

COMMENT COLUMN

Our Duty to Explain the Folly of EMU

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If you, as a business economist, are in favour of weak, below trend growth and high unemployment then you may want Monetary Union. But, if like me, you favour a prosperous growing economy, with unemployment falling you should oppose sterling's membership of EMU.

Politicians make mistakes. Usually economic policy mistakes are reversible. Sterling entered the Exchange Rate Mechanism at the wrong time and the wrong rate. This caused severe economic problems, but at least we left the ERM and the economy rebounded. A single European currency is different. Sterling would be replaced by the Euro in an irreversible marriage. Britain can only enter if it intends to stay. Any attempt at divorce would be unthinkable, costly and economically damaging. It would take years to recover. Business economists must ensure that politicians do not get this wrong.

If politicians on the Continent have their way, European Monetary Union will begin on schedule in 1999. Don't underestimate the political momentum in favour of EMU, despite the economic hurdles that lie in its way. Two options now appear to lie ahead. Either the convergence criteria are relaxed sufficiently to allow EMU to proceed on time, or the process is delayed at the last minute. In view of the concerns of the German general public a last minute delay cannot be ruled out. However, as delay could risk the whole process collapsing, and given Chancellor Kohl's commanding position, it is more likely that the process will proceed. However, to alleviate concerns of the German general public, Italy and Spain will be excluded. It will be a DM bloc.

There are six main reasons why the UK should not join this bloc.

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First, 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.

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 that will be repeated in EMU, pointing to weak below-trend growth and high unemployment.

Third, EMU is inward-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 opportunities with the rest of the world. This is particularly relevant now, at a time of globalisation, which is seeing the emergence of Asia as an economic power house.

Although just over half of British exports go to the EU, there are possibly greater opportunities in developing trade ties with Asia. 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. If we enter we will already have given up control of interest rates and also we would no longer have the ability to allow sterling to depreciate to offset any loss of competitiveness. This implies the need for flexibility elsewhere in economic policy, but this will not be possible within EMU.

There will need to be a flexible labour market in order for firms to respond to economic shocks. One consequence is 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 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.

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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 than it presently does and to achieve this may require 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 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 oriented 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.

The fear that the UK will lose out on inward investment is misplaced. The UK is very competitive and has continued to attract inward investment in recent years, despite our well known opposition towards EMU. Such investment would not have been attracted if EMU had been the key issue. Survey results of why firms invest in Britain support this argument.

If politicians are looking after Britain's best interests they should not make the mistake of forcing us into the straight-jacket of European Monetary Union. And it is up to us, as business economists, to explain the problems that lie ahead.