Monetary union: case of mistaken identity

Politicians make mistakes. Economic policy mistakes are usually reversible. Sterling entered the Exchange Rate Mechanism at the wrong time and the wrong rate. This caused severe economic problems, but we left the ERM and the economy recovered. A single European currency is different. Britain can enter only if it intends to stay. Sterling would be replaced by the "euro", and any attempt at divorce would be unthinkable, costly and economically damaging. It would take years to recover. Politicians must not get this wrong.

If politicians on the Continent have their way, European Monetary Union will begin on schedule in 1999. Don't underestimate this timetable, despite the hurdles of weak economic growth and high unemployment standing in the way of unification.

One obstacle has already been overcome this year as lower interest rates have allowed the French franc to remain relatively stable, despite fears of devaluation.

The key issue now is who will qualify for EMU by meeting the Maastricht criteria of low inflation, low bond yields, low budget deficits, low public debt and stable exchange rates in 1997. By early 1998, it should be clear that only Germany and Luxembourg have met all the convergence criteria. Most countries will not reduce their budget deficits in time. Although the Bundesbank may approve of a strict interpretation of the criteria, the prospect of only two countries in a Monetary Union will fall short of Euro enthusiasts' expectations.

It is more likely there will be a last-minute delay or a liberal interpretation of the criteria, allowing a larger number of countries into the EMU. Without this flexibility, the whole process could collapse.

The qualifiers are likely to be France, Germany, Austria, Luxembourg, Belgium, the Netherlands and Ireland. Britain could enter, but like Denmark it will probably decide not to. Even if Monetary Union proceeds, it is not in Britain's best economic interests to enter. The benefits of membership are far outweighed by the costs.

There are five main reasons why the UK should not join.

■ Sterling's experience in the ERM should have taught us a valuable lesson. Replacing Sterling will mean a loss of monetary sovereignty. This means interest rates will not be set in the best interests of the UK economy. This will remove the Government's flexibility to set policy to suit economic circumstances.

■ The Maastricht Treaty is economic nonsense. Maastricht fights yesterday's inflation battle without any allowance for changing circumstances; unemployment is now the challenge. Thus it sets a deflationary tone that will be repeated in EMU, pointing to weak, below-trend growth and high unemployment.

■ EMU is insular-looking and does not provide an optimal currency area for the UK. Although there is nothing wrong with having better trade ties with Europe, to do this within a monetary union could be at the expense of trade and business links with the rest of the world. This is particularly relevant now, with the emergence of Asia as an economic powerhouse. Although two-thirds of British exports go to Europe, there are possibly greater opportunities in developing trade ties with Asia.

■ If Britain enters it will already have given up control of interest rates and would no longer have the ability to allow sterling to depreciate to offset any loss in economic sovereignty.

■ A flexible labour market is needed. The unemployed will migrate from poor regions to wealthier ones. Preventing this social dislocation would require flexible, regional fiscal policies with transfers from richer regions to poorer regions. If not, EMU will result in severe regional disparities and condemn some areas to continued weakness and poverty. Yet there is no room for this policy flexibility in EMU. Instead of offsetting weakness in the private sector, fiscal policies will reinforce economic downturns.

■ 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 increase investment, and to achieve this may require a more pro-active, pro-British, interventionist stance than will be possible within EMU.

If politicians are looking after Britain's best interests they should not make the mistake of forcing us into the straitjacket of European Monetary Union.

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Britain should steer clear from the straitjacket of a single European currency, argues Gerard Lyons