

Most of Europe is Getting Ready for EMU

Financial markets are convinced that European Monetary Union (EMU) will proceed on time in 1999, allowing the Euro to be introduced across Europe. To qualify for EMU countries must achieve the Maastricht convergence criteria of low levels of government debt, budget deficits, inflation and bond yields as well as membership of the Exchange Rate Mechanism (ERM). Britain will not be one of the countries to qualify but most countries on the Continent hope to be.

Throughout Europe there is strong political enthusiasm in favour of EMU. Governments have announced tough budgets, involving cuts in spending or higher taxes. This has pleased the financial markets but it is not good news for Europe's high number of unemployed. Weak growth, low inflation and tight fiscal stances point to European interest rates falling and remaining low for some time.

Britain is Keeping its Options Open

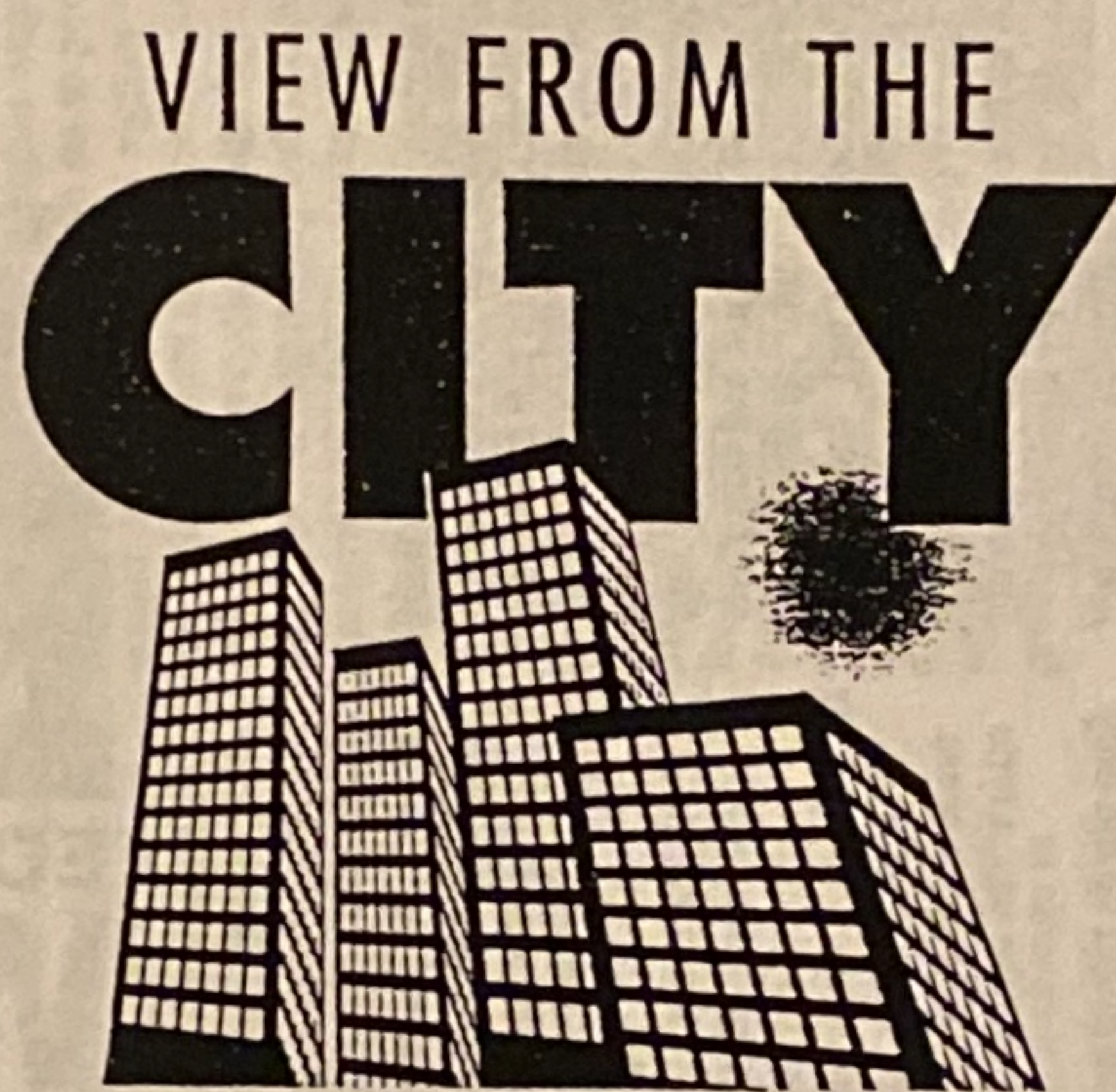
As the rest of Europe prepares for EMU what should Britain do? The Government is keeping its options open, waiting to see what happens. This is right. There are still two hurdles to EMU starting on time. First, European growth will be weaker than most governments expect, making it difficult for them to achieve their budget cutbacks and the Maastricht convergence criteria. Second, the German general public is still sceptical about EMU, fearful that the Euro will be weak and undermine their savings. In view of this, if EMU proceeds on time it is likely to involve a small number of countries. Italy and Spain will be excluded. It will be a DM bloc, with Germany, France, Belgium, Netherlands, Luxembourg, Austria and even Ireland or Denmark.

Britain should make its decision on whether to join on economic grounds. There are six main reasons why we should not join.

Reasons Why Britain Should Stay Out

■ First, there will be a loss of

economic sovereignty. Sterling's experience in the ERM should have taught us a valuable lesson. Replacing sterling means a loss of monetary sovereignty, with interest rates not being set in the best interests of the UK economy. Also, a fiscal stability pact between European countries will prevent flexible budgetary policies once EMU begins. Consequently EMU will remove the Government's flexibility to set policy to suit domestic economic circumstances.



VIEW FROM THE

CITY

In this article,

Dr Gerard Lyons, Chief

Economist of Dai-Ichi

Kangyo Bank (DKB)

International looks at

"avoiding the monetary

union straight jacket".

■ Second, the Maastricht Treaty is economic nonsense. Maastricht fights yesterday's inflation battle, without any allowance for changing circumstances, where unemployment is now the challenge. Thus it sets a deflationary tone, pointing to weak, below trend growth and high unemployment.

■ Third, EMU is insular looking and does not provide an optimal currency area for the UK. If sterling entered a Monetary Union this may help firms trading with other European countries but at the expense of possible trade elsewhere.

■ Fourth, the system is not workable. There is no flexibility in economic policy. Without monetary flexibility there will need to be a flexible labour market in order for firms to respond to economic shocks. The unemployed will migrate from poor regions to wealthier ones. To prevent this social dislocation there is the need for flexible, regional fiscal policies with transfers from richer regions to poorer regions. If not, EMU will result in severe regional disparities and condemns some areas to continued weakness and poverty. Yet there is no room for this policy flexibility in EMU.

■ Fifth, Britain will not be able to address key underlying structural economic problems within EMU. In particular, we may not be able to keep our labour markets as deregulated as we wish, in order to attract inward investment. Furthermore, the UK needs to invest more heavily. To do this requires a more pro-active, pro-British interventionist stance than will be possible within EMU.

■ Sixth, it is simply wrong to assume that sterling will continue to weaken and the UK will face a higher risk premium outside the EMU. There is every likelihood that the euro will be a soft currency, despite an initial period when the European Central Bank will aim to act tough. By contrast, if the UK pursues sensible domestically orientated policies then sterling can perform well. There is much that needs to be done in the UK economy but success cannot be achieved within EMU.

Co-operation but Not Monetary Union

The fear factor that the UK will lose out on inward investment is misplaced. The UK is competitive and has continued to attract inward investment in recent years, despite our well known opposition towards EMU.

I am in favour of greater European co-operation but not through the straight-jacket of Monetary Union.