

EMU's biggest hurdle may be France



Agenda

Sensible economic policies and flexible markets are needed

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The Amsterdam Summit did no more than paper over cracks in the single currency. Hardly surprisingly, the French and the Germans reached a compromise, settling their recent difference of opinion. In addition to reaffirming their support for the fiscal stability pact the European Union leaders agreed on a policy commitment to promote jobs.

As welcome as this new commitment is, it is so vague as to have little immediate consequence. Actions speak louder than words and European Governments will not be compelled to take new initiatives. No new money will be directed to job creation, although a technology fund will be established to help small- and medium-sized firms. Despite good intentions, the overall approach to job creation throughout the EU is lacking.

Rising European unemployment has resulted in various job creation programmes at a succession of summits since the early Nineties. Each programme may have had some success when judged in isolation, but in a deflationary policy environment which has contributed to sluggish domestic demand, unemployment has still risen throughout the EU.

Britain has been a noticeable exception. Even though unemployment is still too high, its fall in recent years demonstrates the advantages of a flexible labour market and sensible economic policies aimed at helping demand. Both are necessary. An economy must be growing to generate jobs and the labour market able to respond.

The French were right in some of their demands at Amsterdam. The economic conditions built into the Maastricht convergence criteria are arbitrary, focusing on financial variables. It is important to aim for low inflation and stabilisation of budget deficits but in the Maastricht Treaty not enough account was taken of economic variables such as growth, employment and output.

Yet the French were also wrong if they think unemployment can fall without increased flexibility in their labour market. The approach of the French government suggests they might rely mainly on the public sector to generate jobs. One of the biggest problems in Europe compared with America in recent decades has been the inability of the private sector to generate jobs on a large scale. This has arisen not just because of inappropriate economic policies, but because European labour markets are too inflexible. In this respect the British and Germans were right to stress that France should deregulate its market. This points to further problems, with the

French and Germans on a collision course again in the next few months. The weakness of the French economy is leading to a build-up of tensions, similar to those we experienced prior to sterling's ERM exit. The French Socialists want to reduce unemployment. But one of the reasons they were elected is the previous Conservative government was unable to reduce unemployment while sticking to its Maastricht commitments. Something has to give and, judging from Prime Minister Lionel Jospin's speech in the French parliament last Thursday, it will be the budget deficit that suffers. He suggested a policy geared to boosting the economy. Even in doing this, he was barracked, suggesting he will come under pressure to do more. France's budget deficit is likely to miss the 3% target, and by a long way if Jospin keeps his promises.

Yet France is still committed to the single currency. Indeed, the French will see developments in Amsterdam as the first step, permitting them to press their case for further proactive policy towards jobs and greater political interference in post-EMU policy. However, with the British Government aligning itself with Germany, the French may find it difficult to achieve much progress.

Even though the German economy is showing signs of recovery, this is concentrated in the export sector and may not feed through quickly enough into the domestic economy to prevent unemployment from rising. The German general public will thus remain wary of EMU. If, at the same time, they see the French making little attempt to reduce their budget deficit, they may become more defensive of their beloved Deutschmark.

Even if the politicians manage to keep the show on the road, the deal signed in Amsterdam could stoke up future problems between 1999, when the euro is introduced, and June 2002, when it becomes the sole legal currency.

During that period the European Central Bank may push interest rates up to establish credibility. If so, France, among others, may interpret the Amsterdam announcement on jobs as a justification for increased government expenditure, despite the fiscal stability pact, which imposes fines on excessive spenders. Having for so long been one of the driving forces behind EMU the economic and political environment in France means it may not be in a position to join. And, even if France remains keen, it may yet delay the process.

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