

Economy Committee – 9 September 2014**Transcript of Item 5: The Europe Report**

Jenny Jones AM (Chair): Now we are going to put questions on London's economy to the Mayor's Chief Economic Advisor on *The Europe Report*.

I will open with a nice, easy question for you. How did you reach the conclusion that the best economic outcome for the United Kingdom (UK) over the next 20 years is to remain in a reformed European Union (EU)?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Good afternoon. Thanks for the question. How did we reach that outcome? It was based on the research that came out of the report. There were a number of different aspects to that including the longer-term economic modelling that was done by an outside economic forecaster, Volterra, but at the same time it was assessing the current state of where we are in terms of the UK/EU relationship. There are probably many other aspects but I am anticipating further questions.

Within the report, one thing that was quite clear was that if we were to leave the EU, there would be considerable near-term uncertainty and many other factors alongside that which we may come on to. At the same time as taking those factors into account, it was a case of how do we reach an outcome where we play to our strengths; our strengths being not just London and the UK but the EU as well. In our view, it was a reformed EU.

Jenny Jones AM (Chair): In two of your favoured scenarios, the UK lags behind London. Do you think that is a matter for concern?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes. It is a wider issue than just the EU. In fact, sometimes when I give talks about London at the moment, I say that there is the global issue about positioning London in the global economy and then there is the regional debate. The regional debate, you could argue, has three dimensions to it. Any fallout from the Scottish referendum, which we do not really need to go into, but devolution might be --

Jenny Jones AM (Chair): Please do not. We do not have enough time.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Devolution might be one aspect of that. There are two other regional aspects. One is the UK/EU relationship. The other regional aspect is London versus the rest of the UK. In answer to your question, it is quite interesting how sizeable London is in relation to the UK compared to other major economies in Western Europe and, indeed, that is something I touch on in the report. There are a number of countries in Europe where the capital city is a bigger proportion of their economy than London is of the UK's, but when one compares the UK with, say, France, Germany and other big economies, London's proportion of the UK's is considerably higher.

In answer to your question as to whether it is a concern, sometimes the word 'concern' can be interpreted in many different ways. I think it is an issue and London needs to continue to be positioned in the global economy but at the same time, we, in my view, need to be positioning other parts of the UK to do better as well.

Jenny Jones AM (Chair): Indeed. You have modelled economic output and exports, inflation and employment growth, but you have not included other objectives, for example increasing median incomes, reducing poverty and tackling air pollution.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): No, that is correct. In answer to that question, the economic forecasting that was used in the report, I probably need to explain why we did that. That would help some of the questions and maybe subsequent answers.

Whenever people look at the issue of the UK being in or out of the EU, there is absolutely no doubt that if the UK voted and decided to leave the EU, there would be major near-term disruption; complexity from a legal side and from a business perspective, as well as actually trying to negotiate a favourable arrangement in the short term. When people tend to, in my mind, do economic forecasts, if they just focus on a two, three or four-year time horizon, it will always show that staying in the EU - whatever happens - is better than the alternative because of that economic disruption.

I thought it would be important, therefore, to have a longer-term forecast that takes into account a couple of economic cycles and we could see over a longer-term time period. In some respects 20 years was chosen in an arbitrary way in one respect; we could have argued longer, we could have argued shorter, but I felt we needed to capture at least a couple of economic cycles. When we discussed the time period over which to do a longer-term forecast with Volterra, their suggestion was maybe, yes, a 20-year period would be the best. I do not think we should get too hung up, in some respects, about the microscopic detail of every forecast within it. It is just to give us a qualitative indication.

Coming back to your question, yes, it was broad macroeconomic indicators, not drilling down into a lot of other issues. However, one would anticipate that if we had a much stronger economic performance, then those other indicators should naturally be better; ie jobs, wages, poverty reduction, etc.

Jenny Jones AM (Chair): You talk at one point about the European social model being broken. On income inequality, it has actually been a benefit, I would argue. Can you see what impact it might have to weaken that?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Within the report, I talk about various options in terms of the UK with respect to the social model. No, I think there are many things within the EU that work well. In terms of the debate at the moment, in terms of the core competencies debate in the UK over in Whitehall and also in terms of the debate over the last few years on the Continent as well, one of the issues has been where the competencies best lie. There are certain things that work better at the European level and one or two things that might work better at the national level. Certainly, if the social indicators work better at the European level, then many people would argue that is a strong reason to remain in. However, again, I think we need to weigh each thing up on its own merits. I hope that answers that question.

Jenny Jones AM (Chair): Yes. We have had a similar conversation before about climate change not being a factor in this. Are you assuming that these levels of export-led growth are compatible with tackling climate change? It seems to me that if you take climate change out of the equation, you are missing a huge chunk of what will impact. I am just curious if you think that what you have written is really compatible with tackling climate change.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes, I think so. In some respects, climate change is an important issue regardless of whether the UK remains in the EU or whether the UK leaves the EU. It has to be something that is important in any future economic or institutional environment.

However, coming back to your question, we should not, in my view, view stronger economic growth as being at the expense of the environment or at the expense of environmental issues, if that is what you are asking about.

Jenny Jones AM (Chair): Are you saying it is not at the expense of environmental issues or --

Dr Gerard Lyons (Mayor's Chief Economic Advisor): We should not be sacrificing environmental issues to achieve economic growth. That is what I am saying.

Jenny Jones AM (Chair): OK, thank you. Which specific EU reforms were modelled by Volterra and by what methods were their findings then translated into growth projections in this report?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Obviously, here at City Hall and the Greater London Authority (GLA), there are a certain number of outside forecasters that we could use, so we did a tender. Out of that, Volterra was chosen. The reason for using Volterra, or indeed an outside forecaster, was that we did not have the capability to do a longer-term forecast and at the same time I thought it was important to have a longer-term forecast for the reasons I mentioned before.

Splitting it down, there are some people, it seems to me, who think that you can have a sort of spreadsheet and say, "This happens; therefore, this is the outcome. This happens; that is the outcome". It is not always possible to do that.

In answering your question, what I asked for was a range of scenarios; what would be a good case scenario where we have good relationships with the EU, which means Britain having access to the European markets or - this is in the event we had left - European countries having access to the UK market and therefore taking on board those factors. At the same time, the way the economic model works is about how countries and economies innovate. Therefore, in answer to your question, it is not a case of saying, "Do this reform. Do that reform". It was almost two different scenarios; one was very positive in terms of being reform-focused and the other, as you could see from the outcome, was where we had left on poor terms.

Likewise, in terms of the two scenarios remaining in, again, it was to take on board the factor that the EU might innovate further in the reformed case and take on board a continuation of where we are now. Central to, therefore, the economic model forecasting process was, after taking on board in the out scenario the initial shock, what then would be the trend rate of growth and in the internal scenarios where the UK remains, again, trying to identify trend rates of growth.

Coming back to your question, it is not possible to pinpoint every regulation change with a set outcome. It was a case of, in the reformed case, having a very open relationship with the EU if we are outside; and within the EU, further reforms particularly on making the single market work in services and things like that.

Jenny Jones AM (Chair): On the growth projections for London, it varies between the four scenarios from just over 1% to just over 3%. What is the margin of error in there?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): I am not sure of the right technical answer to that question because there are standard deviations and different things within -- The way I would answer your question is to say that these forecasts, even though they are numbers in that respect and are quantitative, should be seen in an indicative, more qualitative way. That does not mean that over a 20-year period we should expect to be completely right, but in terms of a margin of error I would need to come back and answer that question.

Jenny Jones AM (Chair): OK. Thank you.

Stephen Knight AM: Is there not a danger in being overly precise in the modelling around what are effectively fantasy scenarios? None of us can say exactly how trade negotiations would go post-exit. Whilst it might be a bit of fun to make up a scenario in which you get fantastic trade relationships with everybody post-exit and then project to a degree of certainty of one decimal place on gross domestic product (GDP) growth as a result of that, does it actually tell us anything? Given that we have no idea what trade negotiations or deal we would be able to do as a lone trading nation.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): OK. First and foremost, I would not use the words 'fantasy scenarios'. Obviously --

Stephen Knight AM: That is what they are, is it not? They are things you have made up in your head and are modelling. They are not scenarios that exist.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Scenarios cannot exist. You have to have scenarios. The scenarios are based on sound economic and judgemental analysis about how we expect the UK, European and world economies to perform, how we expect -- sorry, were you about to say something?

Stephen Knight AM: You have modelled how the economy would perform if this scenario were to take place.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes, of course. That is what you do in scenarios.

Stephen Knight AM: Indeed, but the point is that there is no analysis of how likely it is that this scenario could be created. The scenario in which we manage to create equally good trade deals with all our trading partners outside the EU that we currently have within, it strikes me as very unlikely, but I do not see --

Dr Gerard Lyons (Mayor's Chief Economic Advisor): I would push back and say that it would be fantasy to attach probabilities to scenarios, which is what you are suggesting. What we are actually having here - in terms of the scenarios - is taking four different scenarios, very credible ones.

Let me explain them. One is remaining within the EU and expecting to see changes in economic policy or, for want of another phrase, a 'reformed EU'. Another in the EU is to stay in the EU and nothing really changes. Both of those, you could argue, are a good indication of what is on offer if we were to stay in the EU. Neither is fantasy. They are credible and economic. Outside, likewise, to give an idea of the range of scenarios, we could have tried to be precise and say, "This is going to happen. That is going to happen", but that is not the best way to proceed. The better thing to do is to give an idea of the range of probabilities outside. The range of probabilities if we have good relations and if there is a great deal of innovation within both Britain and Europe, and also what is going to happen if the UK is very inward-looking and, for want of another word, makes a load of policy mistakes in the future. That is quite credible and very sensible.

When Professor Paul Ormerod [Partner, Volterra Partners LLP] and Bridget Rosewell [Senior Partner, Volterra Partners LLP], who used to be Chief Economic Advisor here at the GLA to Ken Livingstone [former Mayor of London], who did the scenarios, sat down with me and a couple of other people internally before they went off and did those independent scenarios, these were the parameters we worked on. It was based on very sensible economic discussion and thinking.

Of course, Mr Knight, you are very welcome to construct a different scenario. However, I would very much push back on the idea that we should be attaching probabilities to them. That would clearly, in my view, be presuming that we can gauge all the different other aspects and say, "This is how politicians here or there might decide on the future".

Stephen Knight AM: The danger here is that you have created a scenario - we can argue about how likely it is that it will take place or not - you have created a scenario and it has been modelled with a 0.1 degree of accuracy of GDP growth. It gives Boris [Johnson, Mayor of London] the opportunity to stand up and say, "Look, we would be better off outside the EU". The reality --

Dr Gerard Lyons (Mayor's Chief Economic Advisor): That is not what Boris said. Actually, what he did say was that the best scenario for the UK was to be in a reformed EU and indeed that is --

Jenny Jones AM (Chair): You have made your point [Stephen] and I agree with you completely.

Tony Arbour AM: We do not agree with you.

Stephen Knight AM: The point is that by modelling a scenario to that degree of accuracy, you give it credence as if it is likely. There really has to be some challenge about whether or not it is realistic for there to be a scenario in which we get as good trade deals as we have now from outside the EU. I do not think there are very many people who think that is credible.

Jenny Jones AM (Chair): There is always a degree of prejudice in any modelling isn't there, because you take your own worldview. Yes?

Andrew Dismore AM: Just to follow up partly on Stephen's point and to risk the wrath of our Chair, Scotland is that close to a decision and we still do not know what the final scenarios are going to be one way or the other because people are arguing about it. In that scenario, even with only a few days to go, people do not really know how it is going to end up. To follow Stephen's point, to try to project what may happen this far ahead with an even greater number of uncertainties. That is all I wanted to say about Scotland. The point I wanted to raise was --

Jenny Jones AM (Chair): You haven't seen my wrath.

Andrew Dismore AM: -- looking slightly beyond this because you focus very much on the economic issues here. Jenny has raised some of the social consequences around the environmental side but there are other social consequences as well. I want to know whether you have taken into account the non-economic, non-hard numbers aspects - for example, consumer protection; employment law rights; health and safety and all these sorts of things - and whether under your reform model, for example, we would lose all of those or would simply transpose what we have from the EU into UK law and maintain them as straightforward UK law. Those are very important protections for people which are semi-economic, I suppose, in consequence. Have you factored those into these numbers?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Thanks for the question. In terms of the report itself, the report covers a number of different things. It has insightful economic forecasts and scenarios, as we have just heard, but it has also looked at the debate from different sectors within the London economy, which is very relevant for your question. It is not just about having some benchmark scenarios in terms of reformed versus unreformed or in versus out. It is also about taking on board how different sectors of the London economy might be impacted and also talking about more general issues linked to the whole debate. Therefore,

yes, they were taken on board in the discussion within the report. Drilling down in terms of some of the sectors, we then identified certain sectors of the London economy that would be more impacted than others.

You are right. There are unquantifiable, for want of a better word, components that you cannot really put numbers to. I agree with that.

Andrew Dismore AM: Yes, but the question I am putting to you is: do your assumptions, under whichever scenario you look at, work on the principle that we maintain existing consumer protection, employment rights, health and safety and all those other underpinning rights that come from --

Jenny Jones AM (Chair): Quality of life issues.

Andrew Dismore AM: -- the Social Chapter¹, basically - not entirely, but a lot do come from the Social Chapter - or are we simply parking all of that and saying it is not relevant to this consideration? If that is what you are saying, then that puts at risk all the benefits that the people have achieved from the Social Chapter; the bits we have signed up to and the bits we benefit from indirectly.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Again, we are coming back to the economic numbers that Mr Knight touched on. Within those aspects, it is more about the trend rates of growth and the economic variables. It is not about going down to the microscopic details in terms of those. If you think they will impact economic growth --

Andrew Dismore AM: They could do, could they not?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): They may or may not. It is very difficult to get all those aspects in terms of each individual component --

Andrew Dismore AM: Let us take a straightforward guess. Supposing you said, "OK, we are going to be like [the United States of] America. We are going to abolish most of the employment rights. We are going to have very little in terms of health and safety protection. That in some respects is good for employers because it reduces their employment costs." That is an economic impact. On the other hand, if you say, "We are keeping things exactly as they are", that has a neutral effect in terms of whether we stay in or whether we come out and what the economic consequences of that are. You could say, I suppose, "We have plenty of rights that come through the EU" - although I cannot see that happening - and that would have a different economic impact.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): OK. I understand what you are saying, yes.

Andrew Dismore AM: That perhaps is quite an important factor. Have you factored that in to your calculations or not?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes, a more open economic model which has some of those components in it was factored in, yes. In terms of the economic forecast, let us be quite clear. Even though I think the forecasts are very good, very credible and I stand by them, we do not have here at City Hall that economic model where we can actually carry out these 20-year forecasts; therefore, we cannot go in and tweak everything like this. What you have basically asked for is a benchmark indicator based on a more flexible economy. In that respect, some of that does come in, yes.

¹ Social Chapter of the 1997 Treaty of Amsterdam

Andrew Dismore AM: Let us just hold that thought. The assumptions behind your scenario are about a more open/flexible economy?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): It is about more than extrapolating past data. That is the key thing. Therefore --

Andrew Dismore AM: The consequence of that is, under your model, therefore, is that all the rights I have been talking about are potentially in jeopardy.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): No, not at all.

Andrew Dismore AM: If you are talking about a more open economy and a more flexible economy, it is my understanding that always means that we have more flexibility in the labour market, ie less rights for people at work.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): OK. If we take the last six years of how the economy has done, how would what you are saying have impacted the last six years? Would you be arguing that you would be in favour of higher rates of unemployment in the UK? Is that what you are saying?

Andrew Dismore AM: No, of course not. What I am arguing is that there has been some degradation of safety rights and there has been some degradation of employment rights. Generally speaking, they have not been interfered with too much and, indeed, in one or two places there have been improvements. My concern is, if we go with the American model, ie the flexible economy model, then a lot of existing rights that people have in relation to unfair dismissal, for example, are lost. You can be fired at the drop of a hat in [the United States of] America and that is tough. It is part of their flexible economy.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): We are not assuming getting rid of everyone's rights or anything like that. That was not part of the forecasting scenario.

Andrew Dismore AM: When you talk about a flexible economy, what do you actually mean?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): The economy being more innovative, basically, which means having flexible working rights, a greater ability to invest, a greater ability to impact --

Andrew Dismore AM: What are flexible working rights, then? How do you define that?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Much as we have had for the last six years, to be quite frank.

Jenny Jones AM (Chair): Zero-hour contracts. I tell you what; this is a really important point. We only have an hour and I know the Conservatives are dying to come in.

Tony Arbour AM: Can I say how much I welcome your report? It is nice to see the reforms you propose all gathered together in one place because we have been talking about many of these for as long as I can remember, particularly the reform of Common Agricultural Policy (CAP). I am hard put to imagine that you think we are going to be able to renegotiate that when we have failed to do so over the past 30 years. Is that a really realistic reform or did you just put it in more in hope than in expectation?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): It is possible to see progress on reform but, coming back to your question, there are some reforms that are more likely than others. As far as the London economy is concerned, probably, reform of CAP is not the most important issue. Indeed, in Brussels people would argue there has already been reform of CAP.

One thing that is quite relevant for London in terms of your question is the Luxembourg Compromise, where the French effectively have a right of say over anything linked to agriculture. Other countries will not go out of their way to, basically, undermine the French in what they see as a key part of the French area of interest. I would argue that we need to try to move towards that situation for the City of London, given the importance of business, financial and professional services for the UK.

In answer to your question on the reform of the CAP, it is difficult to see or difficult to predict, rather. Brussels has said that it has already reformed; however, further reform of many areas - the EU budget, CAP - are nice to have but are probably not essential in terms of the UK/EU relationships.

Tony Arbour AM: There is, of course, one other and in fact you specifically mentioned financial regulations for which you have a veto. That was how you put it. Are there any reforms on which you would be willing to compromise? For example, given that you have this afternoon said how important financial services are to London and to the City, discussing a kind of rank order, is that the most important one we should go for?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): It is difficult. In the sense that the financial sector, business sector - however you want to define it - is one fifth of the London economy, you could maybe use that to argue that it is ranked more highly [in terms of the UK/EU debate²]. It might be unfair to say that because, even though the City is 20% of the London economy, it is 7% of employment in London.

I would answer your question by saying that rather than ranked sectors, there were three sectors where we saw leaving the EU being of almost critical - that might be the right word to use - importance for the London economy: finance and insurance was one; professional, scientific and technical services was another - that is 11.7% of the London economy; and transport and storage is 4.3%. They were the three sectors where the value of a seat at the table, as we called it, was high and where we saw the cost of the UK losing access to the EU was also seen as high. For the other sectors of the London economy, as we outline in pages 49 and 50, it was a case of low to medium impact. I would not want to rank them, but those three were seen as particularly important.

Tony Arbour AM: One might think - and perhaps you would agree with me - that seeing the magnificent offers which have been put on the table by Mr Brown [former Prime Minister] for Scotland if it remains in the union is an impetus for London making a special bid in these renegotiations. In your talk this afternoon and indeed in your list, the only one that you mentioned specifically in relation to us here is in that part of the service sector. Do you think there are things for which London could reasonably claim to say it should be given some kind of special privileges within a reformed UK, which may happen?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): There are two different things here. Given that you mentioned Scotland, the key issue out of next week is about a further talk about the devolution process as it impacts other parts of the UK, given that you asked about that. Here in London, the Mayor, I am sure, would refer people to the independent London Finance Commission report from last year.

Tony Arbour AM: Yes, he would.

² Clarified by Dr Lyons following the meeting

Dr Gerard Lyons (Mayor's Chief Economic Advisor): However, in terms of a special pleading or arguing a strong case for London, in chapter 6 of the report I outline A to K in terms of key aims of policy planning for London in the event - or the unlikely event for some people - of the UK ever voting to leave. It is about positioning the UK and London - if we came to that - and therefore positioning the financial sector.

Of course, to reiterate again, being in a reformed EU, I would think, is the best policy scenario. That is why we should try to genuinely look for further reform. I do not think the UK would be the only country, judging from recent years, which would be in favour of that. The idea is where do the competencies lie between Brussels and national governments. I think we can argue a case for protecting the financial sector, but it is about trying to reposition Europe, the UK and London in the changing global economy.

Coming back to Mr Dismore's question, really a key aspect of the forecasting scenario from Volterra was the need to create an innovative environment where Europe could do well in the future, given the rest of the world is moving with that stronger pace of growth.

Tony Arbour AM: Would there come a time when you would give up renegotiations for better terms for the reforms that you have asked for? In other words, if we go for it and work really hard on this for a couple of years and get nowhere, would that in itself be a catalyst for pulling out?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): The second point is a political and democratic issue for politicians and for the UK general public.

However, in terms of the first aspect, we need to have a clear thought-out process as to what we want to achieve at the end of this and hence, what reforms we want to push for. The reforms need to be seen not just as being in London's or the UK's best interests but maybe in Europe's best interests and hence, others might engage within them. For instance, in the report we say there are a number of things. The relationship between the Eurozone and the non-Eurozone was identified by many people across The City as being a concern.

Then the other issue was the single market. It was generally felt here in London that making the single market work effectively would be a big plus for the London economy, generating jobs, et cetera. That is the single market in services, which is then linked to the single market in people, obviously, and also linked to trying to prevent regulatory intrusion. Over and above that, it is about the general outward-looking nature of the economies involved.

Tony Arbour AM: Suppose we make no headway?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): If we make no headway, then, as the report says, based on these figures, we should actually seriously consider leaving, yes.

Tony Arbour AM: Excellent. On a more local point in relation to the GLA, we have a European Office. Has it been modified in light of your report?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): No. Actually, in the acknowledgements I do say how good the European Office is. It is relevant for the general debate.

As a slight aside, this morning, for instance, I was speaking at a business breakfast here in London to business leaders. One of them around the table suggested that he felt the UK needed to engage more in Brussels. To

the credit of City Hall - and I think it was the previous Mayor but certainly continued by the current Mayor - we have this Brussels office and it positions London well in Brussels. It is a very under-resourced office in some people's minds, but good people work hard.

The reason for mentioning this wider context is that there is this argument that Britain should engage more in Brussels to try to achieve more. There is an argument that I had put forward in the preparation of this report that we should engage more full stop, whether we want to leave the EU or whether we want to stay in the EU. It is only by engaging more that we will actually start to see further change and progress in Brussels. Engaging more is important.

Coming back to your question about whether the Brussels office has changed in the wake of this report, I do not know is the answer to that, but certainly we have spoken to the people upstairs who run the Brussels office about this.

Tony Arbour AM: OK. Thank you, Chair.

Fiona Twycross AM (Deputy Chair): One of the issues in terms of reform would be European regulations. I just wondered what criteria you would use to determine how beneficial or otherwise European regulations are to London.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): In answer to your question, it is necessary to look at it from the bottom up as well as the top down. There are two different aspects. First, it was not uncommon to hear people say there is too much regulation from Europe and then, if you ask people, they are often are not quite sure what regulation to get rid of. It is this regulatory paradox, this idea that when you look at individual regulations in isolation they might be good. What I felt people were saying was that it was more the collective weight of regulation. Small businesses probably feel that more than bigger businesses.

Going back to your question, it was more a case of looking at it from the bottom up and from the individual sectors. In one section of the report, to prevent the report becoming too big and too unwieldy and maybe deterring people from reading it, we put a lot of that information in the appendix. It was looking at each individual core sector of the London economy and how people felt they were impacted by different aspects of EU regulation. We looked at it from the bottom up.

Fiona Twycross AM (Deputy Chair): That is the approach that you think we should take?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes.

Fiona Twycross AM (Deputy Chair): The other thing reflects something that Tony was asking as well, really. Do you have an absolute bottom line if we did not get a particular EU reform? Would you have an absolute bottom line for making that decision about recommending a withdrawal from the EU or not?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): No, I did not view it in that respect. The way I would answer your question is that the way the debate seems to be at the moment in the UK is that we have to accept the EU at all costs because the costs of leaving are considerable and we should not underestimate that. However, the different dimension this report provides - apart from looking at it from a London perspective and a sector-specific perspective - is that it calls that into question. It says that maybe we could do well outside.

That is relevant for your question in the sense that it should give us more confidence about maybe pushing for reform. However, in terms of having minimum levels, I would not want to say it like that. There are certain

reforms that are far more important from an economic perspective. A single market in services would be very important for the London economy.

Fiona Twycross AM (Deputy Chair): Thank you.

Jenny Jones AM (Chair): Picking up on the previous point, in your appendix on the models, you do actually say that long-term improvements in our economy come from innovation and productivity.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Innovation, yes.

Jenny Jones AM (Chair): However, you do not really give any credit to EU regulations for the innovations they have actually sponsored, for example in our renewable energy technology, so that we can meet our targets and so on.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): I thought I did in the main report. I said positive things.

Jenny Jones AM (Chair): Did you?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): I thought so. I went through so many iterations of this. I hope I did not cut it!

Jenny Jones AM (Chair): That might have had a red pen through it. I can write to you. On anything we do not cover today, we will write to you because it is quite a brief discussion.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Certainly.

Andrew Dismore AM: Some of the things I was going to ask about have actually been said already. Certainly as far as some of the reforms are concerned, like the CAP, everybody thinks it is a good idea but it is pie-in-the-sky. With the single market, everybody thinks it is a good idea but, again, difficult to achieve.

What I am concerned about, though, is that you are assuming that if we left, we would have a good relationship with the EU. On the downside, your fourth scenario, in which we leave the EU and we have a poor relationship with the EU, is the worst scenario of all.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): That is right.

Andrew Dismore AM: Going back to some of the earlier discussion, it is a bit of a pig-in-a-poke because, if we decide to leave the EU, it may decide it does not want to have that much to do with us, either. Again, going back to the Scottish issue, if Scotland decides to leave, we do not know what sort of relationship we are going to have with them. That remains to be seen.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): You have touched on key issues. In fact, as I was saying at the time the report came out, these scenarios are to give us some sort of benchmark in terms of what is achievable and what is possible. You are right. It is possible to leave and have a bad relationship and pursue all sorts of silly domestic policies and the economy would clearly suffer. It comes back to what I was trying to answer to Mr Knight earlier. These are indications of the breadth of possibilities.

I would say that there is generally an assumption outside that the decision to stay -- well, that might be too strong - there are some people who assume that the decision to stay in or the decision to leave is the key issue. What this report should show is that the decision to stay or to leave is an important issue but is not the only issue that determines how well your economy and hence your people do. You can be in and not do as well, in our view, as being out and having a good relationship and sensible policies. In or out is not the --

Andrew Dismore AM: Equally, if you look at --

Jenny Jones AM (Chair): That will bring us on to working with the Government.

Andrew Dismore AM: Looking at your scenarios, the poor relationship out is worse than staying in with no significant change.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): That is right, yes.

Andrew Dismore AM: If one was adopting a risk-averse approach to this, the answer is that you stay in for good or bad, preferably with reform, ideally with reform.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes, you could answer it that way and you could answer it another way by saying it would highlight the dangers if you leave of not pursuing a global outward-looking supply side-driven type of economic policy.

Andrew Dismore AM: To my mind, reading that, the weight is in one direction.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): If you are risk-averse, yes.

Andrew Dismore AM: If you are not risk-averse, then maybe not.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes, absolutely. Yes, I agree with that.

Andrew Dismore AM: Is this your contribution to the Government's consultation on the balance of competencies review?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): We have not submitted it as a consultation. I did take part as I was asked by the Treasury to be on the initial consultation debate that took place at Guildhall and I spoke at that. I have also testified to two committees, one at the House of Commons and one at the House of Lords, on the EU. In answer to your question, we have not submitted this as part of the review - or I have not submitted this, certainly, if that answers your question.

Andrew Dismore AM: Is it going to be submitted? If not, are you going to submit something else, 'you' being in this respect in the place of the Mayor?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Let me think about that. I am not sure.

Andrew Dismore AM: OK. The next question is if you know what the differences are between what you are saying and the Government policy on EU reform. Are there any differences?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): I think the Government is probably going to wait for their competencies reports to all be finished --

Andrew Dismore AM: That is becomes a bit circular, does it not? Are you going to make a contribution to that debate?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): As far as I am concerned, this is our view of the issue from a London perspective. I do not know. You may find that parts of this mirror what is said elsewhere. You might find that parts of this do not mirror what is said elsewhere. I am not sure --

Andrew Dismore AM: I think we are at cross-purposes.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): I am not sure. What is the point of the question?

Andrew Dismore AM: It is not a trick question, actually.

Jenny Jones AM (Chair): No, surprisingly, it is not!

Andrew Dismore AM: It is not a trick question this time. It is quite a straightforward one.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Sorry, does that mean you ask trick questions?

Andrew Dismore AM: No. I set pitfalls for the unwary. I do not ask trick questions; pitfalls for the unwary. It is a simple question. Is the Mayor/you going to make a submission as part of the Government's balance of competencies review or not? If so, is this it?

Jenny Jones AM (Chair): I think he does not know.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): I do not know.

Jenny Jones AM (Chair): Thank you very much indeed.

Andrew Dismore AM: All right. OK.

Fiona Twycross AM (Deputy Chair): Why, in your view, is the financial services sector so opposed to leaving the EU?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): There are a number of different aspects here. The City, as such, is Europe's financial sector. It is sizable in relation to the UK economy. In relation to the European economy, we would say it is not too sizeable. London is basically seen as benefiting from being within the EU or has benefited in the past. The big question in terms of the City is the business models that different parts of the City will use in the future and the future relationship between the City and the Continent. There is a greater concern about regulatory intrusion and those aspects that we have touched on.

I think the key issue, really, is that if the UK were to leave, then it creates uncertainty. It creates legal complexity. Indeed, we highlighted in the report ten papers that we thought were particularly worth reading, if people had the time. One of those by Clifford Chance and CityUK is a very good paper and it really does highlight that if we chose to leave, it is really very complex in legal terms.

In answer to your question, the City does not like the unknown and the City does not like uncertainty. That being said, there is growing discontent amongst some people about the future direction that we may be

moving in because of that relationship between the euro zone and the non-euro zone and because the single market in services is not working fully. I would agree with you that, overall, the City probably feels it should remain in the EU, although we did come across many people who personally had a different view on that.

Fiona Twycross AM (Deputy Chair): From business leaders or from within the City?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): It is not uncommon to meet people in the City who are more sceptical or more wary. However, I would say that certainly - and indeed a key part of this report was arguing - when you look at some of the sectors in the London economy, the ideal scenario definitely for London is to try to reform the European Union and to actually make sure that the City is positioned well in Europe.

One thing we did not really go into too much detail in here because we have talked about it elsewhere is the fact that London is at the centre of the emerging market trade or Brazil, Russia, India, China, and South Africa (BRICS) in some people's minds. It is about London making sure it is globally well placed. It is not a case of Europe versus the rest of the world. It is a case of Europe and the rest of the world. We need to be well placed in the City to be global in our outlook, particularly if other parts of the global economy are growing strongly.

Fiona Twycross AM (Deputy Chair): In your view, is there a real risk of companies relocating their headquarters away from London if we were to leave the EU? What impact would that have on our economy?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes. There are risks. There is no doubt about that. There are different surveys that suggest higher or lower degrees of risk. Also, some of the surveys show contradictions in terms of what businesses would like as well. People want to stay in at all costs and then the same survey from the Institute of Directors showed that businesses dislike many aspects of what is going on. Therefore, what we could benefit from is having a more open debate about this and then that would flush out more of the issues.

Coming back to your question, there is no doubt that some firms would be concerned and would consider where they relocate to. Whether they do or not remains to be seen. If you had a UK economy that did very well in the future, who is to say that despite that they might not stay in the UK?

Maybe, just the other point is that it was definitely the case around the time of the euro debate that some firms said that they would relocate their offices if Britain did not join the euro. That failed to materialise. Of course, the EU, in my view, is a much bigger decision than the euro and certainly some firms would be more concerned.

Fiona Twycross AM (Deputy Chair): OK. Thank you.

Jenny Jones AM (Chair): Gareth, can you move us on to immigration?

Gareth Bacon AM: Dr Lyons, yes, as the Chair has just said, I need to talk to you about immigration from Europe and, obviously, given the founding principles of the Treaty of Rome and the massive expansion that has followed in recent years, it is inevitably going to be quite a large consideration in any discussion around this.

The Mayor made reference in his speech - which I attended, thinking it was going to be very interesting and about Europe and it turned out to be about Parliamentary ambitions, which was rather a pity - about some of

the inconsistencies that we see with the Government policy regarding non-EU immigration and the free rein that immigrants from the European Union have because of the Treaty of Rome. There are some fairly high-level references to it in your report but not granular, prescriptive recommendations as to how things will be managed. How would you see immigration from Europe being managed in a satisfactorily reformed arrangement with the European Union?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): In answering your question and just in the context to highlight how important it is for some sectors, there were three sectors in the London economy where the number of immigrants working from the rest of Europe was particularly high. In two sectors, construction and also accommodation and food, one in four people working in each of those sectors is a European from outside the UK. In the financial sector, one of eight people working is a European from outside the UK. There clearly are certain sectors much more heavily impacted than others.

What the Mayor was referring to was the fact that because there might not be the possibility to have constraints on the number of immigrants from the European Union, in an environment where you then put a constraint on immigration, that naturally limits the amount of people who can come from outside the European Union. He was expressing concern about the fact that that might not allow us to have the right type of student or businessperson. Clearly, that is a problem.

Coming back to your question, what I referred to in the report is something that the Prime Minister did touch on earlier this year or last year about access to benefits. The aim there would be to deter so-called 'benefit migrants'. I think that is the phrase used. Beyond that, it becomes a lot more difficult.

What we need to do is recognise that, as I say in the report, the idea of free movement for labour made a lot of sense when you had European economies that were quite similar in income levels. When you have an expansion of the European Union to the east, we have to accept that that therefore has a significant impact in terms of the encouragement of people to move to where job prospects, income levels, et cetera, are higher.

Are you able to directly limit those numbers? That is an issue. Certainly migrants, it is said, find it easier to come to the UK to claim benefits because I do not think you have to build up a payments history as in some other countries. Maybe we need to look at whether the UK should go on a similar model that other countries have to remove that distortion. These issues are quite complex and are more than just economic. In answer to your question, there are scenarios you could adopt, but none of them are quick-fixes or are easy, probably, politically - let alone economically - to implement. In economic terms, what you want to do is to encourage high-skilled migrants, ideally.

Gareth Bacon AM: Yes. Some of us in this debate would intuitively agree with what you have just said, but I am interested in the degree of depth you have gone into when formatting this and how it falls into your four models, what degree of depth you have gone into in scenario-planning how you would restrict the immigration. Would you use a points system?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): No, we have not gone into that.

Gareth Bacon AM: You have not? OK. That is fine. If there were free movement of EU nationals coming into the UK, would you expect there to be a reciprocal restriction of UK nationals going out into Europe?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): That is really for other countries to decide upon.

Gareth Bacon AM: Would there be an economic payback for that, though? Let us say there were. Would you see economic dis-benefits for the UK in that?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Often, I think of it as: how do we see the European Union of the future? Is it going to be a castle or is it going to be a prison? Is it going to be a prison you are trapped in? No one, ideally, wants to be in a prison. Is it going to be a beacon of strength, a castle that is going to be shining and performing really well in the global economy? In that case, you want to be in it.

If we fear that there are going to be barriers put up, it suggest to me more a prison and more a case of being inward-looking and more interested in process than progress. In that environment, you have to say that maybe it is not an economic club that in the longer-term interests of the UK economy is the best one to be in. Therefore, you then choose in wider economic terms a decision to move otherwise. There might naturally be consequences as a result of that. Some firms, as we have just talked about, might decide to move. Other countries might decide to put barriers up. However, I do not think it seriously works in people's longer-term best interests to start putting those sorts of barriers in place.

Gareth Bacon AM: Sure. In the report you have alluded to the fact that mass volume, low-skilled EU immigration has a tendency to depress wages and create employment problems for domestic nationals in the UK.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes.

Gareth Bacon AM: It is a fair assessment, then, to say that your preference if there were reform of EU immigration would be to prioritise highly-skilled EU migrants to the UK over lower-skilled?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes, that would make sense in economic terms.

Gareth Bacon AM: Yes, I am sticking purely to economic terms, not steering into any kind of social area.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): The last few years have been very interesting about the UK labour market in the whole context you see. Economists back in 2008 would have been unemployment to have risen quite sharply. What we have actually seen in the UK is that the shock absorber has been wages. As the Chair touched on, unfortunately some people are on zero-hour contracts. Also, other people are in part-time work. Some maybe choose to; others do not necessarily choose to. We have seen that the shock absorber, thankfully, has not been unemployment. It has been wages.

Then, on top of that, we have seen a weaker pound leader to higher imported inflationary pressures, whereas in previous cycles when the pound was weak and Britain was in recession, we tended to have low commodity prices. The combination of a change in global environment - where it is not just the West that dictates commodity prices but demand from China, et cetera - and wages being the shock absorber and higher imported inflationary pressures has led to that cost-of-living squeeze. Hopefully, that will start to unwind in the future.

Certainly, when you look at it in a global context, the data from the World Bank at the end of last year talked about globalisation and not just about EU debate. It showed that if you look at the 30-year period from the fall of the Berlin Wall to the Great Recession starting, so not taking into account the last few years, the people who lost out relatively - and 'relatively' is the key word - were those who were, on a global scale of zero to 100 where zero were the poorest and 100 were the richest back in 1989, centred on 85. They were richer than 85% of the world's population, but they tended to be the low- to middle-income earners in the West. The big

relative gainers globally were those who were at 40 on that scale back in the late 1980s. The point is that when you have globalisation, in the initial phase you do see pressures on low costs and that is as true globally as it has been in the UK and the EU.

From an economic perspective, you need to accept that an economy needs low-skilled workers as well as high-skilled workers and we need to make sure that people respect low-skilled workers as much as we thrive after high-skilled workers. We need to make sure that they are well paid - we talked about this at the last meeting - and that we avoid exploitation, etc.

Gareth Bacon AM: It is rather a pity that we only have an hour, Chair, because that alone is a subject we could take half an hour on.

Jenny Jones AM (Chair): I know. I know. We will come on to Onkar because it is our last set of questions and we have four - no, three - minutes left.

Dr Onkar Sahota AM: If we were to leave the EU, what reforms would the UK need to implement to achieve the best economic outcomes?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): If we were to leave the EU, first and foremost we need to manage the near-term uncertainty. We need to try to compensate the sectors that would suffer from a withdrawal of EU funding, like some in the university sector. We need to manage the dislocation. That is the first real message.

We need to, in that interim stage when we are leaving, have a mature, grownup conversation with our EU partners to settle on the best terms of exit. Other countries have exited³. I do not think we necessarily have to copy other countries' exit. We need to look at it from our own perspective. Given that the European Union has a big trade surplus with the UK, there is every reason to think that they will have a bias towards having a good relationship. At the same time, we need to be positioning ourselves in the global economy, much as, you could argue, we are doing at the moment.

In answer to your question, it is managing the dislocation in the near-term. It is actually having a good relationship with the EU and negotiating those terms. It is thinking globally. Then, on top of that, there are things that we should be doing whether we are in or out, which are sensible economic policies --

Dr Onkar Sahota AM: Dr Lyons, which countries have exited from the European Union so far?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Sorry, in terms of countries that have exited?

Dr Onkar Sahota AM: This is what you said. You said since other countries exiting.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes, I did. Sorry. Apologies. I meant it in terms of how, when people discuss this, they often look at other countries' relationships in terms of the EU: Switzerland, Turkey, etc. Sorry, that is what I was referring to. No, no one else has left yet.

Dr Onkar Sahota AM: All right. How do you think that the UK leaving the EU would affect the relationship with developing economies like India and China? They like us being part of Europe. How would they relate to us once we are outside Europe?

³ Following the meeting Dr Lyons clarified this as meaning "Other countries have a relationship outside the EU."

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Again, it is important for us to recognise that this report is saying that we should be in a reformed EU.

Dr Onkar Sahota AM: Assuming we cannot achieve that?

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Then we need to make sure that we clearly position ourselves. We need to be doing trade deals with other countries.

You asked about China. The China relationship is interesting. I think China genuinely - and it has said this - would like the UK to be within the European Union. However, a couple of years ago, the Chinese commerce minister went on the record to say that Continental Europe had a Cold War approach to Chinese inward investment in contrast to the UK, which was very open. The UK was seen by the Chinese as being the only economy in Europe that was really genuinely reaching out and being open towards them.

I think you are right. Other countries would just find it much easier to handle Britain within the EU. That does not mean that we cannot have a good relationship with them if we are outside the EU, but it does require us to actually aim for not just quick wins but also a longer-term strategic vision, certainly.

Dr Onkar Sahota AM: From a Chinese point of view, being inside Europe, we may be friendly towards China but we are also part of Europe and give entry into Europe. If we were not part of Europe, then China might look at us differently.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): Yes. Again, repeating maybe an earlier point, some people said something similar [at the time of the euro debate⁴]. Nissan was widely quoted as saying that it would leave the UK if we did not join the euro. The Nissan plant is still very successful and, indeed, the UK motor industry has transformed itself. Indeed, when you talk to people in the motor industry, they highlight the fact that in services and the single market, the single services component of the single market that impacts autos works really well across Europe. We want to see the single market work well across services generally.

However, you are right. There is no doubt that there is increased uncertainty, full stop. I agree with that.

Jenny Jones AM (Chair): Dr Lyons, I know you have to go. Thank you very much for this hour.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): OK. If you want to ask another question --

Dr Onkar Sahota AM: I was going to say that if we were outside Europe, to what extent is the UK at risk of engaging policies where we reach for the bottom in terms of regulation and wages? We will be competing with Europe. We will be reaching for the bottom with the European people outside of Europe.

Dr Gerard Lyons (Mayor's Chief Economic Advisor): I think that debate is an existing debate generally in terms of the whole globalisation debate. However, we have to accept that Britain is the sixth biggest economy in the world. We have big influence in many of these decisions. Obviously, while being on the United Nations Security Council does not impact here in this question, there are many things where the UK does have big weight globally. We should not be driving things to the bottom. In terms of price versus quality, we should be looking at the quality component. What works in our longer-term economic best interests? It should not always be a race to the bottom. I agree with that.

⁴ Clarified by Dr Lyons following the meeting

Jenny Jones AM (Chair): Thank you very much for coming.