



HOUSE OF LORDS

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Financial Affairs Sub-Committee

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COMPLETING EUROPE'S ECONOMIC AND MONETARY UNION

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Witnesses: Fabian Zuleeg, Guntram Wolff and Hans Hack

Members present

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

Examination of Witnesses

Fabian Zuleeg, Chief Executive, European Policy Centre, **Guntram Wolff**, Director, Bruegel, and **Hans Hack**, Managing Director at FTI Consulting Brussels

Q118 The Chairman: Mr Zuleeg, Mr Wolff and Mr Hack, thank you for agreeing to give evidence to us today for our inquiry into completing Europe's economic and monetary union. This session is on the record and we will take a verbatim transcript of proceedings, which will be published in due course; you will have the opportunity to correct any minor errors or misunderstandings. We have started a little bit late, so I would like to go straight into things, if I might. I wonder whether all three of you could give us a brief overview of your understanding of the Five Presidents' Report and the shorter-term actions proposed by the European Commission. In doing so, perhaps you could comment on your perspective on the euro's longer-term sustainability and if you think there are significant political obstacles to achieving what is proposed in the report.

Lord Butler of Brockwell: Chair, when our speakers first speak, could they just identify themselves, because we do not have name places?

The Chairman: Indeed. Mr Wolff, would you like to kick off?

Guntram Wolff: Yes. My name is Guntram Wolff. Thank you very much for having me today. I run the European think tank Bruegel. We are coming out with a paper this week called *One Market, Two Monies: the European Union and the United Kingdom*, where we look specifically at the current negotiations with the United Kingdom but take a more long-term view. That is not the topic of today's discussion, which is why I only mention it here.

The Chairman: We will be coming to it a bit later in the questions.

Guntram Wolff: Right, so let me quickly say a couple of words on the Five Presidents' Report. Essentially, the report has two phases, the first phase and the second phase. The second phase is quite weak in terms of what is being put there. It mentions all the right things

that are in the discussion—fiscal union, democratic accountability and so on. The long-term elements are all there without being very concrete and so it is up to political discussions what will happen there. The time horizon is 2025, and my sense is that people at the political level think that this is very far away still and so no concrete progress has to be made at this stage. There is a reflection, though, at least in some quarters, that perhaps we should be a little bit more specific on some of the concrete issues ahead of the big elections in 2017—the French election and the German election—and then, of course, at some stage, also the European Parliament election. There is no final political decision, but my gut feeling currently at the moment is that, given all the other ongoing political issues, in particular the refugee crisis, political capital is very much in different quarters at this stage.

Then there are the short-term issues. The big debate this year concerning the eurozone will continue to be on banking union, where we have a proposal for a European Deposit Insurance Scheme on the table. Overall, this proposal is done in a smart way, in the sense that it proposes to start with a reinsurance model and eventually to move to a full insurance model. There are a lot of questions about whether Germany buys into this or not, so let me be straight on this. The resistance is very large in Germany; that is very clear. At the same time, I also hear important messages that, especially if combined with a risk reduction approach, it is possible to introduce that system. The discussion at the moment is really about whether we should have deposit insurance plus risk weights for sovereign debt or large exposure rules for sovereign debt. There is already an agreement forming that those two things are connected: we get deposit insurance on the one hand and, on the other hand, we get risk reduction. Personally, I favour risk reduction through large exposure rules, not risk weights. It raises all kinds of questions.

The Chairman: We will be coming to that in a little while. Mr Hack.

Hans Hack: My name is Hans Hack and I am head of the financial services part of FTI Consulting, which is a consulting firm here in Brussels that helps companies deal with EU legislation. Before that, I worked for the Dutch Government for 10 years, at the Ministry of Finance and as a permanent representative just across the street.

I agree with much of what was just said in this introduction. On the short-term actions, you do see progress. For example, on EDIS, you do see that countries that were initially as hesitant as the Germans have become much more positive—not least the Dutch, who are chairing the negotiations right now and have made it a priority to progress. So I see significant chances to progress the short-term actions.

If you ask about the long-term viability and the long-term projects, indeed, it is relatively undefined and attention is elsewhere, but I find one aspect of that quite relevant and that is how member states will start to own procedures around, for example, the European Semester. What do I mean by that? Until now, there was always an implicit agreement between member states that it is the European Commission that comes out with its assessments and recommendations and member states then have a bilateral discussion with the European Commission about whether they were right or wrong. It would be a significant game-changer if that were to become a multilateral discussion whereby member states openly discussed with each other the pros and cons of their economic policy and the value of those country-specific recommendations. There might be a chance that that will happen, because I have heard the Dutch Government quite clearly state that they want to focus on that in the European Semester in the next six months—to break that implicit agreement a bit and get that discussion going between member states. We will see how that turns out, but that could be a significant change in how the systems operate and could lead to more co-ordination of economic policy.

Fabian Zuleeg: I am Fabian Zuleeg; I head up the European Policy Centre, which is another Brussels-based think tank. I agree with much of what has been said, so I am not going to repeat it. It is a useful report in that it has the right terms. What is worth emphasising is that the political buy-in into the report by the member states was not particularly convincing. They welcomed the report, which is, in my view, a way of saying, “We have noted it, but we are not intending to do anything with it”. The big question of what will happen in the longer term with the recommendations in the report is not addressed. While you could have some discussion around some of the specific solutions, as much as they are specific in the report, it is much more important to recognise that the political will is not there at the moment to progress in that direction. In the longer term, we will need to have some form of political deal, particularly between France and Germany, on the way forward, which will not be easy before the elections, so we are not going to see much progress.

In the shorter term, we have had the proposals from the Commission about revamping the European Semester in line with the Five Presidents’ Report. I am not sure that this will really make such a big difference to how the European Semester works. It is not working at the moment, which is a major concern that we have. One of the key planks of the whole new governance does not seem to be performing very well and maybe there will be more pressure from some of the member states. But, so far at least, it does not seem to engender any change

within member states' policies, which ultimately is the purpose of the country-specific recommendations.

We should also not forget Greece—not in the sense of the structural issue, but there are some Greek-specific issues that will have to be addressed in the coming years. I do not think we should wait until we have another crisis in Greece before we start addressing those. We also need to make progress on banking union, but I am not going to go into any more detail, because it has already been mentioned and there are more questions later on.

To wrap up with the question about how sustainable the euro is, I would not expect the euro to collapse any time soon, but if those structural issues are not addressed we can be fairly certain that some sort of crisis will recur. Then the question is how you deal with that crisis and whether the eurozone is robust enough to again find political consensus and the countries can pull themselves together to take whatever actions are necessary. We should recall that when it came to the crisis with Greece last summer it was a very close call, so maybe we should not risk doing this again. But, at the moment, there is very little action that makes me feel confident that we will not.

Lord Butler of Brockwell: Could I just ask Mr Zuleeg to be a little more specific about the Greek-centred questions that he sees coming up in the next two or three years?

Fabian Zuleeg: There is the ongoing discussion about the debt level in Greece and what will happen with it in the long run: whether at some point in time there will have to be some form of debt forgiveness or postponement into the future. It is not necessarily an immediate problem, because the way the debt repayment is happening now is not a particular burden on the Greek economy, but it is a long-term question that remains unanswered. The more acute question is going to be how well Greece performs in relation to the support package, which has been very strongly emphasised as being the last. What happens if we get to the end of this support package and Greece still needs support? For me, that is the big question, which we have not really answered.

Guntram Wolff: I have two quick remarks on Greece. The first is on debt sustainability. We clearly still have far too high a goal for a primary budget surplus and there will have to be an adjustment. From a political point of view, let me make a broader point. In the Greek financial crisis there was a lot of talk about how we need to keep Greece in the euro for geostrategic reasons, because it is our outside border to the EU. The current refugee issue raises lots of doubts about this question, in the sense of whether or not we believe that this is really the outside border or whether, in fact, the fences will be in Macedonia or elsewhere. This raises all kinds of questions and, certainly in the capital of my home country, Germany, I see a lot of

sentiment that says that this is really changing the whole game, so I would warn that this is an issue to take into account.

Lord McFall of Alcluith: Could I ask if the migration crisis will spill over into economic issues and economic policy? Will there be trade-offs?

Guntram Wolff: The direct spillover is not very big. The fiscal costs of the migration crisis are quite limited. Undoing Schengen would be costlier. There, we end up with something like, perhaps, a two-digit billion number and then there is the big psychological dimension that you would undo a significant integration step, which raises all kinds of questions in other policy areas.

Q119 Lord Shutt of Greetland: Not unsurprisingly, we are concerned here about the UK and we look forward to this paper, *One Market, Two Monies*. I do not think one of those monies is Swedish, but we nevertheless hang on to other outs as well. What impact is all this going to have—the direct and indirect impacts of all these actions identified by the Commission to complete EMU—on non-euro member states and particularly the UK?

Guntram Wolff: Thank you for that question. Let me consider the long-term issue that you raise, which is: if the eurozone takes additional integration steps, what are the consequences for the outs? The fundamental question is whether euro integration steps will have an impact on the operation of the single market, of which the UK is a member. Let me put in parentheses that no matter whether the UK is inside or outside the EU the question is the same, because the access to that market is of fundamental importance. The governance is different, but the access to the market is fundamental.

The eurozone deepening will involve three major markets: banking markets, capital markets and, potentially, labour markets. A defining feature of all these three markets is that these are not just some random, free-floating markets; they are fundamental for our economies and they are characterised by very heavy government regulation, government intervention and implicit or explicit fiscal arrangements. If you believe that we will go forward with deeper integration in the eurozone—and there is a big question mark here, but let us assume we will do this—there will be, at some stage, the creation of new governance mechanisms to cope with the deeper integration of the eurozone. Then the question arises: will these governance mechanisms, be it institutions, stronger euro group meetings—you can think of different ways of organising this—be a problem for the UK and other outs? The bottom line here is that, in order to come to a sustainable arrangement, one has to find a way to protect the minority against the majority of the eurozone. Conversely, of course, the eurozone also needs some

form of protection against the veto of the minority. The minority should not be able to veto major steps that are necessary.

This whole discussion is already starting to be quite concrete. Let me give you one example, which relates to the discussion on capital markets union, where the Five Presidents' Report contains a clear statement saying that deeper capital markets will require a European capital markets supervisor. This is a clear reference to an institution, while Lord Hill's proposal on capital markets union carefully avoids any reference to a supervisor. Already within the Commission you see that there are different lines of thought around what it takes to deepen capital markets and they are fundamentally different because of the different logics of monetary union and the single market. Our paper will be published this week.

The Chairman: We look forward to it. Mr Hack, you wanted to come in on that.

Hans Hack: I just want to say something about whether the interests differ or not. So far, the UK's approach has been to let the eurozone sort out its own mess, if I can put it that way. But of course it is in the interests of the UK as well that the eurozone does do that and sets up sustainable institutions to have that economic growth.

If you look at some of the longer-term or shorter-term points in the Five Presidents' Report, I would see more alignment than differences in terms of what they are trying to achieve. For example, we still have to see how national competitiveness councils will work and what influence they have, but the basic idea would be to have external experts assess the governance policies from a competitiveness point of view. I tend to think that that is something that would be in alignment with the UK's view on how an economy should be managed, so I do not immediately see a disconnect between the interests of the UK and those of the eurozone and what those countries are trying to achieve through the Five Presidents' Report. Of course, what is a certain risk is a two-speed Europe and how that impacts, but Mr Wolff has dealt with that aspect.

Fabian Zuleeg: I have a couple of points. Firstly, there needs to be recognition that greater stability in the eurozone directly benefits the UK, so the question of what is in the national interest of the UK, whether it is blocking something that might have a specific negative impact on the UK but has a positive impact on stability in the eurozone, needs to be questioned. Secondly, we already have a multi-speed Europe and the big question going forward is: even if we are seeing more integration in the eurozone, is that going to involve all eurozone countries or are we moving more towards a model where groups of countries will go ahead and integrate particular issues? For some of those areas of integration it might well be in the UK's interest to join them. There is an argument about whether banking union would

make more sense with the UK inside, from a UK perspective—the question of whether it is really just the eurozone or is it going to be some form of combination of countries. We also have other things on the table, like the financial transactions tax, which is not carried by all the eurozone countries. There will be different models of integration. It is very unlikely that we will have one master plan for the eurozone that will advance integration in a uniform way. Finally, I want to put down a marker that, while there is a legitimate concern of the UK around eurozone integration and what that might mean, we should also recall that when it comes to single market regulation the single market is, by law, qualified majority voting. That means there is the possibility for countries to block, but there will be no possibility, in my view, that a particular country will get a veto on single market legislation for particular sectors. Sometimes when you hear the debate in the UK there is this idea that this means that the UK will get a veto on anything that affects the financial sector. Politically, this is an impossibility.

Q120 Lord Davies of Stamford: I would just say that the Prime Minister has not asked for such a veto and the Government do not expect one. What is your concept of fiscal union? What do you think is the minimal degree of fiscal union that is necessary to establish a sound basis for monetary union and can that minimal degree of fiscal union be achieved within the context of the present treaty without treaty change?

Fabian Zuleeg: I am not a particular fan of the term “union”. We throw the word “union” around a lot in many different contexts. A union implies a very high degree of integrated policy-making, which I am not sure fiscal union always refers to. There are some minimal requirements in something that you would call fiscal union: some form of risk sharing, some mechanisms to deal with ex ante and ex post shocks. A transfer element is an essential part of fiscal union.

Lord Davies of Stamford: Permanent structural transfers exist in other states.

Fabian Zuleeg: Yes. I mean a permanent mechanism. It does not necessarily imply that it would be permanently in one direction or permanently to the benefit of certain countries, but a permanent mechanism. The key thing for me is that, if we are talking about fiscal integration, we have to talk—and here I do use the word “union”—of some form of political union. Fiscal integration is getting too close to the key issues of sovereignty within member states, so there has to be some form of democratic accountability, and a mechanism that allows constitutional courts across the eurozone to sign off on some form of fiscal union. That is a major challenge. It does not necessarily mean there is only one specific way that that could be designed, but there has to be something in there about how you make that democratically accountable.

Lord Davies of Stamford: So your answer to my question is that the degree of fiscal union necessary for the viability of monetary union cannot be achieved without treaty change.

Fabian Zuleeg: In my view, it cannot be achieved without treaty change. We will have to have a round of treaty change. There are things that can be done before treaty change but, in the end, if we are talking about anything approaching a political union, it clearly requires treaty change.

Guntram Wolff: Thank you for that question. My first point is that it is quite unclear what “viability of monetary union” means and what that term really refers to. Is it meant in the sense that political support in all countries will continue to be there to stay in the euro or is it in the narrower sense of fiscal backstop mechanisms to prevent a break-up at the level of monetary integration? I would argue that, in terms of the viability of monetary union in a more political sense, we will need more integration in order to strive and have better economic performance. Currently, we are surviving; we are not breaking apart with the mechanisms we have, but we are not really striving. That is my first point.

My second point is that when we think about fiscal policy, we have basically three old functions from Musgrave: allocation, distribution and stabilisation. For allocation, it is very difficult to think about public goods that are genuine eurozone public goods. Defence, Schengen, all these things are for the EU or different combinations of countries, but not eurozone public goods. Therefore, on the public goods side, I would argue that there are very few public goods beyond financial stability for which we need a banking union with a fiscal backstop.

On redistribution, we are clearly not at a stage where we want to have large redistributions around the union, where money flows from one country to another. Living in Belgium, I can tell you that even countries like Belgium are under a heavy strain because of this.

That leaves me with the stabilisation question, and here the important point to understand is that stabilisation means that you have to have significant budget spending items and they are all at the national level. Ninety-eight per cent of government spending is national. In other words, if we talk about stabilisation policy, we are talking about national fiscal policies and how we can ensure that the sum of the national fiscal policies makes sense for the eurozone as a whole, as well as that each national fiscal policy makes sense for that individual country. It is very much about co-ordination of these national fiscal policies and we need to step that up, improve it, and get a more symmetric notion there that considers the area-wide fiscal stance. That co-ordination will probably be extremely difficult, which is why I currently have a preference for adding an element of additional risk-sharing to what we have. We currently

have the ESM as a risk-sharing mechanism and as a way to prevent excessive austerity in countries that lose market access. We need something on top of that and I would do that quite automatically, perhaps something like an unemployment reinsurance model.

Lord Butler of Brockwell: Does it follow from that answer that you think that the fiscal board proposed in the Five Presidents' Report is a necessary step forward and do you think it will be effective?

Guntram Wolff: It is a good and necessary step forward. Whether it will be effective we will see, but the first problem is already that its independence relative to the European Commission is not totally clearly defined; let me put it that way. It will be extremely important for the new fiscal board members to, early on, announce that they will make their recommendations very public and have a public press conference to have an impact on the debate. Of course, a fiscal board or fiscal council is never the authority that takes the decision. It can only advise. That is what fiscal councils do and I hope that they will push the debate a bit in the direction of a euro area fiscal stance and the better co-ordination of national fiscal policies.

Q121 The Chairman: I wonder if I can pick you up briefly on the fiscal stance. Do you think that there are explicit ways to arrive at such a stance? How do you see the direction of travel?

Guntram Wolff: How do we co-ordinate the national ones?

The Chairman: Yes.

Guntram Wolff: What we need to make sure, especially in exceptional times when monetary policy is really constrained—and I am in favour of QE but it may not be sufficient to do the job—we have to find a way of saying that certain countries have to spend more and increase their deficits, while others that already have quite a problem with fiscal sustainability continue with a gradual fiscal adjustment path.

The Chairman: Thank you. That is a very clear hint, we think, to the country you come from. Mr Hack wanted to come in, then I will bring you in.

Hans Hack: I will be brief. The fiscal union part is very much linked to the political union part and that is where the greatest challenge lies. There is a lot of talk about the expenses side of fiscal union, but on the income side there is also a great challenge. One of the greatest challenges of this whole report and what might be missing is more integration of labour markets, taxation, even healthcare systems. If the fundamental economic policies differ too much, it will make it very difficult to integrate. It is carefully crafted to not touch directly on

those areas and this is where the treaty change comes in, because that is where the powers of the European institutions to do something are very limited.

Fabian Zuleeg: I wanted to make a brief comment on fiscal councils and those kinds of mechanisms. I agree with Guntram that they are useful; they can help to create greater transparency and maybe engender some discussion. What we are fundamentally not addressing comes back to the political question. What we are fundamentally not addressing is that the political decisions linked to fiscal policy are still accountable at the national level. They are not accountable at the European level, so it is very difficult unless you have a country in extremis, which does not have the choice any more because it needs support at the European level. For those countries that are in a normal political situation, it has proved extremely difficult to encourage co-ordination.

The Chairman: So how would you get the Germans to run down their surplus a little bit?

Fabian Zuleeg: The big question, which also goes into some of the other questions, is that it is very difficult to make progress if we are looking at it single issue by single issue. This is a way of getting the narrow national interest to the forefront of the debate. If you are discussing a particular issue, then it is very difficult for Germany. For instance, for Germany to address the export surplus it immediately creates a political backlash, which immediately creates political problems at the national level. We have to look at this as a much bigger package that even goes beyond EMU, where we are looking at what it is we can give and take across a number of different areas to get more structural long-term solutions where countries also transfer some of the sovereignty in these areas to the European level, which they are not willing to do.

The Chairman: Do you see that happening after 2017?

Fabian Zuleeg: I do not think you should ask an economist to make predictions. For the first time in a long time, Europe is truly at a crossroads. We can decide to continue to try to muddle through, which is what we have been doing for a number of years, or we will have to face the very difficult question of finding a big structural solution. It is not necessarily clear what that structural solution is, not least because we would also have to discuss that kind of thing with populations. This is not something that you can simply install. If we are looking at a treaty change process, we are talking about a large number of actors being involved down to referenda in a number of different countries. It is a very involved process, so clearly we are not going to do that in the short term and there is no appetite for having any of this kind of discussion in the short term. Whether the political constellation is more favourable in that direction after 2017 is a possibility, but it is not a certainty.

Lord Haskins: Are you not really hitting at the nub of the issue, which is the lack of political leadership across the EU? If you go back to the 1980s, the big countries had a strong common understanding and agreement about where they wanted to get to. Today that common understanding simply does not exist.

Fabian Zuleeg: I agree.

Q122 Lord Davies of Stamford: As Mr Zuleeg said, there is little appetite at the moment, in the immediate future, for treaty change. Therefore, we need to look and see what can be done without treaty change to stabilise monetary union as far as possible. One of the most interesting risk-sharing or stabilisation measures being talked about is the Bruegel proposal for a common reinsurance of our unemployment fund. I gather you have devised something that addresses the potentially serious problem that you would otherwise have of reverse incentive. You do not want to have taxpayers or premium payers in virtuous countries with no unemployment rates subsidising high structural unemployment elsewhere, so you have to find a way of avoiding that. I gather you have succeeded in doing that and I wonder if you could tell us a bit more about how your proposal would work.

Guntram Wolff: Thank you for that question. The idea of an unemployment reinsurance model is to keep unemployment insurance at national level, as it is, but in the case of a large shock there would be a reinsurance payment to that country's unemployment insurance, coming from a common fund. That shock would be clearly defined; let us say an increase in the unemployment rate by two percentage points or three percentage points—one can discuss that. As is usually the case with insurance, every country would have to participate because otherwise you just get the bad risks. You would have to make sure that there are certain minimal conditions that need to be fulfilled on the labour market side. I would also ask for variable fees for the different countries depending on some objective criteria—insurance premia depending on more or less objective risks.

That is the way of designing it, but the broader question is: what if we do not get the fiscal union and the adjustment that we would all like to have? What is important to understand is that we have the ECB currently buying a lot of sovereign bonds. My take is that, if we have another financial assistance programme, like an ESM programme, because despite these sovereign bond purchases a country runs into trouble, at this stage it would be quite important to ensure that the private sector somehow stays on the hook. The proposal to increase the maturities of sovereign bonds once you start an ESM programme is something we should very much keep in mind. It is a soft form of debt restructuring because, if debt needs to be restructured, it is not a good idea to put the burden, five years later, on the public sector, as we

have done in Greece. If we do something similar to what we did in Greece, for a big country, it will be very difficult to survive that. That is why, if we have a problem of that sort, we need to find a mechanism for keeping the private sector on the hook and one way would be to automatically extend the maturity of all sovereign bonds.

The Chairman: Is this a publicly available paper?

Guntram Wolff: I can send you some material on unemployment insurance.

The Chairman: Thank you. That would be very helpful. I am conscious of time, so will you be very brief, Mr Zuleeg? Then I will go to Lord McFall.

Fabian Zuleeg: I will be very brief. I just wanted to say that it is not only about treaty change. The political will to take even those steps that can be done without treaty change is not there because, ultimately, we are facing the prisoner's dilemma at the heart of this. It is about the trust between those member states that can provide this support demanding to see the reforms, the action on the ground in the countries that need the support, and those countries saying, "We cannot do those reforms without the support".

The other thing we are seeing, with respect, is part of the UK disease. We all know what we have to do at the European level, but we cannot do it because we cannot sell it to our populations.

Q123 Lord McFall of Alcluith: How effective will the European Semester be in driving macroeconomic adjustment and economic and fiscal policy co-ordination in Europe? I am thinking particularly of creditor countries and what means you would have to ensure that they do reform in that area. Mr Hack, you mentioned the National Competitiveness Board and that external experts would look at that, but some would suggest that, if it is just external experts, we are not going to get very far because the political buy-in is missing from that, as it is missing from the European Semester as well. How do you ensure that this National Competitiveness Board is not just words on a page but meaningfully contributes to the form, design and implementation?

Hans Hack: There is not that much detail on how this National Competitiveness Board would work or be structured, but there are some examples and I will turn to one that I know well in the Dutch situation, the Central Planning Bureau. It sounds a bit communist era, but it is more of an independent economic institution that calculates and projects what the economic effects of different policy measures would be, and it does that for political programmes in the run-up to elections. It is very well respected. It is independent, but it is institutionalised to a certain extent, because it assesses the national budget in a forward-looking way and that is taken on

structurally in policy discussions in the Netherlands. It is still an independent board, but it has some sort of anchor to the political system.

If you structure it in that way—I am not saying that that would be the model for every member state—there is the possibility that that would have an influence. I do agree with you that you need political buy-in, so you need to structure those competitiveness boards in such a way that they have that political influence, but they are going to be experts. It is not politicians who run the Central Planning Bureau in the Netherlands.

Lord McFall of Alcluith: We have the OBR, the Office for Budget Responsibility, in the UK and it is independent under Robert Chote. In the last budget it found £27 billion, which the Chancellor bagged, and there is a view politically that “Wait a minute, this is money that was just behind the sofa that has come up and has been convenient for the Chancellor”—so I see problems in the future for the OBR if things like that continue. Is there a case for, say, the OBR, rather than being accountable just to the Treasury, being accountable to the British Parliament, so that the assessment it makes is available to the whole of Parliament? My experience, including with one of the committees in the past, has been that it is very hard to understand the figures for individual departments and how you tie that up. Indeed, Paul Johnson, who is a director of IFS, came to Parliament a month or so back and said that he could not understand it. If we cannot understand that, there is a huge problem there and, therefore, we need some game-changer to ensure that there is more transparency, which would lead to more accountability. Is the OBR initiative one you think that could have some traction to it?

Hans Hack: I would be very careful in advising the UK how to structure its institutions.

Lord McFall of Alcluith: Well, is it a good subject for a think tank?

Guntram Wolff: One reaction is that the United States has the Congressional Budget Office, which is very independent and plays quite a big role in the congressional debate, as far as I can see from here—so that may be an interesting model. Here, the competitiveness boards have more of an aim of influencing not just the parliaments but also the trade unions and the wage negotiators, so it is a bit of a different aim. There, the Belgian example is often evoked. Belgium has the Belgian Competitiveness Council that issues guidelines on what it thinks is an appropriate development of wages, given the productivity developments that it sees. These are non-binding, but the wage partners see it. It is a number that is out there that is computed from data that independent individuals compile. There are lots of questions that arise from this, especially if there is wage differentiation across sectors, at sector-level and even

industry-level wage bargaining processes, but at least it is a way of informing the public debate.

One of the problems of monetary union is that countries came to monetary union with very different approaches to the wage-negotiating process. The Italian system, for instance, always had very high wage rises and eventually relied on a nominal devaluation of the exchange rate. Every 10 years, Italy had a nominal devaluation. If you look at the gap between wage development and productivity in Italy, it is very significant. The question is whether we can create some mechanisms whereby these debates happen a little more prominently and people are aware that they do not have their own central bank any more but monetary union, and there are certain stability criteria that you need to take into account.

Fabian Zuleeg: Very briefly, one of the things we need to consider here is the European dimension of this. This is not about better governance at the national level. It is a question of how that improves European policy co-ordination. My suspicion is that this will work well in countries that have the culture, the history, the background of doing this already, and it will not work well in those countries where it is not present. Unfortunately, it is in those countries where we need it most. I would not expect too much from this, certainly not in the short term, because we are talking about cultural changes, which are much longer term.

Q124 Earl of Lindsay: Can we go back to the plans for completing banking union, which you touched on in your first answers? We particularly wanted to tease out the difference between what the five Presidents think should happen and what you think will happen, given that we do not live in a perfect world and there are certain hard realities that political pressures bring to bear in the shaping of final plans. You touched on how you think the German resistance to a European Deposit Insurance Scheme might be reduced through risk sharing and risk reduction. Is it a realistic ambition to achieve that risk sharing and risk reduction in order to make EDIS something that could be supported by Germany and those other countries that are nervous about it?

Mr Wolff, in the paper that you issued earlier this month you talked about the need for a European deposit insurance and resolution authority. How effective do you think such an authority could and would be? In terms of financing, you also talked about reinsurance being a key ingredient of making the insurance scheme function, but would such an authority also need access to bridging finance provision, as anticipated in the Five Presidents' Report? Can we just pick up on the remaining aspects of banking union plans that we have not touched on, but also on what you think really will happen in practice rather than what should happen in an ideal world?

Guntram Wolff: Thank you for the question. The first point is that economists are not political forecasters. We are much better at saying what should happen than in predicting political processes. Even for the insiders, and I saw that you talked with Thomas Wieser, it may be very difficult to predict. That is my first point.

The second point is that we have had a number of important steps on banking union already, including the creation of a common supervisor, but I have to say that the office of supervisor itself is still very young. It has only been there a year and it still faces a number of obstacles, which I had hoped were already overcome. Let me give one important example, which is national ring-fencing. A little naively, I thought that ring-fencing would end very quickly. To explain, national ring-fencing means that deposits and capital are kept in the banks of the country concerned and cannot be shifted, in the banking group, across borders. That is something that was introduced at the height of the crisis. I thought that having a single supervisor means that the supervisor looks at the banking group as one group, say UniCredit or whatever, looks at the capital of that group and allows it to shift capital and deposits across countries, across borders. Apparently, they still face very big difficulties in doing this, because the majorities are not always there. An excuse in the supervisory board that is often made is: "We cannot do it because the deposit insurance remains national and so we cannot allow you to shift deposits somewhere else because my deposit insurance is still liable for this". There is an inconsistency here and most people see this inconsistency between a centralised supervisor and a still relatively strong decentralised system.

Will it happen and how quickly? I am fairly confident that it will happen, but it will take time. There will be a substantial transition period. It will not be in the next two, three or four years. We are talking more about a five to 10-year transition period. That is the period during which, gradually, risk weights or large exposure routes for sovereign debt will be introduced and, simultaneously, an insurance component will be built up. That is the way I see it and I still think the overall logic goes in that direction. The political support will eventually be there, but perhaps I am too optimistic.

Earl of Lindsay: With that and your article, do you desire to see that as a Europeanisation of the banks? That will be part and parcel of that.

Guntram Wolff: That is the ultimate aim, yes.

Q125 Lord Butler of Brockwell: Do you see capital markets union as particularly relevant to the euro or something that is more a matter for the 28 as a whole?

Hans Hack: The initiative is based on some of the lessons learned from the euro crisis. In that sense, it is maybe born from the euro sovereign debt crisis, in a way, because it is very clear

that Europe is too dependent on bank financing and, in the current situation, that is something that is holding back recovery and there needs to be more diversification of funding mechanisms. In its aim, though, it is certainly something for all 28. It is something that some countries that are not part of the euro could be very helpful contributors to, including your own. It is also not a project that will change dramatically in two or three years. 2019 is being set as the end, but that is certainly not the end of the capital markets union, because the ultimate aim is to change the way businesses look at funding and to increase the mix of funding from venture capital and seed capital all the way to private placement regimes for bond buying. That will take time, because it is traditions that need to change, but this is something that is valuable for all 28 and we need the expertise of all 28 to get there.

One aspect that we need to bear in mind when looking at the CMU is that there is a risk that, if you integrate further, it will lead simultaneously to raising fences to the rest of the world. Very often, if you harmonise legislation regarding capital markets there is also an equivalent regime that raises the bar for external financiers to enter Europe. That is a risk that is not being discussed enough in the context of the capital markets union. We need to make very clear that one of the aims is to make the internal market for capital work better, but also with the participation of non-European entities in that. Therefore, we need to be very careful in the design to allow third-country participants into the capital markets union. That is not what you asked, but I thought it was an important point to make.

Fabian Zuleeg: It is a useful long-term development, but it touches on some areas that are very difficult to deal with at the national level, particularly when you are talking about legal frameworks and the specificity certain countries have developed over time. This will be a slow process and it will be a process where you need to get buy-in from the countries. It is not something you can impose; you have to get some kind of agreement over time, so it is going to be tricky. The nature of the thing is advancing reasonably well, but it is certainly not something that will happen in the short term. Changing legal systems within the national system will take a lot of time, so 2019 is optimistic.

Q126 The Chairman: Can I briefly come in and ask if you agree that, when it comes about, as it develops, it will also reduce the level of risk in the eurozone itself?

Guntram Wolff: It should achieve risk-sharing across borders. Let me make two quick points on this. The first one is that the shift towards capital markets is very welcome. Recent economic research by Pagano, for example, has shown that it is beneficial for economic growth and for systemic risk, so we should have that shift. The second point is that yes, the eurozone needs deeper capital markets much more urgently than the outsiders, but that does

not necessarily imply that the outsiders will suffer from this. On the contrary, they can actually benefit by being the hub that provides these services.

The Chairman: It could be a win-win.

Guntram Wolff: Absolutely, but then it depends on the governance.

The Chairman: That is an important point. I am conscious of the time. Would you be able to stay for another five minutes or so? We just have to wrap up with a few questions. Is that acceptable? Lord McFall wanted to come in and then Lord Haskins.

Q127 Lord McFall of Alcluith: What we are seeing in Europe at the moment is that the economic losers are in revolt against the elites and there is a big issue here. As think tanks, are you doing or have you done any work on globalisation and looking at the rougher edges of globalisation? As we came here, we saw the deal that the UK Government did with Google, but today there is a story that Facebook is resisting UK attempts to claw back. Regarding doing something on that, we have seen individual attempts by France and Italy. The *Times* is running the story of Italy trying to give money back, but would that reduce tax competitiveness in Europe and disadvantage the drive to achieve a more coherent tax policy for companies that are obviously more adept than individual countries at dealing with their own issues and tax problems? There is an issue looming there; is it something you have looked at?

Guntram Wolff: I have a couple of points. The first is that I totally agree with you that we have an issue of loss of trust in elites and we need to take that absolutely seriously, because it is one of the biggest problems we are facing. Then there is the question of what is behind this and certainly there is the question of whether the labour share continues to fall as it has in some countries. It has fallen quite significantly in the United States, in the United Kingdom and also in Germany, but much less in other countries of the EU.

The Chairman: What do you mean when you say “labour share”?

Guntram Wolff: The labour share in national income—so the amount of income going to labour has fallen. Then the question is why that is the case and there is a very big debate on this in the United States. Roughly and simply put, there are two camps. One camp says, “It is induced by technological change, robots taking our jobs” and so on and, basically, robots are capital, right? The other camp would say, “It is basically power politics and we have a structural shift in power towards big corporations”. I do not know which view is correct, but those are the two views out there in the US.

Irrespective of which view is correct, if we think that the labour share is falling structurally, where is the tax base going to come from? Taxes are now mostly collected from labour and

thinking about how to tax other sources of national income, especially capital income, is therefore necessary. Then there is the question of how you do this with tax competition and so on, on which there is a huge amount of literature.

Q128 Lord Haskins: The governance of the eurozone, at the moment, as we understand it, lies predominantly with the Parliament, which raises a few questions as to how that affects the non-eurozone members of the Parliament. Should they have responsibility for it or not, or should there be an additional approach to the governance of the eurozone, which would, in a sense, be quite divisive if another form of democratic supervision was created? What is your view on that?

Fabian Zuleeg: I am not convinced that we should split the European Parliament into a eurozone and non-eurozone parliament, because it is extremely difficult to distinguish what issues would be discussed by which parliament. Also, someone would have to make the decision about who would allocate the different issues and that would be a political process in itself. There are also a number of issues around having a eurozone parliament, if we start going down that route. We have a differentiated integration model already. We have a number of other areas where there are particular opt-outs. We have a different configuration every time we discuss a different type of topic. If we are talking about justice and home affairs, there are certain opt-outs, but then some countries, not least the UK, have also opted back in to some of those issues. You would have to then decide on a case-by-case basis who has to leave the room and who has to come back in. That is not a very workable mechanism.

What we need is a mechanism for better co-ordination within the eurozone. The euro group can fulfil that function and it could work better if we had a permanent president of the euro group who would be responsible for pulling that together, but I would not change the parliamentary system.

Hans Hack: Democratic accountability is very important and I totally agree with you. I might be slightly biased because I have a Council past, but the democratic accountability of the European Parliament is something that, in itself, is not a given, in my view, with voting once in five years and they do not have a constituency. Different political systems in Europe are different, but there is not a continuous dialogue between the European Parliament and its constituents. I find the UK push, as it were, for more involvement of national parliaments in European decision-making a very healthy one.

As I have heard over the many years I have been coming to Brussels, one of the things that Europe suffers from is that the good things coming from Brussels are nationally sold as being a national initiative and there is no reference to the fact that they might have originated from

co-operation between member states, whereas bad things are easily shifted onto Brussels as being bad. There is a very lopsided view of what Brussels does. That is where the national parliaments do need to step up their involvement in the European decision-making process and how they co-operate with the European Parliament, because they do have a role themselves, from a European perspective and not a national perspective. I do not know how to structure that best, but with the current European Parliament and the way it is elected and functions, I would not place all my bets on them to increase the democratic accountability of decision-making.

Guntram Wolff: I agree with Hans on this but will just add one thing. I would also say that we do not need a eurozone parliament at this stage but, if we think of serious fiscal integration, it is very difficult to conceive that a European Parliament with British MEPs would vote on eurozone fiscal matters. I do not think that is possible, so at that stage there would have to be at least some split on fiscal matters.

Lord Butler of Brockwell: We have a parallel with English votes for English laws.

The Chairman: I was just thinking that. We are having that very discussion in our own Parliament vis-à-vis the other parts of the United Kingdom. Thank you very much for that. That now concludes the public part of this meeting. Mr Zuleeg, Mr Wolff and Mr Hack, thank you very much for coming and giving us your time today. It was an invaluable session.