



HOUSE OF LORDS

Revised transcript of evidence taken before
The Select Committee on the European Union
Financial Affairs Sub-Committee
Inquiry on
**COMPLETING EUROPE'S ECONOMIC
AND MONETARY UNION**

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Questions 1 - 14

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10.15 am

Witnesses: Philippe Legrain, Dr Dermot Hodson and Graham Bishop

Members present

Baroness Falkner of Margravine (Chairman)
 Lord Borwick
 Lord Davies of Stamford
 Lord Haskins
 Lord Lawson of Blaby
 Lord McFall of Alcluith
 Lord Shutt of Greetland
 Lord Skidelsky

Examination of Witness

Philippe Legrain, Visiting Senior Fellow, European Institute, London School of Economics and former economic adviser to the President of the European Commission (2011–14),

Dr Dermot Hodson, Reader in Political Economy, Birkbeck, University of London, and

Graham Bishop, Independent Consultant and Professorial Research Fellow at London Metropolitan University's Global Policy Institute.

Q1 The Chairman: Good morning and welcome to the Financial Affairs Sub-Committee's first session of inquiry into the impact of the Five Presidents' Report and Europe's economic and monetary union. You have a list of interests that have been declared by Committee members, I understand. This is a formal evidence-taking session of the Committee. It is being webcast live, and a full transcript will be taken and put on the public record and the parliamentary website. You will be sent a copy of the transcript and will be able to revise any minor errors.

Mr Bishop, Mr Hodson and Mr Legrain, we would be very grateful if you first say your names. I understand that you would like to make very brief opening remarks, and I will start with Mr Bishop.

Graham Bishop: Thank you Lord Chairman. My name is Graham Bishop. I am honoured to be giving evidence on the Five Presidents' Report and on completing economic and monetary union. Unfortunately, I am very powerfully reminded of the British political class's reaction to the Maastricht treaty in 1992. To paraphrase the celebrated quotation from Bretherton at Messina, "It won't happen. If it does, it won't be very big and it won't matter". Following the timetable of the Delors report, the three-stage process started in 1992. In 1994, the Heads of Government decided to begin the technical preparations, and that was almost ignored, and even ridiculed, here in the UK, because the EU was engulfed in an existential crisis at the time about exchange rates, including sterling. In 1995, I was honoured to be on the committee of

experts from the European Commission to design the changeover to the euro. We flawlessly got 300 million people to change their notes and coins by 2002. A decade later, 340 million use the euro. We have now had a series of Presidents' reports laying out a fairly detailed plan for the major deepening to economic and monetary union, with a two-stage process of achieving it by 2025 at the latest. Again, the British establishment, with the exception of this Committee of the House of Lords rather than the elected Members of the Houses of Parliament, seems to be ignoring this process because the EU is engulfed in another existential crisis, this time about migration. If the EU survives that crisis, it has probably launched itself on a path to genuine economic union, financial union, fiscal union and, finally, political union, which will provide the necessary democratic legitimacy. As I listen to the debate in the UK about this process, I rather fear that there is now a clear risk either of an actual Brexit soon or a de facto Brexit by 2025 at the latest. I look forward to your questions.

Dr Dermot Hodson: I am Dermot Hodson, from Birkbeck College. I have submitted written evidence, so I promise to be very brief. In a nutshell, I see the Five Presidents' Report as vintage Juncker; it is a set of concerns that he has taken through his time as the Eurogroup president. It is very integrationist in its rhetoric but rather modest in its proposals; it talks about a lot of unions, but if you dig deep, a lot of the time it is very incremental in what it proposes. I would argue that it is woefully inadequate when it comes to legitimacy. The real weak link is the talk of political union, which amounts to very little other than a bit more co-operation between national parliaments. Even though it is modest, it stands limited chance of success. This is vintage Juncker in its ambition, but perhaps also in its difficulties in reading where the power lies in the European Union. I think of the European Union as an essentially intergovernmentalist organisation, so much of it depends on what happens in France, Germany and, I am afraid less these days, the UK.

Philippe Legrain: I am Philippe Legrain. From a Brussels perspective, the most significant thing about this report is that it is in the name of Jean-Claude Juncker, whereas the Four Presidents' Report was in the name of Van Rompuy, and that Martin Schultz has managed to get his name on to it. From an outside perspective, the most significant thing about it is that the European Council merely took note of it—in other words, it feels free to completely disregard it. So I take a rather different view from Graham's; I think this report, like the Commission Blueprint and the Four Presidents' Report, is of little significance, and I do not think there is going to be much movement towards further integration in the eurozone any time soon.

Q2 The Chairman: Thank you very much. I would like to delve just a bit further into your overall impression of the report, particularly in respect of the timings and the step-by-step approach that is advocated. What you said about it from your different perspectives is very interesting, but I would like your overview of timings and whether you believe that this is accomplishable.

Graham Bishop: These are classic EU incremental steps. Going back to the Schuman plan of 1949, Europe is not all done at once; it is done by a series of concrete achievements. The Delors process, which I mentioned, was a three-stage process, and all this is just the same approach. I agree with Philippe that many of the parts are being done already—banking union, and now capital market union. It is done by incremental steps rather than a giant leap forward, and I think that is a much sounder way of doing it.

Dr Dermot Hodson: I have a slightly different take. The firmest date is 2017, and the significance of that date is the UK referendum on whether to remain in the European Union. One of the main political objectives of this report was not to trigger major treaty reforms that could get caught up in the treaty negotiations or the UK search for a new settlement. In a sense, there is a bit of subterfuge about this report. It is not quite the same as the Delors report, which had a genuine and reasonably credible path towards monetary union. This is about not mentioning the “T” word.

The Chairman: So you are saying that the end of stage one was deliberately chosen in order not to get in the way of the UK referendum, or that the integrationist aspects of it were meant to come into place after there was a decision on the UK referendum.

Dr Dermot Hodson: Correct. The report treads very cautiously when talking about treaty change. It is very vague on that, which is understandable because the idea of UK renegotiations getting caught up in a big bang treaty negotiation on the European Union would be very difficult. It would trigger referendums in more than just the UK.

The Chairman: As a little follow-on from that—I will come to you, Mr Legrain; I saw that you disagreed—I want to press you a little, Dr Hodson. If it is so irrelevant and trivial, or not realisable, where does that leave the future of the euro?

Dr Dermot Hodson: I did not say that it was trivial. Some of it is not realisable. The report sketches out a broad path for completing monetary union. It is relatively specific on banking union, but the broader narrative on things such as economic and fiscal union is very, very light. That would clearly trigger some sort of treaty reform, which is precisely why it does not go into as much detail compared to the Four Presidents' Report, in which there was a lot on

fiscal capacity. There are just a few references to a stabilisation mechanism in the Five Presidents' Report.

Philippe Legrain: First, on timing, a key consideration is not the UK referendum; it is the French and German elections in 2017, and everything is on hold at least until then. Secondly, the limited ambition has more to do with the ending of the panic through the ECB's OMT and now with QE, which took the pressure off, and given the huge changes that were made between 2010 and 2012, there is reform fatigue. Thirdly, there is a realisation that referendums would not be won were there to be treaty change in countries such as France or the Netherlands, where public opinion has become even more sceptical since the no vote a decade ago.

The Chairman: What you say about the French and German elections does not quite add up, from my recollection, because the German election takes place towards the end of September 2017 and the formation of the Government might not be complete by November, so I certainly cannot see the German election having an impact. The report says that stage one will take place between July 2015 and mid-2017, so stage one will be complete well before the German election. Do you accept that?

Philippe Legrain: Stage one will not be complete. I am willing to bet any member of this Committee that there will not be a deposit insurance by June 2017. Secondly, even if stage one were complete, stage two would only be started at the time of the German election, so nothing of consequence would have happened by then.

The Chairman: Lord Lawson, did you want to pick up on the UK point?

Q3 Lord Lawson of Blaby: Yes. We have had three very interesting answers to the question. I must say that I find Mr Bishop's answer the most convincing of the three: his account of how the British Foreign Office and the British establishment generally have consistently underestimated the determination of the European leaders to move into fundamental change, of which the single currency was one and this is another, with full European fiscal union to complement monetary union and then a political union which must go with fiscal union. I find that very compelling. It seems to me that although Dr Hodson said that he disagreed with it, in fact he agreed with it, in the sense that it is going slowly in order to get over the UK referendum and perhaps, if you believe Mr Legrain, the elections in France and Germany, but then it moves on. So this was purely a tactical move. I have three questions, if I may. First, do you agree that the object as set out by Mr Bishop is the purpose of the exercise, even though it may take a long time? Secondly, if, as Mr Legrain has said, public opinion throughout the European Union has changed, should not the whole process be aborted? Thirdly, influential

figures such as Mr Hollande and Wolfgang Schäuble have explicitly said that it will be necessary to have a eurozone parliament to provide democratic legitimacy for the development of the eurozone. Do you agree with that, and how will this mesh in with the existing European assembly?

Graham Bishop: First, I am pleased that you agree with me about the path that I believe we are on. On whether there will be a sufficient revival in electoral support, one of the critical questions will be the growth path of the EU economy. If that revives and the benefits of the competitiveness which is the core of the economic policy thrust at the moment come through, over the sort of timescales that we are talking about—not next quarter but the next two, three, four or five years—and if it is seen that unemployment comes down as a result of European actions, that should have a very positive impact on public opinion. What is clear is that the intention is to move as far as possible without treaty change, and a lot can be done, a lot has been done and I am sure that a lot will be done in the future without it. The role of the European Parliament is, of course, critical. We have already moved to a co-decision basis between the Parliament and member states and Council on legislation. What the communication on completing the EMU is about is giving the European Parliament co-decision on economic policy, because it will have a say on the European Semester et cetera. There is no doubt that the European Parliament will play a much more substantial role. That might require a reformatting of it in some way. The way in which it is laid out in the communication suggests that that is up to the Parliament. The people I speak to there within their rules of practice can already see how ECON can meet in a eurozone-only format. That can be done within the existing framework—not easily but it can be done. That is how I see that developing, and it gives the European dimension of the political legitimacy for the whole process.

Lord Lawson of Blaby: Sorry, I did not make myself clear. I was not talking about the existing European Parliament; I was talking about the fact that political union requires a parliament. The United Kingdom will not be, we presume, part of a political union, whatever happens in the referendum. How is this going to work out? Will there be a European Parliament as we know and love it, which the United Kingdom, so long as it is in the European Union, will be part of and, alongside, it a parliament for the eurozone members because of the political union? I cannot see how this can work.

Graham Bishop: The outline of the proposal in the communication is not to have a second parliament, but to use the existing European Parliament reformatting itself—and the key committee is ECON, the Economic and Monetary Affairs Committee, because they are the

people who make the initial analysis and decisions on the European Semester process or the economic governance et cetera. They will simply meet in a form for this purpose, which does not include non-euro members and therefore does not include the UK. The comments that I have received are that this is capable of being done within the existing rules of procedure, let alone treaty change. There is no question of a new parliament; it would be the existing one, with a reformatting and a more specific role for looking only at the eurozone.

The Chairman: With a sort of grand committee, as has been proposed in constitutional terms here, to deal with English votes for English laws.

Graham Bishop: Effectively, yes, but in particular for ECON, which is where the economic governance lies.

Dr Dermot Hodson: Jacques Delors has proposed something more ambitious, which is a eurozone parliament.

Lord Lawson of Blaby: That is right.

Dr Dermot Hodson: That is not contained in the Five Presidents' Report and it is not unexpected, because this is all about the fifth president. The President of the European Parliament is not going to allow an idea like this to go into the Five Presidents' Report. The discussion is perhaps a bit too deterministic. I see this as a report that puts some ideas out there. The key institution to look for is the European Council and how it reacts. The European Council is not bound by the ideas in this, so you could in principle see something like a eurozone parliament. Personally, I would find it a very curious idea. I do not see the European Parliament as having very significant powers in macroeconomic policy; I would not have thought that the European Semester is the most significant part of this governance framework. When you have one parliament that is already a second-order player in this area of policymaking, it strikes me as curious that we would want a second.

Philippe Legrain: What is striking about this is that it falls well short of the federal union that Graham thinks is desirable and Lord Lawson presumably thinks is necessary. If you look at banking union, for example, we do not have a banking union; we have a banking union where many German banks are excluded. We have a single resolution mechanism which is unworkable and leaves a veto in the hands of national Governments. We have banks and sovereigns as intertwined as they were when the process was launched in June 2012. Nowhere in here is it mentioned that we are going to remedy those flaws. There are no proposals in here for issuing common debt or for creating a genuine eurozone fiscal Treasury. It does not even set out the federal ambitions that are ascribed to it. More importantly, the European Council has merely taken note of it, which basically means, "Thank you very much. It is going to

gather dust with some of the other reports”. Then politics intrudes, which is the debate in Brussels. People use big words and do not mean what they say. People will use the phrase “fiscal union”, which sounds to some people as though you are creating a common fiscal authority with tax-raising, spending and borrowing powers.

Actually, Wolfgang Schäuble is saying that you need a super-Commissioner, a eurozone Finance Minister, who will simply be able to enforce the existing fiscal rules more stringently on national budgets. That is not a fiscal union of the sort an economist would recognise. What is striking to me is that it is a step back from what was being proposed in 2012, when, at least ostensibly, those bold proposals had the backing of eurozone leaders. Now they do not.

In terms of public opinion and treaty change, my view is that you do not need greater centralisation in the eurozone to make it work better. Greater decentralisation would be a better idea, not least in the fiscal area. I think we have taken a wrong turn during the crisis in the measures taken since 2010.

Lord Lawson of Blaby: Sorry, what does greater decentralisation in the fiscal area mean?

Philippe Legrain: Greater decentralisation means restoring the no-bailout rule and making it credible, first, by creating a mechanism for restructuring sovereign debt and, secondly, by limiting banks’ holdings of sovereign debt so that the operation of that mechanism would be credible.

Q4 Lord Lawson of Blaby: In our experience, when there was a no-bailout rule and the financial markets thought it had no credibility, the financial markets were proved right. Do you think reinstating it could have any credibility?

Philippe Legrain: As I said, two things were lacking in 2010. The first was a mechanism for restructuring sovereign debt, and post-Lehman there was, in my view, a misplaced belief that if you restructure sovereign debt the whole world would end. We restructured the Greek debt in 2012 and the world did not end. Secondly, there was the awesome political power of German and French banks, and even if policymakers had had that desire, politically it was not possible. Indeed, Angela Merkel initially favoured that option and then changed her mind. In order to make it credible you have to minimise banks’ holdings of sovereign debt.

Lord Lawson asked whether it should be aborted. In my view, as it currently stands, the eurozone is not fit for purpose. It does not deliver economic growth and it constrains democracy in an unacceptable way. If you think the move towards a federal union is neither necessary nor feasible, short of breaking it up, the only other option is decentralisation.

On how a eurozone parliament would work, I agree with what others have said. Such is the power of the European Parliament that it is inconceivable that you would create a separate

structure and that a eurozone parliament, if such a parliament were to emerge, would basically start off as a committee made up of members of the European Parliament from eurozone countries. What is striking is that clearly decisions have been taken that involve large transfers of sovereignty, out of the hands of elected officials into those of technocrats. You need much greater democratic accountability. But it is not just a question of democratic accountability; it is a question of democratic choice. We have election after election in the eurozone in which voters reject the outgoing Government, and the first thing that happens is that voters are told that they have to stick to the old policies of the Government they have just rejected because EU rules say so, and I do not think that is desirable or sustainable.

Lord Davies of Stamford: How can you possibly restrict banks' holdings of sovereign debt? Banks need to have access to some so-called risk-free assets in the management of their liquidity, and if you did such a thing you would inhibit open-market operations between the central banks and local banks, the normal medium for which is of course sovereign debt—and usually short-term sovereign debt such as Treasury bills, in our case. There is no alternative for the EU public debt market. Some suggestion has been made, including by Mr Bishop, that a Treasury bill system should be developed, with bills issued by the European Union as such. Full faith and credit to the Union, but that proposal has not, as far as I know, got to the point where anybody is seriously planning to implement it.

Philippe Legrain: First, you are right to say that banks generally hold short-term debt that can be used in the conducting of monetary policy, so this would primarily be about limiting their holdings of longer-term debt. Secondly, if you think that my proposals are unrealistic, similar ones have been made by Jens Weidmann, the president of the Bundesbank, so perhaps he is being unrealistic too.

Lord Davies of Stamford: They have their own agenda, do they not?

Philippe Legrain: He is a central banker and I think he knows how to conduct monetary policy.

The Chairman: Lord McFall wants to come in on this question briefly. After that, I would like us to leave it and move on to the next question, because we will cover this a bit later.

Lord McFall of Alcluith: You mentioned restructuring sovereign debt. Earlier in the week there was a proposal from Italy to establish a bad bank to cover its non-performing loans of about \$330 billion. To do that, it would establish a private vehicle, with senior debt guaranteed by the state development agency. First, how much chance is there of that? Secondly, is that the type of thing you were talking about when you talked about decentralisation?

Philippe Legrain: No, not really. That is a bad bank to deal with the non-performing loan side.

Lord McFall of Alcluith: Yes, but how much chance does Italy have of getting that?

Philippe Legrain: I am talking about the decentralisation of fiscal policy. I would also like there to be the decentralisation of economic policy. I think there is an incorrect view in this report that somehow we need to have a convergence of economic policy. As the United States shows, where different states have very different rules on all sorts of things, there are benefits to policy experimentation. That is perfectly compatible with sharing a currency. The important thing is risk-sharing, which can happen largely through capital markets and cross-border ownership. So the premise behind this is incorrect.

The Chairman: We want to move on to the implications for the United Kingdom.

Q5 Lord Haskins: I get the impression from all of you that this is all a bit of a sham, that without treaty change the Commission is not going to get anywhere, and that the Commission will duck treaty change. There are two situations. I am talking about the non-euro areas. If treaty change has to be part of the process, that raises huge questions for the non-euro areas. If, on the other hand, the sham continues and the issues are ducked, does that make much difference to the non-euro areas?

Graham Bishop: First, on the idea that there will be no treaty change, it is fairly clear that the Commission envisages something in the fullness of time, in particular to fold in the fiscal compact and that sort of thing. The question is when that time comes. In the present situation, we have developed a series of intergovernmental agreements, unfortunately in a sense. None the less, we have developed that for the ESM and suchlike, and if the euro area want to do things and they need to do something between themselves, they will go down that route, with the intention of folding it into an eventual treaty change and make it applicable to all, with opt-outs as appropriate. Lord Davies talked about euro bills. I have put forward a proposal, which is getting some traction I must say, particularly in the European Parliament, which would be run as an intergovernmental agreement to start with; if it happens in years to come, that can be changed. A lot can happen with intergovernmental agreements and within the existing treaty, and that will have major significance for the non-euro area players, because they need to deepen their economic and financial integration, which they are doing.

I have to disagree with Philippe on banking union. I think it is really very significant; 85% of eurozone bank assets are now run by the ECB's single supervisory mechanism. It is only 120 banks out of 6,000, but it is 85% of the assets. They are the big player. We now have capital market union coming in the next two years, of course—I am sure we will talk about that in a

moment—but these are big plans that include a very major role for European-level supervision, rule-making and the enforcement of the rules.

Dr Dermot Hodson: I am sympathetic to that idea of treaty reform. I do not think there is any appetite for a large-scale treaty reform because of the difficulty of ratifying it. That is the reality since Lisbon took effect after 10 long years of constitutional reform that were very difficult. The broader point is that it is in the UK's interests to have a well-functioning monetary union; there is a lot that the UK could support in terms of the modest aspects of these proposals. Obviously, banking union is the key one, where the UK has to look closely at whether it finds itself facing some sort of eurozone court case. Looking aside from the technicalities of treaty reform, it is strongly in the UK's interests to have governance reforms that would strengthen the euro.

Philippe Legrain: I think Lord Haskins is right that it is very important better to define the relationship between euro members and non-euro members. I would think that is the most important aspect of the renegotiation that the Government are embarking on as we speak. In the immediate term, there is little prospect of eurozone members caucusing together, simply because they disagree on so much. In my view, we are not going to see much deeper integration, but areas where there already has been—for example, in the banking union—the model of a double-majority voting system is a good solution which satisfied the desire for the eurozone to integrate in banking matters and at the same time not having the Bank of England systematically outvoted and ignored. Does it make much difference? My initial reaction on being invited to give evidence to this Committee was to wonder why you are having this inquiry, because not much is going to happen. It is quite reassuring from the British perspective—I do not think that much is going to change; therefore, we are talking more about safeguarding against potential future changes than about imminent ones.

Lord Skidelsky: Surely the implication behind Lord Haskins's question is that the monetary union is unstable. Either it is reformed or it will break up. Presumably that possibility will come about when the next crisis comes. To be reformed, centralised institutions have to be set up. That, of course, raises very acutely the question of the UK's relationship with the eurozone and the European Union, which has already been discussed. I do not think one can just say, "Nothing much is going to happen, so we don't need to worry", because what we need to worry about is the next crisis in the eurozone. No doubt if there is a lot of growth quickly, that could be postponed and it may wash away. But there is not going to be, is there? Growth prospects are not so brilliant.

Dr Dermot Hodson: I would challenge the premise of the question, that centralised reform is the only type of reform that we could have. If you think about a fiscal union, a fiscal stabilisation function, that could have made things worse pre-crisis. The idea that transferring more money to Greece would make it take more sensible economic policies is an assumption that can be questioned. I agree that it needs reform, but this idea that it has to be centralised reform is the subject of debate in the literature.

Philippe Legrain: I was not quite saying that. I was not saying that we would not be affected by a future crisis in the eurozone—clearly, we would be. I was saying that I do not think there is going to be deeper integration and therefore political implications from deeper integration within the eurozone. What is striking about this report is that it does not deal with any of the issues that might deal with the current crisis or prevent a future one. It does not tackle the issue of bank and debt restructuring; it does not tackle the issue of the monetary and fiscal straitjacket; it does not tackle the issue of a mercantilist German core and the deflationary impact of that. Actually, it is by the by, for both the current economic problems and preventing future ones.

Graham Bishop: I agree with you that growth prospects are not very buoyant. The demographics of the EU over the next 20 or 30 years are very bad. The only source of growth will be competitiveness, which is why it is such a central part of the whole proposal. If that does not happen, when interest rates rise, as they surely must, for countries on average with nearly a 100% debt-to-GDP ratio, this will be a massive hit to public spending. Something has to be done to prepare for that inevitable crisis, and by far the best way is to grow your way out of it. Competitiveness is the only way, and that needs a good deal of pushing and shoving of many member states.

Philippe Legrain: Competitiveness is completely irrelevant to this. Competitiveness as defined by this is basically a mercantilist policy of driving down your labour costs. The real priority, apart from dealing with the short-term demand problems, is boosting productivity growth. The idea that you grow out of this simply by holding down your wage costs in the short term is disastrous, particularly if you have large debts. From a dynamic perspective, it means you end up specialising in lower-end production rather than dynamically moving up the value chain and producing better goods for higher wages. It is completely confused, and it illustrates why this report is irrelevant to the eurozone's current challenges.

Q6 Lord Davies of Stamford: My question to the panel—and it is a genuine question; I do not understand the answer—is why it is not in our interests to be part of the banking union, as some other countries such as Denmark, which are not part of the euro, have decided to

become. Will we go through agonies, wondering how our position will be protected against decisions taken within the European banking union decision-making structure? I think Mr Legrain mentioned the double-majority rule, but that breaks down once you have fewer than four members outside the system. The idea of preventing caucusing is ridiculous. You cannot prevent caucusing; it is part of human life. It is like saying that in a democratic parliament you are not allowed to talk to colleagues or even opponents occasionally and get together a common position on something—it is simply absurd. Life does not work like that. Surely the only point of staying outside banking union is because you want a different type or different methodology or different style of banking supervision. If you have that, either you have a more onerous or a less onerous system than prevails on the continent. If it is more onerous, you reduce the competitiveness of our own financial sector in this country; if it is less onerous, you undermine public confidence in the banking system or risk doing so. So you have to ask yourself what the benefit is. What you certainly do if you have this sort of dual system is create regulatory arbitrage and a great deal more regulatory compliance cost for all participants. A lot of the bigger banks will be operating on both sides and will have to have different supervision and compliance structures to cope with the different banking systems that they are part of. I do not understand why we are not part of this system. Can I be helped by the panel?

The Chairman: A brief response to those questions.

Graham Bishop: I can see very strong reasons why the UK should be part of banking union. I understand the politics of not wanting to be part of something that is a mark of a deepening eurozone.

Lord Davies of Stamford: So it is just politics, not functional considerations.

Graham Bishop: I think it is largely politics. The fact is that our banks in London do a huge amount of euro-denominated business—foreign exchange, derivatives et cetera. How do we cope with a crisis with one of them where we need euro liquidity? The Bank of England does not print euros. Only one bank does and it is in Frankfurt. So there is a risk for us if we are not part of this, and the ECB does not support us at some critical moment or exacts a price in some way or just dithers. Our banks are at greater risk. We are choosing to have a more rigorous regulatory framework, which put us at a disadvantage.

Philippe Legrain: UK banks also do lots of business with the United States, but it does not mean that we enter into a banking union with the United States. The lender of last resort for UK banks is the Bank of England. If it needs foreign currency, that can be dealt with, as it

was during the crisis, by swap lines between the Federal Reserve and the Bank of England or indeed between the ECB and the Bank of England.

Lord Lawson of Blaby: There is also the IMF.

The Chairman: Did you want to come in on this point particularly, Dr Hodson?

Dr Dermot Hodson: On the economics of it, banking union comes very close to questions of fiscal sovereignty. That is the key reason why the UK is not involved. On the politics of it, or rather the governance of it, it is kind of too late. A lot of these decision-making structures are now located in the European Central Bank—there was a scenario in which they were not. What banking union would mean for the UK is ceding a measure of sovereignty to the European Central Bank.

Lord Davies of Stamford: That is politics, then.

Dr Dermot Hodson: It is economics and politics.

The Chairman: Lord Lawson wanted to come in on a broader point.

Q7 Lord Lawson of Blaby: I do not know whether it is a broader point; in some ways it is more specific, but I suppose it may be broader. It is certainly the case that London and the British banking system is not British or European but global, and in so far as we need a global back-up, that is provided by the IMF, which has stepped in in banking crises in the past, particularly in Latin America. Incidentally, I agreed with a great deal of what Mr Legrain said, but I was interested when he said that it is perfectly possible for there to be economic differences among the member countries of the European Union, and indeed of the eurozone, and he pointed to the example of the United States. Of course, the United States is a fully fledged fiscal and political union in which there are automatic transfers that oil the wheels and solve problems, so it was an interesting answer for that reason.

Coming back to the United Kingdom, do you see tensions between the eurozone countries and the non-eurozone countries, particularly bearing in mind, as Lord Davies has rightly reminded us, that as more of the non-eurozone countries join the euro the double requirement disappears. Do you see, looking ahead in particular, the possibility of tensions? If you do, what are these tensions and how might they be resolved?

The Chairman: I am going to go to Mr Legrain first this time.

Philippe Legrain: First, on the issue of the United States, academic studies show that most risk-sharing takes place through capital markets and cross-state ownership and much less through fiscal policy. While you are right that if the political conditions existed a federal union in the eurozone would make sense, given that the political conditions do not exist for

that, you need to look for second-best options, and second-best options include decentralisation, which I think is preferable to the current system.

On the question of the tensions between eurozone and non-eurozone countries, of course they could exist, and the recognition of that is why we have the double majority. You are also right that over time, were the non-euro members to join, that would no longer operate. I do not think there is any prospect soon of Sweden, Romania, Bulgaria, or Croatia for that matter, joining the eurozone. It would be in Britain's interests, assuming that it stays in the EU, to argue for continued enlargement so that there will always be a group of non-eurozone countries sufficient for that.

In any case, I do not think that the future of the euro is necessarily assured. It might still break up. Indeed, unless it is reformed it probably will break up at some point. So while it is important to have these safeguards, the fear in Britain is that somehow there is an integrated eurozone whose preferences are aligned and that is ganging up on the non-eurozone. There is a hypothetical risk that one needs to protect against, but I do not think it is imminent.

Dr Dermot Hodson: I would say that we have already seen those tensions; they are exemplified by the referendum that we are having in this country. The Bloomberg speech that David Cameron gave in 2013 was premised on the fact that the eurozone was changing, that we did not know what it would look like in 2013, and that we would know what it would look like by 2017. We do not really know what it will look like. It creates uncertainty over the direction of European integration, and there is a heightened risk to the UK's relationship for that reason. That is why it is very difficult in the Brexit discussions to get a sense of exactly where the eurozone is headed. We were supposed to know by now, and we do not.

Graham Bishop: Only the UK and Denmark have a formal opt-out from the euro. Over a period—and we are talking here about a decade—I would be quite surprised if the four or more “out” condition still operates, so I would expect our double majority to fall away at some stage. Would the others give it three or more, which is getting close to a veto? I find that unlikely.

On the tensions that you talk about, as year after year we go through the European semester and the macroeconomic procedure for overall economic policy in the stability and growth pact for public finance, and if they succeed, which they are doing slowly, in driving up the level of competitiveness and productivity of some of these economies to the extent that they are running a current account surplus of some magnitude and we are running a monstrous deficit—5% of GDP, the biggest since 1948, which is hardly ever remarked on—this is evidence of a relative loss of competitiveness here. That will be the source of tension between

us and them. They are solving their problem; we, at the moment, are not. This is very alarming today, not just in the future.

Q8 Lord McFall of Alcluith: The Five Presidents' Report does not touch the ECB, which you can understand; they do not want to waste political capital formalising the role of it. However, questions arise from that regarding the future role of the governance framework, particularly given the outright monetary transaction programme, which, although not used yet, has still been criticised for assisting the finances of member states. Can you give us your view on that, particularly the implications for non-eurozone members?

Dr Dermot Hodson: I think the most significant transfer to the European Central Bank is in the arena of banking union and the single supervisory mechanism. The governance arrangements are very curious; there is a body that is within the ECB but not totally of the ECB. So that is an area that we need to look at closely to see precisely how much control the governing council of the ECB has over its decisions and what role is left for national supervisors. National supervisors still seem to have a pretty significant role in the day-to-day operations of the single supervisory mechanism, so my answer to your question is that the European Central Bank plays an important role, but to a certain extent it has been fragmented in the role that it has been given because of these new governance structures.

Lord McFall of Alcluith: Has the role of home regulators not been weakened as time has gone on anyway?

Philippe Legrain: The problem with the ECB is that it is excessively independent, has no political master and meddles inappropriately in politics, and even questioning what it does is subject to a kind of taboo. The model that we have in Britain, where there is operational independence for the Bank of England to meet a target set by the Chancellor and where ultimately, even with that operational independence, you know that the Bank of England is basically an arm of government, is far healthier than an extremely independent central bank whose independence is in a treaty that can be changed only by unanimity; which towers over 19 member Governments; can refuse to intervene for a couple of years to prevent a panic; can write a letter to an elected Prime Minister saying, "We won't buy your bonds unless you make these specific reforms", and all sorts of things that are really completely outside the purview of monetary policy; which, as Dermot Hodson has just said, has now acquired all sorts of additional powers in the banking area that have distributional and potentially fiscal consequences; and which is largely unaccountable. The ECB just deigns to have a dialogue with the European Parliament. It does not provide sufficient information to the European Parliament for the European Parliament to hold it to account, and in any case ECB officials

cannot be disciplined, or indeed sacked, for failing to do their duties or for overstepping them. It is clearly a completely inadequate state of affairs, and it is very telling that there is no mention of it whatever in this report or, indeed, in previous reports.

Lord McFall of Alcluith: What are there dangers in it for the UK and particular for the home regulators?

Graham Bishop Yes. The UK's risk is that the ECB must be the regulator of anything that is in euros. We have already talked about that, and it lost the court case on whether it was pushing its boundary out too far. I do not think for a moment that it will stop at that, because it cannot. It is required to have oversight of the payments system. Anything which goes into that - securities, transactions et cetera—is something it needs to know about and can control. Its problem—here, I agree that democratic accountability is a difficulty—is that because of the nature of the banking system, it was obliged to provide to the Greek banks, for example, with liquidity on a colossal scale. Therefore, it is a player in any political decisions. It could say, “No, we won't provide that liquidity”. The Greek banking system fails next day and, with it, the Greek economy. It is stuck, for better or worse, with being in a highly political situation. It is clearly uncomfortable with that. One question is how the rest of Europe will resolve that to bring back to democratically accountable politicians those sorts of decisions about providing liquidity to banks. The first thing is that banks are safer to begin with and do not hold too many assets of the member states' Governments, breaking the “doom loop” between the bank and the sovereign. These are longer-term plans—we have talked about reducing the large exposures to the Governments. That has to happen. Then the ECB can be less directly involved. But at the moment, there is no alternative. If banks need support, there is only one place where the support comes from.

Lord McFall of Alcluith: I will ask a quick question to Mr Legrain. There was mention of Italy and the bad bank. You mentioned subsequently that the Five Presidents' Report does not tackle the issue of bad bank debt restructuring. Is that a fundamental issue that needs to be tackled if we are going to achieve growth in the eurozone?

Philippe Legrain: Yes, I think so. There were two ideas behind creating a banking union. The first was breaking the link between banks and sovereigns; the second was the idea that national supervisors were captured by domestic banks and therefore you needed to hand it to an authority which was not. I do not think that it is clear that the ECB is independent of the banking interests that it supervises. I think that the asset-quality-review that it did last year was clearly inadequate, much more is needed to clean up Eurozone banks, which is essential for recovery there and therefore for the UK's prospects of exporting.

Q9 Lord Shutt of Greetland: What is your understanding of what fiscal union is? How might it be achieved? Do you think it is useful?

Dr Dermot Hodson: I see fiscal union as a term that does not have a stable meaning. Acknowledging that fact is the key to understanding how it is used and abused in the European discourse. For some people, it means some sort of fiscal stabilisation mechanism, so a centralised budget; for others, it means strong, central oversight of national fiscal rules. This report, to the extent that it talks about anything that looks like fiscal union, is talking about the possibility of some sort of stabilisation mechanism eventually, although it does not really go into detail on that. I see multiple types of fiscal union in the discourse and a degree of hesitancy about putting anything concrete on the table. Compare it to the four presidents' report, which has pages and pages on a fiscal capacity, this being a euphemism for a centralised fiscal mechanism.

Philippe Legrain: That is a fair characterisation: there is disagreement about what fiscal union means. I would go one step further and say that the idea that creating a eurozone Finance Minister who is basically a super budget enforcer for national budgets is not in my view a fiscal union.

Lord Lawson of Blaby: A fiscal union, I would suggest, occurs when there is to a large extent a common system of taxation throughout the area and public expenditure decisions are taken to a large extent centrally. That does not mean that you do not have—as we are told we are going to have this afternoon—more talk of a northern powerhouse and separate things. But I think that a fiscal union does have a clear meaning.

Philippe Legrain: Absolutely, it has a clear meaning, but the German use of the fiscal union, by, for example, Wolfgang Schäuble, when he talks about creating a super budget enforcer, is a misuse of the expression “fiscal union”. That is not the same as what you have just described, which is how I would also describe fiscal union.

The Chairman: The sort of fiscal union that Lord Lawson is describing is not what is described in the Five Presidents' Report or indeed in the context of this inquiry.

Lord Shutt of Greetland: So it is not the same standard rates of income tax and corporation tax throughout Europe. That is not the case.

Philippe Legrain: It would be having a federal level, like in the United States. There, you have a federal level of government and a state level of government. If one were to create a federal union in the eurozone, one would imagine that the national state level would be much larger relative to the federal level than it is in the United States. You would presumably still

have some common resource, so some sort of tax at a European level. Then you would have varying taxes set at a national level.

Lord Lawson of Blaby: In the United States, federal expenditure and federal taxation are much more important than local expenditure and local taxation. That is the nature of a political union, is it not?

The Chairman: There is also the issue of debt mutualisation—Eurobonds and things.

Philippe Legrain: Which has been completely dropped. In the two four presidents' reports of 2012, there was aspiration to move towards Eurobonds, as indeed there was in the Commission's Blueprint. This was completely dropped.

The Chairman: Greece took it off, essentially.

Graham Bishop: Two very quick points on taxation. The idea of a common income tax is for another century, but a consolidated corporate tax base is becoming a very real possibility. I am not saying the rate, but the tax base. That is something that we will have in a few years. On the common debt, I have proposed a scheme for a temporary Eurobill fund—I think the clerk will circulate my proposal on that. That has had quite a lot of interest. I was appointed to a European Commission expert group and the result of that was that my proposal is still seen as possible. That is being pushed by the European Parliament. I feel confident that the Parliament will come back and take this up. This would very easily fit into a European Treasury, and the way that it would operate would be a good discipline mechanism for the enforcement of public finance and macroeconomic policies.

The Chairman: And we have received this paper, have we?

Graham Bishop: Yes, you have.

Q10 Lord Borwick: Can we talk about within the eurozone and divergences between the economies? Will they try to achieve more convergence between the countries? Will that work?

Dr Dermot Hodson: Well, they are going to try. They are going to try by setting up the competitiveness board, which will have a series of watchdogs at the national level that will sound the alarm. I think that will help to a certain extent. It will add another voice to the call for prudent economic policies. But I think that we are entering the zone of economic policy where economic policy does not necessarily have levers. You do not have a lever over competitiveness. It concerns things like wage-setting, which in many cases does not involve national Governments. So I think that the idea of multiple watchdogs will take pressure off the Commission, which often finds itself very isolated, but the idea that there is some sort of competitiveness lever is—

Lord Lawson of Blaby: It is a good job creation scheme.

Dr Dermot Hodson: Well, okay.

Lord Borwick: Job creation for agencies.

Philippe Legrain: Clearly, we have seen massive divergence since the crisis, with some countries doing badly and others doing catastrophically. There is an effort to promote greater convergence by the wrong means; that is, by driving everyone's unit labour costs down to try to match the efforts that Germany has made. The result of that is that you will have a depression of wages and domestic demand in the eurozone and ever greater reliance on exporting and running large current account surpluses. I do not think that is a viable growth strategy. It will certainly have big implications for Britain—how much larger can the eurozone current account surplus get and how linked is that to our own growing current account deficit?

Graham Bishop: On convergence with public finance, a lot has already been achieved. When you look at the number of countries in the corrective arm of the stability and growth pact process, you see that, in 2010, at the height of the difficulties, it was 15 and next year it should be four. So a great deal has been achieved. On the question of competitiveness and competitiveness committees and councils, I have no great belief that such bodies do very much.

But the scorecard that the Commission keeps on a wide array of economic policies—it goes into education, healthcare et cetera, and everything which goes into the competitiveness of a country—that is what is done and looked at in the European Semester. We are now on the sixth round of that. Not enough has been done by the member states to deal with the identified problems. That is where the process is going to be toughened up. The “revamped”—as they put it in the literature—European Semester process has the capacity to bring much closer convergence; in particular, identifying the countries which have a problem; why they have a problem; and persuading them, and then finally forcing them, to do something about it. There is the threat in this of using the conditionality of all the structural funds and such like. If you are not in compliance with your macroeconomic imbalance procedure commitments, you will not get the money. That is a big threat coming, and it may yet be used. So this should bring the outliers more towards the centre.

Dr Dermot Hodson: That is a threat that lacks credibility. The EU has never used fines.

Graham Bishop: Not yet.

Dr Dermot Hodson: Or the excessive deficit procedure. All those countries you talked about exited the excessive deficit procedure without getting anywhere close to fines. I do not think that the emphasis on pecuniary sanctions is where the real governance mechanisms lie.

Philippe Legrain: I think that there is a tried and tested way of achieving convergence, which is to complete the single market in services. Following the failure to do so a decade ago, the Commission has gone for a different strategy, which is to try to micromanage national reforms. So we have a 10-year plan called Europe 2020 which is operationalised in all sorts of ways. From a British perspective and a eurozone perspective, it would be healthier to prioritise completing the single market rather than somehow deciding that the people in Brussels know best and ought to try to implement the same reforms everywhere.

The Chairman: So the services directive, which has disappeared, would in your view have been the right way to go.

Philippe Legrain: I think so. That is the way to achieve convergence. If you look at the European Union, you will see that massive convergence was achieved largely through trade and investment within the single market. There has been scarcely any progress since the failure a decade ago.

Q11 Lord Davies of Stamford: I agree with Monsieur Legrain on that point. One of my two great disappointments with this paper, and one of my great disappointments with the British Government's strategy for a renegotiation, is that there is no mention of the services directive. We should have taken that up in the course of the renegotiation; I cannot think why the British Government did not do that. The other disappointment I have is on automatic stabilisation, which is a point made by Lord Lawson earlier. Monsieur Legrain said earlier that much stabilisation takes place through the workings of the capital markets, which of course is correct. That will improve in the European Union with capital markets union and with institutional and private savers holding a more diversified portfolio across the different member states. Nevertheless, one does need automatic stabilisation and one needs more of it. One has very little fiscal automatic stabilisation with the EU budget limited to something less than 2% of Union GDP. So it is very regrettable to me that no additional suggestions are made there. Of course, there is a role for direct investment as well as portfolio investment, with people taking advantage of lower factor costs in different parts of the Union and so forth. There was scope for using this opportunity to propose something more specific in the area of fiscal stabilisation. I have always been a great supporter of some sort of common unemployment reinsurance fund. You cannot have merger of unemployment funds, because that would involve subsidy by states with lower structural levels of unemployment of states

with higher structural levels of unemployment, which would be an absurdity. You could have a reinsurance system under which, if the unemployment rate goes up by a certain acceleration factor, that country receives some insurance payment. Was it not a missed opportunity not to introduce some greater element of automatic stabilisation into the economy of the Union?

Dr Dermot Hodson: I think that there is no political headwind for this. They talked about it in the Four Presidents' Report; it got a very lukewarm reaction. It was one of the few elements of political restraint in this report that they did not recycle this idea. If that kind of stabilisation function is to emerge, the best place for it to start is not in a report authored by the President of the European Commission. A big integration step like this should not emerge from the European Commission if it wants to stand a chance of success. It has to emerge more organically from largely Franco-German co-operation.

Lord Davies of Stamford: So we are back to a contradiction between economic functionality and political dysfunctionality.

Dr Dermot Hodson: Well, I would call it political reality. Big political steps in European integration come via the member states, not via bright ideas from the Commission.

Philippe Legrain: The problem is German opposition. Germany looks at any form of risk-sharing as a step towards a transfer union, because it cannot conceive itself as ever being a necessary recipient of any such mechanism. So when we were writing the Commission Blueprint, we were told very clearly that there could be no mention of a eurozone-wide unemployment insurance scheme because it was a red rag to Germany, so the Commission internalised that constraint and dropped it entirely. So I am not surprised that it does not feature here.

Lord Davies of Stamford: A crude system of merger of unemployment insurance funds would not be possible.

Philippe Legrain: Sorry, it was along the lines that you mentioned.

Lord Davies of Stamford: If they used a bit more imagination, they might come up with something. At the end of the day, the Germans have to dig into their pockets or get out their chequebook when nasty things happen to the Union's financing, so they might be persuaded by the experience of the crisis to take a slightly broader view in the future.

Graham Bishop: The problem for unemployment insurance is that it is just such a sensitive and large number. The political sensitivity is huge. That is where you can see very large amounts of transfer payments coming. I can understand why the Germans in particular, as the assumed footers of the bill, would be very nervous about it.

Philippe Legrain: That is the problem behind the whole premise of this: that somehow Germany foots the bill. If we had proper bank and debt restructuring, the losses would have been imposed on creditors rather than mutualised. By mutualising those losses, in effect Germany therefore demands greater control over everybody else as the price for that. That is a ratchet effect which is harmful economically and harmful politically.

The Chairman: Thank you. Lord Skidelsky wanted to pick up countercyclical policies.

Q12 Lord Skidelsky: We have covered a lot of that already, but I have a specific question which goes back to something which Mr Bishop said and other witnesses may have said. The future of the eurozone depends on growth in the eurozone—at least that would postpone the operation of some of the structural problems. But, in fact, the GDP growth in the eurozone was 1.6% in 2011, -0.8% in 2012, -0.3% in 2013, 0.8% in 2014 and it is projected to be 1.5% this year. The output gap, as estimated by the OECD, was 2.7% in this year and unemployment was 10.9%. Those figures would be a lot worse if Germany was excluded. The IMF has also suggested that growth would be more vigorous if there was more countercyclical policy. Are you worried that the European Commission in its view of what should be done really focuses on debt reduction or, loosely, fiscal consolidation at the expense of any of these demand-increasing policies? Does that not jeopardise the future of the eurozone itself? It hopes to do everything through structural adjustment and ignore the problem of demand.

Graham Bishop: I mentioned the problem of debt ratios. When I came into the financial world 40-odd years ago, the debt ratios of the EU states were 30% of GDP. Now they are 100%. The financial markets have now discovered the hard way that you can lose money on public debt, so the idea that countercyclical policy will finish up with a significant rise in public debt is quite alarming, because if you finish up with the financial system taking large losses, then through the leverage ratio, as it were, of the banking system, you knock through to bank credit to the economy being lost.

Lord Skidelsky: What are you going to do about growth?

Graham Bishop: That is where we are stuck with the demographics. The only way out of this box, in a sense, is greater productivity, and I call that competitiveness. If we do not get that, we have a problem, I agree. That is why it is so urgent that we make sure that we get the productivity growth that is then going to feed through into more growth et cetera. We are in a debt trap.

Dr Dermot Hodson: I think that the stability and growth pact is a lot more flexible than it looks. For all the talk of the six-pack and the two-pack and the pecuniary approach of fines at

an earlier stage, we have seen no fines. I think that the Commission, by not talking very much about the stability and growth pact, is trying to usher in a more flexible interpretation of it. There are not many mentions of the pact in the Five Presidents' Report, which in itself is significant. I think they are trying to encourage stabilisation through national budgets.

What the pact fails to do is have any mechanism for encouraging some sort of fiscal stimulus package, and that is where it falls short on growth. How much faith you can place in a stimulus package for long-term growth, I am not sure. You could perhaps generate more growth for a few quarters, but that is only going to be part of the solution.

Lord Skidelsky: There has been almost no growth for four years.

Dr Dermot Hodson: But if you look at the whole history of the project, growth has been regrettably low since the euro was created.

Philippe Legrain: You are absolutely right to point to the terrible growth performance. In fact, the most pertinent statistic is that the eurozone is still smaller than it was in early 2008, whereas the UK is 6% bigger and the US is 11% bigger. The main problem is the deep reluctance to restructure banks and debts. Most of the debt is private debt. Only in some countries is the main problem public debt. That is what from the start greatly exacerbated the crisis, and it is why the terrible growth performance has endured. On top of that is the fiscal and monetary straitjacket, which you partly alluded to. Also important is the refusal to use the macroeconomic imbalances procedure to force Germany to tackle its vast and growing current account surplus. The Germans say that it is not a problem because it is no longer with the rest of the eurozone. Actually that means that it is exporting its capital elsewhere, draining demand from the eurozone and exporting deflation to the rest of the eurozone. That is a very big problem indeed, especially in the context of the other constraints that I just mentioned.

Q13 Lord Skidelsky: Mr Hodson, you saw some wriggle room somewhere, but broadly speaking there is nothing in the Five Presidents' Report or in the European Commission's present thinking that offers much hope for a growth stimulus.

Dr Dermot Hodson: You are right about the report, but if you look at the Commission's record since Jean-Claude Juncker took over, he has promoted a more flexible interpretation of the pact, which I think is consistent with his track record on the pact during his time as Eurogroup president, so he is allowing more room for manoeuvre at the national level than some people suggested when these reforms took hold. How much fiscal stimulus we are really going to get from this is debatable.

The Chairman: Before we go any further, can you stay on for a few minutes more? I am conscious that we have had the hour and 15 minutes that we had asked of you, but if you

could stay for a few minutes I would like to go around the Committee and ask whether Committee members have any other questions that they would like to follow up with. Is that acceptable? Yes. Lord Davies, is there anything that you wanted to pick up on?

Lord Davies of Stamford: No. It has been an excellent session, Madam Chairman. Thank you very much.

Lord Lawson of Blaby: I agree with Lord Davies that it has been a good session, but may I ask one further question? What, in a nutshell, do you three think is the purpose of this whole exercise? I do not think that you want what the five presidents might say in answer to that question. I am talking about the Five Presidents' Report, particularly on stage two, because obviously the purpose of stage one is to transition to stage two. What is the purpose of stage two?

Graham Bishop: I think I laid it out pretty clearly at the beginning, but I see these various unions—the economic, the monetary, the fiscal—and the political at the end, which is the necessary democratic legitimisation of the other economic elements. We have to get there, because if we do not—if they do not—the risk of crisis, from public finance or whatever, is far too great. There will be the risk of a break-up, which would have catastrophic effects. They are on a path, which I do not think they can escape from, of greater integration in all these areas that will produce the necessary result of much greater political union. One manifestation will be the European Parliament having a greater direct role as co-legislator on economic governance as well as purely on legislation, as we discussed at the beginning.

Dr Dermot Hodson: I think it is partly about dealing with urgent business on banking union. Beyond that, it is about Jean-Claude Juncker and his idea of a legacy, putting forward integrationist ideas. For that reason, a lot of the bigger ideas stand a limited chance of success.

Q14 The Chairman: I was just going to wrap what you have said into following up what Dr Hodson said. I shall come to you in a minute, Mr Legrain; I think you will have an interest in what I am going to say. Dr Hodson, in terms of the banking union and wrapping up the urgent business that still needs to be undertaken, what is your assessment of the reinsurance approach being used in building a single deposit guarantee scheme?

Dr Dermot Hodson: The Commission put its proposals on the table yesterday so I am still digesting them, as I am sure everyone else is. They struck me as very ambitious. They have as a goal a pooling of fiscal sovereignty. The reaction from Germany has been as expected: it is very wary of this. For this reason, it is another integrationist idea that is, perhaps, not well judged.

Philippe Legrain: For the purpose of the report, there is a common realisation that the eurozone is not working properly and that its governance is inadequate. There is also a common—false, in my view—belief that further integration is necessary. Therefore, this report tries to suggest that momentum towards that destination exists when, in fact, none does. However, I would also place it in the context of my initial remark, when I said that this is about Brussels politics. The first report was from Van Rompuy, the President of the Council. This is Jean-Claude Juncker, in close co-operation with [others]. As you said¹, this is about Jean-Claude Juncker saying, “This is my vision. I am putting this down in history so that I will be able to claim credit. If any of these things get done in future, I can say they came from me”. That is really at the heart of it. Anyone who has worked in Brussels knows that the biggest preoccupation of people there is where they stand in the inter-institutional pecking order.

The Chairman: Do you have any comments on the DGS?

Philippe Legrain: As I said, I do not think this deposit insurance scheme will happen. As Mr Hodson said, the German opposition has been furious. On carve-outs, for example, one could imagine the greatest opposition coming from the politically very powerful Sparkassen. Contrary to what Mr Bishop said, they are very significant. They have roughly €1 trillion in assets. Given its political power, one way around would be to carve it out, as it has been carved out of the banking union. But even with that political concession, I do not see this flying any time soon.

Graham Bishop: If I may comment on the DGS, we are talking about a €45 billion fund in the fullness of time. It is tiny. Even the remaining bank deposits in Greece—tiny Greece—come to €140 billion. So if there is a systemic crisis anywhere, this will be completely insufficient.

Philippe Legrain: Again, that is not true. If it is a liquidity problem, the central bank can provide liquidity to prevent any run. If it is a solvency issue, you can bail in the creditors, which is what is supposed to happen, and not call on public funds. Therefore, the absence or not of common fiscal funds is not that important. The real issue is the deep political reluctance to bail in bank creditors, despite what the BRRD and the SRM say.

Lord McFall of Alcluith: It is a bit of dismal message this morning: we are not restructuring bank debt, debt mutualisation has been completely dropped and growth is problematic, as Lord Skidelsky said. Graham, you mentioned that the only solution is to increase productivity.

¹ Mr. Legrain clarified that he was responding to Dr. Hodson.

The conundrum of the productivity increase in the UK, never mind Europe, is: how are we to achieve this productivity so that we get decent growth? That is the question.

The Chairman: Perhaps not to be answered right away. Lord Skidelsky, did you have a concluding thought that you wanted to share?

Lord Skidelsky: No. I was just going to say, on how you get productivity growth, that it is not by lowering wages.

Graham Bishop: It is a complex problem but there is a very simple answer: a highly skilled, better educated, healthier workforce, et cetera. All those factors go into it.

The Chairman: Thank you very much indeed. We greatly appreciate your staying so long and speaking to us with such candour and occasional disagreement. This concludes today's public evidence. The Committee will now continue its meeting in private.