Treasury Committee

Oral evidence: Follow up to the Committee's Report on The economic and financial costs and benefits of UK membership of the EU, HC 483

Tuesday 28 June 2016

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Watch the meeting

Members present: Andrew Tyrie (Chair); Mark Garnier, Helen Goodman, Stephen Hammond, George Kerevan, John Mann, Mr Jacob Rees-Mogg, Rachel Reeves, Wes Streeting.

Questions 2064 -2129

Examination of Witnesses

Witnesses: **Lord Turnbull**, former Permanent Secretary, HM Treasury, and former Cabinet Secretary, **Professor David Miles**, Imperial College London, and former member of the Monetary Policy Committee, and **Stephen King**, Senior Economic Adviser, HSBC, gave evidence.

Q2064 **Chair:** First of all, can I thank staff for having produced an outstanding brief at extremely short notice. Can I secondly, even more importantly, thank the three witnesses, who have also come in to see us at extremely short notice. They are all very familiar to the Committee and to parliamentary life, and we are extremely lucky to have such valuable people coming before us.

I was going to start with Andrew Turnbull, who has already made a bid for the door. He has stopped at the door. He has been stopped by the policeman, for those who cannot see the camera, and he is now returning with an iPad.

Lord Turnbull: I missed a question, sorry.

Chair: There has not been a question yet, because I have stalled for time. We have the Prime Minister gone; the Leader of the Opposition looks a bit awkwardly placed. We are out of the EU and we are out of the Euros. Am I not right in thinking you were a classy footballer, at one time, and used to be an enforcer for the team? You were a sort of centre-half who knew how to kick centre-forwards. Is that true?

Lord Turnbull: That does not fit the epithet ‘classy’. I was more a Ron Harris.

Q2065 **Chair:** You were also a UK Sherpa for a while. For those listening, that is the person who would go to negotiate at very senior staff level, official level, prior to prime ministerial summits and heads of state summits. You have also been head of the Treasury and, for a long time, you headed up the Cabinet Office, where you were responsible for overseeing major structural reform of Whitehall under the last Labour Government. It seems to me that you are very well placed to answer the first core question, which is: do we have the Whitehall expertise to fight our corner properly in what will undoubtedly be robust negotiations?

Lord Turnbull: First, I would define Whitehall as meaning both ministerial and official. The first thing is that the politics, as you hinted, are completely broken. The Conservatives are fractured down the middle vertically. Labour is fractured horizontally, between its leadership and its people. Urgent work is needed to correct that. There is a process, at least on the Conservative side, but we are told it will not come to a head until 2 September. Until that point, you can do a lot of preparation and analysis but you cannot have any decisions.

The Cabinet Office has already started by setting up a unit. We talk about bringing together the brightest and the best, but it would have to be a pretty high-powered group to start scoping what it is that needs to be addressed and, secondly, a process by which it is addressed. For the moment, it is under the supervision of the Chancellor of the Duchy of Lancaster, Oliver Letwin, who in my view is completely unsuitable to do that job in the longer term. He has spent the last six years as a kind of consigliere to the Prime Minister; he has been absolutely at the heart of Number 10. That is not the profile that is needed for carrying this work forward.

You can go back to 1973; how did we negotiate entry? The answer is there was a unit, I think located at the Cabinet Office, led by Geoffrey Rippon, known as a senior Minister who was committed to the cause that was being negotiated. One of the first postings that the new Prime Minister will have to arrange is who that person is going to be. In other words, they have started building an apparatus and I think it is located in the right place. I do not think it should be a separate Department; in the Cabinet Office is probably the right place for it, with a Minister who does not have any other ministerial responsibilities. In that sense, we are on the right lines.

The next thing that needs to be settled is that people need to understand what the sequencing of all of this is, the famous Article 50 and when we trigger it. The answer is that the Lisbon Treaty leaves that decision to us and, for the moment, that gives us an advantage. The minute we trigger it, we yield the advantage to them. If you trigger it too early, it is a bit like ordering a taxi half an hour before you need it and you end up paying for it. In other words, all that prep time that we need should all be done before the clock starts ticking because, otherwise, you are using up those two years on stuff that could have been done before you triggered it. I assume that is the plan. Now, this could be quite a long process. It is going to be months perhaps.

Q2066 **Chair:** How long do you think that prep time needs to be, at a minimum, given your knowledge of Whitehall?

Lord Turnbull: I would guess it is not going to be in 2016.

Q2067 **Chair:** You are thinking that, at the very least, this will be at the beginning of 2017, but you are thinking this could be done in the four or five months of the latter part of this year, once a new Prime Minister is in place.

Lord Turnbull: Our preparation of what model we want to seek on trade and the mandate of the 25 different chapters all has to be done before we trigger this. There are also elections in Germany and France next year. We do not want to trigger Article 50 and then find that Mrs Merkel does not want to talk to us, because she has bigger fish to fry at home. That is a tricky thing. There are people saying, "Get on with it" and there is a lot of uncertainty, but getting it right, in my view, is more important than rushing this. There is going to be uncertainty anyway all the way through this negotiating process, so we should not make a move on tabling our application until we are absolutely ready to do so.

Q2068 **Chair:** If you are saying that we should not be trying to run the Article 50 process with our counterparties while they have elections—I am trying to draw out what you are really saying—you are really suggesting, by implication, that we should not trigger Article 50 until after their elections, which is a long time hence.

Lord Turnbull: That is a judgment that we will need to make.

Chair: I am asking you to offer advice on that judgment.

Lord Turnbull: We could probably make a start on this because, at that stage, they will appoint what some would call a committee of experts—they may even have in mind who they are going to be—who are going to be interlocutors. It will not, at that stage, require the detailed attention of European leaders. That comes later on, when you are trying to produce a final settlement. I think the election may not be the reason for delays. Therefore, the spring would be my guess, but it is only a guess. That is the first job that this group set up in the Cabinet Office has to develop.

Q2069 **Chair:** You are suggesting, as a best guess, that we should probably go for triggering Article 50 in the spring, not in January, but in March or April time.

Lord Turnbull: There is a lot of work to get through before 2 September: a new Cabinet, a new Front Bench and new people. They have to get themselves into their jobs and then get down to the details, particularly of trading arrangements and issues like passporting, issues of what we are going to offer on movement of people and Philip Hammond's juxtaposition that, if you want full single market access, you have to have the full monty on the movement of people. We seem to be saying that we want a trade-off between the two. We are not going to get all we want on one and not make a concession on the other. Where can we find the optimal balance between these two objectives? That requires a long analysis and then a lot of negotiation.

Q2070 **Chair:** David Miles, what are the key components of what we need to try to safeguard and what opportunities might be out there?

Professor Miles: I will be very brief. The first thing I would like to say is that a lot of the economic analysis that has been done so far of the implications of a leave has underplayed the huge amount of uncertainty about the impact. There has been much too much confident assertion about what would happen if there was a leave. The reason is that the long-run impact depends crucially on what being outside does to labour productivity. Much of the analysis is based on relationships between foreign direct investment and productivity, and the amount of trade the UK does in productivity, and those relationships are not in any way robust statistically.

The first thing I would say is that the long-run implications of being outside, even if you knew what the trade arrangements would be, are extremely uncertain. I do think that it is likely that access to the single market would be beneficial, all else equal. The question is at what price—price in terms of a budget contribution, price in terms of having to accept some version of free movement. It seems to me that the UK Government, at some point, are going to need to work out what price is acceptable to them and then see what price is acceptable to the other members of the European Union and see if a deal can be done.

In terms of short-term things, there are some bits of relatively good news in this difficult situation. One bit of good news is that I do think the UK banks are in a relatively strong position. They have far more capital than was in place in 2008.

Chair: We are going to come on to that in a moment.

Professor Miles: Another bit of moderately good news is that, even though we have seen a fairly significant change in the exchange rate, we start from the position of inflation very low. With inflation at 0.5%, even the kinds of orders of magnitude of exchange rate change we have seen do not look likely to take inflation significantly above the target level over the next few years. It is good to start from that position as well.

There is obviously a difficulty on the fiscal side. It seems very likely that there will be at least a short-term hit to spending. It is likely that GDP growth will be slower than it otherwise would. Whether or not there is technically a recession is not a particularly interesting question, if you define a recession as two quarters when GDP may fall a little bit. Whether or not that happens seems to me, in itself, not a terribly significant issue.

The bigger issue is what happens to government revenue and spending. The situation will be clearly worse than in most people's forecasts made a few months ago. My own view would be that it is important, in that context, that the Government give themselves some flexibility in adjusting to that. Pretty clearly, they will need to change the aim of trying to close the deficit over the next three or four years to give themselves more flexibility to allow fiscal stabilisers to work.

Q2071 **Chair:** Linking these two points that have been made—Lord Turnbull arguing that we should delay Article 50 and the short-term market volatility—does stabilisation of the markets point also to delay of Article 50 or have no bearing on it?

Professor Miles: My personal view is that delaying Article 50 is a sensible strategy. Until you know what you want out of the negotiations, to start the clock ticking seems to me a bizarre strategy.

Chair: You may not know, but this Committee made the recommendation and indeed pressed from an early stage for delay of Article 50, in the teeth of a good deal of opposition from the Government at the time.

Professor Miles: It seems to me very sensible to delay.

Q2072 **Chair:** At the time, they were arguing vigorously that it should be pressed immediately. Stephen King, how much of this market volatility that we have is fundamentally an attempt to reprice risk and how much of is just repricing the inevitable volatility you will have as a consequence of the increased uncertainty? In other words, how much is it based on fundamentals, as opposed to something that markets will finally absorb?

Stephen King: At this stage, it is impossible to answer that question. We have only had two or three days of trading since the event. What I think I can reasonably say is that my currency strategists working alongside me at HSBC have come up with two views of what would happen to sterling, in the event of the UK staying in or going for the Brexit vote. The view of sterling if the UK had stayed in was that perhaps it would rise to 1.50 or 1.60 against the dollar. The view if we had a Brexit was that it might go down to 1.20 or so by the end of this year. You could reasonably say that what we have seen so far is consistent at least with those earlier projections, which were made before any of this volatility first came through.

Secondly, when you look at the UK economy, there is one particular imbalance that people do not tend to talk about quite as much these days, but it matters with regard to the potential departure from the EU. That imbalance is the size of the UK balance of payments current account deficit.

Chair: We will also come on to that in a moment.

Stephen King: The important thing here goes back to David's comment about currency movements and other adjustments. I may be that, if sterling falls, there is no significant impact on inflation, but then the question is: what is the mechanism that comes through from the fall in sterling in changing the path of the UK economy? Exactly how does a fall in sterling work?

One positive view is that we could say it works by making our exports more competitive. Therefore, we have an export pick-up and the current account deficit shrinks for that particular reason. Another more negative view, which in one sense is what we saw from 2008 onwards when sterling fell during the global financial crisis, is that, specifically by raising headline inflation relative to wages, you end up with a very significant squeeze in real take-home pay. The consequence is that you end up with a big loss of consumption. Rather than seeing stronger exports, you end up with significantly weaker imports.

Q2073 **Chair:** Are we going to get hit by attempts to force relocation of parts of financial service businesses into the euro area almost immediately or can they be resisted? I am thinking for example about the ECJ judgment that, at present or at least while we are still in the EU, should continue to protect us from any attempt by the euro area to force relocation of counterparty trading and euro-denominated instruments.

Stephen King: First of all, I have to tread quite carefully here, only because of the kinds of view that were taken when the euro was created and people warned about the possibility of London losing its strength as a global financial centre. Actually, it got stronger rather than weaker in the years that subsequently followed.

It is worth stressing that passporting arrangements in Europe are very important in attracting banks and other financial institutions to the City. Just to give you some numbers on this, comparing the UK with Germany, for example, the number of non-EU banks operating in 2014 in the UK was 175. In Germany, it was 35. That is a ratio of 5:1. In terms of total assets, in the UK it was €2.8 trillion of assets. In Germany, it was €119 billion of assets, which is a ratio of 25:1.

If I were a regulator or politician in the EU thinking about how I could adjust things to make the EU more attractive and the UK a little less attractive, I would look at those kinds of numbers and think whether there were ways to encourage more of that business to come into the EU and away from a UK that had exited from it. The big question there is: what is the single market access that we would have if we left the EU? How would that work in terms of financial services?

Chair: We are going to come on to that in more detail, in a moment. In fact, we are going to go first to part of what you were first touching on.

Q2074 **Rachel Reeves:** Following up on some of those things that you were talking about, Mr King, about sterling and the current account, I will start with Andrew Turnbull. The pound is obviously at its lowest level against the dollar for over 30 years. What would you see as the main risks of that depreciation of the currency?

Lord Turnbull: You have to distinguish between level and fall. I do not think that that level is at all worrying; if anything, the evidence seems to be that we would have had a lower exchange rate in the future, partly because we have had a kind of lead sector Dutch disease, first of all by oil and gas, secondly by financial services, both of which will be less powerful. That has caused a change to the balance of activity in the economy. A lot of people subscribe to the view that a rebalancing is required and that a lower exchange rate has to be part of that.

If that takes place gradually over time, it will not be a problem. Indeed, it is probably a move towards where the economy needs to be, in particular correcting the current account balance so UK assets become more attractive again. The level is not what I worry about; it is if you then get very sharp falls and they begin to feed on themselves. I do not think there is really a great deal that the authorities can do in terms of an intervention. People have fallen out of love with that as a policy tool. You have to hang on to the fundamentals and wait until the market stabilises itself.

Professor Miles: We have had a pretty big current account deficit for the last few years, about 5% of GDP, but more recently slightly larger than that. If anything, a decline in the value of sterling was probably what was needed to put the economy on a more sustainable path. I think sterling is probably down about 10%, but trade-weighted sterling is down a bit less, maybe 8% or 9%, relative to Thursday at the close of polls. Of course, it is actually down a bit less than that relative to where it was a few weeks earlier, so the reaction has actually been relatively limited so far.

I rather agree with Lord Turnbull that I cannot see any reason for looking at the level at the moment and saying, "Gosh, that is a problem. The Bank of England or the Treasury should try to do something about that". It would be a different story if sterling continued to decline 2% or 3% every day for a protracted period of time. That has not happened yet. Who knows quite where we will go next but, in terms of the level at the moment, I do not think there is any reason to think that it is inappropriate.

Q2075 **Rachel Reeves:** Do you think, Professor Miles, that it will continue or that it will find its floor quite soon?

Professor Miles: It is extremely hard to say. People are trying to work out what a sustainable level might be. It is very difficult to know that in the absence of knowing what trade relations the UK will have with the rest of the world. I suspect that it will bounce around a fair amount. I do not think anybody really has a good idea what the right level is for sterling at the moment.

Q2076 **Rachel Reeves:** As Mr King began to do, I am looking at some of the impacts on the real economy of a fall in sterling. Mr King gave two scenarios: the export pick-up one, but then also the reduction in imports scenario. How confident would you be, Professor Miles, about the potential fall in sterling to lead to an increase in exports? Are you more worried about the other scenario that Mr King set out, with a reduction in imports because of the fall in real incomes?

Professor Miles: Part of a reduction in sterling might be needed to offset the fact that the UK could face somewhat higher tariff and non-tariff barriers against other people. It may be that you need a significant fall in sterling merely to keep the volume of your exports up, rather than to boost your exports, because it has to offset some headwinds on trade from potential tariff and non-tariff barriers. I am not terribly optimistic that, if sterling now stays at the current level, we should expect a marked increase in exports from the UK and a significant reduction in the current account deficit. It may be that what we have seen so far is about enough to stop exports from actually falling.

Q2077 **Rachel Reeves:** What about the import side and the real incomes effect?

Professor Miles: That is clearly a factor, because trade-weighted sterling is down 6% or 7% right now, as I say. It is unlikely that that would be offset by lower prices charged in other currencies, so it is a straightforward increase in the cost of importing things. We will continue to import most of the things we import, so it is a reduction in the real disposable income of households. It is not a huge reduction, if the type of change we are talking about is what we have seen so far, 6% or 7%. Given the proportion of imports into the UK, that is not a devastating change in the real income of households.

Q2078 **Rachel Reeves:** I have one other question to you, Professor Miles, around the other side of the current account deficit, which is the capital account surplus. How worried are you about what happens to capital inflows, now that this decision has been made?

Professor Miles: I suspect that, in the short run, there are not many people falling over themselves to invest in the UK, with the lack of clarity over what the trading relations will be. My guess is that foreign direct investment will be pretty weak for the next few quarters. That makes the funding of the current account more problematic, other things being equal. Of course, it is part of the reason why the exchange rate might have fallen. It could be that the exchange rate has a bit further to fall yet to generate an equilibrium in the foreign exchange market.

Q2079 **Rachel Reeves:** Mr King, you spoke earlier about scenarios for the current account. Do you have concerns around capital inflows in the forthcoming period?

Stephen King: Very simply, yes. We have a current account deficit that is currently 7% of GDP. It has increased a long way over the last few years. You may recall, back in 2008 when sterling fell, that the whole idea was to rebalance the UK economy to have export-led growth and presumably have a smaller current account deficit. We have exactly the opposite. It is difficult to be precise as to how much of that current account deficit is financed through foreign direct investment specifically to be part of the European single market, but it is a reasonable assumption to make that at least part of it is for precisely those reasons.

To go back to what Professor Miles was saying, lots of companies will not be falling over themselves to be investing in the UK over the next few months and quarters given the uncertainty that currently exists. It is reasonable to therefore assume that we cannot live with a current account deficit that is as big as it is currently. If it has to shrink, then obviously it can shrink through the export-led channel. It would be lovely to believe that that is going to be happening, but it seems rather implausible currently, so you come back to the idea that it shrinks through some kind of an adjustment in domestic living standards. This is when you get into the whole risk of recession, stagnation and income squeezes of one sort or another. It matters for the simple reason that, as Mark Carney put it, we have been dependent on "the kindness of strangers", and I think their kindness will now be in relatively short supply.

Rachel Reeves: Thank you very much, I suppose.

Stephen King: I am trying to be cheerful.

Chair: Have you something to cheer us up with?

Rachel Reeves: Labour MPs especially need a bit of cheer at the moment, so I really appreciate that.

Chair: We all do; in one way or another, we all do. We want cheering up.

Stephen King: I was hoping that England would pull off a famous victory last night, but they pulled off a famous defeat instead.

Q2080 **Rachel Reeves:** They let us down too. Lord Turnbull, can you do anything to brighten the mood?

Lord Turnbull: If we look at the people who have the surpluses, China still has a large surplus and has to invest these things somewhere. At some point, they will come back into the market and they will still be wanting to acquire assets, both from sovereign wealth and also wealthy individuals who, if they fall out of favour with the regime, will still want to acquire property in particular. I suspect the fall in property has probably been a bit overdone and there will come a point where this will stabilise.

Our biggest danger is not something that will happen quickly. It is where a decision has to be made to locate a piece of economic activity. Let us call it the Qashqai car, which is very, very successful and partly owned by France. They will go on producing that until that model needs to be replaced and then there will be a big competition as to where the next one is. It might be five years down the line. Our chances of winning that will be diminished and that will repeat itself. Where do the various Airbus projects, particularly the civil ones, get located? Where do people make railway vehicles or whatever? Gradually, those decisions will tend to run against us unless we can produce the sense that this is a more dynamic economy than in Europe.

Chair: We collected a good deal of evidence about those risks prior to the 23rd, not least in response to some questions from Helen Goodman. We have got that point on board.

Q2081 **Mark Garnier:** Stephen King, if I come back to you on the financial services side of things, you started to come out with some quite interesting statistics. I wanted to really get a sense from you of what you see the future of the City of London as a global financial hub is likely to be. By all means, if either of the other two witnesses want to step in, please do. You talked about the fact that the City of London is very important and has a huge amount of stuff going for it. I was making a quick list of why people come to the UK. We have a strong rule of law. We have the infrastructure to support financial services, including lawyers and accountants. We speak English. We have a 300 or 400-year body of expertise, which is incredibly important. We have the time zone. Also, certainly when I go to places like China, the Far East or America, access to the single market or an entry point to the single market also seems to be quite important.

My first question really is: to what extent do you think that access to the single market of Europe is important? Is it important enough for international financial services firms to try to find a new entry point to the single market outside the UK?

Stephen King: First of all, it is hugely important that financial institutions around the world come to London in part because they expect to have and do have access to the single market. It is also worth stressing of course, as you have rightly said in your comments, that the City of London was a centre of financial services long before the EU was ever created, so there is something else that explains why a global financial centre succeeds. Hong Kong is a global financial centre; Singapore is a global financial centre. They are not in the EU.

Mark Garnier: Yes, but Singapore is in ASEAN.

Stephen King: ASEAN is not quite the same as the EU, to be fair, but my point is that you can succeed outside of a particular arrangement. The question, though, is: to what extent have there been additional resources coming into the City of London, over the last few years, as a consequence of the single market, as a consequence of the passporting facilities and so on? You cannot be 100% sure as to how much has come through but, overall, it has been a significant positive for the City of London. In the event that the UK no longer was attached to the single market, then it is quite possible that people would move, that assets would move, that liquidity would move to other parts of Europe.

Now, there is still an issue about whether people are willing to live, say, in Frankfurt or in Paris. The very fact that we have a huge French community in South Kensington, many of whom work in the City, tells you quite a lot about the attractions of London versus Paris. It is important to recognise that people vote with their feet for a whole bunch of different reasons rather than specifically access to the single market. Nevertheless, from the point of view of an EU without the UK, politicians, regulators, policymakers in the EU, outside the UK, would look at the City of London and think this is easy pickings, in terms of changing the competitive environment to benefit themselves at the City of London's expense.

Q2082 **Mark Garnier:** The point that Lord Turnbull made a little bit earlier was about attrition. We are not going to suddenly see Honda pick themselves up from Swindon and go to Germany, let us say. What we will happen is that, as their current models run out, they will look elsewhere. If we do start seeing a move and actually access to the single market is more important than some of the other stuff we have in London, do you anticipate that you will start to see Goldman Sachs picking themselves up and moving to wherever—we do not know where, and we will come on to that particular point as well, a bit later—or do you think we will start to see a bit of attrition, as it has already been suggested we have done? If an international bank wants to expand in Europe, it expands possibly in Frankfurt or possibly in Luxembourg. Will it be death by a thousand cuts over a number of decades?

Stephen King: Again, this is very uncertain, but I suspect that it is more likely to be the latter than the former. Rather than seeing a revolution, there will be an evolution or a gradual change. Another example to use is not the European example. If you take the shift from the City of London to Canary Wharf, look at Canary Wharf now. It is an enormous thing; it is very successful, but the actual process of movement was extremely slow, in getting the infrastructure in place, getting the skills in place and getting the logistics in place. All those things took a long time to feed through, but it did happen.

Mark Garnier: The developer went bust to start off with.

Stephen King: Indeed, but it shows that things can move. Of course, in that particular case, the regulatory environment had not changed at all. It was merely a case that the location had changed. I suspect that, over a longer period of time, if there was a sense that there was a growing competitive advantage in a non-UK EU, then of course there would be a gradual shift of people and business to the non-UK EU.

Q2083 **Mark Garnier:** Do we not face a really interesting problem with the EU? One of the things that we have known is that the single market in goods has been pretty well established and that is working very well, but the single market in services is very shallow. There is no real depth to it whatsoever, plus of course it is the one area where we have a positive trade balance with the EU. Is it not really the case that, for the EU, developing a single market in services will probably be what they concentrate on, over the next years and decades ahead? Actually, this makes it even more compelling for financial services, and indeed other services, to be looking to get involved in the EU, because it is going to make it easier to work there, not more difficult.

Stephen King: In looking at the gains in trade over the next few decades, it is pretty obvious that, for the developed world in general, services are where a lot of the big opportunities still exist. You are absolutely right that, in the EU, the depth of service markets across borders is still relatively shallow. That is something that has the potential to change significantly. If you are looking at growth opportunities in the EU as a consequence of changes in trade arrangements, then services are where you would probably put the most focus. It would be useful if the UK was a part of that discussion, rather than not being part of that discussion.

Q2084 **Mark Garnier:** Andrew Turnbull, I am going to turn to you. You have been involved in negotiating things in the past. I am interested in looking at the balance of trade with the UK and the EU. As I say, the EU has a trade surplus in goods and a trade deficit in services. If you were negotiating a trade deal on their part, would you not be expecting the UK to sacrifice something in services in order to gain other things in goods? It is a rather inarticulately asked question.

Lord Turnbull: They would certainly want to try to bite off some bits of financial services. The evidence of that is that we feared it sufficiently to make it a key part of the new settlement for the UK announced in February, which then sank without trace. They have had this ambition for a long time and we have relied on this ECJ judgment, so we are clearly vulnerable.

Just to try to cheer up Rachel Reeves, there are other services that will be less affected: the whole information technology, Google, Amazon, Facebook and all that. We are very strong in that and they are locating here quite strongly. Google has just opened its massive new office in the old King’s Cross railway lands, for example. They are things that are quite difficult to obstruct, because you do not need goods; nothing has to pass any kind of frontier and there is no kind of licensing. People can just get to Google, Amazon and all those other services simply through the internet. That is a force that is beyond the control of the European authorities. I think we can still remain strong, and possibly pre-eminent, in those areas.

Other areas where we are strong are in the whole business of entertainment and media, films and so on. There is a great amount of money made in those and, again, it is very difficult to see how the EU is going to be able to obstruct that. We will probably have to give some ground on banking.

On insurance, I personally think that the Solvency II that has just been negotiated is an absolutely dreadful piece of legislation, because it treats insurance companies as though they were banks, as though they had to mark to market every day, because their liabilities could disappear every day, as they can with banks. It will actually help insurance companies if we can leave that arrangement, and then you can arrange your insurance, and people can come to London to insure, whether it is insuring aircraft, factories, satellites or whatever, and they may find that we are in a better place to offer trade. There are certain things where we can fight back.

It is the passporting of banking in particular that is the most worrying, but we should not allow that to tell us that the whole of services can be obstructed, because the nature of modern services is that the authorities cannot get a grip on them. They cannot get a grip on them. They cannot tax them. They do not know where it is happening. That is an area where we can still remain very strong.

Q2085 **Mark Garnier:** That is a really interesting point. You are not worried overall. Particularly talking within the insurance market, you are not worried that UK insurers would still have to comply with Solvency II in order to be able to start trying to sell insurance products, say for example household insurance. I appreciate the difference between what happens in Lloyd's of London and what happens in Aviva or Legal & General. You do not think that we would still have to adopt Solvency II in order to try to get access to the single market.

Lord Turnbull: The one I was associated with was Prudential. I have now stood down and done my time there. It has very little business in the EU.

Q2086 **Mark Garnier:** That is because of the lack of depth of the single market in services. This is what I was trying to explore. As that gets greater depth, it provides greater opportunity to, for example, UK life insurance.

Lord Turnbull: Countries like that would prefer to develop into Asia and the US. Solvency II actually makes it more difficult to expand. A European-based and regulated insurance company is at a disadvantage, relative to a Canadian or an American insurance company.

Professor Miles: I have one very small point. It is sometimes worth remembering that the great majority of people who work in financial services in the UK are not doing anything to do with the rest of Europe. I am not sure exactly how many people work in financial services, but it is probably above 1 million. There are probably 350,000 or so in London.

Mark Garnier: There are actually 2.2 million in financial services.

Professor Miles: The proportion of people who sell financial services to the rest of Europe, in some sense, is probably a very small proportion of that. Now, they may be people who are very highly paid and, therefore, from the point of view of tax revenue, it is a slightly different story. In terms of numbers of people, I suspect it is a rather small proportion of those.

Mark Garnier: It would be in the tens of thousands, if that.

Q2087 **Stephen Hammond:** Good morning. I wonder if we could have a quick look at the reaction of the equity markets in the UK. When the first poll for leave came through on 14 June, the market fell back to 5900. It is trading at 6100 this morning. Are you surprised at the market's reaction in the short term?

Stephen King: Not really. It is important to look at the reaction of stock markets in the context of the broader reaction of financial markets. I took the liberty of putting some figures together this morning, just to give a sense of what has happened. First of all, if you take the FTSE itself, as of the close yesterday, it was down 5.6% from the peak last week. The FTSE 250 was down 13.6%. The big difference between the two, of course, is that the FTSE 100 is very dependent on earnings from overseas. Currently, 62% of revenue comes from overseas, whereas for the FTSE 250 45% of revenue comes from overseas.

If you look at those figures in dollar terms, the numbers are in some sense more revealing of the global shock that has come through. In dollar terms, the FTSE 100 is down 16.2% and the FTSE 250 is down 23.3%. If you compare that with the other major markets in dollar terms and adjust for all the currency effects, the S&P 500 is down 5.3%; the Nikkei is down 2%; and the Euro Stoxx 50 is down 14.4%. Once you adjust for the currency changes, it does look as though the UK markets have been particularly hard hit. Obviously that applies more to foreign investors than it does to domestic investors, but it is important to look at the changes in the stock markets in conjunction with the movements in currencies.

Q2088 **Stephen Hammond:** It would be very helpful if, as part of the evidence, you could supply us with those numbers, because it makes that point. The point I was going to make back to you, which you made to me, is the clear difference between the composition of the FTSE 100 and the FTSE 250 and whether you expect that trend to continue and accelerate into the medium term, i.e. the differential and perhaps the much greater fall in the 250.

Stephen King: The underlying question there is whether the UK is heading for a recession or a significant slowdown relative to what we see elsewhere in the world. To the extent that the 250 is a better gauge of domestic economic conditions, the fact that it has fallen so much further is potentially worrisome. If that were to continue, and of course it is a huge "if", and it reflected the weakness of builders and of certain banks and other financial institutions that had a particular domestic business, it might be an indication of stress that is specifically coming through within the UK.

I stress that this is incredibly early days. These are day-to-day market reactions. The markets are incredibly volatile. Obviously they picked up again this morning, as we speak, but if it were an indication you would expect that to be confirmed in UK economic data, over the next year or so.

Q2089 **Stephen Hammond:** Given the continuing drag on the Nikkei against other markets, do you think that that is actually an indication that, although markets are expecting a slowdown in the UK, they are not expecting a recession?

Stephen King: The Nikkei is an odd one. Again, just focusing on the figures, the decline of the Nikkei since the Brexit vote is actually relatively modest, down 5.7% in local terms and down 2% in dollar terms. It is important to recognise that Japan has a particular vulnerability at the moment. Not only have its own QE policies not really worked very effectively and not delivered the outcomes that the Government and the Bank of Japan had expected, but also the yen is traditionally seen to be a safe haven currency. Just at the point when Japanese QE is designed to try to make things a little easier in Japan to get the yen to a lower level, we have seen a really very big appreciation over the last few months. Anything that reinforces that sense of Japan being a safe haven country with a safe haven currency makes it more difficult for the Japanese to resolve their own domestic economic challenges.

Q2090 **Stephen Hammond:** Whilst I understand that you are a chief economist rather than chief markets strategist, you did give us some predictions for where you saw sterling going. Can you give us what the predictions are for your institution, in terms of FTSE and the 250, for the next year? Do you have those to hand?

Stephen King: For the FTSE, I believe we are talking about a further 10% correction from where we are currently. Again, all these predictions come with the usual significant health warnings.

Q2091 **Stephen Hammond:** I was involved in financial services for 20 years before here, in equity markets, so I know what you mean by that. This is the final question from me: do you think that the statement by the Governor of the Bank of England last Friday in particular, directly addressing markets, had an impact on stabilising markets more quickly or no impact at all?

Stephen King: We do not know what the counterfactual is, so it is very difficult to know the answer to that. The Bank of England's job, more than anything else, was to make sure that markets functioned, that they were orderly rather than disorderly and that they were moving with some level of liquidity rather than being totally chaotic. To the extent that, so far, the evidence suggests that that is what markets have been doing, you could say that the Governor's intervention was helpful.

Stephen Hammond: Thank you. As I say, if you could supply the Committee with the figures that would be very helpful.

Q2092 **George Kerevan:** Good morning, gentlemen. Professor Miles, if I could start with you, given the interregnum while negotiations take place, is there a case for a precautionary fiscal stimulus in the UK economy, both to underpin business confidence and to forestall any potential recession?

Professor Miles: You could make a case for it. I do not think it is a terribly strong one. My own view would be that a wiser strategy might be to make it clear that the UK Government were going to let the fiscal stabilisers work to the full extent, which would mean that, should there be a significant short-term slowdown, the deficit will inevitably be even bigger. One would not try to claw that back, over the next two to three years, to continue to hit a target, which has been to run a very small surplus three or four years down the road.

My own guess would be that that would be more reassuring in terms of confidence than introducing some specific measures that you might find would actually backfire slightly. People would say, "Gosh, they really think things are going to be very bad. They are doing that". The case for introducing some special measures is not a very strong one right now. Who knows? Two or three months from now, if things are playing out really badly, it is a different situation, but right now I would not rush to do that.

Q2093 **George Kerevan:** Lord Turnbull, that appears to be gently advocating that the Chancellor abandons his golden rule of running a budget surplus. Are we effectively saying that the budget surplus rule has gone with Brexit?

Lord Turnbull: I never supported that rule. Oddly enough, I supported the rule that the Labour Party had adopted, and indeed the current leader of the Labour Party has adopted, of emphasising the current surplus. The idea that a state cannot borrow, particularly at very low interest rates, when there are big returns to be earned on borrowing I think is a mistake. The crucial point is that, if your borrowing is sufficient large that your debt-to-GDP ratio is rising, you are in a danger zone and you have to get below that. We now have got below that. I have never supported the idea that we drive on to balance overall by 2020, and drive on even further to have a large surplus.

There is one area of policy where I think that some action could be contemplated. I would not do things like cutting VAT or something that you have to put back later on.

George Kerevan: That would only be if you are in the European Union.

Lord Turnbull: The House of Lords Economic Affairs Committee is looking at the housing market at present, and the housing market is in a dire state, because the only people building houses are the private builders. The private builders have shown no inclination to ever build more than 120,000 to 130,000 houses a year. You can see today exactly why they are so cautious, because they have been absolutely hammered. In other words, they never want to be caught with more than a few thousand houses unsold, so they build a small number and then they sell a small number.

We will never get a proper balance in our housing market until we re-engage local authorities and housing associations, building some for rent and some for assisted home ownership. The emphasis on home ownership, home ownership, home ownership of the current policy is going to lead us nowhere. That is one area where a change of policy that would actually have a stimulating effect would be worth doing on its own merits. I would not go in for emergency budgets and a lot of small stimulus packages apart from that.

Q2094 **George Kerevan:** You would go with Professor Miles in saying that it might be helpful to assure the markets that there is not going to be a pre-emptive deflationary package and that the fiscal multipliers work for the economy.

Lord Turnbull: I am amazed at that emergency punishment budget, because the state, both in its monetary existence, i.e. the Bank, and as the Government is the kind of shock absorber of the economy. Letting that shock be absorbed, then regrouping and getting back to the direction you wanted to be in is the function of the state. To say that you would immediately say, “Because our productive potential has been marked down by X”, and it may have been marked down by X, “we have to start now on reducing taxation and the public services that they finance”, I thought was quite extraordinary. Equally extraordinary was the speed with which it has disappeared into history.

Stephen King: I just wanted to clarify one point on the Chancellor’s fiscal rules and that is that, if the OBR forecasts GDP growth to fall below 1%, under those circumstances, the legally binding mandate to target a surplus by 2019-20 is suspended. A lot in terms of fiscal flexibility boils down to exactly what the OBR itself projects for economic growth over the next few years; you then come back to all the issues of whether we have lost some degree of underlying productive potential, whether the current account deficit has to correct quite a long way and whether uncertainty leads to a greater chance of recession. In those circumstances, if you were to get a forecast of that kind from the OBR, it would actually create more room for fiscal flexibility than appears currently to exist.

Q2095 **George Kerevan:** Is that support for fiscal flexibility in a broader sense than the current uncertain period?

Stephen King: What I am saying is that, within the framework that currently exists, there is some room for fiscal flexibility, if you take the view that you only use that flexibility once you are forecasting growth of less than 1%. Of course, you could argue that you should anticipate in advance that this might happen and, therefore, you should avoid it happening but, given this current very uncertain outlook, there is at least a safety valve contained within the current fiscal arrangements.

Q2096 **George Kerevan:** How do you think the financial community would respond if there was more fiscal flexibility?

Stephen King: One question I suppose is what happens to gilt yields, but what is interesting here currently is that virtually anywhere in the world, regardless of whether a country has an expansionary or contractionary fiscal policy, the government borrowing costs are continuously declining. Government bond yields are very highly correlated across countries. The declines themselves partly reflect very weak nominal activity around the world and also a tremendous reluctance on behalf of companies around the world to invest. These are global themes, rather than local themes.

Having said that, it is important to stress that, even if yields themselves remain low in the event of some fiscal stimulus, the fiscal stimulus itself is not guaranteed to deliver you a sustained economic recovery. Here we come back to the experience of Japan. Bond yields are incredibly low. There are continuously large budget deficits and occasional significant fiscal stimulus. The government debt ratio rises through the stratosphere in Japan’s case and yet there appears to be no financial punishment for those kinds of events, at least so far. There is flexibility there.

Again, on the balance of payments position, one worrying feature might be that, if you were to imagine that you have lots of fiscal stimulus and imagine that, at least for a stronger economy, you would therefore need more borrowing from abroad to support that.

It may not be gilt yields that rise in those circumstances; it might instead be sterling that comes down quite a long way.

Q2097 **Chair:** Just on this safety valve in the existing arrangements for fiscal stability, is there much logic in binding medium and long-term fiscal policy and fiscal stability to what amounts to a short-term forecast by the OBR, twice a year?

Stephen King: I was merely saying that the framework has a safety valve in it. I was not saying that the framework is necessarily any good.

Chair: I am now asking that question or a variant of that question.

Stephen King: It is odd, I think, to have a framework that is focused on very short-term forecasts and focused on forecasts, rather than reality. The forecasts themselves can be wrong.

Chair: They always are.

Stephen King: They always are, yes. If you have a medium-term fiscal plan, to have it moving around rapidly just because of a short-run forecast injects an element of instability and uncertainty.

Q2098 **Chair:** In itself, it is exactly the opposite of what having a medium-term fiscal policy is supposed to be designed to address.

Stephen King: Yes.

Chair: I have got you round to saying what I think anyway, so I am very pleased that you have finally done so in that set of leading questions, which I plead guilty to.

Stephen King: I will now retract it, of course.

Q2099 **Wes Streeting:** Good morning. In the hours following the vote to leave the European Union, the Leader of the Opposition suggested that Article 50 should be triggered immediately. Was that a wise judgment and what would be the consequences of such a course of action?

Lord Turnbull: As I was referring to at the start, I think it is completely the wrong judgment, because it would then mean that the timed deadline was working against us whereas, at the moment, we have a degree of flexibility. We would just be giving our negotiating opposition an unnecessary advantage.

Q2100 **Wes Streeting:** I am keen for a range of views. Do you have a view about when negotiation should take place? I know, Lord Turnbull, that you gave a view: not this year.

Lord Turnbull: The answer is when we have done our homework and when we have a new Administration, with a new Prime Minister and a new designated Minister in charge of EU negotiations. When this work has been done, it may develop a negotiating strategy and a set of negotiating objectives. The more difficult thing then is that each Department then has to set up a negotiating team. This is where the staffing constraints will really bite. So long as it is dealing with a centralised strategy at the high level, I do not think we will have any difficulty in finding people of the calibre needed to do this. When you simultaneously have work going on in the Home Office, DWP, DECC, etc, finding teams that can conduct those negotiations is going to be quite a difficult ask.

Q2101 **Wes Streeting:** In the Prime Minister's statement in the House of Commons yesterday, during the question that followed, my colleague Caroline Flint picked him up on the curious omission of the Home Office in the list of Departments that would be at the centre of some of those discussions about arrangements. Given the centrality of immigration and freedom of movement to the referendum debate, and given the centrality of freedom of movement to issues around single market access and the economic dimensions, do you think the Prime Minister should reconsider that?

Lord Turnbull: That is a serious omission, because there is a whole chapter in the negotiations about acquired rights. Let us say there are 2 million EU nationals here and we have a similar number of UK citizens either living or retired abroad. They are the people I feel most concerned about and I thought they should all have been given a vote. Only those who had been here within 15 years got the vote. They are in a limbo. What rights do you have to work, reciprocal healthcare, own property, exchange property, move from one to the other? Getting deep into family things, if someone has an English husband or a French wife, these are absolutely crucial issues. Not to put those or to try to get some early stability about that group of people, which applies as much to EU citizens living here as to British citizens living there, is a serious omission.

Q2102 **Wes Streeting:** In terms of the negotiations themselves, this follows on from Mark Garnier's question really about the unique position of London and the City of London. The Mayor of London today has given a wide-ranging speech calling for both significant devolution of power to London, but also a seat at the table in the negotiations for the Mayor of London. Obviously he is co-ordinating with the First Minister of Scotland and the heads of other devolved Administrations. Do you think that would be appropriate?

Lord Turnbull: Probably not for this main central group. It would be like a Tube map; there is then a sort of tier two. The first people that that group goes to have to involve the devolved Administrations, in terms of nations, and also the city groups and local mayors.

It is not just for London and the London mayor. They need to be closely involved. I do not know that they should necessarily be in this work group on the overall strategy.

Q2103 **Wes Streeting:** How much scope and flexibility do you think there could be for pre-negotiations, as it were? I can understand the frustration of European partners. As much as it is in our national self-interest to delay triggering Article 50, I can understand why European partners would feel more than a degree of frustration. The uncertainty that hangs over our economy and direction is also affecting our partners and allies across the European Union.

Lord Turnbull: It would be helpful if it were possible to find various channels. There are all sorts of walks of life in which people say, "I am not going to talk to you", but they actually find ways of talking. The other route of course is that we have embassies in all these places and they have ambassadors here. If the central authorities in Brussels say that they are not going to talk to us until X, Y and Z, that does not stop us from working closely through our normal bilateral diplomatic channels to find out what people think, where alliances can be struck and so on. Even with the central Brussels authorities, it would be quite useful for both sides to have some unavowed but confidential channels of communication.

Q2104 **Wes Streeting:** Thinking about both the negotiations themselves and then the work that would need to be done simultaneously and beyond to negotiate new trading arrangements, both with partners across the European Union but also the rest of the world, do you think that we currently have, within our civil service capacity, the skill set required for the negotiations to leave the European Union and then to negotiate new trading arrangements with the European Union and the rest of the world? If we do not have those skills, where would we draw them from and how big a task do you think that might be?

Lord Turnbull: The first thing a Department has to do is to prioritise. We have to get people into these areas. If we take Defra and agriculture, my first job in the Treasury—you may remember this—was working on the agriculture desk. You had to understand the deficiency payments regime that we had. What was the CAP regime for each product group and the transitional arrangement between them? Someone has to reconstruct what this new regime is. Are we simply going to replicate on our own the kind of support system that we have at the moment or go to something different? Some very serious policy work has to be done.

Now, it may mean that other things will have to give way for a time, but some additional resources are probably going to need to be brought in. That problem will be replicated Department by Department, and then it all has to be co-ordinated in this central group.

Q2105 **Helen Goodman:** Lord Turnbull, as you say, we were both in the Treasury 35 years ago and one of the things we worked on was oil prices. Given this fall in sterling, how long do you think it will be before petrol prices go up?

Lord Turnbull: I think they went up last weekend. They have gone up about 3p already.

Helen Goodman: I have not filled my tank since the referendum. I have not noticed.

Lord Turnbull: I think you will find it is 114p to 115p rather than 111p. There the logic is that we have to buy this stuff to replace what we are selling you. On the other hand, the price of petrol of that 112p is mostly actually tax, so it does not necessarily go up that much. Those kinds of things will respond.

Q2106 **Helen Goodman:** That was the point I wanted to move on to actually to follow up on the discussion about the pros and cons of this new sterling level. It is a long time since I did any theoretical economics, but is it not the case that the impact on import prices comes through much faster than the benefit to exporting possibilities?

Lord Turnbull: Yes, this is the old J-curve, now renamed the "Nike swoosh". It is the same phenomenon. It probably does, yes, but part of the theory is that, to change the template, if you were at full employment, you would need to depress real incomes in some areas of activity in order to make room for exports. We are pretty near full employment, but I do not think we are at our potential, so maybe that is not necessary. The two gentlemen on either side are probably better qualified to comment on that. He worked at the Treasury as well.

Helen Goodman: I will come to Stephen first and then I will ask Professor Miles.

Stephen King: I was only at the Treasury briefly.

Q2107 **Helen Goodman:** How long are these lags on improvements to exports?

Stephen King: There is a danger of overstating the improvements to exports, because of the way in which trade takes place today, compared to how it took place 30, 50 or 100 years ago. Sorry this a long way back but, if you go back to 1931 when Britain came off the gold standard, you effectively had British products made in Britain sold to the rest of the world, competing with French products made in France sold to the rest of the world. Today, we have global supply chains and often you find that the effects of movements in currencies on export performance are very limited because, unless they disrupt the global supply chains themselves, there is no particular reason why things will change particularly quickly.

Helen Goodman: I so wish you had said that two weeks ago, Mr King.

Stephen King: People were not listening all the time. Anyway, if you go back to 2008 and look at the fall in sterling then, it would be nice to believe that, thanks to that fall, Britain hung on to its competitiveness thereafter, because it clearly was a relative competitiveness improvement in a relatively short space of time.

To go back to the point that Professor Miles made earlier about productivity, what actually happened in the years that followed, and admittedly these data are not necessarily the most reliable, was that UK productivity performance relative to its main competitors was significantly worse. When you measured competitiveness in terms of what are called relative unit labour costs, you had this big improvement in 2008 and almost all of that has now unwound over the last few years because of that relatively poor productivity performance. You need to have the devaluation; you need to deliver continuous good productivity performance thereafter, and then you might have a chance of attracting industry to your country, as opposed to it going somewhere else.

Now, the problem today is that the fall in sterling is a reaction to a fear that companies will not invest in the UK, rather than a process of encouraging them to invest in the UK. That is a much more worrying story than might have been the case back in 2008.

Q2108 **Helen Goodman:** Just on this labour productivity aspect of the evidence you are putting forward, at this juncture, what do you think the likelihood is and what do you think the mechanisms might be for seeing a step change in our labour productivity?

Stephen King: I am going to try to give a positive story. I know I have been negative so far, but there is a possible positive. This actually came from a conversation with a group of businesspeople in Liverpool on Friday, the day after the momentous event. One of them said, "Look, these are now going to be tough times. We now have to think very carefully about whom we export to and whom we trade with. We have to think about new markets that perhaps we have not done so well in previously. If we start to think about those things more seriously, work a lot harder and focus on those new markets that we have not done so well in, in the past, then maybe there is a chance of our productivity performance being better, as opposed to thinking we can bail ourselves out through continuous exchange rate declines".

One thing that is worth nothing here, and this is possibly out-of-date data but the story still holds, is that if you go back over the last quarter of a century or so and compare the UK's export performance to the emerging world with the export performance of Germany, France and Italy, you find that the UK has lagged behind quite significantly. Maybe, just maybe, being outside of the EU gives this focus on thinking about other parts of the world. Perhaps we would then think more seriously about how to engage with those countries to a greater degree than we have done so far.

Q2109 **Helen Goodman:** Professor Miles, first of all on this point about export improvement and, secondly, you talked about labour productivity earlier, so I wonder if you could expand on your views about how that might change now.

Professor Miles: The short-term impact of sterling falling comes through most clearly in an increase in the cost of things that we import. It comes through very quickly. Most imports into the UK are priced in foreign currency; it just flows straight through that prices in sterling will go up. For things like oil, it is almost immediate; we are seeing it right now.

As a result of that, there may be a little bit of switching of people moving their expenditure from imported goods that have become more expensive to domestically produced goods. In the short term, that is likely to be very limited. Over the longer term, there may be a positive effect of it being a bit easier for UK firms to export. All the evidence to me suggests that those effects come through with quite a long lag. They may not be very powerful and it may be that the reduction in sterling will do little more than simply offset the less favourable trading conditions, because we may have to pay tariffs and there are non-tariff barriers when you export into the rest of Europe. The predictable impact will be a bit of a squeeze in the real income of households.

On the labour productivity issue, I cannot see much of an argument or a reason why, in the short term, the underlying productivity of the UK workforce has been damaged. The technology of producing output has not changed as a result of the vote last Thursday. The bigger issue then is if there might be some long-term impact. That was certainly the argument in many economic analyses of what the effect of a no vote would be. It was at the absolute centre of the Treasury's analysis that the cost was all about labour productivity being lower if the UK pulled out. As I said earlier, that was based on a view that you would do less trade, that there would be less foreign direct investment and that there was a link between productivity, how much trade you did and how much foreign direct investment there was into the UK. Those relationships are pretty unclear and not well established at all statistically.

I suppose on balance, if you asked me whether the long-run impact would be neutral, positive or slightly negative for productivity, I would tick the box "slightly negative", but it would be somewhere between neutral and slightly negative, not clearly very negative. It depends a bit, as do so many of these things, on what relationships we end up having.

Q2110 **Helen Goodman:** It depends on what the deal is. Thank you. I want to flip over to a couple of questions about government asset sales. I think RBS and Lloyds share prices are down by about 25%. It is bumping around, but it is roughly 25% in the last four days. The Government's proposals to raise money, if they are to go ahead, would mean that they would probably raise about £8 billion less than the OBR was predicting in March. Mr King, do you think that they should not go ahead with these sales in these circumstances or go ahead, because things are not going to get much better and we need to address this? I will come on to the fiscal implications in a minute.

Stephen King: Given the current uncertain circumstances, it does not make much sense to go ahead. I would also like to make one other point, which is that the loss in the Government's stake in RBS and Lloyds, over the last three or four days, amounts to about £7 billion, which is not so different from the annual contribution that the UK makes to the EU budget.

Q2111 **Helen Goodman:** That is a very interesting comparison. I am sighing in despair over here. I am sorry; I cannot even ask my questions. What about the programme of sales of the Bradford & Bingley mortgages? It was hoped that there would be proceeds to repay their £16 billion of liabilities. Do you think that should also be halted at this juncture?

Stephen King: I have to say that I am not an expert in this, to be fair, but in uncertain market environments things are often postponed.

Lord Turnbull: May I add one point? All this comes about through a quirk in the way we account for Governments' liabilities. We take a certain set of liabilities; we net off a small number of financial assets, but we do not net off assets in general. Whether we sell or whether we do not sell, if we took the entire net worth balance sheet of the Government, it would not make any difference at all. If these sales are delayed, we are not impoverishing ourselves. It is a very minor point, in my view.

Q2112 **Helen Goodman:** I accept that. I just wanted to ask Lord Turnbull a question about the homework for the negotiations. Would you say that what we really need now is a map of all the issues, where there might be trade-offs, which issues are interlinked and what the consequences might be? The first piece of work is to work out what the possible ramifications might be, before one starts rushing in and saying, "My preferred deal is this" or "My preferred deal is that".

Lord Turnbull: There are two bits at the start. One is that, which is basically scoping, and the other is sequencing. We should not say, "What is the best deal that we want to get on pharmaceuticals" or "environment" or something. We need to look at the contingencies in the picture.

Q2113 **John Mann:** Mr King, what impact is technology going to have on the location of financial services, in the next five years?

Stephen King: That is an interesting one for all sorts of reasons, first because the answer is very uncertain. I would like to answer in part because I wanted to demonstrate how difficult it is to predict exactly what technology would do to financial services and their location. This goes back a few years in my career. If you go back, say, 20 years and then think of the advent of the internet, Skype, FaceTime, video conferencing facilities and so on and so forth, the one thing that I might have predicted 20 years ago was that financial services would become evermore diffused and that there would be no obvious need for particular financial centres. Why would you need them? I also thought that maybe the number of air miles that people would earn travelling around the world would go down significantly, because why would you have to travel to see your clients?

What appears to have happened, oddly enough, is exactly the opposite. The technology certainly enables more communication that is virtual, rather than physical, but the more virtual communication you have, the more opportunities it gives you for physical connections. You find that people are travelling around the world much more now and specifically going to those particular financial centres. I can see lots of theoretical reasons why technology moves people around the world and makes financial centres smaller, for all sorts of reasons, but it strikes me that the evidence so far has not been as consistent as I might have expected 20 years ago.

Q2114 **John Mann:** Hotel chains were saying the same about Airbnb six months ago and taxi companies were saying the same about Uber 12 months ago. I just throw that in, because it does seem to me that that is rather a fundamental question, in terms of the numbers of jobs in the industry and where they might choose to be located or not, or whether indeed the industry will have that level of control over where they are located.

Stephen King: I should stress that I am not trying to be complacent about this; I am fully aware of what Airbnb and Uber have done. I am simply saying that, relative to my expectations of 20 years ago, the actual results are somewhat different from what one might have thought, given the information that has subsequently come through.

Q2115 **John Mann:** In terms of the skills that you need as a bank, how will any change to inward migration or free movement of labour impact?

Stephen King: I would hesitate to speak on behalf of HSBC. I am merely an economist working for HSBC, rather than anyone who actually runs the bank. What I would observe in general, though, is that, at least in the City of London, it is a remarkably diverse group of people, in terms of people from a huge number of different backgrounds, particularly European backgrounds. To the extent that London has become a hub for a variety of skills and those skills have been drawn from across Europe and also from the rest of the world, then there is a concentration of knowledge, which has been there, which in the event of a significant reduction of inward migration would be under threat, unless of course you have your technology effect that allows people to be diffused.

Q2116 **John Mann:** I appreciate that you cannot speak on behalf of HSBC but, Lord Turnbull, if we were to take any financial institution the size of HSBC and they were offered the opportunity of corporate visas, in other words, in agreement with say the British Government and the Mayor of London, they could issue, in some appropriate bureaucratic way with government visas, for the people they want working here, because of the nature of the size of the company and the importance to the economy, would you see that as a potential advantage for them?

Lord Turnbull: It could be pretty bureaucratic compared to what we have now. One of the things we need to look carefully at is the student market.

John Mann: I will come back to students. That is a separate issue.

Lord Turnbull: Companies recruit very heavily from overseas, particularly European, students. They come here usually doing second masters or PhDs, and they then compete for jobs in the London market. Now, there is a lot of bogus student immigration, which we have been trying to clamp down on, but not very successfully. That bit of student immigration is an extremely valuable source of highly trained and highly motivated people that the financial sector uses and the consultancy sector uses a very great deal. We should not cut ourselves off from it.

Q2117 **John Mann:** Is there anything wrong with the concept—I could ask you, Professor Miles, as well—of the British Government saying to the corporate sector, "You can have corporate visas", as in work permits? You can have whatever people you choose to have working here and moving here, without the hassle of HSBC and us trying to get Chinese people in here for three months, which is one of the complaints that has been made. The model is that of having corporate visas issued directly by the company.

Lord Turnbull: Would the number of permits allowed be controlled—the Government say to HSBC, "You have 1,000 per year"—or are you saying that HSBC could recruit whomever it wanted? One of them is consistent with free movement of people and one of them is not.

Stephen King: One thing I would stress here is that any large company wants to be able to hire what it considers to be the best people for the job. If there is any sense that there is an impediment to that process or a limit to how many of those people can be hired, it is basically a constraint on the ability of that particular company to do business.

Q2118 **John Mann:** Of course it is. What I am trying to get to, Professor Miles, is that I have not heard anybody in the last year object to, in a generic term, "bankers coming in from abroad to work here". I have not heard anybody object to students going into higher education from wherever, coming into this country and working here, not a single person. I have heard lots of objections to low-skilled agency work coming in and the perception that that has undermined pay, conditions, etc. If one looks at the geography of the vote, it is quite astonishing how the high-skilled areas of London, Oxford, Cambridge and Bath voted very largely to remain and the areas where there is a dearth of such high skills and high-skills industry, such as the former coalfield communities, voted in exactly the opposite proportions to leave. Is there a potential solution here, if the European Union is up for rational negotiation, in terms of facilitating all the higher education students who want to go wherever, all the high-skilled people who, corporates specifically have chosen to employ, and doing so automatically, and putting the restrictions on the low-skilled?

Professor Miles: I can see the logic of it. Whether or not it would be acceptable to the rest of the European Union or the European Union is pretty hard to judge. It clearly would not be consistent with the current rules of the game for free movement of people. Whether it is acceptable as part of some overall bargain, which may involve some limited access to the single market and some contribution from the UK financially every year to be part of that system, who knows.

Q2119 **John Mann:** What you will know about is economic impact. If we are allowing, as government policy—"we" the Government; I am not part of the Government—the corporate sector with high skills to bring in people not just from the European Union, but more easily from China and other places where there have been bureaucratic problems and delays relayed to me, not from your bank but from your competitors very directly in discussions I have had in recent years, in terms of the economic impact, would that not have quite a powerful positive impact for the UK economy? The skills that the corporate sector says we need come in.

Professor Miles: If you set up a system that successfully identified where there were skills shortages, the costs of implementing that system were not particularly high and you also worked out where we had a surfeit of domestic labour that wanted to work at current wages, if all those things were true, you might say that that sounds like quite a sensible place to go. Whether or not you could do all those things is partly the issue.

As you will know, the statistical evidence, for what it is worth in this area, is perhaps slightly out of line with people's worries about low-skilled immigration. My impression, and it is not work I have done myself, but just from reading other people's work, is that the extent to which the wages of relatively low-skilled jobs have been driven down by large-scale immigration is pretty small. As I say, it is not research I have done, but that is my reading of the literature. That does not mean that people's reaction to large-scale immigration in parts of the country where people have moved into low-skilled jobs is any less real, but it might make one question what the economic impact is.

Q2120 **John Mann:** Are you counting wages there as hourly wages or annual income?

Professor Miles: I think hourly wages is the norm.

Q2121 **John Mann:** That is the problem with that analysis, is it not? The pressure of increased supply is that one can bring in contracts with zero hours or four-hour contracts or twelve-hour contracts, and have a ready pool of labour. We have minimum wage legislation as well. While the hourly rates might actually be pretty much the same, the real ultra-flexibility comes from the fact that the individual does not know how many hours they are going to be working that day, never mind that week.

Stephen King: Could I just come back to you? I have been thinking, while you have had this discussion, about the particular question of getting people with certain skills or students to come into the UK. HSBC, for example, could hire all the people it wanted to under your corporate visa system. In thinking about this, one of the problems with it perhaps is that you do not know what the unanticipated subsequent demand would be for so-called ancillary workers, if I can put it that way.

To take an example in London, Pret a Manger has expanded in part because it sells sandwiches not just to people who are from the UK, but also people from France, Germany or whatever who would quite like to have a sandwich. The larger number of people coming into London has led to a huge demand for ancillary services as well. If you can find, as Professor Miles was saying, a spare labour pool that can fill that in the UK, that is all very well and good but, if you cannot, then you are still left with the problem of how you support those ancillary services when these people come in.

Q2122 **John Mann:** I fully understand that. I am trying to get your impression as economists, though, whether it is significantly more important to this economy to have the high-skilled people going into universities and going into your bank, as opposed to the reasonably skilled, but not quite as high-skilled, baristas at Pret a Manger, etc, going into the economy.

Lord Turnbull: Something can be low-skilled, but still in demand: the care sector, looking after our children, nurseries; some of the less-skilled jobs in the NHS, porters and cleaners; and in the agricultural sector.

John Mann: Fruit pickers in agriculture.

Lord Turnbull: One of the things is that, despite this high immigration, it has not led to a depression or to an increase in unemployment. We have actually found ways of absorbing the very large import of labour, and part of the productivity mystery in my view is that we have a very, very successful labour market, and a very flexible labour market. We are just using labour-intensive ways of doing things. If you want a model to choose from, would you rather have that model or would you rather have the French/Spanish model, where 40% or 50% of young people do not get jobs? I would much prefer our model. Simply by taking people with degrees and professional qualifications, we are missing out an important contribution that has come from people filling other equally important and successful jobs.

Q2123 **John Mann:** Indeed, but would not the Seasonal Agricultural Workers Scheme, which has operated from before the single market very successfully, not also provide a very clear model and one again that I have not heard complaints in relation to ever? It is quite big in my area. People are coming in for fixed periods of time, under fixed pay and conditions, and leaving after fixed periods of time. I suppose what I am driving at is: what is wrong from an economic point of view, or is there anything wrong, with the Mayor of London, for example, determining with corporates in London, including the NHS and including the care home sector, what the demand is and what should be there, allowing the Scottish Government to be doing the same in relation to Scotland, allowing the Mayor of Manchester to do the same in relation to Manchester and actually changing the basis on which we allow people to be working in this country?

Stephen King: Could I offer two responses to that, if I may? The first is that we have a European example of what you described just then from the 1960s, which is the

Gastarbeiter system, the guest worker system, in Germany. It works on the basis that you give citizens different rights, depending on whether they are citizens from that particular country or from somewhere else. What is particularly intriguing about the Gastarbeiter system, as it worked for Turkish workers who came into Germany at the time, was that, because they were typically only given low-skilled jobs, they returned to Turkey still with low skills. It gave them some extra income from what they would have got in Turkey but, in terms of a broader development of both Germany and Turkey, Germany did well and Turkey did not do quite so well.

The second thing I would note is that, in the debate about who has benefited and lost out from immigration, there is a danger of conflating the immigration impact with the technology impact. This is a big debate taking place in the US currently. There is a big debate about the hollowing-out of what might be described as traditional white-collar clerical jobs. What you have is a bifurcated labour market, where you have some people who do very well who have a certain level of skills, and a very large number of people who are competing for jobs that, in many cases, are below their skill level. That puts tremendous downward pressure on those wages. What I am getting at is that this is not an EU issue. It is not a migration issue. It is possibly a technology issue, yet it can be easily blamed on migration, rather than technology.

Q2124 **Chair:** Can I go back to some of the questions that we were asking very early on? We had an exchange, Lord Turnbull, when you were talking about getting the skills together. Is it not in the trade negotiation field above all where we have the least skills? Bearing in mind that we have not been doing this work for a very long time now, how on earth are we going to assemble that in Whitehall, at speed?

Lord Turnbull: One of the things I did on a number of occasions in the Treasury and Cabinet Office is, where you have a particular skill that is required—in this case, I can think of project management, procurement or negotiating private finance deals—you do not simply spread everyone very thinly. You may need to start by centralising a lot of things, so that the people who are most skilled are doing as much of the work as they can. Gradually, you build up enough people then to go off and become the kind of captain of whatever—the DWP team or the health team.

Q2125 **Chair:** Can that be done in a number of months?

Lord Turnbull: No, it cannot be done in a matter of months.

Chair: You gave us an end date for the pressing of Article 50 of six to nine months.

Lord Turnbull: The people who are going to be the scarcest of all are parliamentary draftsmen familiar with the European legislative system. They will be like gold dust. Someone will need to start a programme that is trying to identify, amongst all those legal firms, all the Slaughter and Mays and so on, secondments or short-term contracts to strengthen that particular skill. When it comes to trade negotiation, it is more difficult. It is not as though the private sector has a lot of what we can then borrow. Somehow or other, we have to build that up.

Q2126 **Chair:** How we are going to do this? That is exactly the point that I am asking.

Lord Turnbull: One part of this central team has to be a kind of manpower planner. We have to look at where these requirements are and try to help organise, with Departments, the building-up of the necessary teams and where there are certain new types of civil service contracts that need to be brought in, in order to make that possible.

Chair: With a bit of luck, the people who are Brits, who are not very many, who do this work in the Commission and have expertise elsewhere in the EU—

Lord Turnbull: We have 4% in the EU.

Chair: Yes, 3.7%, I think.

Lord Turnbull: It is tiny. Even if we repatriated them all, it would not make much of an impact.

Chair: If I just finish that sentence, with a bit of luck, there will be a silver lining to the suggestion that is already being put about of their being frozen out of the work that they are doing out there. The silver lining is that they might be more inclined to take up the offer from Lord Turnbull's successor, as he hunts for some expertise.

Lord Turnbull: In the Lords yesterday, when the statement was repeated, one of the most controversial elements was why Lord Hill resigned. Should he not have been asked to stay, because we need someone to fight our corner? Equally, though, now that he has returned, he has a lot of relevant expertise. Are we just going to lose him, so he goes back to his old world of public relations, or can we redeploy him? We have to look for where these people are who have some Brussels literacy.

Q2127 **Chair:** That point was also raised in the Commons at least once, I think by Gisela Stuart. I have one other question for you. I have one question for David Miles and one question for Lord Turnbull. David Miles, when you were talking about single market access, you said that we might be required to make a financial contribution in exchange for this. What is the logic, in order to conduct trade and enable exchange of factors of production, of paying money? Surely the exchanges—trade and factors of production—should have mutual benefit to both parties to justify it.

Professor Miles: That is a powerful point. If you could persuade the people you have to deal with that you should get access and not pay anything in terms of a contribution, that would be a great argument to have won.

Chair: In other words, there is no logic to it.

Professor Miles: To a large extent, I agree with you. There might be some potentially rather limited costs.

Chair: There are admin costs, but those are trivial numbers in comparison.

Professor Miles: You would expect that they are a small number. I am not disagreeing with you. The economic logic of having to pay some significant fees is hard to fathom, but it does not mean that we will not be presented with a price tag.

Q2128 **Chair:** It is always helpful in negotiations, even if one deviates from it, to proceed from the point of reason and try to establish mutual interest. I have one last question for Lord Turnbull. It is a tough question that you may not want to answer, but you have talked about the need to work out what we want before we press the Article 50 button. I am very pleased that the Committee made that point so vigorously, well prior to this referendum, in its report on the economic costs and benefits. There is another question, though, which is the legitimacy and credibility of the people who do the negotiation at a political level. The question I have for you is: will it add to the firepower of the Sherpas and the people all closely associated with that work if, when dealing with their counterparties, they are representing a Government that have secured an electoral mandate for the position that they are now negotiating?

Lord Turnbull: I am not sure I can answer that one. It is certainly helpful if whoever is doing this negotiation is seen to be representing a strong Government position, and that it is not simply one faction that takes over this negotiation. There are all sorts of people who feel they have lost out. People say, "The people have spoken", but it was actually a very narrow result. These negotiations have to be very much based on the national interest, balancing the interests of different regions, older people, younger people, etc. Whether you need an election to do that, I do not know yet. I certainly do not believe that the simple act of changing a Prime Minister requires an election.

Chair: That is not what I asked at all, but by all means comment on it as a former Cabinet Secretary.

Lord Turnbull: I thought you were going to ask a slightly different question, which is whether we need to put some people into these teams who started life with some enthusiasm for Brexit. If you take the people who lived in London, you can be pretty sure that a vast majority of civil servants voted remain, because that is where they live. My borough, Lambeth, was about the biggest remain.

Chair: You were very influential, Lord Turnbull, I am sure.

Lord Turnbull: Only on a local level. It is impossible to be influential in London. Do we need to give assurance that people are really committed to the cause or do we try, as I would prefer, to say "forget that"? "From now on, you are civil servants; serve the Government of the day. The Government of the day will be a mixture of the people who wanted an exit and the people who did not, although the balance between them may change, but you are serving the Government of the day and they should be negotiating on a national interest basis trying to accommodate the variety of views."

Q2129 **Chair:** The Civil Service has a rich tradition of doing that and I did not ask the question, because I have never seen evidence that they are incapable of making adjustments, with quite radical changes of policy required on occasion, as elections are won every four or five years. Indeed, it is an open secret that a substantial proportion of the Civil Service favoured a change of Government in 1997 and voted accordingly. When you ask those who are now retired and prepared to tell you, you have that sense, but they had, up until then, been advising the Government to the best of their ability, and a considerable ability, in exactly the opposite direction. It was not a question that I felt that I needed to ask. You have not answered the question I did ask.

Lord Turnbull: Do we need a general election? Not to validate the status of the new Prime Minister, but—

Chair: To bolster one's negotiating position with one's counterparties.

Lord Turnbull: I do not think that that is a reason to depart from a very well established principle that the Government of the day is who commands the House of Commons.

Chair: Thank you very much, all of you, for coming to give evidence to us this morning. It has just become this afternoon; I wanted to bring it to a close at midday. You have all given outstanding and interesting answers to these questions, which are just preliminaries in what will have to be quite a lengthy investigation by Parliament of the process of preparing for Brexit, prior to the triggering of Article 50. Thank you very much indeed for coming to see us this morning and particularly at such short notice.