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FABIAN PAMPHLET 572

Against a Single Currency

by Roger Berry

PAMPHLET COLLECTION

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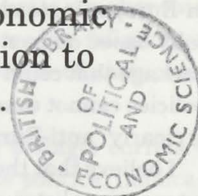
Introduction

1

Labour's attitude to the proposed single European currency has been ambivalent. On the one hand, following the Maastricht summit in 1991, Neil Kinnock attacked the Government for its "double opt-out" – the opt-out from the Social Chapter and the opt-out from Maastricht's proposals for monetary union. Subsequently, Labour's official view has been that the UK should only join a single European currency if the conditions are right, and the conditions currently agreed by the European Union (EU) – the "Maastricht convergence criteria" – are not sufficient since they focus exclusively on inflation rates, interest rates, exchange rates and government borrowing. Specifically, Labour would require "convergence of real economic performance" across Europe – in relation to employment, productivity and growth.



This position does, however, beg a number of questions. Is "real convergence" likely? And, if it happens to occur at some point in time, what measures will be taken to sustain it? Is not the Maastricht Treaty's massively deflationary approach to a single currency totally incompatible with "real convergence"? Would not a very much larger European budget be the minimum necessary to rescue the idea of a single currency? Is it sensible to have monetary policy determined at the European level and fiscal policy somewhere else? How are Labour's new proposals for the governance of the Bank of England and the transparency of economic decision-making to be reconciled with current steps being taken to set up an independent European Central Bank?

Of course, there is a perfectly good reason why Labour is not drawing attention to these issues at present. Why should we engage in a debate on a

single currency, highlighting our differences of opinion over Europe, when Tory divisions on that issue seem to be bringing us enormous political dividends? Better, some might think, to say very little and bask in the warmth of unprecedented opinion poll leads.

Decision

Sooner rather than later, however, Labour will have to address in more detail its attitude to a single currency. Otherwise, we will not influence the debate on what is perhaps the most fundamental policy choice facing Britain today.

A single European currency does, of course, have supporters and critics in all political parties. The dividing line is not obviously between Left and Right. For some this suggests that doubts about the benefits of a single currency can simply be put down to a Euro-scepticism based on outdated nationalist ideology observed right across the political spectrum.

Indeed, it is frequently asserted that those – like myself – who opposed the Maastricht Treaty must, by definition, be "anti-European". This is not the case. Many of us opposed the economic package agreed at Maastricht for a very simple and extremely important reason – because of a firm belief that, if implemented, it would be a recipe for even more unemployment and poverty, and would threaten the whole objective of European unity.

Unemployment in Europe is already at crisis levels (Coates, 1995). Even according to official statistics, almost 20 million people are out of work – a quarter of whom are under the age of 25. Yet, the economic provisions of the Maastricht Treaty do not address the problem of how to secure full employment in Europe. Instead, they impose an economic framework that is unapologetically based on monetarist free market principles. It amounts to a deflationary package that could put another 10 million people out of work. To advocate such policies cannot conceivably be described as "pro-European". In terms of jobs, it is clearly "anti-European".

I believe that there are compelling reasons why "good Europeans" and "good internationalists" on the Left should conclude that, in foreseeable circumstances, a single currency would be so damaging to the people of Europe – and to European unity – that it should be strongly opposed.

Summary

In summary, this pamphlet will argue the following:

- It is not self-evident that a single European currency is desirable or undesirable. Any sensible assessment must weigh up the advantages and disadvantages, the costs and the benefits.
- However, it is clear that the the economic benefits of monetary union do not outweigh the costs. As economists would say, the EU does not constitute "an optimal currency area", not least because the importance of trade within the

EU varies dramatically between member states, and differences in economic structure – for example, between Greece and Germany, or Ireland and France – are very great indeed. Moreover, any enlargement would make the EU even more heterogeneous in economic terms. These are not the circumstances in which it would be wise for individual member states to relinquish control of monetary policy, particularly the possibility of exchange rate adjustment.

- Monetary union, if it were to take place, would require a dramatic increase in the size of the EU budget to deal with changes in competitiveness when the possibility of exchange rate adjustments has been relinquished. Without this there would be no significant mechanism to redistribute income amongst the regions of Europe. Instead, there would be only one way in which a region's economy could adjust to a fall in competitiveness – even higher unemployment.
- The nature of the transition to monetary union agreed at Maastricht would itself dramatically increase unemployment. The deflationary effects are draconian. If one were to introduce a single currency, Maastricht is a good example of how not to do it. Indeed, it is arguable that such an approach can never succeed in establishing a single European currency.
- The "independent" – that is, unaccountable – European Central Bank, which is part of the monetary union package, is unacceptable because it would preclude democratic control of monetary policy and its agenda is firmly monetarist, with the overriding objective of price stability. In truth, there is no evidence that zero or low rates of inflation generate a higher rate of economic growth, that independent banks can guarantee low inflation or that the costs of inflation are high compared with the costs of unemployment.
- Not only are the economic implications of introducing a single currency along the lines agreed at Maastricht grave; so too are the political implications. Unemployment breeds social instability, nationalism and racism, as current experience so tragically demonstrates. It is no exaggeration to say that the introduction of a single currency could put the very existence of the European Union in jeopardy.
- In the event of a "core" group of EU members forming a monetary union, the arguments for the UK opting in are unconvincing. The evidence suggests that the UK, and most other EU members, would almost certainly be better off opting out.

2 Benefits and costs

"For currency union to be sustainable there must be real convergence between the economies of member states...the ultimate judgement must be an economic one" *Tony Blair MP*, Leader of the Labour Party, 30 May 1995.

The introduction of a single European currency would not be the first monetary initiative taken in Europe. Previous ventures have included the Werner plan of 1970, which proposed economic and monetary union by 1980; the "snake" introduced in 1972 to seek to limit exchange rate fluctuations between European currencies; and, more recently, the Exchange Rate Mechanism (ERM) from which the UK was ejected in September 1992.

Despite the fact that previous plans have not been conspicuously successful, steps agreed at Maastricht are being taken to introduce a single European currency which would replace German Deutschmarks, French francs, Italian lire and other national currencies of EU member states. Whether the single currency is called the Ecu or (following Kenneth Clarke's recent suggestion) the shilling, florin or crown is, of course, immaterial to the economics of the case.

What is crucial is the fact that monetary union would mean that participating countries would relinquish control of their monetary policy. In particular, they would give up the possibility of varying their exchange rates. Each country would no longer be able to vary the rate of exchange between its currency and those of other members of the union. In addition, there would, of course, need to be a single central bank and a common monetary policy.

It is not self-evident that a single currency is either desirable or undesirable. The truth of the matter is that there are costs as well as benefits. Indeed, if there are no disadvantages in adopting a single currency, it is not clear why we do not have one already.

The benefits

The main benefits claimed for monetary union are twofold and microeconomic in nature: the efficiency gains that may arise from the elimination of the costs of exchanging currencies and the costs of exchange rate uncertainty.

The first of these benefits is undoubtedly real but has frequently been overstated. The EU Commission's own evaluation of the costs and benefits of a

single currency gives the example of a traveller starting out with 40,000 Belgian francs in Brussels and embarking on a clockwise tour of Community capitals (except Luxembourg and Dublin). It is assumed that the traveller exchanges his cash into local currency at each stage of the journey. At the end, his accumulated loss is about 47 per cent as a result of commission charges and differential exchange rates (EC Commission, 1990). Although there are transactions costs with multiple currencies, such a scenario is clearly absurd in the age of the plastic card.

Arguably, the more important costs of changing money are those that fall on business. Yet these, too, are far less burdensome than is commonly supposed. Companies typically engage in high volumes of transactions that benefit from economies of scale and transnational companies typically hold balances in a range of currencies, and hence frequently rely on internal financing.

The economic benefit from the elimination of transactions costs has been claimed by the EC Commission (1990) to be between 0.3 and 0.4 per cent of EU GDP per annum. However, the importance of intra-EU trade – and hence potential savings – varies significantly between member states. This can be seen from Table 1, which shows the relevant figures at the time the Commission came down so clearly in favour of a single currency and for the most recent year available.

Table 1
Sum of Intra-EU Imports and Exports
(as percentage of GDP)

	1988	1994
Belgium/Luxembourg	87.3	75.1
Ireland	77.3	67.1
Netherlands	63.1	54.9
Portugal	44.8	42.4
Denmark	25.9	26.2
Greece	27.3	23.8
West Germany	25.6	22.9
UK	20.9	22.5
Spain	17.1	21.4
France	23.8	20.1
Italy	18.3	18.4
EU12	26.8	25.6

Sources: EC Commission (1990) and *European Economy*, 59.

One implication of the situation described in Table 1 is that the benefit to the UK of eliminating the costs of exchanging European currencies, would be considerably less than for some other member states, since UK trade with other EU countries (as a percentage of GDP) is below average. Moreover, transactions costs in the UK are lower than in many EU countries due to more efficient foreign exchange services being available. The benefit to the UK therefore is more likely to be around 0.2 per cent of GDP per annum.

The second efficiency benefit most frequently identified is the alleged gain from less exchange rate uncertainty. It is commonly assumed that eliminating exchange rate risk reduces the real rate of interest and hence puts the economy onto a higher growth path. However, reducing exchange rate variability is not the only way of reducing risk (this can be done, for example, by hedging). More importantly, what is frequently ignored is that a reduction in exchange rate variability also reduces firms' expected future profits and hence the net effect, at the theoretical level, is ambiguous (De Grauwe, 1992).

We must, therefore, examine the empirical evidence. In fact, this shows no clear link between exchange rate uncertainty, international trade and investment (IMF, 1984; De Grauwe, 1992). Interestingly, the EC Commission (1990) itself notes: "Since the empirical research has not found any robust relationship between exchange rate variability and trade, it is not possible to estimate the increase in intra-EC trade that might derive from the irrevocable fixing of exchange rates."

One might add, that the lack of empirical evidence of a negative relationship between exchange rate variability and trade means that it is also not possible to assume that fixing exchange rates will *increase* trade!

Moreover, the idea that a single currency introduced within the Maastricht framework would reduce interest rates is very difficult to accept. After all, the central feature of economic policy under Maastricht, as discussed below, is to seek to secure price stability through high interest rates. It seems to me, therefore, to be far more likely that this package would lock Europe into a high interest rate, deflationary regime.

In conclusion, while there is a theoretical case for some gains from a single currency, no evidence has been produced that convincingly demonstrates that this is of any significant magnitude.

The costs

Let us now consider the costs of monetary union. The most significant are macroeconomic and arise because the introduction of a single currency restricts the range of instruments of economic management that may be used at the national level. Most significantly, of course, a country would no longer be able to allow exchange rate adjustments to influence its competitive position.

The question is: how important is this? Under what circumstances would the costs of abandoning the possibility of exchange rate adjustments be more than matched by the benefits of a single currency?

This issue has been addressed in the extensive literature on the economic theory of "optimal currency areas", which identifies a number of factors relevant to assessing the appropriateness of introducing a single currency within a given geographical area. The Maastricht criteria refer to some relevant factors – for example, similarity of inflation rates – but totally neglect other crucial considerations.

For example, also of relevance is the importance in the economy of tradeable goods (goods that enter into international trade, through being exportable or importable). The more open the economy – in the sense of the greater the importance of tradeable goods – the more impact exchange rate changes have on the domestic price level and the less the impact on competitiveness. Hence, the more open the economy, the lower the costs of monetary union; and the less open the economy, the greater the costs of monetary union (De Grauwe, 1992).

Another factor that needs to be considered is how the economies of a single currency area would respond to an external shock, such as a significant change in the price of oil. Clearly, the inability to reduce the impact of such an external economic shock via exchange rate adjustment is less important if all members of the monetary union are affected in the same way. In the extreme case, if they have identical economic structures, bilateral exchange rates between members of the union would not matter. If, however, economic structures were different and therefore shocks were, as economists say, *asymmetric*, then the impact on union partners would be different. Adopting a single currency reduces the flexibility of adjusting to such asymmetric disturbances across countries, in comparison to a regime involving separate currencies.

Hence, we have a standard conclusion that the costs of monetary union will be less the more open the economies and the greater the similarity between member states. Conversely, the costs of monetary union will be greater the less open the economies and the greater the dissimilarity in economic structure between members – and the more likely it is that costs will outweigh benefits.

So, is the economic structure of the EU such that a single currency is likely to be beneficial? I believe not. Indeed, given the origins of the EU, it would be a remarkable coincidence if boundaries that have evolved essentially for reasons of international politics happened to coincide with appropriate boundaries for a single currency.

Two particularly significant reasons why the EU does not constitute an optimal currency area have already been considered. First, the importance of intra-union trade varies dramatically between member states and, second, differences in economic structure between member states are also very great. Indeed, the case for a single market rests (at least in part) on the alleged benefits from specialisation brought about by free internal trade. Such specialisation

itself is a force perpetuating or creating structural differences, and hence throwing into considerable doubt the case for a single currency.

Any enlargement of the EU, embracing the countries of Central and Eastern Europe, would make it even more heterogeneous in economic terms. These are not the circumstances in which it would be wise for individual member states to relinquish control of monetary policy, as clearly demonstrated by the disintegration of the ERM.

The collapse of the ERM has also demonstrated three other important points. First, even if the convergence criteria agreed at Maastricht *are* satisfied – for example, exchange rate stability is achieved – there is no reason to assume that this will be sustainable. Different economies develop in different ways and competitive positions change over time, as a cursory examination of history will confirm. Economic cohesion will not occur without specific policy initiatives.

Second, the *rate* at which a country seeks to fix its currency in such an arrangement is important. It is now generally agreed – although I well recall it being a minority view at the time – that the exchange rate at which the UK entered the ERM was too high. Indeed, if the initial exchange rate had been lower UK membership may well have been sustainable for many more years. As this and the German experience with unification shows, the rate at which a country enters a fixed exchange rate or single currency regime may be set incorrectly. Of particular importance is the fact that it may be set at a level that is incompatible with full employment.

Finally, the ERM crisis has demonstrated that floating exchange rates are not inherently less expansionary than fixed rates. Freeing sterling from an overvalued fixed rate has clearly been more expansionary than the alternative.

The EU's inadequate budget

3

"I fear that an attempt to introduce monetary union without a much larger Community budget than at present would run the risk of setting back, rather than promoting, progress towards closer integration in Europe" *Sir Donald MacDougall* (1977).

It is true that a change in the exchange rate is not the only possible response to a change in competitiveness. Free marketeers, for example, argue that adjustment to changing levels of competitiveness will come from labour mobility between countries or regions and/or changes in relative prices. The Right clearly prefers the latter. In fact, however, labour mobility within the EU, whilst increasing, is limited – not least because of linguistic and cultural barriers. Similarly, relative prices do not adjust speedily to restore "full employment equilibrium" as free marketeers assume. Europe would not be facing its current unemployment crisis if that were the case.

From a more interventionist perspective, what is the scope for EU budgetary policy being used to counteract the adverse effects of falling competitiveness in particular regions? In practice, very little. In the foreseeable future, the scale of the EU budget will be far too modest to be an effective alternative to adjustments brought about by changes in exchange rates.

There is a fundamental problem here that was clearly recognised in the MacDougall Report published almost 20 years ago (EC Commission, 1977) and reiterated more recently (MacDougall, 1992). Within existing nation state monetary unions, governments typically appropriate and spend around 40-45% of national income and thus, to some degree at least, fiscal policy redistributes income from more to less prosperous areas. Regions with rising unemployment automatically receive a fiscal stimulus through a boost in benefit payments and a reduction in tax revenue. In some cases more formal redistributive mechanisms operate, such as those occurring between states or *Lander* in Germany.

To make the common comparison, the USA is a monetary union and shocks impact on states within the union in different ways because of different economic structures. For example, a significant fall in the price of oil will reduce income, output and employment in Texas because oil is important to the Texan economy. At the same time, a fall in the price of oil will boost income, output and employment in an oil-importing state such as California.

The Federal budget, however, reduces the impact. In Texas less is now paid in taxes and more received in unemployment and other social security benefits. In California, on the other hand, as incomes rise and unemployment falls, more is now paid in taxes and less is received in benefits. It has been estimated that the existence of the Federal budget operating in this manner eliminates about 40 per cent of such relative income changes between states (Eichengreen, 1990).

No such mechanism can come into operation in the EU. An oil price shock would affect the UK and the Netherlands – the only significant oil producers in the EU – quite differently from, say, Germany. Yet the European budget is quite inadequate to do the job that the Federal budget fulfills in the USA. The resources of the "Eurofed" amount to only 1.2% of EU GDP, rising to 1.27% after 1999. Moreover, the current structure of the EU budget does little to assist cohesion, given the dominance and distribution of Common Agricultural Policy (CAP) expenditures (Tomaney, 1994). Quite simply, there has not been the political will to allocate to the EU budget the resources to fulfil a similar function to that of the Federal budget in the USA.

The MacDougall Report was based on a study of eight existing monetary unions – five federations (the USA, Canada, West Germany, Switzerland and Australia) and three unitary states (France, Italy and the UK). It concluded that: "a Community budget of the order of 5-7% might just suffice (or 7.5-10% if defence were included), if, but only if, it concentrated much more than existing federations on the cushioning of temporary fluctuations and the geographical equalisation of productivity and living standards" (MacDougall, 1992).

That is, an increase in the Community budget of at least fourfold would be necessary – the estimate before Spain, Portugal and Greece joined the EU.

In the absence of a dramatic increase in the size of the EU budget, monetary union will give rise to a situation where a worsening of a country's competitive position will inexorably lead to growing unemployment. Indeed, we have recently seen how even the ERM's limited degree of monetary union contributed to the deflation of the UK economy during its two years of membership. No one seriously believes that devaluation in 1992 had no beneficial effects – that maintaining the pound at DM 2.95 and interest rates at 15% would be better for the economy. On the contrary, the latter was probably the most untenable economic policy stance ever taken by a British government.

The implications for the Left are clear. The minimum necessary to support monetary union must be a much larger EU budget (or other automatic redistributive mechanisms). In the absence of this, monetary union would have a deflationary impact on less competitive regions leading to increased unemployment. This would be exacerbated by the provisions in the Maastricht Treaty for grotesquely deflationary convergence criteria and an independent European Central Bank. Let us now consider each of these in turn.

The Maastricht criteria

4

"The remarkable thing about the Maastricht entry conditions is that they have so little to do with economics. Even more remarkable, the economic theory of monetary unions has stressed completely different conditions from those adopted at Maastricht...The theory of optimum currency areas has left no trace on the Maastricht Treaty" *Paul De Grauwe* (1994).

"The deflationary effects of fulfilling the financial convergence criteria for monetary union are draconian...Meeting the 60% debt stock requirements in full could reduce employment by over ten millions" *Stuart Holland* (1995).

The Maastricht Summit of 1991 adopted the strategy for transition to monetary union set out in the Delors Report (1989). This involves a gradualist movement to a single currency through three stages. In the first stage (beginning on 1 July 1990), countries in the European Monetary System (EMS) abolished all remaining capital controls. In the second (starting on 1 January 1994), the precursor of the European Central Bank (ECB) – the European Monetary Institute – was established. And at the start of the third and final stage exchange rates between the currencies of participating countries are irrevocably fixed and the ECB adopts the responsibility for issuing the single European currency.

A country can, however, only join the currency union at this final stage if it satisfies certain "convergence criteria":

- an inflation rate that is no more than 1.5% higher than the average of the three lowest inflation rates;

- a long-term interest rate that is no more than 2% higher than the three lowest interest rates;

- membership of the ERM, in the narrow band, and no realignments in the preceding two years;
- a government budget deficit that is no higher than 3% of GDP;
- and government debt that is no higher than 60 per cent of GDP.

Under the provisions of the Maastricht Treaty, the third stage should have started by the end of 1996, if a majority of EMS countries satisfied these conditions. In fact, last year only two countries satisfied these criteria – Germany and Luxembourg. Ten out of the twelve member states had "excessive budget deficits". The target date for monetary union is, therefore, clearly out of the question. According to Maastricht, however, the latest date for the commencement of the third stage is 1 January 1999, with those countries that satisfy the convergence criteria.

These criteria have been criticised for many reasons. For example, convergence of inflation rates may be *necessary* for the credibility of fixed exchange rates in the stage before full monetary union. However, it is clearly not *sufficient*, as the ERM crisis of September 1992 demonstrated.

Arbitrary

More importantly, the fiscal constraints – 3% budget deficit and 60% government debt – are quite arbitrary and have no basis whatever in economic theory. The asymmetry is startling – upper limits, but no lower limits. The Delors Committee assumed, without offering a shred of evidence, that the bias is towards government deficits that are too large rather than too small.

Even assuming that the sole purpose of these constraints is to ensure the fiscal discipline necessary for economic and monetary union, Delors and the Maastricht Treaty get the economics wrong. In fact, neither condition is sufficient or necessary to ensure a sustainable fiscal policy, not least because they neglect the importance of the interest rate (Wickens, 1993).

Moreover, a government's debt and deficit position have to be sustainable *irrespective* of monetary union. What is not necessary – nor, indeed, sufficient – is satisfying the Maastricht limits or maintaining a constant debt:GDP ratio, as advocated by the Economic Policy Commission of the Labour Party (1995). This is just as well, since a glance at economic history shows how rarely this has occurred.

Whilst the Maastricht convergence criteria do not have any economic foundation, they do reflect the views of fiscally conservative central bankers and would inflict seriously deflationary policies on economies in need of reflation.

For example, in 1993-94 the UK ran a budget deficit of 8% of GDP. To meet the 3% target would have required public expenditure cuts and/or tax increases of around £30 billion. This is the same as total expenditure on the NHS, or twice the combined expenditure on education and transport. With multiplier effects

the loss in output and employment – in the depths of recession – would have been catastrophic. Not even a Conservative government could contemplate such economic insanity.

Stuart Holland (1995) reports the conclusions of recent studies analysing the effects of meeting the Maastricht convergence criteria for the period 1994 to end 1999. For the twelve members before enlargement this would require taking 2.6% off GDP each year. In the case of Italy, public expenditure would need to be cut to 30 per cent of its 1994 level in real terms or tax rates would need to double, with similar projections for both Belgium and Greece.

Moreover, meeting the 3% annual deficit targets would reduce employment by nearly a million, and meeting the 60% debt stock requirements would reduce employment by 10 millions.

Given its monetarist origins, it is hardly surprising that the Maastricht package totally ignores the real economy and concentrates entirely on monetary variables (the avoidance of "excessive budget deficits" is justified for counter-inflationary and interest rate reasons). What is truly astonishing, however, is that such a package could ever have been agreed without any careful consideration of the implications for public spending, income and employment.

It is difficult to conceive of a transition to a single currency that is more doomed to failure. And, given its implications for unemployment in Europe, it would be an extremely good thing if it does fail.

5 A European Central Bank

"If an independent central bank uses restrictive monetary policy to control ...inflation...it can plunge...a whole continent into an unnecessary recession" *Denis Healey,* 30 June 1995.

Clearly, a single European currency would require a European Central Bank. However, the operation and objectives for such a bank agreed at Maastricht are unacceptable. First, the bank would be independent and thus would preclude democratic control of economic policy. Second, the agenda for the independent ECB is deflationary – it is geared to the monetarist objective of zero inflation to the exclusion of objectives for the real economy, such as full employment.

In principle, there is no need for a European Central Bank to be independent of democratic control. However, if the bank were to be accountable to elected representatives the question would remain: would this not require political union and the determination of macroeconomic policy by an elected European government?

Unaccountable

Unfortunately, the Maastricht Treaty makes it quite clear that the European Central Bank is *not* to be accountable. The independence of the ECB is uncompromisingly stated in the remarkable Article 107: "when exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB and the national central banks in the performance of their tasks".

An independent central bank would therefore create a situation where one group of people (elected representatives) was in charge of fiscal policy and another group (independent central bankers) was in charge of monetary policy. Such a separation of responsibilities for economic management is built on the fallacy that these policies are independent of one another. They are not.

Both monetary and fiscal policy affect prices and employment by stimulating

or curtailing the demand for goods and services. There is no magic link between interest rates and prices. Increasing interest rates will discourage investment and vice versa. Changes in taxes will affect consumer spending. Monetary and budgetary policy need to work hand in hand with the balance between them depending on the circumstances.

Monetarist

Similarly, the size of the budget deficit and its method of finance clearly have implications for monetary policy. Is it, for example, to be financed by borrowing from the bank or non-bank sectors? Each has quite different implications for monetary policy. It is a nonsense to take decisions about fiscal and monetary policy independently of one another.

The objective of the monetary regime set down in the Maastricht Treaty is also uncompromisingly stated, in Article 105: "The primary objective of the European System of Central Banks shall be to maintain price stability".

It is true that the European System of Central Banks (ESCB) should also support the "general economic policies" set out in Article 2. However, these policies are not seriously referred to elsewhere in the Treaty and the ESCB is instructed only to do so "without prejudice to the objective of price stability".

The Maastricht Treaty, therefore, establishes an independent European Central Bank, with the legal requirement that its overriding objective should be price stability, i.e. zero inflation. National central banks will be subordinate to the unaccountable ECB and not to their elected governments.

This approach clearly reflects the monetarist free market position that underlies the economics of the Maastricht Treaty. The sole responsibility of government is to secure stable prices. If that is done then the real economy can be left to the free market, which will secure full employment, the optimal rate of growth and all the rest. Stable prices can, and should, be achieved through monetary policy, i.e. controlling interest rates, which in turn has no effects on real economic variables such as employment and growth. And, just in case the electorate is not persuaded by this nonsense, it is necessary to take control of monetary policy out of its hands. Hence, the need for reliable, independent bankers to do the job.

Unconvincing

All of this, however, is extremely unconvincing.

First, unless we get into double-digit inflation, there is no evidence to suggest that low or zero inflation brings about a higher rate of growth. The most recent of numerous studies concludes that there is no proof "to support the notion that a low rate of inflation has in the past and in various countries been associated with improved growth rates" (Stanners, 1993). He goes on to point out that there is no evidence to support the assertion "that low or zero inflation is an essential or very important condition for high or sustained growth".

Moreover, it is far from clear that independent banks can guarantee low inflation. Recent experience with monetary targets, whether in Germany and the USA (usually seen to have independent central banks) or in the UK (which does not), suggests that central banks have very great difficulty in controlling the money supply. As Baimbridge and Burkitt (1995) observe: "German experience since reunification demonstrates that an independent central bank is unable to guarantee low inflation, while the Bank of Japan, no more independent than the Bank of England, has frequently presided over falling rates of price increase".

Finally, there are the enormous costs of unemployment frequently created to secure lower inflation. As Professor Mark Blaug (1994) has concluded: "there is absolutely no warrant in economic theory to support the contention that the costs of inflation are greater than the costs of unemployment. Economists have measured both and the overwhelming evidence shows the costs of inflation to be small compared with the enormous costs of unemployment."

The political implications

6

Not only are the economic implications of introducing a single currency as agreed at Maastricht grave; so too are the political implications. Unemployment and cuts in public services breed social instability, nationalism and racism, as current – and past – experience so tragically demonstrates. They provide fertile ground for political movements of the extreme-Right. The deflationary policies set out in the Maastricht Treaty will further increase unemployment, and thereby will further exacerbate social instability and discrimination.

But it is not just the deflationary economic policies that have alarming political and social consequences, serious though they are. When these economic policies are combined with the removal of any semblance of democratic control over monetary and fiscal matters, the dangers of political alienation become acute. Voter dissatisfaction can lead to support for extreme-Right political parties. Indeed, there is evidence that electoral support for such parties is directly related to high unemployment (Baimbridge, Burkitt and Macey, 1994). A European Union so conscious of its past should surely be able to grasp the importance of addressing this issue.

EMU anti-European

There are two most important political implications of the Maastricht road to a single currency. First, if such a policy were fully implemented it would lead to such economic and social instability as to put the very existence of the EU in jeopardy. Indeed, it is difficult to see how a breakdown of the European Union could be avoided. If this analysis is only partially correct, then those who support Maastricht are supporting policies that are more "anti-European" than those many of us who oppose the Treaty advocate.

The second implication follows from a recognition that the obstacles to a single currency are so great that, in all probability, it will not come about.

Policies required to introduce a single currency – along the lines agreed at Maastricht – are so deflationary, and damaging to employment opportunities, that it is difficult to see how most European governments could implement them and survive. For that important reason, it is extremely unlikely that the Maastricht strategy will ever lead to a single currency. Indeed, arguably the convergence criteria were never intended to be implemented by all EU members. Germany's reluctance to lose its hegemonic position in European monetary affairs, without appearing to be too strongly opposed to monetary union, is accommodated skilfully in the convergence criteria. Since it is virtually impossible that these criteria will be met by all EU members in the agreed timetable, Germany will be able to argue that the economic conditions are not satisfied for a single currency, although of course it is as committed to monetary union as much as everyone else. In these circumstances, the realistic scenario is for a "core" group only to consider monetary union. If that happens, what should the UK do?

Can the UK opt out?

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For the UK to participate in a single European currency at the beginning of 1999 would require re-joining the ERM within 18 months. This has been ruled out by the Government and is not advocated by Labour. In one sense, therefore, the issue of opting out in 1999 is unlikely to arise.

However, the same arguments that suggest that the EU does not satisfy the basic requirements for a single currency, also suggest that a smaller group of EU countries might gain from monetary union. Germany, the Benelux countries and France are frequently mentioned in this context: first, because they exhibit greater similarities in economic structure and hence the occurrence of asymmetric shocks is relatively low, and therefore adjustment problems are less: and, second, because they have a high degree of interdependence in trade.

If such a group decided to establish a single currency, what should be the policy response of the UK, and indeed other EU members?

The first point to note is that the key arguments about the costs of joining – in particular, the restrictions that would be imposed on the use of instruments of macroeconomic management – are in no way changed. The second is that the magnitude of any benefits from reduced transactions costs and reduced exchange rate uncertainty will clearly be less, the fewer members of the EU who participate in a single currency. As the table overleaf shows, less than half of all UK trade is with other EU members. If we were to join a "core" EU with Germany, Benelux and France, less than 30% of our trade would benefit from reduced transactions costs and exchange rate uncertainty. Foregoing these benefits does not seem to me to be a high price to pay for avoiding the economic damage caused by the Maastricht road to a single currency.

Left behind

Other arguments, however, are typically deployed against a UK "opt-out". It is frequently asserted, as if self-evident, that if some countries adopt a single currency "we must not be left out". What arguments could be put forward in favour of this position?

First, it is sometimes assumed that a country that decided not to sign up for a single currency would experience higher interest rates than those that did.

The argument is that the markets would exact a "risk premium" against currency depreciation and a higher rate of inflation. This was why it was said that if the UK left the ERM, interest rates would be forced up. In fact, when the UK was ejected from the ERM interest rates were cut and the economy's downward spiral was halted. Again, the evidence of a benefit from monetary union is not convincing.

More significantly, there is a fear that a UK opt-out would reduce inward investment, because it would be more attractive for Japan, for example, to invest in the single currency area. And, at present, the UK receives over 40 per cent of all inward investment in the EU, more than any other member state. But why should this investment be put at risk? Presumably because it is believed that relocation would generate significant savings in the cost of exchanging currencies or that greater exchange rate stability encourages investment.

Table 2
UK Exports and Imports, 1993
(£ billion)

	Exports	Imports
Germany	26.0	29.9
France	18.1	21.7
Netherlands	13.6	14.3
Italy	12.3	9.1
Belgium/Luxembourg	11.0	11.3
Ireland	8.7	7.5
Spain	6.2	6.7
Sweden	4.9	4.4
Denmark	2.8	3.1
Finland	2.0	2.2
Portugal	1.9	2.1
Austria	1.8	1.8
Total EU	110.8	115.6
Non-EU	126.1	132.5
World Total	236.9	248.1

Source: *Economic Trends*, March 1995.

However, as already noted, there is no evidence for either proposition. Indeed, focussing specifically upon investment, figures published by the EC Commission (1990) show that growth rates of output and investment in those counties experiencing the greater exchange rate stability of the ERM in the 1980s were less than in non-ERM countries.

The reasons for a high level of inward investment in the UK are much more likely to be the use of the English language, access to other European markets, the supply of skilled labour and/or low labour costs, none of which would change if the UK did not join a core group in a single currency. Indeed, being outside the ERM in the 1980s did not result in a decline in inward investment. Quite the opposite, in fact.

So, I would argue that it is very far from obvious that if some EU members sign up for a single currency the UK, or everyone else, should do same. It is much more likely that the balance of costs and benefits of a single currency will continue to differ as between members of the EU. Many will find that opting for full employment means not opting for a single currency.

8 Labour's agenda for Europe

"Labour will put jobs back at the top of the priorities of Europe" *Robin Cook MP,* Shadow Foreign Secretary, 30 January 1995.

It is not difficult – but no less important for that – to make a powerful case against the transition to a single currency as agreed at Maastricht. What, however, should be Labour's alternative agenda for Europe? First, it must be recognised that failure to proceed with a single currency need not inhibit progress in other areas of European policy. The UK should sign up to the Social Chapter and co-operate with other EU members on employment policy, not least in developing strong measures to stop discrimination and extend workers' rights. We should protect and improve the environment we share through policies at the European level, not least because pollution does not recognise national boundaries. We should support measures to protect consumers and end the enormous waste of the CAP. And there is a powerful case for improving co-operation in the areas of security and defence.

Jobs

But above all we must give priority to creating jobs. This means not only opposing the deflationary economics of Maastricht but also acting in support of reflationary action at global, European and national levels.

At no time this century has UK economic policy been able to be set in isolation from the global economy. However, the increasing integration of the world economy, not least in relation to capital markets, has in recent years created an even greater need for international economic co-operation.

First, there must be greater co-ordinated action to promote growth and jobs. Reflation of the world economy and the rejection of mass unemployment and poverty must replace the free market/monetarist obsession with price stability as the dominant objective of economic policy.

Second, although a single European currency is not the way to do it, action does need to be taken to reduce currency speculation. The scale of foreign exchange speculation is enormous. Hundreds of billions of dollars are traded in the foreign exchange markets every day, and over 90% of such transactions have nothing to do with international trade – they are speculative. And, as we have seen on countless occasions in the last 30 years, such speculation can seriously destabilise currencies.

Together with other member states of the EU, the UK should start serious efforts to secure international agreement for a turnover tax on foreign exchange transactions – a tax on speculation. This would aid both international policy co-ordination and the effectiveness of national monetary policy (Kelly, 1994, 1995).

At the European level, top priority should also be given to jobs. We desperately need a European recovery fund that will invest in economic recovery. Indeed, the original idea for the European Investment Fund, as proposed in the 1993 White Paper, *Growth, Competitiveness and Employment*, was to counteract the deflationary effects of the Maastricht convergence criteria, achieved by the simple device of agreeing that EU borrowing would not count against public sector borrowing by member states.

The development of Trans European Networks in telecommunications and transport and increased use of European structural funds can also contribute significantly to a package of co-ordinated measures to tackle unemployment.

A Europe-wide policy of expansion is undoubtedly the first best solution to Europe's unemployment crisis, given the generally high level of interdependence in trade. An expansionary economic policy in the UK, putting pressure on imports, would clearly be assisted by a boost in exports resulting from expansion elsewhere.

We do, however, need to be clear about two things. First, such co-ordinated expansion would require a rejection of the monetarist economic ideology that dominates the Treaty of Maastricht. And, second, the fact that a co-ordinated expansion in economic activity in Europe is the first best option does not mean it will happen. Indeed, we continually observe governments of the Right blocking such initiatives. This does not mean that individual governments can do nothing. Putting jobs at the top of Labour's political agenda, therefore, also requires domestic economic policies that are expansionary and reject the monetarism of the Maastricht Treaty.

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