Britain is safer staying away from this party

There are seven reasons why the UK should not be rushing to join EMU in 1999 – or perhaps ever, **Gerard Lyons** argues

WHEN Ireland entered the EMS, the latter earned the nick-name "Easy Money Soon", as money flowed in. When the pound was in the ERM, it was referred to as "Europe's Recession Mechanism" as the economy suffered. If we enter EMU, it may be termed "Even More Unemployment".

Having missed EMU's original start date of 1997, Europe's politicians do not want to postpone the rescheduled one in 1999. Delay could finish the single currency for good. So they have pulled out all the stops. A single currency will begin in 1999, with 11 starters.

This is already putting political pressure on the Government and partly explains its dithering in recent weeks, but does not excuse it.

There are strong economic arguments why Britain should not rush in. I am not against co-operative relationships with our European partners. There is no point trying to play a key role in Europe through the strait-jacket of a single currency, because it is flawed and not in Britain's long-term economic interests.

Why, then, does industry want it? There is a misconception, that, if we replace the pound with the euro, stability will be bought and at little cost.

There are seven fundamental reasons why the Government should avoid EMU.

First, there is no guarantee EMU will be a success. To qualify for a single currency, countries have to meet the Maastricht convergence criteria of low levels for budget deficits, government debt, inflation and bond yields as well as ERM membership.

These criteria are arbitrary and narrowly focused on a small number of mainly financial variables. Important as these are, they can achieve only a minimum degree of economic convergence. The failure to focus on "real" variables such as growth and employment means there is no guarantee countries joining will have converged sufficiently to survive difficult economic conditions.

The fact that the criteria have been fudged exacerbates the problem. We do not even know if the convergence that has been achieved is sustainable.

There is a political fear Britain will miss out on the party. If my six-year-old daughter were invited with 11 of her friends to a party, she would naturally want to join in. If this party were held in a safe location where nothing could go wrong, such as a caring home, I would not mind.

But imagine if the party were to be held in a field near a cliff edge. There is a high risk of tragedy.

EMU is like this. The Government should behave like a grown-up, surveying the whole scene, not like an impetuous child oblivious to the risks. If something goes wrong, it could be fatal for the economy.

Second is the lesson of Black Wednesday, when the pound was forced out of the ERM. There will be a clash between domestic and external needs. The Bank of England Governor Eddie George calls this "the one size fits all" problem. A single currency means one interest rate for all countries. It may be too high for some, causing weakness and unemployment, and too low for others, leading to inflation.

Remember the Lawson Boom, when overheating in the South-east pushed interest rates sky high, even though this was not appropriate for the whole country.

Third, flexibility is crucial to a single currency's survival. I am often asked: "If the US can have a single currency, why can't Europe?" America has monetary, fiscal and labour flexibility, which EMU will not have.

UNLIKE the US Federal Reserve, the European Central Bank will not be politically accountable, with only a narrow mandate to achieve low inflation. The Federal Reserve has to achieve low inflation and stable employment, leading to balanced policies.

The US labour market is flexible with, on average, 7.7 million people moving between states each year. This allows much-needed flexibility in local economies. Europe's rigid labour market will not allow this. Similarly, EMU will not have inbuilt fiscal stabilisers like America, where funds are directed to regions in economic difficulty.

Europe's task is to avoid America's social problems but enjoy its growth. Yet, if Europe does not have the US's monetary, fiscal and labour flexibility, then the shock absorber will be unemployment, with depressed regions. In this environment, nationalist tendencies, which the architects of EMU hoped to avoid, could thrive.

Fourth, history shows that if EMU is to survive it must become a political union. There is no middle ground. EMU must have a single fiscal policy, with central control of tax and spending powers.

Monetary unions of large sovereign states eventually fail, sometimes after a long time. The gold standard collapsed in 1931. A Latin monetary union, set up in the mid-1860s, collapsed in 1927. Scandinavian monetary union folded in 1931.

Not only did all these monetary unions eventually fail but they also did so at a similar time, when there was a big external shock such as a deflationary environment. Monetary unions of countries that have not converged economically or merged politically eventually fail, particularly if the international environment is tough.

Fifth, qualifying for EMU may be easy compared with the problems afterwards. The immediate concern of financial markets is the "free rider" problem that a high-spending government will trigger instability. To tackle this problem, another one has been created through the stability pact, which aims to control government spending and in doing so will result in "deflationary policies" leading to weak, below-trend growth, high and rising unemployment.

Sixth, academic theory supports empirical evidence by showing the euro will not mean an "optimal currency area" for the UK, because we are a medium-sized open economy with key trading and financial links with the non-EMU world.

Seventh, the UK and continental economies are not in synchronisation. If we are to join the single currency, the pound must fall to a sensible rate and interest rates decline, converging to European levels. Taxes would have to rise sharply to compensate.

This is the sole government concern about joining. Yet the economic argument against EMU should be based on more than cyclical factors. There are fundamental flaws with the euro, suggesting it is more than simply a case of waiting a few years.

All of this should dispel the fear factor about staying outside a single currency. Waiting and even staying out for good need not cost jobs. Two-fifths of Japanese inward investment in Europe has come to the UK, as has the bulk of Korean inward investment.

Some multinational companies have shut plants here, but many others have done so in Belgium and Germany. It is not just the euro that determines where firms invest. Globalisation will ensure that protectionist trade barriers cannot be erected in Europe.

Whatever happens elsewhere, Britain needs sensible and sustainable policies, aimed at boosting investment in the infrastructure, public services and value-added areas of the economy, raising living standards, with lower unemployment.

EMU is not the stepping stone to such longer-term goals. You will not hear this from the Chancellor's spin doctors, but you will from the one in eight who are unemployed across the Continent.

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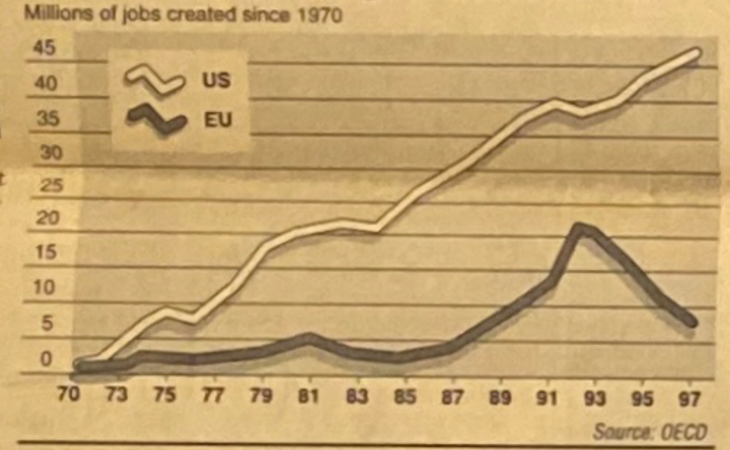
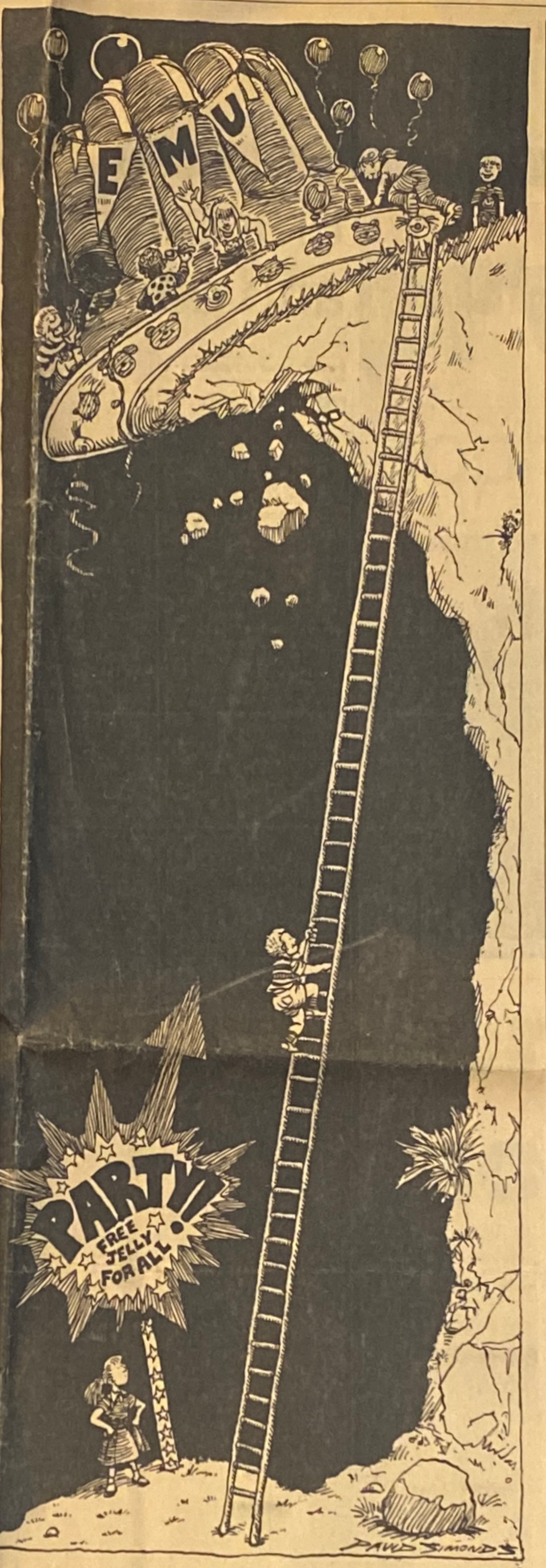
How Europe lags behind US

Millions of jobs created since 1970



Source: OECD



Two-timers have had their day

Worm's eye

Dan Atkinson

THE last of the great flat earthers was, by all accounts, former president Kruger of South Africa. While heading into exile in England after the Boer War, he asked a crew member to explain some principles of navigation.

A quick talk on latitude and longitude persuaded Kruger that the Old Testament description of the earth was inaccurate and that the globe is, er, a globe. Certain consequences follow from the acceptance of a spherical world, one of the most important being the need to face up to the impossibility of a single "day", the same the world around.

We apply one solution to the calendar and another to the clock

Somewhere it is always night, somewhere noon. In the same way, one zone's summer is another's winter.

One response is to retreat into a rural indifference to any chronology more complicated than, in the dimly remembered words of a long-forgotten snack-food advertisement, the sun goes up, the sun goes down, the pressures of life are getting me down.

Another is to impose a single system and accept that it will mean different things in different places, what may be called the single temporal currency.

And a third is to allow the different parts of the world to "float" against one another, so that each description means the same thing, but at any time each zone enjoys a different share of the clock or calendar.

For reasons buried [illegible] past, we apply the s[illegible] solution to weeks[illegible] months and the thi[illegible] time as shown on the [illegible] In other words, Decem[illegible] is December 1 every[illegible] at the same time, alth[illegible] it may be deep midw[illegible] in England and high [illegible] mer in Adelaide.

By contrast, 11pm [illegible] ways the last hour o[illegible] night, but it reaches [illegible] land the best part [illegible] hours after reaching [illegible] laide.

In the wake of our re[illegible] yesterday to GMT, som[illegible] has to ask the obvious [illegible] tion: have we got it [illegible] wrong way round? [illegible] ness and industry [illegible] clearly di[illegible] vantaged [illegible] the pres[illegible] system; i[illegible] global fi[illegible] cial age, [illegible] imperati[illegible] that deals [illegible] executed [illegible] documen[illegible] signed in [illegible] single t[illegible] framewo[illegible] while [illegible] booming tourist indus[illegible] would benefit enormou[illegible] from being able, for exa[illegible] ple, to sell "July break" [illegible] ternationally, without h[illegible] ing to define Ju[illegible] differently around t[illegible] globe.

The present set-up mak[illegible] a mockery of "real time" [illegible] the basis of modern co[illegible] puterised financial tradi[illegible] mecahanisms.

Had someone executed a currency deal on the do[illegible] 2am on Sunday — either the BST 2am or the GMT version — how would it have registered on British systems?

In other words, let us have one clock — even though it may cause 5am to mean different things to different folk — and a "zoned" calendar, in which May will always be May, although at different times of the year around the world.

Now there is a millennium project worthy o[illegible] the name.

Tourist rates – bank sells

Australia 2.24	France 9.39	Italy 2,766	Singapore [illegible]
Austria 19.78	Germany 2.80	Malta 0.62	South Afr[illegible]
Belgium 57.96	Greece 444.15	Netherlands 3.15	Spain [illegible]
Canada 2.21	Hong Kong 12.23	New Zealand 2.53	Sweden 12.11
Cyprus 0.82	India 59.05	Norway 11.30	Switzerland 2.33
Denmark 10.76	Ireland 1.08	Portugal 285.75	Turkey [illegible]
Finland 8.48	Israel 5.77	Saudi Arabia 6.01	USA 1.5925

Supplied by NatWest Bank (excluding Indian rupee and Israeli shekel) as at close of business on Friday

Indicators

TODAY — UK: Parliament reassembles after recess.
US: Import prices (in week, Sep).
JP: BoJ quarterly report.
TOMORROW — US: Consumer confidence (Oct).
WEDNESDAY — US: Greenspan testifies to Congress
JP: Industrial production (Sep).
THURSDAY — FR: Monetary council meeting.
FRIDAY — US: GDP advance (Y/Y, Q3).
JP: Unemployment (Sep).
JP: CPI Tokio (Y/Y, Sep).
FR: Unemployment (Sep).

Source: HSBC Markets Ltd

Productive end of the tigers' tale

Briefing

Charlotte Denny

THE reputation of East Asia's tiger economies has been tarnished by the financial turmoil of recent months. Adding insult to injury, economists are now revising their views on what drove the growth of these economies over the last 30 years. It appears their performance may owe more to hard work than any increase in productivity.

League tables of economic performance usually rank countries by income or GDP per head. Ranked this way, the United States comes top of the table, and Britain has slipped to seventeenth.

Singapore, which in 1950 had a GDP per head less than a third of Britain's, overtook the UK by 1992 to take sixteenth spot. Similarly dramatic advances were made by Hong Kong, now at number five, Taiwan and South Korea.

Economists thought at first that the tigers' rapid growth was attributable to higher productivity than the industrialised West. The efficiency which enables one country to make more from the same is what economists call "total factor productivity". It is the economic equivalent of the alchemist's stone: it enables a country to grow faster without sacrificing consumption for investment, or giving up leisure time to work harder.

In a famous article some years ago, economist Paul Krugman, from Stanford University, US, looked again at the performance of the Asian tigers, and suggested that their growth could be attributable to more intensive use of labour and capital. More people worked, and more factories were built.

He likened their performance to the Soviet Union's growth record in the 1950s, when it appeared to be catching up with the West. But the point about the Soviet and the Asian miracle was that it was a one-off, says Krugman.

You can only put more of the population to work once, and there is a limit to how far you can increase workers' hours before the pay-off starts to reverse. Investment in physical plant is also subject to diminishing returns.

In the latest issue of the National Institute's economic review, Professor Nick Crafts of the London School of Economics looks at the league tables from this standpoint: What happens if instead of measuring their performance by income per head, we rank the same countries by income per hour worked?

Rankings of performance based on GDP per person underplay European success, maintains Prof Nick Crafts of the LSE

The rising hours worked per person, he says, and the increasing workforce participation in the tiger economies are reminiscent of Europe and America during industrialisation.

The trend in the West since the second world war has been for working hours per person to decline. So some of the explanation for why growth rates in the West fell below the East lies in the fact that as the industrialised world has become wealthier, its workforces have preferred to work fewer hours.

When the league tables are re-ordered by income per hours worked, many of the tigers are relegated. Singapore falls from sixteenth to twenty-first place, while Hong Kong drops from fifth to [illegible] and Britain are [illegible] to the rule of leisure [illegible] western workers. [illegible] in both have been increasing since the late 1980s. [illegible] Crafts goes on to examine the effects of taking other [illegible] of economic well-being into account. The Human Development Index, for instance, which is used by the United Nations, includes education and life expectancy. But as Prof Crafts notes, once we move away from monetary measures, there are problems of weighting.

But even the simplest adjustment, to take account of hours worked, radically alters the picture. Prof Crafts finds that growth adjusted for hours worked was, in many cases during Europe's golden age of the early post-war period "at least on a par with that achieved during the East Asian miracle".

He concludes that conventional rankings of economic performance based on GDP per person underplay European success. But the general message is clear. In the West, particularly in Europe, workers increasingly prefer leisure to labour, and the result is lower output. GDP per capita figures are often bandied about in public debate as if they were the definitive measure of economic success. But the basis of comparison should be broader than simply income per head.