HOUSE OF LORDS

Unrevised transcript of evidence taken before

The Select Committee on the European Union

Economic and Financial Affairs (Sub-Committee A)

Inquiry on

THE EURO AREA CRISIS: UPDATE

Evidence Session No. 1 *Heard in Public* *Questions 1 - 21*

TUESDAY 2 JULY 2013

10.30 am

Witnesses: Ruth Lea, Professor Stephen Haseler and Vicky Pryce

USE OF THE TRANSCRIPT

1. This is an uncorrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.
2. Any public use of, or reference to, the contents should make clear that neither Members nor witnesses have had the opportunity to correct the record. If in doubt as to the propriety of using the transcript, please contact the Clerk of the Committee.
3. Members and witnesses are asked to send corrections to the Clerk of the Committee within 7 days of receipt.

Members present

Lord Harrison (Chairman)
Viscount Brookeborough
Earl of Caithness
Lord Carter of Coles
Lord Davies of Stamford
Lord Flight
Lord Hamilton of Epsom
Lord Kerr of Kinlochard
Baroness Maddock
Lord Marlesford

Witnesses

Ruth Lea, Arbuthnot Banking Group, **Professor Stephen Haseler**, Global Policy Institute, and **Vicky Pryce**, former Joint Head of the Government Economic Service

Q1 The Chairman: Ruth Lea, Vicky Pryce, Stephen Haseler, we are most grateful for you coming in to see us today to help us as we return to our half-yearly examination of the euro area crisis. Next week we will be having the Financial Secretary to the Treasury, as we do on these occasions, Greg Clark. I will be able to ask more pointed questions on the benefit of your advice on this. I invite you to say anything in terms of introduction, but we will be furnishing you with transcripts of this conversation we have today. We would be most grateful not only if you would correct them if there is anything faulty, but also if you have any bright ideas when you leave the room today to communicate them to the Committee to help us think about this current stop in the euro area crisis which we are having a look at. Ruth Lea, François Hollande recently went to Italy and said the euro area crisis is over. Could you give us an assessment of what you think is the state of the euro area short term and long term? Is there light at the end of the tunnel or has the tunnel grown longer?

Ruth Lea: It depends what you mean by crisis. There is the sense of existential crisis that we saw in the middle of last year when it really looked to me as though the eurozone may be beginning to break up. Greece looked very vulnerable and, of course, the Spanish and Italian bond yields were rising very rapidly and unsustainably. To some extent, Draghi put an end to that by saying that he would do "whatever it takes" to keep the eurozone together and then, of course, he came out with the OMT policy. That crisis, in a way, has gone, although it is not to say that it could not return, but I do not regard that as my central case. The crisis in the sense that the economies are desperately underperforming is clearly still with us and, in fact, if anything, it is getting worse. We saw the latest unemployment figures out yesterday from Eurostat: record levels. We know that, in Spain and Greece, unemployment is now over 25%; youth unemployment is over 50%. If these are not countries in a sort of crisis, in an economic crisis, I do not know what is.

In the short term, I see the sort of "muddling through the crisis" scenario continuing. There have been various ad hoc measures that have kept the thing together—somewhat to my surprise, but they have kept it together—and, in a way, I could see that happening for the foreseeable future unless there is some particular crash within the eurozone.

Of course, if I wanted to be more optimistic, I would think of other scenarios as well, to which I would assign fairly low levels of probability. One is that they push ahead with genuine economic and monetary union, which is very much the topic of today, and that in itself would obviously help the eurozone to cohere. Another is, of course, if the current economic policies of structural reform—enhancing competitiveness, fiscal discipline—work and you find that the struggling economies of southern Europe actually get back to robust growth—that would be the nice scenario. But I fear that the probability of that is rather low. Other scenarios include the possibility that Germany would come along with a fiscal transfer union, which is low as well. I think Germany's funding for the eurozone is pretty finite. Then, of course, you get to the break-up scenarios and they are a different matter. But, in the near term and the foreseeable future, I see this thing holding together.

Q2 The Chairman: Thank you very much. Vicky Pryce.

Vicky Pryce: The first question was about whether we see an endgame. I think we are not going to see an end to the crisis we have been witnessing for the last couple of years unless there is something decisive done about the debt levels in Europe. We are having countries where GDP is declining, like in Greece for the sixth year running, and loads of other countries. Of course, we are forecasting growth possibly to resume next year but perhaps not, so there will be more declines in some of the really big countries, including of course France, Italy and Spain. If that is the case, then the debt situation gets, if anything, worse. Whatever you do in terms of trying to restore competitiveness as we call it and reducing unit labour costs takes away from spending.

We see, for example, in Greece, that people have just stopped even asking for receipts for the goods that they buy, because the VAT is so high, so they can get it without having to pay VAT. They do not drive their cars, so the tax collection is actually getting worse rather than getting better. There are self-defeating issues in any austerity package that has been set up, which means that it takes that much longer for anything to return back to normal. That is a real issue for the deficit, for the debt. Unless the debt is written off to a considerable extent in most of the periphery countries such as Greece, but also Portugal—and we will probably need to do something in Spain, and who knows what will happen with Italy—I think we are going to carry on like this.

The second thing that needs to happen for the endgame to at least lead to some improvement is for the European Central Bank to really heavily intervene and finally be allowed by the Germans to buy bonds in the market. It has not done that. So basically we need our own QE—quantitative easing—in Europe to see us through. A big stimulus package is what is needed. The structural reforms take far too long and we are basically only seeing problem after problem arising. I think the crisis will not be over unless those two things are done.

Q3 The Chairman: Thank you very much. Stephen Haseler.

Professor Haseler: Being a political scientist and not an economist, if you will forgive me for that sin, I take a view of this that takes into account the geopolitics of Europe as well as the economic situation, because the euro was essentially originally a political construct. The view I take is that there will be no break-up of the eurozone. It is not going to happen. Although there may be problems in some of the periphery countries, and I know there have been debates about Greece and Cyprus, broadly speaking, the glue that holds the eurozone together is the fact that if anybody did go bust, or was allowed to go to bust—the Greeks, even the Cypriots and, of course, big countries like Spain or Italy—of course German banks would start to topple; French banks would start to topple. So there is a huge vested interest in the banking community, in the global financial community—both in the United States and here—to keep the eurozone together, and not only to keep it together, but to make sure that ultimately there are no defaults. Vicky quite rightly mentions defaults as a way out of this. It is a potential way out, but I do not think it is going to be allowed to happen ultimately, in my view, for political reasons.

The Chairman: Would you say, about that very important point, that the commentariat here in the United Kingdom perhaps never properly understood the implications of it being a political problem?

Professor Haseler: There is very much a financial view of it in the United Kingdom, in the commentariat, seeing finance as the leading element in this. Even though the global financial system has essentially collapsed and imploded, they still take a financial view. They do not look at it in political terms as I would say they should—only partially in political terms. I do not for a moment want to give the idea to anybody that you can continue with these debt levels. I do not think you can. But the political underpinning of this thing is so strong that if it was let go, and if we had these break-up scenarios that people sometimes talk about, it really would be a break-up scenario for the whole global financial system, including American banks in Wall Street. So it is not going to happen.

The Chairman: Ruth Lea, you are nodding your head vigorously there.

Ruth Lea: I quite agree. I know I am an economist but I also take an interest in politics as well. I remember when we were discussing here whether the United Kingdom should join the euro. I said, "This is a political project, but it has huge economic implications". It always reminds me of a possibly anecdotal story of Mitterand and Kohl talking and, of course, they wanted the "ever closer union of the peoples of Europe". This is part of the political project. I think Kohl said to Mitterand, "You really cannot have economic union without political union". Mitterand said, "The way to get to political union is to have economic union because that will force political union". All the way through, this was quintessentially a political project. Stephen may be surprised, but I essentially agree with his analysis. The political investment in this project is absolutely huge now. That is why I said I think they will just basically muddle through, rather than actually think about breaking it up.

Professor Haseler: The final thing I wanted to say in the introduction was that one way to look at this—and I am not absolutely sure of this, but in my guts I think it is going to happen—is that, once the German election is over in September, no matter who wins, even if Chancellor Merkel wins and the FDP comes back with her, I think there will be an agreement between the French and the Germans. I think Hollande is waiting for that moment rather than confronting Germany at the moment. You will then see the German Government, the German elite—at least, that is what they say to you behind cupped hands—alter the policy towards the things that Vicky was talking about: debt neutralisation and so on. If there is an endgame, I think that is the political endgame.

The Chairman: Vicky Pryce, do you share the view of your colleague panellists about it being perhaps ill-understood that it was always seen as a political project?

Vicky Pryce: Completely. What it does mean is, just as Stephen was saying, they are going to make sure that the whole project survives and therefore we are going to see all of these things that I said happen, because otherwise the eurozone will continue to be stuck in very, very low growth and their own electorates are going to get rather annoyed with them.

Q4 Lord Davies of Stamford: First of all, I would like to congratulate Ruth Lea, who very characteristically, and very much unlike many of her Eurosceptic colleagues on this argument, has just publicly admitted that she got it wrong in expecting that the euro would break up as a result of this crisis, and she now does not expect this to happen. She deserves congratulation on her honesty and straightforwardness in acknowledging that. Thank you very much. To come back to the issue of growth, we all know that bailouts and bail-ins and austerity packages are not ends in themselves. The objective was to get us back to sustainable, respectable growth rates in the eurozone and, indeed, in the EU generally. I think that Vicky Pryce, in her first statement this morning, was really saying that it is all hopeless because the supply side measures are counterproductive, real wage reductions are counterproductive, there is not sufficient demand and stimulation in the economy. Both on the supply side and the demand side, the formula is not in place to achieve the objective. But then you said, in your second intervention, that you thought in fact there was a determination to make sure that this whole exercise is a success. There is a bit of a contradiction there. Can you just explain that?

Vicky Pryce: Not necessarily. What I meant was that the way that things are being set at present—the austerity packages and the focus on debt reduction through those austerity packages—is not going to lead to the right results. They will have to be amended. We will get back to growth once the debt issue is sorted out, in the sense not just of bail-ins and perhaps more write-offs, but also not necessarily the abandonment, but certainly the change that we have already seen happening in terms of achieving targets at a particular date, which has been extended already for a number of countries. Nobody is expected to reach even 3% over the next two years; it has now been extended by another two years and then will be extended again.

Lord Davies of Stamford: Is that a good or bad thing?

Vicky Pryce: It is a very good thing. There will be extra stimulus coming of the sort that I mentioned before. There is no doubt in my mind that the ECB—the European Central Bank—will have to intervene massively, pumping loads of money into the European economy.

Lord Davies of Stamford: So the elements are in place, the policies are in place, to achieve the right solution?

Vicky Pryce: Yes, the elements are there; they are just waiting to be deployed. They have not been deployed. The markets calmed down for a while thinking that things would happen so, up to a point, you can influence expectations by saying something that is positive, like Draghi did, back in September. Just saying that we are going to use the financial power of the ECB, through the fund that has been created to intervene in the market and buy the bonds—the Outright Monetary Transactions it is called, strangely—calmed the markets very substantially. Yields came down, in fact halved, in a number of countries. So the crisis was sort of overcome at that moment. But, of course, nothing has happened. There has not been any serious purchase of bonds at all. As the markets realise this—particularly with the US talking now about withdrawing its own support, which would affect all those markets too because yields are linked across the world—they will now have to do something and do something quite soon. At present, it is blocked by the German Constitutional Court, which is saying that it is illegal for the European Central Bank to intervene. But as Stephen was saying, because the project has to succeed, I think after September it is all going to be eased.

Q5 The Chairman: Before I come to Ruth Lea for a right of reply to Lord Davies, Stephen Haseler, maybe you have a comment on the question of growth.

Professor Haseler: I am afraid I am an old-fashioned Keynesian and take the view that you are not going to get serious growth—in this phase, anyway—unless you have serious stimulus policies, either through the ECB, or, as I would prefer, fiscally. I do not think we can count on that until we have a revision or the end of austerity Europe. It seems that the European elites have, broadly speaking, decided that the way to deal with this debt crisis is by austerity. It is not working. Debts are not going down, as Vicky said; they are going up, in the short or medium term at least. I do not think you are going to get growth—if you do not mind me saying so—by the view that we must all become more competitive and we all must become leaner and stronger. That does not, in my view, lead to growth except in the very long term, by which time the debt situation would have overcome us. The austerity programme is leading to a situation where debt is becoming an even more important issue than it was before the financial crisis. This has just got to change. I think the elites have got it wrong.

Ruth Lea: Again, Lord Davies may be surprised, but I agree with a lot of what my colleagues have just said. By the way, the break-up was always one of my scenarios, not my only scenario. I am a multi-scenario person.

The first thing about austerity is I do not think anybody questions that the incredibly hard austerity packages in the southern European economies have undoubtedly been a factor in their recession. They are much more austere than in the United Kingdom, and there was an OECD study that showed that. It was interesting recently when there was a relaxation in the deadlines for several of the countries; it was really just a prolongation of austerity rather than an abandonment of it. I tend to agree with Stephen that if there is not going to be more major relaxation on the austerity packages, these countries are really going to continue to suffer and will find it very difficult to grow.

Q6 Lord Davies of Stamford: Should we not be distinguishing between the cyclical deficit and the structural deficit? Was it not necessary to bring down the structural deficit by reducing quite substantially Government spending? That reduction has produced, of course, a reduction in demand and therefore a fall in real wages which has increased competitiveness. But if we move on to deal with a cyclical deficit, then demand stimulation measures—whether monetary or fiscal—are the appropriate instruments. Should we not make that distinction?

Ruth Lea: It is a good distinction to make.

Professor Haseler: It is difficult to make, though.

Ruth Lea: Certainly, when you are talking about supply side, as Stephen was implying—the competitiveness-enhancing structural reforms—he is right. These take a long time to bed in. You saw what happened with the British economy in the 1980s. But, in the meantime, we do have this major crisis of a lack of growth in a lot of the eurozone countries. For that, short-term demand stimulation is completely appropriate. We've talked about fiscal policy, of course. Vicky has talked about whether the ECB will come in with a lot of QE. I suspect that they will not do that unless there is some sort of renewed existential crisis in the financial markets. That is my concern about that.

Lord Davies of Stamford: Which there will be.

Ruth Lea: If that is true, that is true. Otherwise, it seems to me as though the response of the Commission to getting growth going in these economies is extraordinarily feeble. In the recent summit, I think it was agreed that there would be some sort of assistance to getting more credit into SMEs through the European Investment Bank. This is a very good idea because, of course, the banks—especially in Spain and Italy—are damaged as they are here and the credit really is not flowing through. But, my goodness me, it is pretty late in the day to start thinking about improving credit to the SMEs. There is a terrible reluctance to grab hold of this thing and really make some serious difference to it.

The Chairman: Vicky, do you share that viewpoint with Ruth—the reluctance to grapple with these things?

Vicky Pryce: We have seen it so far. That is why people have begun to despair. We are stuck in a political problem of waiting for the German elections. There is no doubt that this has been a fundamental issue. Merkel wants to get re-elected and will with an interesting coalition—we will see how it actually happens. There are internal disagreements right now in Germany about how to progress, but I do not think she wants to be seen as the person who breaks the whole eurozone up. Already, of course, she is depicted in all sorts of interesting ways across Europe. There has not been the willingness to do anything so far for political reasons, but I think there will be because, as I said at the beginning, this is a political problem.

There is also an issue about the deficit. You are absolutely right to mention the differences that exist and the different definitions that sometimes get confused. Take primary surpluses: there are a number of those deficit countries whose primary balances have now moved to surplus. That is mainly because those Governments are not spending. If you look at Greece, of course, and all the problems with firms and lending to SMEs, the greatest debtors to the various firms in Greece were the Government, the public sector, which has not been paying its bills. That, of course, kills an economy. If you go to the banks and try to get any money from them on the basis that the Government is going to pay you one day, you do not get anywhere. What we have actually got in Europe, in any case, is a credit crunch that is getting worse and worse. Any small attempts to help the SMEs are not going to solve the problem. I agree entirely with Ruth there. There is a much bigger banking problem that we have still got there.

Q7 Viscount Brookeborough: You are all agreed that the saving of the situation is really being politically driven and that ultimately we have to have growth and therefore competitiveness must be the key to that. Can you see anything that is going to increase competitiveness in the short term while there is political interference in order to make it survive? The two things are almost working against each other in that, ultimately, it will have to be a free market that drives the economies forward.

Lord Flight: What about the politics? The assumption that we will muddle through assumes that Madame Le Pen does not end up getting elected in France or someone in Italy who is actually pledged to exit. Are you just taking that for granted?

Professor Haseler: No, absolutely not. We have a window following the German election for a reflation of the European economy. We have not talked about the United States in this. There is beginning to be an argument, I am not absolutely sure about it myself, that the Americans have fundamentally got this one right and we have got it wrong in Europe. In other words, the Americans engaged in stimulus, massive quantitative easing; that has, broadly speaking, worked. They have got the economy moving now; they are now withdrawing quantitative easing, much to the annoyance of emerging markets and so on. My point is I think we need a dose of that in Europe now after the German elections and before the Madame Le Pens and—if I may say so, Lord Flight—the UKIP and so on get under way. They will get under way in my view if austerity continues so we need to end the austerity regime and have a German-French-led reflation of the European economy to deal with that very point. I do not think we ought to be complacent about this.

The Chairman: Ruth, do you want to respond to that suite of questions and Stephen's comments?

Ruth Lea: I will touch on the first question on competitiveness. If you look at the unit labour costs—in some of my written evidence, I provided a chart—it is quite obvious that it is "working" on that particular narrow criterion. Certainly, Ireland and Spain have actually had a lot of internal deflation and their unit labour costs have fallen quite considerably compared with Germany. In other words, they are improving their competitiveness against Germany. Greece and Portugal have had an improvement too, but less impressively than in Ireland and Spain. But in France and Italy, there has been no improvement at all.

Of course, when France gets criticised for its uncompetitive economy, it gets rather infuriated, but there is a sad element of truth there. The French economy is not what it was by any means. If you compare it with Germany and look at the trade deficit, France has a very large trade deficit with Germany, it indicates that there is a big competitiveness problem there. So, to cut a long story short, there is a little bit of progress in some of the countries, but a lot more to come down the line.

Talking about politics, if I may, I know that Stephen takes the view that there will be a big change in German politics after the September elections. I am not convinced about that at all. I think there is a continuity here. Even if the SPD wins, there is a terrific continuity in the German approach to all this. As far as Germany is concerned, the key word is competitiveness. We have already mentioned this several times today. "These countries must heal themselves. It is going to be painful, but if they cannot heal themselves, then tough, because after all that is what we, Germany, did in the 2000s. Fiscal discipline must be allied with these structural reforms otherwise, I am sorry, our impatience is just going to be too much." As to the notion that somehow Germany will suddenly dig deeper and deeper into its financial pockets to provide a sort of fiscal transfer unit or a big eurozone fiscal capacity, I just cannot see that happening. They will talk about integration, but it will be integration that does not mean almost unlimited liabilities for the German taxpayer. We know that really, the German electorate has got to the point where it thinks, "Well, we have contributed to this and we have contributed to that. Look what they do. They insult us and really we have had enough."

Ruth Lea: One final, very quick point: do not let us forget that the demographics in Germany are actually adverse. There was a survey done recently about German business. What was their number one concern? The demographics in Germany.

Professor Haseler: Very briefly on Germany: German policy at the moment is not sustainable even for the German population. The great tragedy is that German politicians have not told their public—most politicians do not tell their public anything—that their success story as a country is based on the European single market. If that European single market, or the eurozone as well, was to break up, they would be in very serious trouble. They have not told their people either that German banks have been lending money around the eurozone at an unbelievable rate. Rather as the American banks lent money out in the housing market, German banks have been lending money in southern Europe, and this is one of the causes of the crisis.

So the German policy of austerity is not sustainable and I do not buy this question of competitiveness. I do not agree with it. Who are we supposed to be competitive with in Europe? Let us take the Spanish situation or the Italian. When we say competitive, are we saying competitive with Germany so that the German public and the German employers lose their edge and Germany becomes less wealthy? Or are we saying they should become competitive with China and Asia? You see, the word "competitiveness" is put around a lot and I am not sure we are quite fixed on who these southern European countries should become more competitive with.

The Chairman: Such a fascinating area. Lord Kerr will take us into it.

Q8 Lord Kerr of Kinlochard: I must say I do think Dr Lea is right about Germany. I do not see a remarkable switch in German policy after the election and most Germans seem to think that their success is not just the result of the single market, it is the result of a decade of serious domestic structural reform, which is one of the reasons why they are where they are. Political scientists are very important, but I do not myself see Germany following Dr Haseler's advice this autumn. I would like to ask Dr Pryce, who is a great expert on Greece and has warned us before that a Greek tragedy is taking place: you have made the general point about the eurozone economy as a whole; could you look particularly at Greece? We have a coalition that has got smaller, a recession that is in its sixth year, a bailout plan that looks as if it is failing. Can the show be kept on the road by internal means with no change in the policies that the outside world is trying to impose on Greece or do you, as you have said before, believe these policies need to change?

Vicky Pryce: The policies need to change. As you pointed out, the coalition is breaking up, basically. The smallest party has gone and now they have a three-person majority in Parliament, which is pretty rough. A number of times before with that type of majority, quite a lot of people vote against various measures and I think we are going to see loads of MPs possibly doing that in the future. It is entirely possible that there will be another election.

It is clear that internal politics cannot do it. The pressures are too great. There is no way you can satisfy everybody. We know what is going on around unemployment, youth unemployment and also the continued disquiet of the population about things being imposed on them undemocratically by the Germans and others. As to the big rows with the IMF, the IMF have said that they were wrong, and that they got it wrong about Greece all along. I remember doing lots of debates with them in the past, arguing that myself.

We are in a sort of impasse. There is no way that Greece can actually get itself out of the problems it is finding itself in now. There is a real issue about competitiveness that I would like to go back to that also affects Greece. Actually, labour costs are falling hugely. If you look at real wages in Greece, Greece is probably cheaper than Romania right now. In theory, all the German production could actually move to Greece and we could become the whatever of Europe, whether it is cars or anything else. Of course, it is not happening. It is not happening to some extent because there are issues with the Government itself, the way it has been run through the decades. There is still too much bureaucracy, lots of planning restrictions. We should in this country have loads of renewable energy and other types of energy resources that are springing up to help the entire region. We should have very modern agriculture. Greece imports 72% of its food, which is a sin really. That should never be happening. Instead of having lovely tomatoes from Crete, you get imported tomatoes that have grown up in greenhouses in Holland. That just does not make any sense. It is just not going to happen on its own, because the pressures that are coming from an economy that is really collapsing are too great for any politician to deal with, and with such a wafer-thin majority, we are going to get into trouble. Of course, nationalism is developing very significantly, of the sort that we have heard is happening across Europe.

To finish on the point of competitiveness, there are a number of us. When I wrote a book on this a year ago, I focused on competitiveness. If you look at the unit labour costs in the tradable sector, which is, of course, open to competition, they have not really moved in a lot of countries. Spain was practically as competitive as Germany for quite a large period of the crisis, and since the euro, of course, was created too. If you track what is going on in the tradable sector against what happened in the non-tradable sector during and after the euro creation, what happened basically is that there was obviously a lot of cheap credit. Lots of people started buying retail goods from other countries like Germany, which benefited. A number of the non-tradables—including service sectors such as housebuilding and the construction sector—saw wages going up very, very significantly. You cannot do that on the tradable side otherwise you die because companies are international and global and so on, so they cannot possibly pay their people more. The investment in those countries happened in those non-tradable sectors because there was so much cheap money available. The financial sector, of course, in this country has also expanded significantly, paid its people more. So it is not really an issue. However much you now try to reduce unit labour costs through austerity measures in those countries, they cannot do it by that alone.

Q9 Lord Davies of Stamford: What is the solution?

Vicky Pryce: A lot of infrastructure spending financed, probably, by the European community, by the rest of Europe, by the Commission: all the structural funds that never went in there; all the strategic changes as to how industry is run. We need a structural change in the countries. Of course we need the other reforms in terms of pensions and so on. What you really need, though, is a proper industrial strategy. You have never had it in those places.

Lord Kerr of Kinlochard: But you do think Greece should reduce the size of the public sector?

Vicky Pryce: Without doubt. You need to do all of those things, but that is not going to do it by itself.

Lord Kerr of Kinlochard: There is a bargain there but it is not happening.

Vicky Pryce: You have got to do it at the same time. I agree with you.

The Chairman: Ruth Lea, Stephen Haseler, would you like to respond to Lord Kerr's point about Greece? Would you like to take it? You were nodding again about Stephen Haseler's comments on competitiveness.

Ruth Lea: The idea, of course, is that all the countries within the eurozone become reasonably competitive with each other. Then, of course, the eurozone itself is super-competitive with the rest of the world. That is the German approach to life. It is all about international competitiveness. As far as Germany is concerned, they pull themselves up, compete with us, and then we can compete with the rest of the world. So that is quite straightforward.

I was very interested in Vicky's exposition of what is happening in Greece and, obviously, she knows a great deal more about it than I do. I am afraid that all it confirms to me is that this dreadful state of muddling through will just continue. I know you talk about having a major industrial policy and major stimulus for Greece. My problem is that I cannot see that happening. What I can see happening with Greece is that there will be major defaults coming through on a third bailout or something like that. Alas, I just see the social pain continuing.

The Chairman: Lord Hamilton perhaps takes us to the wider world.

Q10 Lord Hamilton of Epsom: Can I just follow that? Surely if the political pain continues, then the politics change and you end up with a party that says, "If we pulled out of the euro, then all this would change". It may not be right but, on the other hand, that might well have popular appeal.

Professor Haseler: I agree completely with that.

Vicky Pryce: We nearly did that. It nearly happened, of course, and it could well happen in the next election.

Professor Haseler: This is the job of political statecraft mainly in the countries that count like Germany and France, which is that you are risking the European project by austerity programmes. I do not want to put a figure on that. When does Marine Le Pen take over as the major right-wing party in France? When does UKIP take over as the major right-wing party in Britain? I do not know, but there is a risk there and it seems—and I am not going to be backward in saying this—that there is a complete lack of sensitive political leadership on the euro project.

That is why I put so much emphasis on September. I may be a bit optimistic about this, but my point is that if the German leadership does not move to change its policy, in agreement with France—there has to be a Franco-German policy—what they risk is not just individual countries like Spain—maybe not Spain so much because the euro is pretty embedded there—but certainly France with the National Front, they also face a Mediterranean bloc. What would the Germans think if they continue with austerity after September and France decides to lead a Mediterranean bloc? You just look at that; look at the numbers involved in that Mediterranean bloc. Italy is on the brink now. Italy, Spain, France, southern Europe. The Germans cannot afford to see the eurozone and the European Union break-up. It is a bottom line of mine. If the Germans are contemplating that, perhaps we ought to be told. None of them tells us that.

Q11 Lord Marlesford: It seems to me the most destabilising form of austerity is unemployment. Basically, internal devaluation, the sort of thing Ruth Lea was talking about, is a clear alternative to unemployment. Printing money from somebody else's printing press merely masks this ostrich act.

Professor Haseler: You mean currency wars within Europe?

Lord Marlesford: No, I did not mean currency wars at all. I mean cutting—

Professor Haseler: Oh, monetary stimulus.

Lord Marlesford: Devaluation means you reduce wages until you are competitive and then you keep your job.

The Chairman: I am going to lock that question in with Lord Hamilton's question.

Lord Hamilton of Epsom: My question is about quantitative easing, which we have already touched upon. We have seen the Fed announce that they may consider reducing it, tapering it, and that has already led to rates rising. There has been a recent report on the radio today that perhaps our economy is growing 0.6% in a quarter—which, let us face it, is not short of 2.5%. There is no way that we can go on with quantitative easing at the rate we are doing now if the economy really is growing. I agree it is only one quarter, but if the economy is growing at 2.5%, we will have to stop our quantitative easing quite quickly. I have a German son-in-law who works for Berenberg Bank and I have to say that I do not see any German that I talk to having any intention whatever of a neo-Keynesian 180-degree switch, suddenly saying, "All this austerity that is being imposed on everybody has been a terrible mistake and we must now go for massive inflationary money printing." I just do not think that is going to happen, however grave the situation is. Therefore, the chances are that interest rates are going to start rising everywhere and this is going to impact quite massively on some of these heavily indebted countries. What do you think of that?

Ruth Lea: I agree absolutely. Of course, the Fed, as we know, has talked about tapering off its QE3, which I think is about $85 billion a month. It is absolutely extraordinary. They are talking about tapering it off by the end of the year and perhaps finishing it in the middle of next year. But, of course, it will be conditional on what happens to the economy and they are still aiming, I think, for 6.5% unemployment. I think it has come to a point where they will start tapering it off and, as you rightly say, bond yields are starting to move up, which is only as we should expect. The thing is that bond yields have been ultra-low—in fact, absurdly low. When I looked at 10-year bond yields, gilts, and they were under 2%, I was absolutely staggered considering that inflation was 3% or whatever it was. As for QE here, I think we have got as far as we are going because there are signs that the economy is picking up. The BCC, of course, was saying this morning that GDP may have gone up by 0.6% in the second quarter. But the problem is that, for the eurozone—as you rightly imply—this will be yet another horrible turn on the eurozone economies as they are still in recession. I keep saying this, but I can just see this awful, awful, awful crisis, muddling through a crisis, just going on and on. If I could go back to your earlier point about politicians responding to the social tensions in a country where you have these horrendous unemployment figures, they might say, "Well it is time to leave the eurozone, cut our losses" and then default, depreciate, depart—the three Ds. I can see for a lot of countries it is the only way, quite honestly. I know, Lord Davies, you were implying that I was a break-up scenario person; well, this is one of my scenarios. It is a scenario that I would actually recommend for those countries that are still struggling because I really cannot see any other way out for them.

Q12 The Chairman: Vicky Pryce, you once wrote a book about *Greekonomics: The Euro Crisis and Why Politicians Don't Get It*. What about this group of politicians here? Help us.

Vicky Pryce: There are lots of different views all around so I cannot generalise. What we are probably saying, if we have some agreement, is that what we would like to see happen is the Germans doing something sensible and allowing the ECB to do what it is supposed to do. We are not necessarily talking about new rules. After all, it was agreed that there would be this money available and that the ECB would spend it buying bonds and helping countries in advance of any real problems. They are going to have to do that increasingly. The QE issue that you mentioned is significant because it has affected yields not only in heavily indebted countries, but also in Germany, in France and here. In fact, what happens as a result of this is that debt payments for those countries start increasing because the yields are going up so the deficit becomes worse because, of course, that is part of the deficit calculations. What also happens is that asset prices start getting affected. We have seen already what is going on in terms of commodity prices as a result of QE being talked of as perhaps tapering off in the US.

What we do know is that the equity markets have been very exuberant for no real reason other than there was an awful lot of money around that, instead of being lent to companies, went to buy equities, commodities, quite a lot of risky assets in emerging markets and so on, and mortgages. Housing markets have improved in a lot of places, mortgage-backed securities in particular. You have this real problem that you cannot afford not to intervene in that type of environment. If you do not, so if the ECB does not do what it is supposed to do, if the Germans do not let them—I am not talking about this massive fiscal adjustment, but about just easing the monetary pressure and ensuring that you do not have a banking crisis—particularly if asset prices start declining, and with the downgrades that are happening right now—Greek debt, Cypriot debt, the rest will follow—what the banks hold in assets is going to reduce very significantly. The banking issues that the European Central Bank is going to have to face across Europe are going to accelerate. The Germans will not want to do that. Actually, frankly, their banks are in trouble. We are not talking about a country that has not been affected by any of this. They only have one global bank so they are lucky in a way. But the rest of them are not doing particularly well at all, when you look at Landesbank and so on.

The Chairman: I wonder if I can go back a step to Ruth Lea's comments about the vulnerabilities of certain other countries despite the impulse to muddle through. I wonder whether you would like to say a little more about those countries that are vulnerable. I would like to encourage the three of you to talk, as we have not done so much, about France and the crucial position of France in all of this, not only vis-à-vis Germany, but in terms of its own economy and in terms of leading a Mediterranean pack, as it were.

Ruth Lea: It is very interesting why Germany is in such a pre-eminent position because right through the history of the EU, we have always seen a Franco-German axis driving the agenda. France looks so weak economically and politically. We know that Hollande himself is a very unpopular leader. Almost by default, Germany has now become the political leader as well as the biggest economy and, of course, the largest funder for the eurozone. I know that Stephen has got this image that France may be able to muster the southern Europeans and crash its battalions against the gates of the German fortress; I just cannot see that happening. The French power, the French influence, has drained away with remarkable speed. It was curious in a way, when;—it was a bit of a myth with "Merkozy" as we used to say, but with Hollande it is just completely gone. I am actually quite pessimistic about France. It was interesting that recently there was a Franco-German statement which was something and nothing, but basically, I thought it was German.

The Chairman: Do you share that pessimism, Stephen?

Professor Haseler: No, I do not. The reason I do not share it is that this crisis we are talking about now in the eurozone is really a banking crisis. It all started on Wall Street in 2008. That is what it is about. Our commentariat here is unable to continually see through the political crisis and economic crisis in the eurozone to the underlying weakness of the global financial system. Why I raise this is because the German policy of austerity, forcing itself on southern Europe, has only two outcomes in my view. One is that the southern Europeans continue to see their unemployment rising until there are revolutionary situations down there. I could talk about the situation in Spain, in Catalonia; I could talk about the situation in the Italian Parliament. These are big countries, not just Greece, that are on the edge. If you continue to push these countries, what you lead to ultimately is defaulting. This is the point being made. They will say, "We will go our own way and default". What happens if they go their own way and default—I continue to want to stress this—is the German banks collapse. Germany does not want that to happen, and cannot want that to happen. That is why I am making the point that there is a sort of collision between German policy, on the one hand, and austerity on the other. One has got to give. The reason I am optimistic is that I think once the September roadblock is over, there will be far fewer pressures on the German political class, who want to get re-elected like all politicians, apart from in this House, of course. They will, in my view, have no alternative but to ease up.

Lord Flight: If German banks withdraw much of their lending to southern Europe, which has all ended up in the Bundesbank through the central banks—Bundesbank now owns €700-odd billion; it goes up and down—it is actually, ironically, the Bundesbank that is on the front line if things go sour.

Professor Haseler: And therefore the German taxpayer ultimately.

Q13 Viscount Brookeborough: First, can I say I am delighted with your optimism about Ireland, because I live in Ireland on the border with the Republic? Everything that goes on there affects us. It is slightly different from the point of view that Irish labour has always been very mobile indeed and they all came back during Celtic Tiger. Now they are all going out, so the unemployment is not quite the same issue. But I can tell you that, if you were building, concrete blocks went up to €1.20 a block; it has now gone down to about 40-50 cents. It has changed dramatically. Anyway, my question is more about Cyprus and the unfortunate state that it has got into. What do you think will be the repercussions of the poorly managed—if you agree with that—Cypriot bailout and what lessons are to be learnt by other people?

Vicky Pryce: I have to admit that I watched all that with incredulity when it was going on. It was a classic example of the worst bit of muddling through, if you like. They were trying to find a solution that looked okay so the Cypriots themselves would pay for some of the bailout needed once the Russians decided they were not going to help unless Cyprus did the right thing. Cyprus accepted it.

Viscount Brookeborough: Are you saying it was driven by the Russians primarily and not the Germans?

Vicky Pryce: No, no. The Cypriots for quite some time, as I understand it—because I am not really involved in any of this—waited to see if the Russians, who had bailed them out, bailed the banking system out, a little while before, could do something more again. My understanding is that those discussions ended up with them saying, "Actually, unless you do something about restructuring what you have got, it is very risky for us to be doing anything more here." There had been discussions like that. That is why it took so long, I think—and I am very happy to be corrected about this—for a deal to be reached with Europe which, of course, would have all this conditionality attached. When they realised they had conditionality attached with the Russians too that was really the only way forward. The conditionality was—apart from obviously doing the right thing in terms of the public sector that had grown rather fast there as well—that the population or the Cypriots themselves would take on certain burdens of this bailout that was needed. They came up with this crazy idea, in my view, that it was going to be the depositors that would have to foot the bill. Of course, once you do that, you have a bank run. That was practically what happened, and they had to quickly move on.

Now there is an agreement across Europe more or less, although it has not been legalised, that €100,000 of deposits would be safe if any other bailout takes place, which at least takes away some of the concerns that people would have. But it kills businesses. Why would anyone want to leave any money in any Cypriot bank, or in any country where there might indeed be—such as with the third bailout that we have forecast for Greece—a similar burden on depositors? If you are very rich, you will have it offshore somewhere anyway, as we are discovering with the Lagarde list, the millions that are being kept out of Greece. But a normal business would have probably more than €100,000, if they are lucky—perhaps in Greece it is no longer the case, as they do not have any money. You would imagine that the whole commercial banking side would suffer very significantly. If you have that type of concern—first of all, which banks do you go to, which country do you go to?—it undermines your entire belief in the banking system. Of course, it leads to an even bigger credit crunch because the banks do not trust each other either. A real issue has been raised through the Cyprus rescue, if you want to call it that. It has not gone away. It is an issue in terms of what happens next.

Viscount Brookeborough: Is there much discussion going on in the business world about this being a threat more generally?

Vicky Pryce: It is certainly going on in Greece; I can tell you that. They have been very worried about what happens next.

The Chairman: Colleagues, we do have to press on. I want to change direction again—Lord Flight.

Q14 Lord Flight: Could I ask you what you think about the recent agreement to provide ESM funds for potential major, systemic bailouts? To me, it seems to bring huge problems in that it is likely to be unfair to the smaller economies because they do not qualify as being important enough. You get an Irish-type situation where the ECB forces the Government to bail out its banking system. Yet we are looking to try and separate the banking problems and the Government problems. Germany seems to be moving in a direction of being opposed to that and back to forcing Governments to solve their own bank problems. What are your perceptions of the ESM fund, how it might be used, and whether or not the agreement that has been reached is going to be in any way opportune?

The Chairman: Could you also add in the role of the Eurogroup; does that concern you, worry you or encourage you?

Ruth Lea: It was only about €60 billion that has been put aside for a direct recapitalisation of the banks, which is a pretty small number considering the size of the European banking system. As you implied, it is one of the legs of trying to break the banking problems from the sovereign problems. But even on its own terms, there is some burden-sharing in the sense that if there is direct recapitalisation from the ESM then, actually, the national Governments have to contribute 20% or something like that. This is the dilution issue that we may discuss further.

Of course, another aspect of breaking up the banking problems and the sovereign issue is the question of bail-ins that was implemented in Cyprus. Cyprus, of course, that particular rescue, was almost the template. It was the first example of the new banking recovery and resolution plans to take a lot of the burden again off the taxpayer. But I think this ESM is really a bit of a drop in the ocean quite honestly. When push comes to shove and you are dealing with resolving banks then it will be the bail-ins, it will be the shareholders, it will be the bondholders, it will be certain types of depositors who will take the flak. That is essentially what was agreed last week, when they were talking about the Bank Recovery and Resolution Directive, which, of course, will affect us. So this (the ESM) is, in a way, a bit of a distraction. I think it is the bail-ins that are going to be more potent when it comes to dealing with the banks. That is just my reflection.

The Chairman: Do you share that view, Vicky Pryce?

Vicky Pryce: You saw what happened when Spain did not get the money it needed to save its banks. Of course, it led to a serious crisis. If it had been dealt with earlier and the money made available without any conditions, it would have eased the Spanish situation considerably. We may not have in fact seen the very sharp decline in confidence that took place after that. You absolutely do need to have a pot that allows for this, because the most important thing it does is it calms the markets down. It says, "Actually, there will be some money available if there is a problem."

We need to go back to what Stephen said earlier, which I hinted at too: this is a banking crisis we are in. What happened, of course, in a number of countries is that because of the euro—I mentioned the global bank in Germany, which is quite interesting—you started dealing with a region that had a single currency all across. The problem we had with issues in Ireland is because, of course, some of the banks became global banks, or at least they thought they were global banks because they could deal all across Europe, their balance sheets grew considerably higher than the GDP of the countries.

Once that happens, and there is a crisis, you are stuck. Leaving the individual countries to deal with it imposes a huge cost on those countries that then has to be borne by the taxpayers and everyone else. In other words, they had global banks that were there because of the euro creation and then you say, "No, it is the national Government that needs to deal with it." That is an impossible thing to reconcile.

The Chairman: Can I pass on to the Earl of Caithness? I am anxious that we finish on time.

Q15 Earl of Caithness: I would like to take you on to genuine economic and monetary union. I think Ruth Lea called it the topic of the day. Given our discussion so far this morning, is it still relevant? If it is relevant, what do you think the final format will be? Could you comment on whether it is of any concern to you that the banking union, which seems to be the main principle of it, now seems to have disappeared from the text and we have instead an integrated financial framework? Is that as strong as a banking union and will it sever the link between banks and sovereign debt?

The Chairman: Stephen, you were eager to come in.

Professor Haseler: We are meeting here in July, and the German election is in September. We have to take a lot of what is happening in the European negotiations on further integration with a pinch of salt until those elections are over. I basically agree with David Cameron that the future of the eurozone is for more integration rather than less and, personally, I think it is going to happen very rapidly. The basic answer to your question—

economic and monetary union—is that it becomes even more important in this crisis. The global financial crisis, in my view, is forcing increasing integration. There is a scenario that everything breaks up and takes the global financial system with it, but I still do not see that happening. If that does not happen, then I think the logic of events in Europe, the sheer logic of protecting the financial system, will lead to further integration. The Germans actually, on paper, say they want it, do they not? They pull back and, on the banking union, they have their issue of Landesbanken and all the political corruption that is involved—sorry, I should not say that, should I? With all the local politicians involved in the Landesbanken, they have their own particular problem. But broadly speaking, they still do see the way out of this crisis as a federal union with increasing integration, which is something, as a concluding remark, we have got to take into account here. If that is happening over there, it is going to have a very big effect on us. The short answer is that economic and monetary union, with a few bumps in the road, is, in my view, still very much on the cards.

Q16 The Chairman: Ruth Lea, I must say thank you very much for your excellent written evidence to us on our separate inquiry into genuine economic and monetary union. Would you respond, first of all, to the Earl of Caithness? You also mentioned the recovery and resolution directive. I would particularly like your views and Vicky's on whether you think the recent deal is one that is just another muddle through.

Ruth Lea: I will just respond generally. As you know, I got quite excited when I saw the Commission's blueprint and the Van Rompuy report. I thought, "This is exactly where we need to go." After all, they are trying to put into place those institutions that you find in the United Kingdom or the United States of America that will underpin any monetary union. This is the political union that we were hinting at earlier. Since the crisis has sort of gone, the enthusiasm seems to have gone. The December summit itself was very disappointing. They agreed to the supervisory mechanism, of course; the ECB will push ahead with that next year. I've talked about the Bank Recovery and Resolution Directive this morning. When it comes to actually having a common resolution mechanism, which is the second leg of banking union, or indeed a common deposit insurance system, which is the third leg of banking union, we have not just hit a few bumps in the road; we have gone crashing into the wall. It is not that Germany does not like these things. It is not that it does not support banking union. But it does not want to pay for it, and I suspect that that is why there will be such difficulties in pushing ahead with the common resolution mechanism, the common funding schemes and the common deposit protection. Having been enthusiastic for what they were trying to do, I have now become slightly despairing again, because I really cannot see they are going to push a lot of this stuff ahead at all.

The Chairman: I should tell Ruth Lea that we were enthusiastic in our published report on banking union for those three elements of the banking union, and we too have watched as dilution seems to have set in everywhere.

Vicky Pryce: I think we are all agreed on that. I agree with Ruth, for once, on this; I have watched this stepping back by the Germans with quite a lot concern, thinking about what Lord Kerr said earlier, but perhaps they are not wanting to change their spots at all after the election. It worries me that we have gone already so far that it might be difficult to rescue the banking union. The issue of a common deposit insurance scheme, which really should have been there, has been raised through the Cyprus crisis. Although, if you go round each country, you will find that indeed there is some sort of deposit guarantee scheme that gives you some sort of confidence, you still have to depend on individual countries being able to support it when it comes to the crunch.

I am quite worried that we have backtracked on that so significantly. What will happen, in my view, is that there will be another crisis. This crisis will be caused perhaps by the withdrawal of QE, perhaps by Draghi not being allowed to do anything very quickly, and then there will have to be something that takes us a step further. The way that everything has moved in the eurozone is through a series of crises, and that continues to be the case. So we need another good crisis!

Ruth Lea: It is called muddling through.

Professor Haseler: We have not talked much about the European Central Bank, which is the most integrative and the most supranational of all the EU institutions. You can make a case that the whole crisis mentality was taken out of the European system in the summer by Mario Draghi, and that is why people are dragging their feet. The idea that the European Central Bank is there now as a backstop has I think led some people to be rather complacent about life. The European Central Bank as a backstop is an example of the absolutely important role of European monetary integration in the prosperity of Europe. The ECB is keeping us all going, like the Fed.

The Chairman: Can I ask Lord Carter to introduce that subject?

Q17 Lord Carter of Coles: Thank you Chairman. In many ways we have covered much of this, but, just looking backwards, do you think that the ECB performed well in a crisis—did it overstep its mark, or did it understep it? We have all commented on Draghi's doing what it takes, but looking forward, do you think it will be able to do what is needed?

Professor Haseler: It has got the space to do it, compared with the Fed. The Fed and the Bank of England have been buying bonds like a drunken sailor. On our own Bank of England, I know all these plaudits have gone out to Mervyn King and so on, but he spent a lot of his time buying British Government bonds. If you look at it in a certain way, you could say the ECB, because they have not gone down that route, have more space to act than either the Fed or the Bank of England. A very interesting thing to me is: with the Fed now withdrawing after their QE programme, which I would argue has been relatively successful, is this a role for the ECB to come in? I know the Bundesbank people do not want it to do that, but the ECB, to me, remains in a very crucial position.

Vicky Pryce: There is dissent in the Governing Council, so there is an issue there, and then you have a very strong head of the Bundesbank, who was a trusted lieutenant of Merkel, so there are these issues that Draghi has to deal with. At least he is much better than his predecessor in the sense that he lowered interest rates at a time when there was a recession—there is a recession—whereas Trichet raised them at the time of a recession. At least he realises there is an issue; he talks about credit crunch; he talks about doing things with SME lending in particular; he raises the issue of possible intervention every now and then, but does not do anything very much. He has shown what he would like to do, and I sincerely hope he does it

Lord Carter of Coles: Will he be able to? That is the question. We are getting all the things that may happen, but on balance, in your view, what would you think?

Vicky Pryce: Yes, because he will have to.

Professor Haseler: It is easier for German politicians to see reflation through QE in the ECB than through fiscal stimulus; that is a little more hidden from the public.

Vicky Pryce: If there is anything you need to worry about in Europe it is deflation. Inflation is very, very low, in Germany as well. Now commodity prices are coming down even lower there is no risk; there is a huge output gap there. It is very simple to stimulate things by monetary expansion, and that is what he needs to do.

Ruth Lea: We have discussed this before. I can only really see them going in for bond-buying on any scale, whether it is Italian or Spanish, if there is some sort of crisis there—I think you said there might be another crisis—and that is conceivable. Then the Outright Monetary Transactions would become operative. There are limitations on that; they are only dealing with relatively short maturities on the bonds, but I do not regard that as a particularly big issue. Of course, if the Central Bank is to buy bonds in any large numbers, then the countries in question are meant to go under special surveillance, adjustment programmes, and all that jazz. My speculation is if there were a real crisis, and the Italian and Spanish bond yields began to go up to 6%, 7% or 8%, you would see the ECB coming in quite quickly. Then, of course, it is up to the markets to take on the ECB, which I could not see—you would basically frighten the markets into getting off.

It is all right saying, "There are all these conditions on the OMT", but let us be honest about this, when push comes to shove, these conditions are probably flexible. This is how the eurozone crisis has gone on time and time again—this is why I call it muddling through. They look at the rules: no bail-ins, no bailouts—"must not have that"—but if there is a crisis they do something; they twist the rules, which I am not criticising them for. That is the fact; that is how it is run. I could see the ECB, under those circumstances, going in quite big, if it felt it needed to.

Lord Carter of Coles: Accelerated muddling through driven by the crisis.

The Chairman: Baroness Maddock, the ECB has got a couple of new friends.

Q18 Baroness Maddock: I wanted to ask you about the troika's handling of the crisis. Could it have managed it better? Do you think it should survive? The IMF itself has been quite critical of the handling of the first Greek bailout; they have also been rather critical of the European Commission.

Vicky Pryce: It is interesting about the relationship with the European Commission, because they are coming up and saying there should be less austerity in a number of places, and the European Commission says, "No, no, no; structural reforms and improvement in competitiveness will do it". I know which side I am on, which is, for once, the IMF side. They did not distinguish themselves in the way they handled the Greeks. I remember doing a debate with the head of the IMF mission, and having students with banners saying, "IMF out—IMF out", because they were seen to be the ones pushing for the austerity programme. The interesting thing is that, if you talked to them in detail, you would see that quite a lot of what they were doing was being pushed by the Europeans. In many ways, the Germans and others were stronger, wanting them to force the Greeks to cut back more substantially, more quickly, than perhaps the IMF would have done itself.

It had a problem: until this crisis, while they had done a little bit in eastern Europe, they had hardly dealt with—if you want to call Greece a developed country—developed economies, or with the scale of the bailouts that those countries needed. It was virgin territory for them really, and they made loads of mistakes, but at least they have now come out and said, "Perhaps we did not do it quite right", and that is something.

Ruth Lea: The IMF has let the cat out of the bag when it comes to the handling, particularly, of Greece, because they essentially said that almost from day one Greece should have defaulted, taking some of the burden off Greece, so that it could recover. They dallied; they messed about and delayed, because they were "saving the euro", because the Commission was pressuring them to save the euro and give the Europeans time to build up some sort of firewall to defend the other countries, such as Ireland and Portugal, that by 2010 also looked very vulnerable. In other words, what the IMF is essentially saying is, "We should have gone in straightaway with Greece, sorted out the problem, but we were held back, because there was more concern about saving the euro". There was quite a spat, was there not, between the Commission and the IMF over the IMF's report?

On a more general point, I could never really see why the IMF got involved in the first place. The eurozone is a rich part of the world, it had taken these problems on itself; why on earth should the IMF get involved? We are where we are. Mr Strauss-Kahn had some sort of involvement in it, but I am not going to discuss Mr Strauss-Kahn any further. It is true; there were a lot of criticisms of the troika, over Greece in particular.

The Chairman: Stephen Haseler, would you like to elaborate on your sotto voce comments?

Professor Haseler: I agree; I do not know why the IMF got involved. The Europeans would rather like it if you gave them a bit of political cover. This was other people as well as the Europeans involved here; I think that is one of the reasons they wanted it. Again, it was essentially a political act. I agree utterly with this: this is Europe's problem, it should be for Europe to deal with it, and Europe will deal with it or it will be a failure.

Baroness Maddock: Do you think the IMF will carry on being involved?

Ruth Lea: It is so involved now it is going to be difficult to get out of it.

Vicky Pryce: It wished it was not, I am sure.

Ruth Lea: The big problem, if I may say so, is Greece, because there is some optimism that Ireland—we mentioned Ireland earlier, and as you were saying it is behaving incredibly flexibly—may exit its adjustment programme by the end of this year. Portugal may exit next year. Then it is really the problem with Greece.

The Chairman: Before we come to the last and most important question, which will be put by Lord Kerr, Lord Hamilton has a question.

Lord Hamilton of Epsom: Could I just say that surely the delay that took place in dealing with the crisis has produced a recession in the eurozone, which would not have happened if they had acted faster?

Ruth Lea: Yes.

Vicky Pryce: That is absolutely true.

Lord Hamilton of Epsom: The Germans are primarily responsible for it, and the recession even affected Germany.

Ruth Lea: Yes.

Lord Hamilton of Epsom: At the end of this, Merkel is going to be re-elected by an enormous majority—unbelievable, is it not?

Stephen Haseler: The polls do not show that.

Q19 The Chairman: Let us go to our final question. I am going to ask Lord Kerr to put it, and say to the three of you, we will have in that seat in front of me next week Greg Clark, who is the Financial Secretary, who will reply to this, and we will ultimately write to him. We would benefit from your advice and your answer to Lord Kerr.

Lord Kerr of Kinlochard: We have been talking about the eurozone. What does it mean for us, the United Kingdom, and what should we do about it, if anything? In her excellent written evidence, which you mentioned, Chairman, Dr Lea spoke of the risk of the UK finding itself in a small minority of non-participating member states, and finding it more difficult to ensure that its voice is heard as time goes by. That risk clearly does exist. Mr Farage, in his evidence to us, put it a little more bluntly; he said, "If you are not in the meeting, you are on the menu". What would you three advise that we should do about it? We seem to have stopped shouting at the others to get a move on. I am relieved that we stopped doing that—I thought we did a little bit too much of that a couple of years ago—but we are not as keen to get in the room as are, say, the Swedes, or the Poles, or the Danes. We seem sometimes to be rather deliberately distancing ourselves, but that may be unfair. Could I ask the witnesses what they think it means for us and what, if they were the Government, they would do about it?

Ruth Lea: If we are distancing ourselves even more than the Swedes and the Poles, that is wholly mistaken, because, as we have already discussed, if you are not there, you are not influencing, then you are disadvantaged. It was your Banking Report itself that got me thinking along those lines. You have the decisions made in the eurozone; they feed into EU 28 meetings, as they are now, and with a lot of these decisions already made it is very difficult then for the non-eurozone countries to have the sort of influence they would like on a whole range of policies.

Lord Kerr of Kinlochard: It is not really two groups: the eurozone and the non-eurozone group. On so many of these issues, it seems to be on the one hand the eurozone plus—the eurozone plus the Swedes, the Poles and those others who wish to keep close to the Germans—and on the other hand, us.

Ruth Lea: We are still in the EU; let me put it that way.

Stephen Haseler: Just about.

Ruth Lea: While we are, I would prefer it that the British Government gets more involved than it is doing, but that is not to say we should necessarily stay in the EU.

Stephen Haseler: I take a very controversial view on this, which is that we ought to get involved in the European integration process. In the situation we have got, I agree with Lord Davies; I am a fanatic like him. The danger for us is that, whereas the continental countries, call them that, are talking about integration—various forms and various speeds of integration, but nonetheless the direction is towards solving this global financial crisis as far as it affects the European peoples by integration—we are talking the exact opposite language. We are talking about disintegration, ultimately, in this country, as far as Britain is concerned. We are talking about taking powers back; we are talking about using the treaty, or whatever, if there is going to be one, to repatriate powers. That is the direction that we want to travel in.

I would suggest that—again, I do not want to keep harping on about September—if after September we find a rapid integration of the eurozone countries, increasingly bringing in the eurozone plus that you mention, we face a very difficult decision, and we ought to have some contingency plans for that, frankly. We have been lulled into a false sense of security in this country in the sense that we have been in the single market, but not in the single currency. I am afraid to say I think that is ultimately unsustainable. We have had a good run at that—ever since John Major got that deal out of Helmut Kohl when he was not looking, frankly. We are a country in the single market, with all the advantages of the single market, which everybody accepts is vital for this country, and yet we have a special deal in which we do not have to adopt a single currency, which normally would run a single market; you cannot have a single market without a single currency really, in my view.

The American experience shows how successful a single currency and a single market is. America is a very successful country; we ought to learn from it, frankly. We have had this cake and eaten it. Tony Blair once said, "We are pleased to have the cake and eat it." All I am saying is, whether or not we want to continue to have the cake and eat it, my view is that the continental countries, particularly France and increasingly Germany, are going to say to this country, "You are either in this show or you are not". That is the essential thing that has changed, in my view, since the global financial crisis: attitudes to this country on the continent have changed. They are now beginning to question whether or not we ought to regularise our relationship with them; we are either in the whole game, or we are not. I had never heard that before.

Q20 Lord Kerr of Kinlochard: Professor Haseler, what you are saying is very important. I do not agree with it at all. I think it is perfectly possible to be an active, full participant in the single market without taking part in the single currency. What worries me is not that issue, which we have lived with perfectly well for a decade. What worries me is our new tendency to define the need to integrate as something that applies only to members of the single currency, and to stop defining things that pertain to the single market, and involve more integration, as pertaining to the single market, but saying they pertain only to the eurozone, and therefore require integration only among eurozone countries. We are starting to say that we do not need a deeper single market.

Stephen Haseler: We are bound to say that.

Lord Kerr of Kinlochard: Since Mrs Thatcher's time, our aim has been to deepen the single market, in things like banking, insurance and the rest of financial services.

Stephen Haseler: We can agree on that. The pro- and anti-euro people can agree on that proposition; that is bound to happen. All I am saying to you is that that is bound to happen in a country that has consistently said we want to disintegrate our relationships with the European Union. That is what we are saying at the moment, is it not? Is that not what our Prime Minister is saying when he goes over there? He wants to repatriate powers; he wants to loosen the integration process, so that is bound to occur.

The Chairman: I want Vicky Pryce to finish in a minute, but Lord Hamilton, very quickly.

Lord Hamilton of Epsom: To respond to Professor Haseler's remarks, would he get the United Kingdom to apply to join the euro as soon as possible, and would that be with or without a referendum?

Stephen Haseler: You have to have a referendum. I know I am in a strong minority here, but I do not see how we can continue our relationship for a long time being in a club, but not basically abiding by the central rules of that club. The central integrative flagship of the European market is the euro; it goes hand in hand. There is a very strong case for saying we ought to be out of the whole deal. I do not believe in that. That is, of course, why UKIP are growing now, because the logic of that on the right of British politics is considerable—we ought to be out of the whole deal. If we do not want to be out of it, to simply say somehow we are special, we should have a special relationship with the European Union that Germany does not have, and France does not have, I do not think is sustainable over the long term. I know how it was arrived at; it was arrived at in the heat of battle after the fall of communism when we got a good deal, and it was a good deal. If you can have your cake and eat it, have your cake and eat it—that is my view. But that is now coming to an end. Yes, a referendum, but we cannot carry on in this limbo; that is my position.

Q21 The Chairman: Our final contribution from Vicky Pryce: would you respond to Lord Kerr's question, bearing in mind you have been a government adviser in the past, and now hopefully you are going to advise us when we talk to Government. Lord Kerr makes the quite interesting point about the priority of the single market, and being sure that integration works for the United Kingdom in the respect that we are not deflected by criticising the euro, or asking questions about whether we are integrating via the euro. The single market is key, is it not?

Vicky Pryce: I agree with that entirely. It is worth remembering, since you mentioned that I was a government adviser, that there is an awful lot going on in Whitehall, which Lord Kerr knows anyway. There is a constant push for greater integration across Europe. We are more open in a number of areas than many of the countries that are united by the euro, but put up loads of restrictions in terms of companies setting themselves up, in terms of buying their products, their whole procurement side. You see what goes on in France, where the state is still so significant as a percentage of GDP, and there are still loads of partly state-owned companies, which are very heavily subsidised.

In reality, we are integrators; we may perhaps not use the same words in terms of politics, but there is an awful lot of work going on. It is partly through our push that a lot of the retail banking, energy markets and service integrations—which have been the main priorities of the Commission for a little while now and are for the next year—have been pushed. We should not despair from that point of view. I agree entirely with Lord Kerr's point that we can certainly be part of a single market without being members of the euro.

The Chairman: Ruth Lea, Vicky Pryce, Stephen Haseler, we will send a transcript of this conversation we have had this morning, where you have been so helpful to us. Please correct it, update it, add anything further that you think is worthy for us as a committee to think about as we prepare for our duel on a six-monthly basis with the Minister, Greg Clark. Can I say that your replies have been magnificent and extremely helpful to us? We have covered an awful lot of ground. You have given us a lot of food for thought, even the cakes that Lord Hamilton was talking about extensively. If I may say so, one of the themes that I have plucked out of this conversation came from Lord Carter, where, as so often in the European Union, "accelerated muddle through" is the name of the game. Maybe that is something we are going to have to emphasise to the Minister when we see him next week. In the meantime, my very real thanks to all three of you for coming in today and helping us with that task. I close the meeting. Thank you.