preference that it should be international. It was felt that if we led internationally, then maybe others would follow where we would go; that maybe the anti-Wall Street demonstrations that there are at the moment might get a body of opinion behind them in the United States, though they would prefer some kind of balance sheet levy to a transaction tax. Though we are not without friends there, Barney Frank I believe would contemplate that, though he is no longer chair of the committee in the House.

There are some interesting ideas in it and certainly it is also intended partly to kill off or slow down certain types of trading that it thinks do no social good. We will have more or less simultaneously of course reports into these algorithmic and high-frequency trading matters coming from the European Securities and Markets Authority. We will get a fuller picture in a few months, but from the discussions I witnessed at the informal ECOFIN when Tim Geithner was there, which I was part of, the importance of the financial transaction tax as a mechanism for paying down debt weighs heavily on the minds of many Finance Ministers in the eurozone.

The Chairman: Sharon Bowles, we are most grateful for your time. If you have any further reflections on some of the earlier answers, especially on the European Central Bank, we would be most grateful if you would write to us. Or indeed if ever you are in London we would as a Committee love to meet you and talk about the whole range of issues that are coincident to your work and to our work. In the meantime, we are most grateful for the intrusion into your lunchtime. We hope, as I say, to see you in London in the not-too-distant future. Many thanks for coming this morning; it was really a very helpful and useful session. Thank you very much indeed.

Sharon Bowles: Thank you and I will do what I can when I can. As I am sure you know, I have something like the equivalent of 45 Bills on my plate, so time is a scarce factor.

The Chairman: Many thanks. Goodbye.