

**THE EUROPEAN FOUNDATION**

# **Economic and Monetary Union What would it really mean for me?**

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## **Contents:**

### **Introduction**

**A Word of Warning**

### **Preparation for EMU**

**Convergence Criteria  
The European Central Bank**

### **Is there a case for EMU?**

**Lower Inflation?  
Lower Interest Rates?  
Lower Unemployment?  
Lower Transaction Costs?  
Lower Inward Investment?  
Exchange Rate Policy  
The Answer to Globalisation?**

### **Political Implications of EMU**

**Who will control Britain if we join?  
A United States of Europe**

### **A Final Word**

## **Economic and Monetary Union What would it really mean for me?**

The European Movement recently published a booklet called *The European Single Currency - what does it mean for me?* According to the Movement's Chairman, Giles Radice MP, "*EMU is a crucial issue, and people need to be fully informed*". But the booklet is often misleading and avoids the real effects that EMU would have on the UK.

This leaflet from the European Foundation balances the debate by:

- outlining the preparations so far for EMU
- examining the European Movement's arguments for EMU
- explaining the political implications of EMU

### **A Word of Warning**

Note that EMU stands for *Economic* and Monetary Union, not European Monetary Union. EMU means a single economic policy for Europe set by the European Central Bank in secret and centred on a single interest rate. EMU is not just a single currency bringing benefits to travellers and holidaymakers for two weeks a year. It will affect everyone, all year round.

The portcullis emblem - symbol of Parliament - on a one penny coin reminds us of the British Parliament's responsibility for the UK's public finances. If Britain joins EMU, bit decisions on everyday spending, including domestic and foreign policy, will be taken by the Bank in Frankfurt, and not in Westminster. EMU would take away our say in where our money is spent.

British people are overwhelmingly opposed to joining a federal Europe. Yet this is what EMU will create. This is why supporters of EMU in this country concentrate on the supposed economic advantages of a single currency and play down the irreversible effects that economic union would have.

## **PREPARATIONS FOR EMU**

### **The Convergence Criteria**

The convergence criteria were a rule of thumb to ensure that the countries joining EMU were ready for the same economic policy. When it became clear that the criteria were too strict, they were fudged. 'Nearly' not 'exactly' became the benchmark.

The European Movement argues that the criteria were not fudged:  
*The 'convergence criteria', i.e. qualifications for entry into EMU, have not really been fudged, the exact figures for inflation or public borrowing are less important than the trends.*

Some examples of the fudge:

- The Italian Government levied a one-off 'Euro-tax' to meet one of the demands. This was actually a loan - showing the desperation of the government to meet the criteria.
- In France, the government took on France Telecom's pension liabilities to raise funds by selling off the company.
- The German Government broke the criteria outright - at the end of 1997 German debt was rising from 61.5%.

If the exact figures are unimportant, why were states at such pains to meet some criteria exactly by fudging? The fact is that EMU is a project with tight political deadlines.

### **The European Central Bank**

The European Movement says:

*The European Central Bank will be independent and given the objective of keeping inflation down.*

The ECB is the keystone of arguments for EMU: supporters of EMU say that as the European Central Bank is modelled on the Bundesbank, it will behave in the same way. Wrong. National banks have one priority: setting the interest rate that suits the national economy. The European Central Bank will have as many priorities as it has members and these priorities may conflict.

With a national bank, decisions are taken in the national interest. Governments can redistribute tax to smooth out regional differences afterwards. The ECB cannot do this because no country is willing to see its taxes used to support other nations.

During a recession, or whenever there is a tough decision on interest rates, European Central Bankers are unlikely to vote in favour of interest rate policies that have a bad effect on their home countries' economy. Price stability (low inflation) may no longer be the priority of the majority of the ECB when Europe goes into recession. The Bankers would be under tremendous political pressure from home. The larger EMU becomes, the more diverse it is, and the more likely there will be differences of opinion.

The European Movement disagrees. It says that the Maastricht Treaty prevents political pressures on the European Central Bank. But the Maastricht Treaty has proved to be a rather flexible friend of those who want to see political union at any cost. The criteria became unimportant and the new Bank's President was only selected after 10 hours of political wrangling. Surely if the President is independent,

the decision should have been a simple one to take? Reality is never that simple: national interests and external political pressure will play a considerable part in the Bank's life.

No one can guarantee that low inflation and lower interest rates will result from the creation of the European Central Bank.

## **IS THERE A CASE FOR EMU?**

### **Lower Inflation?**

The European Movement says:

*If Britain were to join the European single currency we could expect to have significantly lower inflation.*

Supporters of the single currency argue that an independent European Central Bank will control interest rates to guarantee low inflation. Governments may want the Bank to run looser inflation policies and will pressurise the Bank. Inflation would help continental governments in the short run because many have high unemployment and high debts.

- Continental Europe is suffering from high levels of unemployment that will almost certainly increase when EMU starts. In the short run inflation reduces unemployment. Therefore continental politicians will be tempted to push for lower interest rates than those needed to hold down inflation.
- European governments have not saved enough money to pay old age pensions to Europe's growing number of pensioners. Britain has almost saved enough. Its shortfall is 10% of Gross Domestic Product (GDP), but France and Germany have shortfalls of over 100% of their GDP. Governments have three choices. They can reduce the state pension or increase taxes (both politically impossible). They could work round the borrowing rules of EMU and increase their national debts (though this will mean higher taxes) or reduce the value of the pensions by debasing the currency through inflation. So much for lower inflation!

### **Lower Interest Rates?**

The European Movement says:

*Short-term interest rates are likely to fall. If Britain joined, our long-term rates would also be likely to fall to German and French levels.*

Interest rates in Britain are currently 7.5%, double the expected interest rate inside the Euro-zone, which will be based roughly on the average of national interest rates. If Britain joined EMU, this low interest rate would be totally unsuitable, because our economy is out of step with France and Germany.

The European Movement says as much:

*Britain would still be able to change taxation and spending policies to deal with economic conditions in the UK. If we needed to cool our economy down we could increase taxes.*

This would mean a £20 billion tax rise to stop our economy booming out of control.

Inside EMU interest rates would be like a stopped clock - only right twice each cycle. To make things worse, changes in interest rates made in Frankfurt would have a much bigger impact in Britain than in the rest of the Euro-zone because more British people have mortgages than on the continent. EMU would hurt British homeowners, because it has not been designed to suit them. Total mortgage debt in the UK is four times that in Italy - a similar sized country to the UK.

The single economic policy inside EMU would be rather like trying to drive a car by moving the steering wheel once every half hour. At the moment, Britain economic policy mirrors British needs.

The European Movement says:

*Falling interest rates means that mortgage costs will fall.*

This is an attractive argument. Unfortunately, you don't get something for nothing: any reduction in mortgage repayments would be made up for by tax rises, to balance the economy.

The European Movement assumes that public borrowing will not increase. The shortfall in pensions in many country makes long-term borrowing likely to rise - pushing up interest rates. More importantly mortgage rates will not often match British economic conditions: British homeowners, most of whom have variable rate mortgages, will have their repayments dictated by the needs of countries on the continent.

## **Lower Unemployment?**

The European Movement says:

*Inside EMU higher growth will mean more jobs.*

The EU, with the exception of Britain, is one of the world's unemployment blackspots. In America more new jobs were created in the last two months than in the EU over the past ten years. People in the USA are able to work anywhere in the country because they speak a common language. Labour mobility and flexibility are crucial for EMU's success but the continent has neither. Eddie George, Governor of the Bank of England, echoed this fear when he said, *"It's less likely that people will be able to move to where the work is because of language and cultural differences"*. EMU - suitable for some countries, harmful for others - would cause severe regional unemployment in Europe. The European Movement's prophecy that "unemployment would probably fall" looks very unlikely.

Adair Turner, head of the CBI, has said, *"there is a real danger that monetary union, unless it is accompanied by appropriate parallel policies, could increase European unemployment"*. Britain enjoys low unemployment precisely because it has made these reforms.

Again, the European Movement admits this:

*Britain has more flexible labour markets than some of the other EU countries and therefore we would be in a better position to adjust to the disciplines of the single currency.*

This misses the point. Inside EMU Britain would be affected by other states' problems which would influence Europe's single interest rate and economic policy. We would be hindered from choosing an economic policy suitable for the country and popular with the electorate. Voters could do nothing to stop a bad economic policy.

Some people argue that unemployment caused by EMU will force continental governments to undertake similar measures to reduce joblessness. There are currently 18 million people unemployed in Europe - how many more jobless will it take before continental governments undertake the necessary reforms?

### **Lower Transaction Costs?**

The European Movement says that business would benefit from EMU because *"most of our trade is with the rest of the European Union" and "many businesses have to spend significant sums of money changing currencies in order to sell into the European single market and coping with unexpected changes in exchange rates"*. This is misleading.

- Trade accounts for one third of economic activity in Britain. Less than half of UK trade is with the EU - worth 14.4% of GDP.
- The number of people who would benefit every day from no exchange rate costs with the Euro-zone is small. In fact 80% of British businesses do no overseas trading whatsoever.
- Even if British trade with the EU was significant, there would be few savings from adopting a single currency. Transaction costs amount to 0.1% of GDP and this figure is falling every day as electronic transfers become more widespread.

Any savings would be swamped by the costs of changeover including the minting and printing of new coins and notes, changing accounting machinery, computer software, slot machines, bookkeeping and records. The actual costs of updating equipment are already proving to be ten times the EU's original estimate.

## **Exchange Rate Policy**

EMU is based on the belief that the right exchange rate for France and Germany would also be the right exchange rate for Britain. Oxford Professor, Walter Eltis, disagrees: *"With EMU membership, the UK's exchange rate would be locked into France's and Germany's, and the interests of UK high-tech production would become subordinate to the influences which determine the appropriate exchange rate for the predominantly mid-tech products of Continental Europe"*. The wrong rate would seriously damage the British economy. Once inside EMU, Britain could not devalue the pound to find the rate which suits British business best.

The European Movement says that this is not a problem:

*Under EMU we would lose the power to devalue, but though devaluation might provide a short-term advantage, in the longer term the economy is worse off as a result.*

Two recent examples show how bad the wrong exchange rate can be for Britain:

- The Exchange Rate Mechanism (ERM) which tied the pound to the D-Mark meant the pound artificially overvalued. Our current prosperity can be dated from when Britain left the ERM in 1992 causing a 10% devaluation of the pound, to its natural level.
- In the 1980s when the pound was held down in order to shadow the D-Mark, sterling was undervalued, thereby fostering inflation.

## **The Answer to Globalisation?**

The European Movement believes we should join EMU because:

*No country really has full control of its economic policy any more.*

The European Movement argues that national economic policies are not powerful enough to cope with global pressures. It believes that a federal Europe could stand up to economic shocks. We disagree because:

- The European Movement has confused the issue. Economic policy has always been about managing, not controlling, economic pressures. Hoping that EMU will stop Japanese economic problems spreading is rather like King Canute trying to stop the sea.
- The UK needs individual tax policy and interest rate that are tailored to its unique requirements to cope with the global economy. Remember David and Goliath - biggest is not always best. An EMU-wide, one-size-fits-all interest rate does not meet the global challenge.

## **Lower Inward Investment?**

The European Movement fears that:

*Inward investment would be put at risk if we did not join the single currency.*

In 1992, Britain received £7.6 billion in direct investment from countries outside the European Union. Supporters of the single currency argue that being outside the Eurozone would cause a fall in Britain's share of the investment into the European Union (currently over 40% of total investment into the EU). A survey of foreign businesses carried out by the Government in 1994 listed 11 major attractions of working in Britain. Being in the EU was not one of them.

The reasons are simple. People invest in Britain because of our advantages over our European partners. Haruko Fukuda (former Vice Chairman of Nikko Europe plc) says that Japanese companies have invested in Britain *"because of the language, the lower cost of employment, the more welcoming response from government, local authorities and trade unions, because of comparatively honest administration and political and social stability"*. EMU means higher taxes and higher social costs. These will frighten investors away.

## **POLITICAL IMPLICATIONS OF EMU**

### **Who will control Britain if we join?**

On the continent politicians and commentators tell the truth when they talk about the implications of EMU for Europe. In Britain, this is not the case. The European Movement brushes over the political effects of EMU:

**Britain will still be able to determine its own tax and spending priorities if we join a single currency. The European Central Bank's powers will only run as far as setting interest rates.**

Here are two examples which show the opposite:

- Hans Tietmeyer, President of the Bundesbank: *"A European currency will lead to member nations transferring their sovereignty over financial and wage policy as well as monetary policy. It is an illusion to think that member states can hold on to their autonomy over taxation policy."*
- Michel Rocard, a former French Prime Minister: *"Once we have a single currency we will immediately have a single foreign policy."*

The healthy financial state of Britain is one reason for our current prosperity. Low taxation makes the UK attractive to foreign business, and other countries are envious of Britain's excellent record on attracting foreign investment. Our European partners have already made it clear that they will force Britain to increase taxes, otherwise Britain will attract businesses now based on the continent. If we join EMU, British taxes would go up to the continental average, an increase of 18 pence in the pound - or rather, 16 cents in the Euro.

## **A United States of Europe**

The European Movement says:

*For some people there is a political motivation, too. They want to create some form of democratic federal European system. But you do not have to share this idea to see the sense behind the European single currency.*

What we are seeing is the creation of a centralised European state. The European Movement avoids this development, arguing that *"in fact, nobody wants a centralised Europe"*. What is more centralised than a Central Bank? If no one wants a centrally controlled European state, why did the European People's Party announce in 1989 that its "goal" was "the United States of Europe"?

Chancellor Kohl said in an interview with the *Financial Times* in 1993 that *"an economic union will survive only if it is based on political union"*. The British public may not want to see the European Union evolve into a European superstate, but many people on the continent actively do.

The EU's motto is *"ever closer union"*. Logically this means a federal Europe with power delegated from Brussels and Frankfurt.

EMU means more bureaucracy and less democracy. Repeated calls from the British Parliament and from the European Parliament for the ECB to be more open have been rejected.

What matters to EMU's architects is that it goes ahead on time. The economics are flawed. A single currency *"does not solve the unemployment problem of Europe"* - according to 155 German economists earlier this year. All too late people are realising that Europe is not ready for EMU. The single market, which removes barriers to trade, is far more significant a force for prosperity in Europe than one currency.

The real reason for the Euro is a political one. It will

- centralise control of decision-making and spending in Brussels and Frankfurt
- reduce the role of Europe's voters to choose their economic policies

## **A FINAL WORD**

The former Prime Minister of Spain, Felipe Gonzalez, wrote in May 1998 that:

*"the single currency is the greatest abandonment of sovereignty since the foundation of the European Community ... It is a decision of an essentially political nature ... We need this united Europe ... we must never forget that the Euro is an instrument for this project."*

Yet the British are still led to believe that EMU makes economic sense.

As EMU goes ahead regardless, British people have a chance to recognise the motives behind the project and the democratic concerns raised by economic government by a

secretive and elitist body. We have been promised a referendum on EMU. Unlike many similarly concerned Europeans, we have the chance to steer well clear.