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ECONOMIC VIEWPOINT

If sterling is consigned to Europe's slow lane it could be a blessing in disguise for the British economy, argues **Dr Gerard Lyons**

# A chance to get our house in order

Germany's Helmut Kohl (left) and French President Francois Mitterrand: at the centre of a new ERM

CHANCELLOR Norman Lamont's comments last week suggest that early re-entry of sterling into Europe's exchange rate mechanism is unlikely.

Such news should be music to the ears of mortgage holders and British industry. For, if Lamont means what he says, British interest rates could reach 6% by next summer.

Is it feasible to expect the Government to distance itself from policy in Europe? After all, Europe is still our biggest trading bloc. And despite sterling's hasty exit, our Continental partners are determined to continue with the ERM.

But the ERM will need to change. The key problem is its inflexibility, and politicians, not the markets, must take the blame for this.

Doubts about monetary union have exposed cracks in the ERM. Ratifying the Maastricht Treaty has been difficult. Also, a single currency requires the European economies to converge. This was never going to be possible in the time-scale set by politicians.

> ‘Recent events show a strong currency does not guarantee a strong economy’

Politicians never allowed the necessary realignment that would have eased ERM tensions.

But Lamont would never agree to sterling being devalued against the franc, while the French would not agree to a franc devaluation against the mark. But, as we saw two weeks ago, a realignment with sterling left unchanged against the mark was not credible.

The Prime Minister was correct to criticise the Bundesbank, which did not help matters through its "misplaced" comments on sterling. However, John Major is optimistic if he thinks greater future intervention by the strong economies, like Germany, will improve the system.

Even greater intervention by the Bundesbank would not have helped the UK, as it was not just speculators selling sterling. In recent months the pound continued to weaken as international investors lost confidence in the UK economy. The recession devalued sterling.

Even if other countries ignore Major's comments, the new ERM system will be different. It will contain a "hard core" of currencies, which avoided devaluation and are likely to go on to form a single currency.

These currencies will be a "Dm bloc", comprising the German mark, French franc, Dutch guilder and Belgian franc. Ironically, the Danes could be part of this group.

The countries will seek closer political and economic ties. Germany will continue to set interest rates, which the others will follow. It is doubtful whether the French, or others, will be able to tell the Germans when to raise taxes! Essentially they will be German clones.

In addition to this hard core, the ERM will still contain a number of weaker currencies, like the peseta, escudo, lira and punt. Last week some of these relied on exchange controls to remain in the ERM.

But these measures are temporary. These currencies will need to be at competitive rates to remain in the ERM. If not, markets will force them to devalue. They will be in the "slow lane", as they are unlikely to join the others in a Monetary Union. Even though sterling will not rejoin the ERM, Britain will be deemed to be in the "slow lane".

So what! These terms are misleading. Rather than a "fast" and "slow lane", we should regard it as a German currency bloc and the rest. As long as the free movement of labour, capital and goods continues throughout the Community sterling's absence from the "fast lane" will not damage Britain. It could be a blessing in disguise.

Recent events show that a strong currency does not guarantee a strong economy. The reverse is true. The Government should rebuild the economy and it has more flexibility to do this outside the ERM.

The aim must be to improve the supply side: boosting manufacturing, skills and training. If a clear policy lead is given, international investors will regain confidence and sterling will recover. Even if the Government wants to re-enter the ERM, its cause may be best served by first getting its own house in order.

● *Dr Gerard Lyons is chief economist of DKB International.*

## PS

BRITISH privatisation schemes have many imitators around the world. But one with a unique pedigree is the privatisation of elephants in Zimbabwe.

These sales, dubbed Operation Campfire, have been running since 1975 when the former Rhodesia was run by Ian Smith.

Mercifully they do not involve sales underwritten by ivory smugglers. They are supported by increasing numbers of African villagers, who have been given title to animals roaming on their land.

Hence money from selling hunting rights no longer goes to the State but to local people.

They may be fed up with elephantine attacks on their grain storage sites, and weary of the noise they make. But villagers no longer slaughter elephants or collude with poachers interested in tusks.

On the contrary, the beasts have been turned into valuable financial assets, protected by fences the villagers put up.

According to Forbes magazine, Zimbabwe's privatisation principle, increasingly applied over the years, has lifted the numbers of elephants in the country from 32,000 to 77,000.

The money coming into the villages through the sale of hunting rights pays for grain formerly supplied by aid organisations.

In the rest of Africa, where wild game belongs to the State, poachers have halved the elephant population from 1.2 million to 623,000 in the eight years to 1989.

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