The Pros and Cons of Economic and Monetary Union

Jeremy Nieboer, European Foundation Advisory Board Member, gave a speech to the Political Action Group for Europe on 23rd May 1998 under this title. The transcript of this script is reproduced below.

LADIES AND GENTLEMEN may I just touch on what our German guest and friend said just now, namely that the conception of Economic and Monetary Union can be likened to childbirth: the painful delivery must precede the happy outcome. It is quite true that childbirth can be attended by pangs of pain both natural and also economic – but childbirth is natural and childbirth is necessary; and I hope by the end of my talk that you will have doubts about whether Economic Monetary Union is either natural or necessary. I will be taking a little longer than my MEP opponent speakers because I have found it quite impossible to compress the issues associated with Economic and Monetary Union (or EMU for short) into less than 45 minutes and I trust that I will not trespass upon your time or your appetite. I hope the interest of the subject and the controversy of it will keep you alert and on the edge of your seats. I break my talk into the following:

To open, I will deal with the history and origins of the whole idea of the EMU. Then I will talk about its political basis. Thereafter I will address the question of whether EMU can work: that it can be *established* effectively and; can it be *maintained* effectively. Then I will address the economic effects of entry and consider separately our special position in Britain. To conclude I will deal with the arguments in favour of EMU. I am bound to say I have had difficulties this morning deriving from the earlier MEP speakers any substantial argument in favour of EMU. I will, nevertheless, address the arguments that are commonly put up in its favour. I think you have apprehended that perhaps I am not a total enthusiast of the proposal.

MY MAIN THESIS IS THIS: that Britain's entry into EMU will result in the ultimate but certain loss of the democratic control of our economic life and that it will lead inexorably to political union. On the economic front my position is this: that the risks to us of entering this system are so great that they vastly outweigh any possible economic benefit.

So what is the history and what are the origins of this whole project and design? What stage have we now reached in it all. Well I say to you, Ladies and Gentlemen, we have reached the stage where it is quite clear that the goal and purpose of the EEC and now the EU is the creation of a European State.

EMU: Its Origins and History

THE ORIGINS of this grand design go back to the post War period. They are born from the horrors of the 6 years of war on the European Continent and in Russia which Churchill described so effectively as "this hideous epoch". It was his idea and Jean Monnet's idea that if you could bring France and Germany together in some sort of United States of Europe, this was the best surety for peace in Europe. Churchill himself, of course did not believe that we should be part of that political system; he believed that Britain should remain as head of the Commonwealth and in strong association with North America, particularly the United States.

From the beginning the European ideal, including its economic and monetary manifestations, had a political origin. I turned up an article the other day by a lady who may be known to you by repute, Shirley Williams, writing as long as October 1958 – she must have been a very young politician of her time – although just as misled – but had the advantage of youth in those times before she brought out education system to its knees – she wrote then that:

> *"The ultimate goal is the complete economic and political unification of the 6 countries... In the end, even the integration of policies that the Rome Treaty fails to mention – such as monetary policy, the creation of credit, and the setting of exchange rates – is bound to come about."*

NOW HOW DOES THIS IDEA DEVELOP? When we all voted in 1975 few of us, I think, if we were honest, few of us, except perhaps the most informed, felt they were voting for political union – is that not right? We thought we were voting for the continuity of just the sort of things that our German friend has described: a continuing free trade association, a say in the affairs of Europe to which we are so close. We did not think we were voting for a political union or anything approaching it. De Gaulle did not think the same either, de Gaulle had a quite different view. He had a view of a Europe of Nations: *Europe des Patries* he called them. He believed in the democratic nation state. He did not think it was necessary to have political union to have trade.

And that was how the position remained until 1989.

What happened in 1989 caused a fundamental shift in French thinking. When the Berlin Wall came down, when Soviet Russia returned to a semi-democratic basis and its empire broke up, the long postponed reunification of Germany followed. It was this that compelled the abandonment by France of the idea of a Europe of nation states. M. Mitterand developed and established the policy of enfolding this new Germany of 80 million people in an all embracing political treaty. Chancellor Kohl on the other side for Germany was most concerned and remains concerned about German aspirations. He wanted to see Germany locked into and contained by a politically integrated Europe. That was the aim – that remains the aim. At that time, also, Jacques Delors the former well known president of the European Commission, prepared a report to the Madrid Council of Ministers in 1989 about the next stage of Economic Monetary Union which, in turn, led to the Maastricht Treaty.

NOW THE MAASTRICHT TREATY is the most significant Treaty entered into by the United Kingdom I would say, certainly since the War and possibly of the Century. It represents a fundamental shift from the old trade and economic based idea of Europe that we all entertained. It revealed for all to see the reality of the emerging single European state. It did so in three ways:

i. It established European Citizenship;

ii. It established the European Union and removed the name "European Economic Community", it is now the European Union; and

iii. It set out the blueprint for this Economic and Monetary Union that we are now so concerned with and the commitment to a single currency.

EMU and Political Union

SO EMU HAS A CLEAR POLITICAL BASIS. Indeed there is no example in history Ladies and Gentlemen, not that I can discern, of any economic and monetary union system with one currency *without* political union. Now we have heard from another MEP speaker about Ireland. But he cannot really suggest that the currency union with Ireland was the same economic and monetary union we are talking about here. He is not suggesting that the British Westminster Parliament set the Irish interest rates or that it had direct monetary control or had budget deficit control.

There have been other currency unions of course. There was a Latin Monetary Union in the 1870s which had a standard coinage as between Belgium, France, Italy and Switzerland, but that was not an economic and monetary union; a standard coinage is not a monetary union. There was no central bank controlling interest rates and exchange rates.

People often talk about the United States – one of the earlier speakers talked about the common dollar in the United States. But the United States had first to achieve political independence of England, then political unity within itself. They had the War with England in 1775 followed by the Articles of Confederation, the Constitutional Convention to decide how they were going to be governed, a national debate about it (for example the Federalist papers), then they had the Constitution ratified, the President was elected, Congress was elected and only then was there an emerging tariff system, currency system and national debt. After all, the Civil War was not fought over slavery, it was fought initially over self determination; self determination and political union, it was only later that slavery became a major issue in that terrible conflict.

So what are the dangers of having monetary union without political union? Are there any dangers? Does it matter if there is no precedent? Ladies and Gentlemen, putting it simply, if you do not have political union then the voters, through the ballot box, cannot change the economic policy set by the European Central Bank. They cannot change it through the ballot box. That is the danger. You cannot have monetary union without political union unless you are going to create the risk for conflict. Chancellor Kohl has made it quite clear, when in 1995 he told the Council of Europe "*We want the political unification of Europe. If there is no Monetary Union there cannot be Political Union* and vice versa." And I say this: that the pace of political integration here in this country and in the other parts of Europe, is being forced by the European political establishment and outreaches our capacity and willingness to make this great change.

The entire momentum of EMU is political. This is repeated again and again by the leaders of Europe.

Hans Tietmeyer, President of the Bundesbank recently said that, *"A European currency will lead to member states transferring their Sovereignty over financial and wage policy and in monetary affairs"*. And he said this, *"It is an illusion to think that states can hold on to their authority over taxation policies"*. An "illusion": and that is the President of the Bundesbank. And Jacques Santer, again: *"The realisation"* as he says *"of the Economic and Currency Union is not possible without a political union."*

So is this the inevitable result of all these 40 years of convergence and 25 years of membership? Was Shirley Williams right? Is it inevitable? Is it bound to come? Should we go in for it *because* it is inevitable? I do ask you to consider what the leader of the Conservative Party said earlier this week about this in his Fountainebleau Business speech – a remarkable speech, all the more to be studied for being so strongly attacked by those who disagreed with it – I was very pleased to see what Douglas Hurd had to say following that speech. William Hague said that *"the European Union is now in danger of proceeding with political integration not because it is right but because it is said to be inevitable; in danger of living in the past rather than facing up to the future. We must now allow Europe's future to be driven by an obsession with the past."*

EMU: Its Political Impact

SO we have heard a lot about the political importance of EMU but what will be the political *effects*? Can I spell them out because they are going to affect all of us.

Under the combined effects of EMU and the Stability Pact, which regulates deficits, we will lose our currency, our £; we will lose our fluctuating exchange rate; we will lose control of our interest rates; we will lose the control of our money supply; we will lose our ability to deficit finance (except in very narrow limits) and we will lose our national bank and management control over our national reserves – and I say this: that no nation can be properly regarded as an independent political entity without these rights and, further, that the European Union, through the European Central Bank, will be acquiring, effectively, almost all of the characteristics of a Sovereign State.

An effective EMU: Can it be established?

HOW CAN THIS SYSTEM, the EMU, actually work? What are the necessary conditions for setting it up? Now the benefits claimed by the Commission are these, among others; low inflation, they say, low and stable interest rates, growth, leading to reduced unemployment. Now these are major, important targets; very ambitious targets for a project without any precedent at all. Furthermore they will be impossible to attain unless we do have an *effective* Monetary Union. It is no good talking at large about Monetary Union. What is effective Monetary Union? What are the conditions and the risks? What sort of system to we have to set up that will be secure and safe and workable. It cannot be done by the goodwill of politicians. It cannot just be done by wishing it any more than weddings make good marriages. So can EMU succeed? Will there be an effective monetary union? Could I put to you three conditions I suggest need to be fulfilled to *establish* a successful Monetary Union.

Popular support

The first one is a very simple one, it is a political condition. Do the people support it? Without the willingness of the people it is bound to fail – bound to fail because there would be no safety valve in what is proposed without a democratic political union. Free trade areas do not require political union – the North American Free Trade Association does not need political union. Monetary Union does. Is there the popular support? Well, Ladies and Gentlemen, there is not. I do not what to labour the statistics. I will just give you two:

At the time of the last election in May 1997 the MORI Poll organisation took a poll and one of the number of points they asked electors as they were going to the polls was whether they agreed with the idea of a United States of Europe. Only 16% approved of that. When they were asked about a single currency they said only 25% agreed. Well I do not think that last figure matters much because quite honestly we are not told anything about this single currency – are we? We do not know what is involved, we do not know what the impact is going to be. We are sitting here and we just do not know. So no wonder only 25% voted in favour of it. If they had indeed known about it they might have taken a different view but there has been an exercise in non dissemination of vital information on EMU: something which I hope to correct this morning.

In Germany it is quite plain that the majority of the electorate withhold their political support. The well known publication in Germany, *Handlesblatt,* which is the equivalent of our *Financial Times,* recently published an analysis of a poll which stated that at least 58% were against EMU – and is it surprising Ladies and Gentlemen? Trends in the world are not towards centralised states. They are not towards less accountability, they are not towards less democracy. They are towards Nation States; they are towards democracy; they are towards accountability. It is democracy that has been the great maintainer of peace in Germany and Europe and democracy that will continue to maintain peace in Germany and Europe.

William Hague also warned in the same speech that the dangers of Monetary Union without a political union are, "*...that a single currency will take European political union beyond its acceptable limits. It is irreversible. Under a single currency* [for instance] *the fit-all one size interest rate* [that is for everybody] *may affect different countries differently, but if it does the voters cannot change the policy and the Government cannot change the policy.*" Those are the dangers. That is the first condition, the political condition for coming together: it is not fulfilled.

Natural convergence

The second condition I call 'natural convergence'; this is the key one. Quite simply: do the participating economies in Europe face similar economic problems and face them at the same time with similar solutions? This is the issue. Now there are countries where the economic factors are consonant or moving together. They are not complete in their convergence, that is too much to expect, but Austria, Germany, Netherlands and Luxembourg are certainly very closely in line. We are, however, not in the same position, for the reasons I shall be explaining. Moreover the cycles of countries are very different; Ireland, Finland, Denmark, Sweden, the Mediterranean countries – their business cycles are very different to the core country cycles. Their periods of recession, their periods of expansion do not coincide with the core countries. Achieving a temporary similarity of interest rates to prepare for a single setting of a rate by ECB, that might achieve a consonance at a particular moment in time, but this state of affairs is, as it is often called, 'ships passing in the night'. But those ships are not going to remain there in the same position, latitude and longitude in the economic constellation; they are going to move forward, to diverge.

Artificial convergence

So unless you have natural convergence between economies then you have to strive for convergence by setting down criteria – providing an artificial basis for it. This was attempted by the architects of Maastricht. They said, "We've got to bring these countries who want to come in into convergence. We're going to have a number of tests and one of them is going to be that your debt can only be 60% of your wealth – or GDP to economists. Another is your budget deficit – that is the difference between your income and your receipts as a Government – must not be more than 3% of your wealth.", putting it simply. There were other tests but let us just focus on those. It has been said that there has been great suffering in Europe in meeting these tests. But these tests are the creature of European Commission itself – they are not something somebody else has made up – this is what the Commission said had to be achieved to ensure enduring Economic and Monetary Union. Within the Maastricht Treaty it is absolutely clear, if you read the Protocols, it is absolutely plain, there is no room for fudging in the Treaty.

But it has been fudged. Only Finland, France, Luxembourg and the UK – which is not going in – qualify on an absolute application of these tests – the only ones. Italy, you remember, imposed the euro-tax: it did this so as it could comply with the budget deficit test; so it has procured more tax, so the deficit is down; but they are going to pay it back! The French, they were allowed by Brussels to transfer from French Telecom FF37.5 bn (something like £4 bn Sterling) to the public sector accounts. Why? To get back into balance, just to squeeze under the Maastricht net. But this is not the way to approach an economic union. These are criteria, not hurdles; they are not tests, they are not prizes for being good in 1999 – they are a continuing requirement for a successful union. That is why the German economists wrote that letter, the 155 German economists wrote that letter to the FT in February this year. They saw no true reduction in the deficit below 3% of GDP. They saw that the debt ratios – true debt ratios – were above the Maastricht level. They saw that that employment could not be solved by EMU. They warned that political pressure was bound to be brought on the Central Bank to weaken convergence criteria even further.

So none of the conditions for establishing an effective EMU are fulfilled – none of them are satisfied. And let us remember – the disciplines of the Central Bank do not require entry into EMU: they can be imposed within by the nations themselves.

An effective EMU: Can it be maintained?

So can EMU work once established? *Will it endure?* What are the conditions needed for keeping it working? To find out one has to understand how economic systems work. The best way of putting it seems to me to be enunciated by Professor Milton Friedman in an article I read recently in the *European Journal*. He stated that whether a common economic and currency system is good or is bad depended on its capacity to absorb and adjust to the economic dislocations or shocks that affect one or more of its members. That is very simple and reasonable. So what are the key 'shock absorbers' as I call them? Well there are 7 – and I think these are the recognised economic ones – I'll be corrected if I'm wrong.

1: Exchange Rate

The first is the *exchange rate.* If you are in recession, if you have declining competitiveness – then you can arrange to drop the exchange rate by adjusting the interest rate – prices fall and exports go up, at a cost of course. In a boom, a rise in rate will guard against inflation, as we know.

2: Interest Rate

Then there is the *interest rate;* increase may apply the 'brakes' in a boom to prevent overheating: that is needed in Ireland where growth is getting out of hand at 8% a year. It can also be a release mechanism in a recession. The best recent example is the interest rate fall from 15% to 6% when we came out of the ERM, the first stage in our recovery.

3: Fiscal Policy

The next one is what is called *fiscal policy,* which is the balance of Government revenue through taxation and government expenditure – keeping it in approximate balance – that is the 3% Stability Pact requirement. But in recession, an increase of demand stimulated with public expenditure can, according to some economists, be a vital tool. It was, after all, the basis of the New Deal and the recovery in the United States in the 1930s. Of course EMU advocates say that you can have high taxes and high expenditure as long as they are in balance – but that is not what I am talking about. I am talking about high expenditure and low taxes so as you really get the economy off the ground. It may not be a popular economic theory at the moment but it saved American in the 1930s. Adopting it must remain the decision of our democratic parliament here in Britain: we should not throw away this weapon of our economic arsenal.

4: Mobility of Wages

There are other factors. There is *mobility of wages:* quite simply people may take less in order to keep in work when there are staple industries collapsing, for example shipbuilding and coal mining.

5: Mobility of Labour

Then you have what is called *mobility of labour*. This is Lord Tebbit's solution – "get on your bike". That is movement across the economic area from a region of no demand to a region of demand. This happened in the United States: the black workers from the cotton fields went to Detroit and the plains worker in the Dust Bowl Migration went to California and there was great mobility.

6: Transfer Payments

Then there is what is called the *transfer payments mechanism*. This is Government using tax revenues and social revenues to help areas that are not doing very well. The United States has an automatic system for this; an automatic system for compensating states (for example Michigan, recently) from the federal revenues.

7: Unemployment Before

And finally the last shock absorber is *unemployment*. If the others do not absorb the shocks then you are into unemployment: this is what happened in the ERM. At the time ~~When we~~ left the ERM without the protection of a true fluctuating exchange rate, without the effective protection of interest rate control (which was far to high) we suffered serious unemployment – well over a million – due to ERM alone.

So which of the shock absorbers will survive in this new system? Well the *exchange rate*, that is gone. When we came out of the ERM there was a 15% plus devaluation of our currency which enabled us to start again. What we would be doing if we joined the EMU is adhering to a fixed system forever. You cannot exit, you are going into it forever. You are throwing away the key. Then *interest rate control.* That is gone. There will be a single interest rate set by the ECB for the whole area. Then the *fiscal policy* opportunity. Can the British Government deficit finance to assist people in times of high unemployment – no it cannot. The Stability Pact will stop that. Of course you could have high wages and high expenditure or low taxes and low expenditure. We have learnt that high wages and high expenditure are not a good basis for a sound economy. Low wages and low expenditure would not be politically acceptable; not in this country, at least as yet. So what are we left with. *Mobility of wages*, mobility of labour and transfer payments. Well there is no evidence that people are going to accept lower wages. They have not fallen since 1932 – not in real terms – and wage levels are far more rigid in the EMU area. Workers' rights, as you probably know, are enshrined over there. So there is not going to be an adjustment there. It is astonishing that the French workers will not accept lower wages even at a time of a rise in serious unemployment. It is quite astonishing isn't it?

Then there is *labour mobility*. The economists talk about this a lot. What about labour mobility? Will that be available to ease the shocks? Will that be able to sustain the disparities between the different economies and the natural outcry that will result unless relief is given for sudden or severe economic shocks. Well labour mobility in the Economic Union is very limited. I will just give you two statistics. Under 1% of the working population comprises foreign residents in Denmark Finland, Greece, Italy, Portugal and Spain. It is a little better in France, Germany and the Netherlands, where the figure is 3%. In the United States, which is often cited as an example of a common currency, the position is very different. Not only do they have political union but 17% of their population move around every year. Children change school on an average every 3 years. When people move they take their pension entitlements, they take their security benefits. In the EU there is no certainty this will happen, certainly there is no provision for it to happen unless you are employed by a global company.

What about *transfer payments*? Well, it has to be said that this need has been recognised by the European Commission. They procured a report in 1977 which said that a budget of 7.5% of the GDP of the whole of the EEC was required to deal with the unacceptable disparities in living standards between regions. The actual budget today is about 1.3% of GDP. And things have got much worse since then with the admission of Greece and Portugal and Spain and the increase and spread of unemployment. How do you manage in a situation closer to home, as in Northern Ireland. Northern Ireland and Southern Ireland were in the sterling area until I think the late 1970s. Ireland pulled out. She devalued. Her economy was very successful for a while. But she devalued against sterling. Northern Ireland could not do this; went into declining competitiveness and she had to be bailed out in the single currency system, the Economic and Monetary Union that she had with Westminster. I believe the subsidy rate is about £2,000 a head.

Why is the budget provision so inadequate in Europe. Well it is quite simple. Rich states do not want to pay for poorer states and the EU budget, I am afraid, is discredited. The audit report prepared by the EC audit people put the unaccounted for level of budget, due to fraud, corruption or just misappropriation, at 5.4% of the total. There is a reluctance to pour more money in to help the others. There is a disbelief that it is going to get to the right hands eventually. Anyway it is not there now – and if EMU is going to work it is going to have to be there because without the political safety valve something is going to have to be done.

Thus the only thing left is *unemployment* and that clearly is an unacceptable mechanism for absorbing economic shocks. It may be inevitable but it cannot be a policy.

So since there is no stabilising mechanism in this Economic Union to deal with uneven shocks the need for a true convergence is critical. But, Ladies and Gentlemen, the convergence criteria have been overridden.

Economic effects of EMU entry.

CAN I JUST DEAL WITH A FEW POINTS concerning the actual effects of EMU entry; how it will affect us.

We will lose the exchange rate, we have heard that: but trade imbalances are going to continue. There are still going to be balance of payment deficits, aren't there? So people say well we must go and get the *right* rate. But there is never a "right" rate. Countries can never know what economic conditions may prevail in the future needing the use of the very weapons of policy that are now being abandoned. Look at the costs to the United Kingdom when we came out of ERM. Something like £68 bn was lost in output, unemployment went up by over 1 million and a scourge of repossessions went through this land.

Then will have the single interest rate. Control of interest rate is a very powerful weapon to balance consumption and investment, to regulate economic activity, to restrain inflation. What is the effect of having one rate with different economic cycles? It is simple; these are not complex questions are they? The economic cycles of these countries in the EMU system will never by synchronised so fully that all need to same rate at the same time. That is obviously isn't it? At present the German and the United Kingdom economies are diverging. If we have not converged after 25 years, how are we going to after 5 years which is the period during which Mr Blair believes that somehow there will be a natural convergence. Short term interest rates are widely diverging in the EMU area. Italy has over 6%, Belgium a little over 3.5% and some countries will need faster growth. The Mediterranean countries will need faster growth – so they will need a low rate. Other countries are in a state of boom, of expansion, with a high growth rate, like Ireland at 8%, will need a higher rate. Which is it going to be?

Some hope it will be in a high rate for a strong euro: that is Mr Duisenberg's aim. That is what he is going to work for, for the first 4 years. Let us hope it is so, because the euro will need credit if it is going to work. It will need to be believed in the market place. But what will the effect of that be when countries go into recession, when they come off the top of their expansion? What is going to be the effect then? Tell me, why is that going to be different from our ERM experience? If the interest rates are indeed too high what is the effect going to be. We cannot change them.

Or is it going to be a low rate, the French idea, the Trichet view, a fudge whereby he was able to say that he was going to come in as ECB President in 4 years and so do it the French way. They are pro-employment, they would like a lower rate, a soft euro. But a low rate leads to unsustainable booms and inflation in countries already expanding. We, in Britain, are very sensitive to interest rates – do you know that in this country 79% of our wealth is tied up in personal debt of one kind or another, household debt? The figure in Italy is 24%, France 50%. That is because we like to own our houses.

THEN what about the impact on taxation? We have heard it said – "well don't worry about that because the Maastricht Treaty – which has been so religiously adhered to from the moment of signature and now, which has been adhered to its every particular right through to the convergence criteria – this Maastricht Treaty says that we are not going to be responsible for each other's debts": but it said, didn't it, that we are not going to have any divergence from these vital criteria. We would not have monetary union until everybody agreed and was within its own straitjacket and what has happened to that? Remember the words of the President of the Bundesbank "*It is an illusion to think that states can hold on to their authority over taxation policies.*"

In this country our average tax levels are 36% of our wealth, a position achieved in many ways with great political courage by Margaret Thatcher who revolutionised the political and economic face of this country in the space of 12 years. Whether you agree with her or not, this country is not as it was in 1979. We have a low tax base here – we have an enterprise economy. Our labour market is not over-regulated – yet; it is still relatively mobile. What is the position abroad. What is the position on the continent? Denmark and Sweden have a 60% tax rate, Germany and France an average of 50% (approx.) tax rate. These are rates not just marginally higher, they ware qualitatively higher. The disparity represents a different view of the labour market and the enterprise economy that we have here. I say there are going to be two major forces to push these tax rates up. The first is the need for transfer payments which I will try to explain. We are going to need to help the areas that need help. Politically that has got to happen. We are friends in Europe: we cannot say I'm not going to help my neighbour. Northern Ireland receives £2,000 a year per head. In the European Union there are about 100 million living in weak economic areas: that is to say the areas I have described, particularly the rural and North of Scandinavia, Portugal, Greece – although she's not in EMU she's in the EU – Southern Italy and so on. If you allow only a £1,000 per head (half the Northern Ireland figure) you are talking about a cost of £100bn in transfer payments – to bring them up to half the rate at which we subsidise our poor areas in Britain. That is 10p on the tax. How else is it going to be funded other than through tax? You cannot just deficit finance. You are not allowed to do that. If we are to befriend our neighbours we'll have to pay; there is nothing wrong in that but you should know that that is the consequence; and we know that a high tax economy is not a sound economy.

And now I turn to the second cause: this is the issue of unfunded pension liabilities. This is not a side show. Some of you might have heard on the radio the other night on Radio 4 quite how serious this problem is.

I will first tell you what the problem really is. Then I will talk about the cost and why we are going to pay tax to meet it.

First of all there is the ratio of those over 65 (and I do not have any personal interest in this just yet – but very nearly), the ratio of 65 years olds, and more, to 16 to 64 year olds; that is to those broadly speaking who are not and who are working. Now in Germany, Italy and the Netherlands there will be an increase from the 1990 level of approximately just over 20% to a figure of 45% in 2030. This is going to happen unless there is an awful catastrophe. That population boom balloon bubble is going through. In Germany elderly dependants are now about 22% of the population. They will be 41% in 2030. In the Netherlands the respective figures are 20% and 45%.

What is the cost? Well, currently, in Europe the States pay the pensions, by and large, and they do not provide for them on a funded basis. There are no underlying investments or assets to pay for them. They are funded on the basis of future taxation. That is to say they budget on the basis that those who are working in the future will meet the cost. Those of you who were working after 2005 would be paying for my pension if we were living in France. In the United Kingdom the position is quite different. Only 4½% of our national wealth is spent by the state on pensions and only 5% will be spent, on present estimates, in 2040. In Germany that figure is nearly 19%. And that is out of an unfunded position. These are very worrying statistics. The unfunded costs of these pensions in Germany represent 110% of its entire GDP. In the UK it is 10%. France's position is ever worse – at no less than 115% of GDP. The total value of our pension funds in the UK exceeds the value of all pension funds on the European continent put together.

We have a different notion of provision for the future. We are not State bound would you believe it. It makes one wonder why pension provision made by private people, which we all are after all, has been placed under threat by this present Government. But why will we in Britain pay for this enormous disparity. Well the answer is again simple and pragmatic. You have this impending crises and it is not going to go away. EMU countries have got to fund it, and they have not even started to tackle that pension problem like Margaret Thatcher did in the 80's with the reduction of the level of benefits and the opting out on SERPS. They have not even started that. So how is the burden to be borne? It has to be borne and the liabilities met through high interest payments on government debt. It has to be raised from their people through taxation. Will the pressure not be for that suffering to be borne by their partners in the Union? What will we say to our partners when they say "you must help us"? Will we say "no, we will not? It's your fault, you haven't provided for the future as we have provided." I say this to you. Do not rely on the words of the Maastricht Treaty, they have been broken already.

Britain's special position

What about our special position here in Britain? If there is to be an even reasonable chance of avoiding an ERM disaster, it is essential that our economy is running roughly in parallel – it is called "in convergence with" – a running in parallel with the other EMU economies because there is no exit this time.

Now you ought to know that we are very different – some of you will know that we are very different – from our partners in Europe. We at the moment need much higher interest rates to slow growth. Other economies require lower rates to achieve higher growth and to reduce unemployment. Ireland is the exception. Again, we are very sensitive to short term interest adjustments. It is amazing the effect that a 1% change in rate will have on us: it can move £10bn in or out of our spending power. It has a far more direct effect on us than any other country in Europe. Then our trade pattern is quite different. 13% of our trade is with the United States of America. Germany only has 8% trade with that country. Germans trade heavily with Eastern Europe as you know. She exports more to Eastern Europe than to the United States. We export 4 times as much to the United States as to Eastern Europe. Again we are less dependent on EU trade than any other country. A little over 50% of our external visible and invisible trade is with the EU: that is the lowest figure than almost any other country other than, I think, Finland. Our labour market is more flexible. Our labour costs are 50% of the average in Germany, France and Italy – an enormous advantage. Any increase in such costs will have a serious impact on inward investment in this country. We are a net exporter of oil and gas. We have lower taxation than any other EMU country.

Now the British Treasury: what is H.M. Treasury's view about the chances of Britain actually achieving conversion in the near future? The Treasury states in its analysis of October 1997: *"It is not safe to assume that convergence will be sustainable for some years... While the UK remains insufficiently converged with the rest of Europe there are risks for stability in (this country) and hence for inward investment as compared with staying outside."*

EMU: The Pros?

May I conclude with a brief review of the arguments in favour. I think I will be the only speaker – although you will appreciate that I am not wholly in favour of this proposal – to try and deal with the arguments put up in support of EMU because we ought to address them. There are arguments put up that people tender in favour of it.

The first one: lower interest rates. Now why do you think there are going to be lower interest rates? Interest rates depend on the state of an economic cycle. They are not written down in the Old Testament anywhere. The interest rate has to be right for the economic area. That is the issue; not that they should be higher or lower. If we are in recession – and will somebody tell me affirmatively if we are going to be in recession in October 1991 1999 or, say, February 2001? – if we are going to be in recession then we need a rate that is consonant with that, a lower rate. If we are in EMU we will have no choice.

Will it give rise to more growth? Will it give rise to lower unemployment? It's a similar point. The interest rate is so important in all this. It is only going to happen, growth and unemployment reduction, if the interest rate is at the correct level. A high rate produces nil growth and high unemployment if you are in recession. That is exactly what happened in the ERM between 1990 and 1992. Low interest rates produce inflation and instability in expanding economics. I am sorry to state the obvious but I have had no one tell me that this is economically unsound.

What about the savings in transaction costs? Well there will be some. It is very difficult to put a measure on what this will be – possibly up to 0.25% of GDP. Nobody really knows what the apparent saving may be. But let us remember this: almost 50% of our trade is outside the EU and certainly outside the EMU area. So the transaction cost saving is not going to be so significant for us as for other countries who are more imbedded in that Union – and do not forget the costs Ladies and Gentlemen! Do not forget the costs of this vast experiment. The British Retail Consortium estimates that the retail sector, with its costs of labelling, its training, its tills, its software, will suffer a cost of up to £3.5bn. Small to Medium-sized Enterprises, those people employing 50 or less – the majority of the businesses in this country – are going to bear a cost of £2,000 each. It does not sound much does it? Add it up – it is £6 bn Ladies and Gentlemen.

What about the volume of trade expansion? The IMF have found that there is no significant proven link between volume of trade and exchange rate volatility. Japan and the United States had very wide fluctuations in their exchange rates through the 70s and 80s but trade expanded at an enormous rate. 80% of businesses in Britain never trade in the EU at all. And what about the "muddle" that was described by Edward Kellett-Bowman one of the earlier speakers? The muddle? Is that the way to describe the immense sophistication of a system established through international trading over 500 years enabling immense volumes of foreign trading transactions to be conducted in a market twice as large as New York and Tokyo combined?

Then it is said that inward investors would be deterred from commitments in Britain if we do not join EMU. But there is no evidence that inward investors are indeed being discouraged – the key factors they consider are skills, labour costs and taxation levels. The continuing high level of the £ sterling suggests a continuing confidence in the UK economy even under the very shadow of the euro.

Then it is said that we must join in order not to suffer damage at the hands of our trading partners in Europe. But it is inconceivable that EMU members would introduce protectionist policies. Leaving aside the illegality of the issue, you should know that since 1973 our EU 'partners' have a balance in their favour of £130 bn from the sale of goods and services to us than we have had from sales to them. Indeed the whole question of any benefit from our membership of the EU is in doubt: we are net contributors to the budget to the tune of about £2 bn every year and we pay £1,000 per head for the common agricultural policy. The question of any benefit is very much open.

Again some commentators say that the City would lose out to Frankfurt. But the City owes its pre-eminence to its skills, its global trading experience and our national association with international financial transactions over centuries. This is nothing to do with our belonging to a particular currency area. You should know that a director of the Deutsche Bank itself has said that *"the idea that the financial sector of continental Europe could obtain a competitive advantage against London in a currency union without Great Britain is an illusion"*: Ulrich Cartellieri.

And then finally it is said – perhaps the most emotive plea of all – that EMU and political union will prevent war. But wars of aggression are never initiated by Nation State democracies. There has been peace in Europe since 1945 because of democracy and because of Nato – not because of the EU. I fear that the suppression of National electorates is a much more likely cause of explosive tension.

These are some of the arguments in favour of EMU – the advantages which are said to justify the abandonment of our economic integrity and the inevitable loss of our political sovereignty. I would say to you that at the very least we should wait – wait for a brighter horizon and a better prospect.

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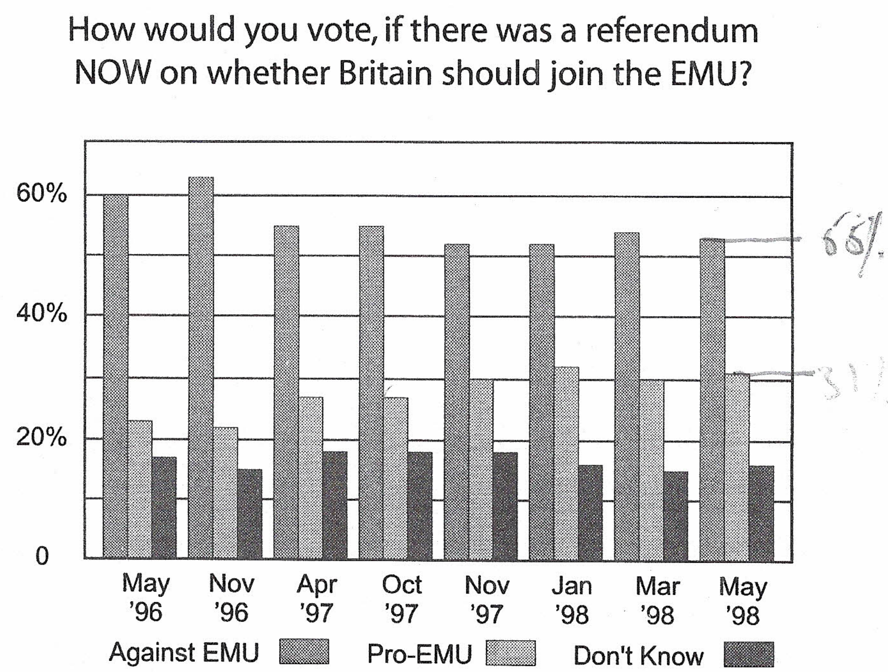

Source: Salomon Smith Barney, investment brokers. The polls were conducted on the basis of a simple question "How would you vote?".