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FABIAN PAMPHLET 573

For a Single Currency

by Keith Hill

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Introduction

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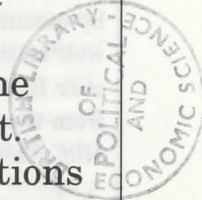
It will still come as a surprise to many people to find that Britain is already in the second stage of European monetary union. Yet the Conservative Government's well-known opt-out under the Maastricht Treaty did not apply to the preparations for a single currency, only to the eventual decision on whether to join it or not. Meanwhile, new European economic institutions are being actively developed and it is a matter of British government policy to pursue the economic convergence demanded by the Maastricht criteria. Indeed, the Chancellor, Kenneth Clarke, recently attended a meeting to discuss the name for the single currency (he apparently favoured the florin, shilling or crown!). All these solid moves are in progress despite the splits and evasions of the Conservatives and the deferral of the original target date of 1997 for the start of Economic and Monetary Union (EMU).



Monetary union is still very much a live issue, among member states and in the Commission. The European Council meeting held in Cannes at the end of June re-affirmed the later 1999 target. Certainly, the key decisions on EMU will not be taken during this British Parliament but in the next. On all present indications, therefore, they will be taken by a Labour government – possibly very early in its first term if the election is delayed until near May 1997.

For Britain, the eventual decision is not one that can – or should be – divorced from the economic practicalities and circumstances of the time. We know that not all 15 Member States will be eligible to join a single currency in 1999. It is

still uncertain who might take part in the initial inner core. It would be foolish to make a firm prior commitment before Labour Ministers are in possession of the full facts showing the nature and extent of Britain's economic position and before the consequences of a single currency for non-participants as well as participants are clear. A Labour government could well decide that it was not in Britain's interests to be part of a single currency from Day 1.

Nevertheless, the question of British membership will inevitably be posed and it is vital to establish the principles and values which should influence Labour's approach to this major and controversial issue. Let us begin, therefore, by examining the history and context of moves towards a single currency as well as its economic desirability, and revisit the fundamentals of the debate over Britain's involvement in Europe. After all, the idea of EMU is not a bolt from the blue dreamed up by Brussels bureaucrats, and those who oppose it often have a larger target in their sights.

A long-standing goal

The history of monetary co-operation in Europe goes back to the establishment of the Bretton Woods regime of fixed but adjustable exchange rate parities. Born of the lessons drawn by John Maynard Keynes about the effects on mass unemployment and conflict of the economic nationalism of the inter-war period, the Bretton Woods system gave rise to a generation of unprecedented prosperity. Exchange rate stability became a cornerstone of the post-war economic settlement.

Only a year after the creation of the customs union between the original six members states in 1969, the Luxembourg premier Pierre Werner began work on a report that was to recommend a monetary union of what were then highly divergent national economies.

To make EMU work in the prevailing circumstances, Werner envisaged a degree of centralised budgetary and fiscal powers that was unrealistic in the Europe of a quarter century ago and would not find agreement in Europe today. The Tindemans report six years later was more realistic and suggested there could be a shared commitment to the goal of a single currency whilst countries travelled at different speeds towards it. Meanwhile the establishment of the snake in 1972 had been the first European attempt to lock together national currencies but this initiative foundered quickly on the rocks of the first 'oil shock'.

The creation of the European Monetary System (EMS) in 1978 was the first practical step in reviving the shattered dreams of monetary union. The initiative was taken by the first British President of the Commission, Roy Jenkins. It was due to his efforts that Helmut Schmidt and Giscard d'Estaing put their weight behind a new approach that combined political idealism and economic pragmatism.

EMS was a bold attempt to recreate in Europe on a more limited continental

scale the benefits which in the immediate post-war era Bretton Woods had brought about for the West as a whole. Under the exchange rate mechanism (ERM), exchange rates of participant members were locked into a complex 'parity grid' with a leeway of 2.5%. Adjustments were possible by mutual agreement, though it quickly became apparent to all that the strength of the Deutschmark was the anchor of the whole system.

The ability of other ERM members to maintain fixed parities with the Deutschmark was bolstered until the late 1980s by the existence of exchange controls in many member states, particularly France and Italy, and later Spain. Exchange controls limited the scope for speculation against a national currency, particularly by a country's own nationals. Ironically it was the commitment of the Single European Market to remove these capital controls that led ultimately to the effective disintegration of the EMS. This eventually occurred when European Finance Ministers bowed to the inevitable in September 1992 and acknowledged it was no longer possible to maintain currencies within a 2.5% narrow band. The replacement bands – 15% on either side of a central parity – allow considerable exchange rate fluctuation. But Britain has been unwilling to recommit itself even to these broad 'target zones'.

Central preoccupation

From this brief history, therefore, it is clear that exchange rate stability has been a central preoccupation of post-war European policy makers. Monetary union is not a gleam in a Euro-fanatic's eye, but a living idea nurtured within the Community for a generation.

The arguments for and against are however bound up with the wider question of Britain's role in Europe. Those in favour of a single currency have tended to argue the case not on its economic merits alone but out of a general belief that greater European unity is a good thing and that it is against Britain's national interest to stand apart. Similarly, those who have emphasised concerns about loss of independence over monetary policy and surrender of sovereignty have tended to be intrinsically hostile to European co-operation. So, before moving to the specific arguments about monetary union, let's remind ourselves of the political case for Europe and the benefits that come from co-operation with our partners across the continent.

2 Why Europe at all?

The first point that must be made, given the Continent's turbulent history, is that European integration has given us peace and with it the conditions for economic prosperity. This was the key goal of the founding fathers of the European Community and the fact that we now take it for granted is only a testimony to their success.

Despite periods of recession the growth in European GDP has been enormous – 186% since 1960. Individuals' and families' living standards have risen massively in just two or three generations. Closer economic co-operation and the eventual (if still incomplete) establishment of the Single Market provides a huge 'home' market for British business to sell goods and services – a Single Market which is increasingly interdependent and barrier free. In parallel, Europe's institutions have had to develop sufficient muscle to ensure that the Single Market operates freely and effectively. A strong Commission and Court are vital to enforce the common regulations and rules that underpin the Single Market.

Increasingly in the modern world, solving problems and creating opportunities require action beyond the reach of nation states, and European co-operation has been possible in many fields – such as research, the environment and crime. Many young people now growing up see the 'continent' not as a foreign place to visit but as somewhere to learn, work, live and call home.

Not perfect

Of course no-one would argue that the European Union is perfect. Far from it. Like all institutions the Commission can be overly bureaucratic and, like the Council of Ministers, it can make mistakes. The Parliament is often criticised for being ineffective and has to guard against being prey to the special interests that swarm around Europe's institutions. Often, though, the public's perception is based on misinformation and deliberate distortion (of the bent banana and even the paternity leave for soldiers variety!) rather than on substantive failures. The EU has many achievements to its credit. It would help occasionally if Ministers broadcast these instead of using it as a scapegoat for awkward decisions to which they have been a party in Brussels.

Reform

Nevertheless, there is a genuine – and extensive – reform agenda which needs to be promoted. The carping attitudes of the anti-Europeans, aimed at undermining the EU, should not deter pro-Europeans from their own constructive criticisms. Pursued in the right spirit, this approach strengthens not weakens Europe. It is on this basis that the Labour Party is putting forward its proposals for reform.

There must be a greater transparency of decision making, notably in the Ministerial Council meetings where European legislation is determined. The Union's institutions should be made more accountable and the Parliament should have more opportunity to scrutinise the work of the Commission and the Council of Ministers. Here, in Westminster, more must be done to ensure that European legislation and decisions are properly discussed and debated. Politicians, media and the public must become more familiar with European ways of working and be able to influence them more directly. The mechanics of this co-operation – the new procedures and compromises they inevitably involve – must be judged in the light of the opportunities they bring and which otherwise would be beyond our grasp – not judged against abstract notions of sovereignty compared with which they will always seem second best.

This notion of real rather than illusory sovereignty is at the heart of any discussion about Europe. If Britain had an entirely self sufficient, successful economy, existing pretty much in isolation from the rest of the world, able to set its own interest rates and manage the financial markets with only a 'nod and a wink' from the Bank of England, then only a fool would propose Monetary Union. But the world isn't like that. In Britain post-war economic management has on the whole failed rather than succeeded. So what is the reality of Britain's economy and what benefits might a single currency bring us?

3 Britain's economy in the modern world

Britain is a trading nation. Our economic prosperity – past, present and future – comes from our ability to produce for markets far beyond our shores. Europe is a vast market of 370 million people – and with the potential, after enlargement, of being twice the size of the USA. European integration makes this our home market – with all the advantages that brings to British business. We also export services. Our financial sector, media and advertising industries are heavily involved in European business.

Membership of this market has been particularly important to Britain. Trade with Europe now accounts for over half our exports. Growth in trade with Europe has now more than compensated for the loosening of economic ties with the old white Commonwealth.

The ability of companies to trade freely across continental national borders – and the growth and prosperity this brings – has been the driving force of European co-operation since it began. First the customs union, then the single market were created to remove artificial barriers to free trade. On this basis strong European companies grew up, operating across the community but using the strength this gave them to compete around the world. For many companies, the European market is their springboard for international success – strong in Europe and strong in the world. This strength helps those companies succeed against the competition from companies based in the world's other great trading blocks – America and South East Asia.

The single market and the harmonisation of standards and regulations that went with it removed a lot of the costs and uncertainty facing businesses trying to export. Product development could centre on core innovation rather than

coping with the minor technical differences which national regulations required for entry and use in, say, Italy and Germany.

Currency fluctuations

However one huge uncertainty remains for any company trading with another country. Large currency fluctuations – and these can happen almost, if not literally, overnight – blow a big hole in the promised stability of the single market. Income and profit projections can be fatally undermined and this uncertainty leads to understandable caution about investment decisions. The smaller the company – and new jobs come overwhelmingly from small and medium sized companies – the worse is the problem of currency instability. New jobs suffer as a result.

Some economists take the view that there is no evidence for exchange rate fluctuations damaging the real economy in this way. They argue that firms can hedge against short-term volatility by the use of the 'forward' markets and so manage their exposure to shifts in the exchange rate without too many difficulties. But this ignores two broader considerations. First, firms find it difficult to cover themselves against exchange rate movements in the medium to longer term. When a company is choosing the location of a new plant with a 20-year life span, serving the whole European market, it is bound to think twice about setting up in a country with a proven track record of excessive currency fluctuation. Secondly, fluctuating exchange rates are linked with volatile inflation rates – and that itself damages investment.

Disastrous

These economic costs of currency fluctuation have been particularly hard on Britain. We have an economy which is exceptionally open – a high proportion of our business relates to exports and imports and no European country has suffered more from the roller coaster of floating exchange rates and volatile inflation. Two episodes have been particularly damaging. First, the overvaluation of sterling in the early 1980s – a direct result of Conservative policy – destroyed a fifth of UK manufacturing industry. Secondly, there was the ERM experience from 1989-92. Margaret Thatcher and John Major's decision to join the ERM at an unsustainably high exchange rate was a major policy error. They did it, we now know, without consultation with any of our European partners. The Bundesbank warned at the time that the sterling parity was far too high and unsustainable. The Government's misjudgement worsened the recession which had been made inevitable by their own domestic economic mismanagement.

Such instability in the value of the pound has had a disastrous effect. It is no wonder that in Britain business has failed to invest – and despite the present recovery, is failing to invest adequately. Nor is it surprising (as Will Hutton persistently points out) that new projects are judged by rate of return require-

ments that are excessive by other countries' standards. Can it be a surprise that our economic capacity has been undermined and our ability to generate new jobs constrained?

What to do?

Is it possible in today's world to do anything about the problems of exchange rate fluctuation and provide greater stability? The development of instant global communications – and the information superhighway – means that the world's economy is linked by computers – enabling billions of pounds to be moved across borders at the touch of a button. Exchange controls are a thing of the past. Capital mobility makes global exchange rates inherently unstable. Fund managers and currency speculators can pick off a currency seen as weak, however temporarily, just as a lion will devour a gazelle who strays from the herd. Huge flows of capital, £300 billion a day on the London market alone, determine the conditions of this market – more a lottery run on sentiment and rumour than a reflection of a country's real economic strength or weakness.

This globalisation of capital may have absurd manifestations but it is here to stay – and it affects governments as well as businesses. Relative levels of interest rates and inflation determine where 'money' is held and a country that ran a monetary – or even fiscal – policy significantly out of kilter with its neighbours would soon find the markets extracting a price. It is an economic fact of life that globalisation curtails the freedom that a modern government has to indulge in quick fixes. The markets are a harsh judge.

Capital mobility and the immense growth in the power of the international financial markets have made it impossible to contemplate a return to a world-wide regime of fixed but adjustable exchange rates. The days of Bretton Woods are over. The old EMS would be difficult to revive. The practical choice is between a free market float and the creation of a single currency zone. There is no longer much prospect of a viable half way house.

Stability

A successful and workable single currency offers the prospect in today's economic conditions of providing a stable foundation for trade and prosperity. It avoids the risk of relapsing into the 'beggar my neighbour' policies of competitive devaluations and rival tariffs for which Europe paid such a high price in the 1930s. It is the only sustainable alternative to being left to the mercy of the market. As Keynes put it: "...to suppose that there exists some smoothly functioning automatic mechanism of adjustment which preserves equilibrium if only we trust to the methods of laissez faire is a doctrinaire delusion which disregards the lessons of historical experience without having behind it the support of sound theory...". Those on the Left who complain of the effects of so-called 'Euro-monetarism' should think of the free market alternative!

The case for a single currency

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Jacques Delors listed the benefits of monetary union as follows: consolidate the single market and create the necessary conditions for fair and productive competition; make investment more attractive, both in the Community and outside, and generally stimulate savings to provide the necessary funds for major infrastructure projects; have a stabilising effect on the international monetary system and pre-empt the speculation responsible for so much instability and uncertainty.

Closer to home, the Governor of the Bank of England, Eddie George, said recently: "If we ask why we should be contemplating a move toward monetary union, the economic – as distinct from the possible political – answer would have to be that the permanent elimination of exchange rate fluctuations between the member states would promote economic prosperity within Europe by increasing further the benefits to be derived from the single market".

He is not alone in that view, which is shared here in Britain by such politically disparate figures as Roy Jenkins, Michael Heseltine and John Monks of the TUC. If successful, a single currency would reduce uncertainty for businesses and thus promote investment and jobs. It would also reduce the costs of converting currency for both business and travellers – which can be considerable if the product is made up of elements from different states or if the person crosses more than one border. These are benefits to all member states that participate in a single currency.

Britain could gain more than others because, relatively, our economic performance has been lamentable by comparison with our partners. The discipline of the Bundesbank – and its record of price stability – would be transferred to the new European Central Bank. We would benefit instantly from lower

Continent-wide interest rates, without the domestic inflationary premium which we pay now. This is no doubt why a majority – 57% – of CBI members favour a single currency and over a quarter believe that it is necessary if the full potential of the single market is to be realised and existing benefits maintained.

It might be argued, of course, that Britain ought to be able to achieve these lower interest rates by pursuing a sound money policy of its own. The record, however, is not exactly encouraging. British governments have variously tried incomes policies, monetary targets, and shadowing the Deutschmark. Not one of these strategies has come anywhere near to giving us the consistent low inflation achieved in Germany.

A final benefit relates to the potential, when circumstances justify it, for co-ordinated European expansion. The reality of globalisation is that for individual countries to act alone is rarely practical and barely effective. If governments still want to retain the ability to take counter-cyclical action to stimulate recovery during a recession, then effective action must be pan European. Otherwise, reflation in one country benefits other economies as much as our own and exacts costly retaliation from the markets. The apparatus of monetary union, the European Central Bank and the strengthened Council of Economic and Finance Ministers (ECOFIN) would in principle make the operation of such co-ordinated action much easier. The will to make a single currency work would in time transfer to co-operation on economic policy more generally.

There seems little doubt, then, that a workable single currency holds out the possibility of improvement for some of the key problems of the modern British economy – exchange rate uncertainty, a poor inflation record, high relative interest rates and therefore low investment. But what is the downside? What are the difficulties, risks and costs? How serious is the loss of sovereignty implied? Could it entrench poverty and unemployment?

Sovereignty – a red herring

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Opponents of a single currency usually make their case on the grounds of loss of sovereignty. Yet does this concept of sovereignty reflect genuine independent decision-making in economic matters or is it a throwback to the glorious days of yesteryear?

It may be tempting to recall a time when British business could deal from a position of strength with the rest of the world and when a British government could determine our exchange and interest rates, irrespective of what might be happening in Paris or Bonn – but it doesn't help us much today.

The real questions are as follows:

- Does a single currency necessarily involve an unacceptable loss of sovereignty?
- Does this matter?
- And how far, if at all, does this currently threaten the existence of the nation state?

We can answer these questions only by being clear about how precisely British participation in a single currency will change the way in which economic decisions are at present made.

At present the Chancellor of the Exchequer in consultation with the Prime Minister sets short-term interest rates, on the advice (now public after a short delay) of the Governor of the Bank of England. They have to defend those decisions in Parliament and before the public. With a single currency, these decisions on short-term rates would be taken by the European Central Bank (ECB). Long-term interest rates (ie on borrowings for six month terms or more) bear some relationship to short-term rates, but are basically determined by the market in the light of its expectations of inflation and required real returns.

Britain would have only a single representative on the governing council of the ECB. So there would be a clear shift in responsibility away from exclusively British institutions.

But at present in the UK, the Chancellor's nominal responsibility carries

with it limited real power. A Chancellor who made interest rate decisions that were perceived as incredible in the financial markets would not be able to sustain his policy indefinitely. In the meantime a penalty would be paid in higher long-term interest rates because the market would anticipate higher inflation at some point in future. The practical margin for manoeuvre is small.

Economists in the City revel in endless debate over whether interest rates should be half a per cent higher or lower (and their employers look benignly on this activity because so much of their business depends on forecasting day-to-day rises and falls in gilt prices and bond yields). The rest of us pay far too much attention. The impact on the real economy of these marginal discretionary movements is grossly exaggerated. Loss of this small freedom for domestic manoeuvre hardly signals the end of the nation state as we know it.

No freedom

So limited is the real freedom of manoeuvre Ministers enjoy that there is a move throughout the world to make monetary policy clearly independent of short-term political manipulation and place it entirely in the hands of independent Central Banks. Labour's own economic policy document urges several steps to make the Bank of England's role in interest rate setting stronger and more transparent. If there is a growing consensus in favour of greater central bank independence, why would it then represent such a dramatic loss of sovereignty for those monetary policy decisions to be taken collectively by a European Central Bank?

The debate here centres on the role of Parliament. Under some schemes for national central bank independence, Parliament would set the policy remit within which the Central Bank would arrive at its monetary policy decisions. This might be framed in terms of a periodic contract setting targets for inflation and possibly, growth.

Differences

With a single currency, there would be two main differences. First, our own Parliament would obviously not have the exclusive right to set the Central Bank's remit. We would be one member state out of 7, 8 or 9.

Secondly, the remit for the putative European Central Bank is laid down in the Maastricht Treaty. It is basically the same remit as that given the Bundesbank by German law – to secure sustainable non-inflationary growth. Without this anti-inflation commitment, the Germans would never have signed up for a single currency. That is a reality. The detail of the arrangement may not be one we would regard as ideal. Nevertheless, when the point of decision on a single currency comes, we will almost certainly have to decide whether to take it or leave it on that basis.

Also under a single currency, national budgets will inevitably be subject to a degree of mutual surveillance by fellow members of the currency union. At

present the Budget Red Book is prepared in conditions of great secrecy in the Treasury, with some political input from No. 10. With a single currency, the contents of that Red Book – at least the broad parameters of government borrowing and the assumptions that underlie them on growth, pay, prices etc – would probably need to be discussed in advance with our partners in ECOFIN: a step forward for Budget openness since no British Government has as yet been prepared to share these deliberations with its own Ministers and MPs, never mind the public.

Under a single currency, the final decision on the national Budget would remain for the nation state. The Germans in particular are adamant that each country must continue to take full responsibility for its own levels of borrowing. They are justifiably worried that national politicians may spend and borrow if they are no longer subject to the discipline of the foreign exchange markets. They fear that a single currency will create too much of a temptation for irresponsible national governments to free-ride on its back in the hope that everyone else would ultimately bail them out. As Europe's paymaster Germany is adamant that no such bail-outs will occur.

However it is clearly in everyone's common interest that such attempted free-riding by Member States should be discouraged. Pressure from our partners could in theory constrain the budgetary freedom of a Labour Chancellor.

Nothing new

There is nothing new about the notion of mutual policy surveillance, carried out by officials and Ministers from other states. It was part of the structure that Ernest Bevin put in place to administer Marshall Aid in the years of post-war recovery. It later became a function of the OECD. Also, on occasion, Britain has had to agree to outside surveillance of economic policies as a condition for IMF loans. In the long run, such outside surveillance is in a country's own best interests. It imposes a discipline on the domestic political process to give up short-term fixes for long-term sustainability. It can hardly be regarded as destroying one of the essential attributes of national sovereignty.

Sovereignty, moreover, is a complex concept in the modern interdependent world. It should not be bandied around as a simple slogan. Take the example of defence and security. In the late 1940s Britain decided it was not capable of defending itself alone against the perceived Communist threat of the time. The Labour Government played the leading role in constructing the Atlantic Alliance and integrating the command structures of NATO forces in Europe. That has involved a very considerable loss of technical sovereignty in the disposition of our armed forces which on the European Continent are under American command. Yet few argue that these arrangements somehow threaten our national independence. Rather the reverse. There is a consensus across the political spectrum that through pooling our sovereignty in NATO, we enhanced our power to defend ourselves.

The same set of arguments should apply in the economic sphere to a single currency. We would only join if we judged it was in our interests so to do. The only case for joining is that it would give us more real leverage over anonymous economic forces than we now enjoy as a nation state. In other words by pooling our sovereignty – as we have in NATO – we would thereby enhance it.

But there is one crucial difference between multi-national defence and a common currency. Both Right and Left accept that the first responsibility of the State is the proper defence of Britain. However the Right do not accept that the government has a legitimate role to play in curbing, controlling or even influencing the market forces and are blind to their destructive potential in particular circumstances. The Right object to a single currency because it conflicts with their laissez-faire concept of how the world might be. So they attack proponents of a single currency because it implies a loss of sovereignty, which is more symbolic than real. Those of us on the Centre and Left should see through their arguments for what they really are.

Real reasons for caution

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The pre-requisite of a successful single currency is genuine convergence of those economies signing up to the currency. This means more than just the satisfaction of the convergence criteria set down in the Maastricht Treaty.

The Treaty says that "member states shall avoid excessive government deficits". The criteria call for government borrowing not to exceed 3% of GDP. This could be interpreted as a ceiling or as an average over the economic cycle. Then there is the requirement that a Member State's debt to GDP ratio should not exceed 60%. Under the Maastricht Treaty the interpretation of these criteria are all matters for further discussion and, if monetary union went ahead, decision by Finance Ministers at ECOFIN. It is already clear that ECOFIN intends to interpret the criteria flexibly.

Labour's view was made clear in its 1994 European election manifesto, which said: "Convergence must be based on improving levels of growth and employment and not just on monetary objectives alone. That is why we have long argued that the convergence criteria must be applied flexibly, and that real economic convergence is of primary importance".

What is at the heart of this matter about 'real' convergence? Some argue that the British economy is so structurally different from the rest of Europe – the way our mortgages work for example – that such convergence will always be impossible.

But there are already signs of such structural convergence. If Britain can sustain low inflation for example, then we may well move to the Continental pattern of fixed rate mortgage finance. Conversely our continental partners are increasingly aware that they have to catch up with Britain's success in establishing funded pensions.

The simple truth is that it is impossible to know in advance how much national economies will adapt and whether the economic fundamentals of the likely core participants will grow closer in coming years. These are the economic issues that will eventually govern our decision to join.

Competitiveness

The key issue relates to UK competitiveness. If, after joining a single currency, our underlying inflation rate were to remain higher than our partners'

– despite the impact of Bundesbank discipline – our costs would gradually become more and more uncompetitive. As a consequence, margins would be squeezed, firms would be forced to make cut-back and jobs would inevitably be lost. So we cannot enter into a single currency without total confidence that our domestic costs can be kept under control. In particular, the British would have to cease their age-old habit of paying themselves higher nominal wage increases than our main European partners – increases that have not been justified by productivity.

This is the critical legitimate doubt about the feasibility of a single currency. It demonstrates the absolutely vital importance of initially locking exchange rates together at sensible parities. We must not repeat the mistake of the ERM in 1990 when we joined at a rate that we had no chance of sustaining. It means permanent, tight discipline on all aspects of cost. But that is a requirement for the British economy in or out of a single currency.

Let us focus on what could happen under a single currency if this tight discipline broke down. What recourses would be available in order to restore competitiveness and reduce unemployment?

Labour market flexibility

Devaluation would, of course, no longer be available. Basically, there would be two options – first, the encouragement of greater labour market flexibility in order to restore competitiveness; and, secondly, transfer payments from more prosperous parts of the currency union to those parts suffering from abnormally high unemployment. Most of us on the Left find the first instinctively unappealing, if taken to the extreme; while the second seems to imply a significant increase in a centralised European Budget.

Mobility of labour has always been a part of social and industrial change, and historically hundreds of thousands of British families have benefitted from it to lead happy and prosperous lives. If individuals and families see opportunities in other parts of Britain or more widely in the European Union, then Labour has to help them to develop the skills that will enable them to succeed in a rapidly changing world. That is why common recognition of qualifications is so important within Europe's Single Market. It explains why Labour is right to support the Social Chapter which envisages a basic framework of minimum employment rights throughout the Union. Indeed, somewhat greater mobility would be culturally enriching and a force for dynamism and new ideas.

Fiscal transfers

What about the alternative of fiscal transfers to weaker parts of the currency union? There are two issues here – the constitutional desirability of a larger European budget and its economic effectiveness.

Opponents of a single currency believe that the necessity for increased fiscal transfers would be the thin edge of the wedge for a centralised super-State.

They argue that, once permitted, those fiscal transfers would never go away and, having failed to meet the specific purposes they were designed for, would lead to calls for their scale to be increased.

We should be wary, however, of swallowing these arguments hook, line and sinker. First, the effectiveness of the present European budget could be greatly increased if CAP spending was radically reduced. Agriculture at present accounts for 50% of the European Budget, yet only 2% of the European workforce is engaged in the agricultural sector. The present size of the Structural Funds could be increased by 260% if the CAP was abolished without any increase in the overall size of the present European budget.

Secondly, fiscal transfers can be effective – as long as they are directed at the right targets and channelled by the right methods. Transfers must be aimed at creating new jobs, not propping up old ones. They should be focused on improving skills and infrastructure not industrial subsidies or welfare payments. Help for firms to grow will be more effective if tackled bottom-up, through regional development agencies and local partnerships, rather than imposed top-down.

Thirdly, the necessity for fiscal transfers largely exists *within* Member States rather than *between* them. Economies are subject to continual shocks, large and smal but mostly affecting particular regions, rather than countries as a whole.

Public policy can help regions adjust to these shocks. It can provide infrastructure for new industries and assist in retaining old skills and to some extent, it already does. It can also do far more to help families through periods of financial re-adjustment than the present Conservative government has done, for example, with either the threat of mortgage repossession or in dealing with negative equity.

The central point is that these public policy issues are and will remain choices for our national government. They raise questions to do with regional policy *within* Member States. They do not require transfers of taxes, powers or sovereignty to a European super-State.

Yet if the primary means of dealing with uncompetitiveness in the British economy will remain in the hands of our own government, we can also expect support in this objective from the EU as a whole. Labour has always made it clear that progress towards monetary union would depend on policy co-ordination at the European level to achieve the pre-requisite convergence of real economic performance between member states. And it is inconceivable that such co-ordination would not continue after the establishment of a single currency. As well as closer economic policy co-ordination, Labour has identified such common measures as the creation of a European Recovery Fund to raise finance for infrastructure and training projects, the full committment of structural funds to assist industries facing structural change and reskilling, and a more effective distribution of the EU budget towards industry, training, re-

search and development.

None of this is to deny that there are considerable practical difficulties in making a single currency work. Yet, facing up to the real reasons for caution is not to be anti-European. It is to be concerned in case a major step of this kind becomes a leap in the dark, ending in disaster. Failure on the single currency would lead to wider disillusionment with the European idea. The chances of deepening European co-operation across a whole field of policy – for example, on defence, crime and the environment – would be set back for a generation.

Making it work

A single currency is a move Europe will only get one chance to get right.

So let us be clear about the fundamental requirements for success. First, the institutions of monetary union must command genuine confidence and support. The fledgling European Monetary Institute – to become the European Central Bank – must win the respect of governments and bankers alike. Other, more long established, EU institutions have a long way to go before they enjoy moral and practical authority among the peoples of Europe, so this will not be an easy task.

Second, political consensus is needed so that the ECB is not turned into a scapegoat for problems such as unemployment by national governments. If that were to happen the whole project would become unsustainable.

Third, public support is crucial. Maastricht has showed the problems of European developments that run ahead of public opinion. Without proper democratic explanation and debate the whole exercise could run off the rails. This is a more acute problem because of the special nature of EMU. Klaus Hansch, the President of the European Parliament, has said: "There is nothing comparable, not the Treaty of Rome, not the single market. This is totally different to anything that has happened before because it will have a direct tangible impact on every individual citizen".

Will it happen?

Given these practical difficulties, what are the chances that a single currency will go ahead? Moves to EMU depend on the political will of Europe's key players. It is inconceivable that there would be a single currency without France and Germany.

In Germany's case, all the mainstream parties remain committed in principle and look to remain so in the run up to the German elections coming in 1998, despite the reservations of public opinion about loss of the Deutschmark. However the Bundesbank is currently extremely cautious if not sceptical, though it has bowed to its political masters before – for example over re-unification. The Bundesbank is concerned that the political will to make EMU work is lacking. It foresees tensions between the ECB and ECOFIN, because it fears that the anti-inflation consensus which prevails in Germany is lacking at

European level.

The political climate in Germany may change as a result of the 1996 IGC. German politicians support monetary union because they see it as an integral part of political union. If the rest of Europe shows little appetite for greater political union, and the IGC makes little progress towards this goal, then German opinion may come to doubt the single currency. As a result, the German Government may concentrate its energy and attention on the option of enlargement to which it attaches very high priority.

In France, Chirac is a less predictable figure than Mitterrand. His approach to Europe is Gaullist – enthusiastic for co-operation in principle; instinctively hostile to significant surrenders of power to European institutions. His electoral platform is full of contradictions – between quick action on unemployment and adherence to the 'Franc Fort' policy. It is still unclear what the new Government will do. However Chirac's right-wing coalition depends on the support of the pro-European UDF, so he is unlikely to alter French policy fundamentally. It is strongly in France's interest to ensure an inner-core monetary union is in place before enlargement proceeds. The basis for a Franco-German trade off on enlargement and a single currency remains a live possibility.

Commentators differ on their readings of the French and German bodies politic but possible problems ahead do not justify a failure to plan for the still real possibility that progress will be made, even if the original Maastricht timetable slips.

7 What must Labour sacrifice?

A single currency means that a Labour government would no longer have devaluation as a policy option. But how much does this matter?

Decades of the pound's value deteriorating against the Deutschmark has hardly had the result of making Britain's manufacturing more competitive than the Germans. True, the immediate competitive advantage gained does for a time boost exports. However the price of devaluation historically has tended to be higher inflation in the long run (because of higher import costs) and higher interest rates (because of the risk premium demanded by the currency markets) which in turn have a negative effect on investment. The cost of this monetary double whammy in time exceeds whatever temporary rise in growth the export boost brought about – and the country is left with a depreciated currency.

Experience since Black Wednesday is often cited to contradict this judgement. However in 1992 there were special circumstances. The exchange rate was fundamentally misaligned because we had joined the ERM at the wrong rate. The unprecedented scale of the recession meant there was enough slack in the economy to hold down costs despite the pound's depreciation and absorb the resulting rise in export demand. However the devaluation has so far failed to boost investment as much as the Government had hoped – presumably because of justifiable scepticism in industry that the present competitive advantage will be maintained. And the relatively high level of UK long-term interest rates shows that the markets still anticipate an inflationary surge at some point in future. The value of sterling against the mark has fallen 21% since 1992. Devaluation has gone far enough.

Of special concern to critics of so-called 'Euro-monetarism' is the belief that the convergence requirements for the economies in monetary union are so strict that they preclude any effective action against unemployment – such as large scale government borrowing to boost demand. This begs two questions: first, is this true; and, second, would such an option be feasible anyway? It is certainly the case that the Maastricht criteria put a cap on borrowing. But this is not to say that fiscal policy is therefore redundant. As the Kingsdown Report on the Implications of European Monetary Union (which was chaired by the former Governor of the Bank of England, Robin Leigh-Pemberton) notes, the levels of tax and spend can (at least in theory) be set at any level. The criteria relate to budget deficits, not the scale of redistribution or the size of the public sector.

Not in one country

It is though a triumph of wishful thinking over reality to think that in today's world a nation state can run a Keynesian demand management policy in isolation from its neighbours. Already the economic ties and dependencies are too great for this to be possible. The key question is not whether EMU would prevent a Labour government from taking a theoretical course of action but whether it prevents us from doing anything of practical use that one could feasibly do in the real world. If old style reflation is no longer an option and the foundation of the Labour government's policy is low inflation combined with supply side measures to boost investment and skills, then who cares whether the convergence criteria prevent us from borrowing an extra 20 billion. Labour would be mad to consider such a policy anyway and, if we tried, the markets would effectively close down the government's borrowing capability.

The plain truth – which both Tory Euro sceptics and some on Labour's left have yet to come to terms with – is that the days of splendid macro economic independence are over. It is not open to us to re-patriate economic policy making in the way the sceptics desire. Labour's new economics, set out by Gordon Brown and by Tony Blair in his Mais lecture, make it clear that both high growth and low inflation must be objectives of government. This way lies prosperity and a return to high and stable levels of employment – a key Labour aim. Inflation attacks the poor and those with savings and fixed incomes, so the war on inflation is unashamedly Labour's war.

But prosperity also requires a strengthening of the supply side. Labour believes that the government has a crucial role to play here – in ensuring that skills and investment levels are high. It is the lack of investment – and therefore capacity – that is our economy's greatest weakness. So measures to boost capacity – and tackle unemployment – must go alongside a commitment to prudence and an avowedly long-term aim of sustainable growth and keeping inflation low. Labour's golden rules of borrowing, Gordon Brown has explained, mean that over the economic cycle government should only borrow to finance public investment not consumption and that the ratio of government debt to GDP will be kept stable on average over the economic cycle and at a prudent, sensible level. Labour will be the party of wise spenders not big spenders.

The New Labour economic approach, therefore, is wholly compatible, in principle, with EMU. Indeed the Maastricht Treaty emphasises that a single currency – alongside the single market – is the basis for: "a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among member states".

Hardly a monetarist creed.

8 The costs of opting out

At present it still seems possible that there will be moves towards a single currency by the end of the century. For a political party that desires – and now expects – power this is a very important consideration. It is for academics and commentators to ponder the abstract, it is for politicians to deal with the reality. It is no good wishing that, because of the risks and difficulties, the matter will go away. So long as it is the stated aim of the EU – and significant players like Chirac and Kohl have yet to rule it out – we must work out what we would do if an inner core of countries went ahead. Would Britain remain outside that group and what would the consequences be?

Inflation and interest rates

If Britain's inflation prospects were perceived to be worse than those of the single currency area then the markets would put a premium on UK interest rates, making them higher and discouraging investment. It is not axiomatic that this would be the case but it is hard to believe, given Britain's record, that we would have lower inflation than those countries whose monetary policy now had the credibility that would come from merging their currencies with the Deutschmark.

Inward investment

As well as the likelihood of higher inflation and interest rates Britain might also suffer a loss of inward investment. Why would an overseas multinational site their new European base in Britain if they could site it in one of the core countries? It is the free access to the Europe's markets that multinationals most prize.

Nissan in Sunderland don't just sell the cars made there in Britain, two

thirds of them go across the Channel to be sold abroad. That is why Mr Naoyuki Kondo of the Japanese Mitsui company told the recent Kingsdown inquiry that: "...any threat to Britain's position at the centre of Europe would certainly be a deterrent to future investors". And he believed that a decision not to take part in monetary union would be perceived as such a threat.

If inward investment did suffer, it should be remembered that it would be Britain's less prosperous regions that would suffer most as they are often the site of such developments. Samsung's new factory in the North East is just the most recent example of such a welcome arrival in an area which has suffered economically for decades but can now face the future with increased confidence.

Of course, there is a right-wing Tory pipe dream of an offshore Hong Kong type Britain where wages would be so low that our industry would be competitive – and still an attraction to inward investors. Leaving aside the social unacceptability of this, one wonders quite what the other countries in the EU would make of it. It is exactly the sort of beggar-my-neighbour approach that the Community was set up to prevent. There can be little doubt that retaliation would, in time, occur. The Belgian Finance Minister has already issued a clear warning: "Participants in a single currency zone would not sit idly by if certain other members wanted to enjoy all the advantages of a single market without the disciplines of a single currency".

That is why, of course, the people who advocate this route are so Euro-hostile. Deep down they hope that failing to join a single currency is the path to eventual withdrawal. One can only wonder at the little Englander mentality which thinks that Toyota or IBM would set up base in a low wage, low skill Britain that had, in a historically tumultuous event, parted way with its partners of over 20 years. That they would prefer to site themselves at the heart of a zone of what would still be, without Britain, a single market of over 300 million people seems pretty self-evident.

Higher costs and the City

So, inward investment is likely to suffer, but so would industries already based here. The transaction costs and trouble of buying parts or raw materials from Britain would surely result in a loss of trade to competitors within the core. And our financial services would be hit too. It is hard to see how the City could retain its pre-eminence if a single currency was evolving in Europe yet Britain was not a part of it. As the CBI put it: "the impact on London as a world financial centre will need particular attention".

9 Arguing our corner

So long as monetary union remains a possibility it is important for Britain to be involved in the detailed discussions about it. Throughout the history of the EU Britain has been a Johnny-come-lately figure, missing out on the chance to ensure that Britain's interests were fully reflected in developments. We are still paying the price for this, most notably with the Common Agricultural Policy. Do we really want France, Germany and the rest sitting down to discuss Europe's economic development and the British Minister having to leave the room while they do so? Are we so sure that we won't subsequently – if a single currency is made to work and seems successful – join it anyway, but at a time and on terms disadvantageous to us and without our national considerations and views taken into account?

There are particular things that we should be arguing for now, in preparation for a possible single currency in the future. Labour has long argued that the ability of any ECB to succeed depends on legitimacy that can only come from a strong and democratic political framework. ECOFIN's role as the politically accountable counterpart to the ECB must be developed as must its role in the formulation of medium-term monetary policy. The national governors of the bank should be accountable to their national parliaments and for us, in Britain, this means ensuring that the right procedures exist at Westminster for that accountability to be real. That is why Labour proposes regular report-backs from Ministers to a new European Grand Committee in Parliament. The European Parliament should play a key role in overseeing the work of the bank and should have full consultative rights before ECOFIN assumes its role of judging the sustainability of member states'

budget deficits with the convergence criteria.

There remain huge questions over the economic and political viability of a single currency. This suggests caution in our approach. Solutions to the numerous practical difficulties, the political will in member states, popular backing and the right economic conditions must all be in place if progress is to occur. It may be that it will take many years and further economic cycles before Europe – and in particular Britain – is ready to participate fully, but the arguments outlined above demonstrate one thing beyond doubt: there are no intrinsic reasons for the Labour Party to be against a single currency in principle.

There is no case that can be mounted to say that – whatever happens among our partners – we must stand outside, on the grounds of either sovereignty or socialism in one country. The decision, when it comes, will be taken by politicians and will require a vision of the future where partnership and co-operation are not dirty words. But the decision itself must be made on economic grounds.

As Robin Cook put it at the 1995 Labour Party Conference:

"Jobs will be the bottom line in our judgement on whether to recommend to the British people that they join up to a single currency. I am not worried about the jobs of men in red braces speculating about the pound. If a single currency puts a few of the speculators out of work that is one price I may be prepared to pay. Our concern is for the jobs of the people who are building our future, not gambling with our future. That is why Labour's condition for a single currency is convergence of economic performance in the real world in growth, output and jobs."

At this stage Labour's policy of keeping open the option of joining is the entirely sensible one. In the future a decision will have to be made on whether it is in Britain's economic self interest to join. That will depend on conditions at the time but the decision must be taken by a government free to do what is right for Britain, not hidebound by internal division.

The issue of a single currency must be addressed on its merits. It must not be used as a Trojan horse for Britain's withdrawal from Europe by those wholly hostile to all things European. The stakes are too high for the issues to be tossed about in party factional games.

Labour should make a decision based on the national interest not party interest. Until then, the more the subject is thoroughly discussed and understood the better.

For a single currency

Published together with *Against a single currency* as part of the Fabian Society's 'Wherever Next? The Future of Europe' series, this forthright statement of the case for a single European currency argues that:

- currency fluctuations "blow a big hole in the promised stability of the single market" and the economic costs of these fluctuations have been particularly hard on Britain;
- "a successful and workable single currency offers the prospect in today's economic conditions of providing a stable foundation for trade and prosperity";
- "a single currency would reduce uncertainty for businesses and thus promote investment and jobs";
- "Britain could gain more than others because, relatively, our economic performance has been lamentable by comparison with our partners";
- "the discipline of the Bundesbank would be transferred to the new European Central Bank (and) we would benefit instantly from lower Continent-wide interest rates";
- "the will to make a single currency work would in time transfer to co-operation on economic policy more generally (with) the potential, when circumstances justify it, for co-ordinated European expansion".

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