

Convergence: the stuff of which economic nightmares are made

By Antony Scholefield

Patrick Minford's new study reached me the same week as I read Milton Friedman's criticism of the euro in a British newspaper. Unfortunately punches are still being pulled by euro sceptics.

Milton Friedman, having admitted his error on the euro - 'I predicted it would not happen and it did' - now claims, rather unhelpfully from the eurosceptic viewpoint, that 'the positive effect will be to generate a greater volume of intra-European trade.'

Irrespective of their merit, such views, coming from so eminent an authority, encourage the belief that it is a good idea to put even more eggs in the fracturing EU basket. However, Professor Friedman fails to acknowledge that the EU's economic future must inevitably involve a smaller and smaller EU population exchanging more and more goods internally, and fewer and fewer with the rest of the world.

Supposed Benefits

Milton Friedman's arguments are at variance with those of Patrick Minford. Having blown out of the water the supposed benefits of 'transparent prices', Minford correctly states that the core of the argument for going into EMU (actually he means the single currency) is the claim that this will lead to the elimination of exchange risk against the euro. Certainly, those in favour of joining the euro place great emphasis on the claim that the elimination of risk will resemble the removal of a trade barrier in its effects and will thus promote much more trade with Europe leading to an increase in foreign investment in the U.K. Minford shows that even if it was true that exchange risk is an important influence on trade, we would consequently increase our exchange risk against the dollar. He also shows that in well-managed

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economies there is not much of a problem anyway with exchange risk in general. Minford is thus at odds with Friedman in saying that the entry of the U.K. into the euro will mean more trade between the U.K. and the euro zone.

Professor Minford also performs another useful service, that of demolishing one of the favourite items in Charles Kennedy's pro-euro armoury. This is that the existence of a separate Canadian currency is the reason Canada trades much more with itself than with contiguous American states - despite the existence of a virtually free [North American] market. Minford points out that Kennedy has grossly exaggerated the importance of the currency barrier when there exist so many other equally or more significant incentives to trade nationally. Indeed, if Kennedy extended his analysis to American states he would find that trade inside an American state is considerably greater than with other states. Partly this is a matter of local regulations and incentives, culture and tastes, partly a matter of common sense and geography.

There are, however, important issues not discussed. Minford barely mentions the convergence argument which has been central to the discussion about whether or not Britain should join. The Treasury Assessment of 1997 bluntly states that 'sustainable and durable convergence is the touchstone' and this will mean 'that Britain has converged with Europe'. Extraordinarily, Britain

is expected to do the converging regardless of whether the euro zone is in a healthy state or not!

In classic studies of national economic performance, the starting point has usually been the geographic basis of the state and its demographic profile. The physical and human geography are the absolutely basic building blocks, along with its political institutions and arrangements. However, when considering the European Union, one is presented with uncertainty in its actual physical geography. Precisely where will enlargement end? Will the EU eventually incorporate all the countries of Europe including Russia, the Ukraine and the Balkans? Will it incorporate Turkey? Will it go further and take in the North African countries? Who knows?

As for Europe's changing demographic realities, these are regarded as static phenomena by EU politicians and, for that matter, by Minford and Friedman. Yet the EU is faced with dramatic change with its labour force contracting by about 40 per cent in the principal member countries of Germany, Italy and Spain by 2050 and, with similar declines in many of the smaller EU countries. Pensioners will double as a percentage of the EU's population during this period.

Pension Problems

The decline of the EU market as a proportion of world markets makes it inevitable that Britain will have to trade more extensively outside the EU, making the euro even more of a regional currency than now. It will remain important, of course, but all incremental trade growth is likely to be outside the eurozone. Given present demographic profiles, does anyone seriously suppose that in, say, 30 years, Britain's trade with the EU will grow more than with non-EU countries? Applying Minford's analysis this

Europe will be major casualty in the war of ideas

The failure of 'trans-national progressivism' will undermine ever-closer union

A sea-change in intellectual opinion which could have profound implications for the future of the European Union has been detected by James Bennett, the US author and journalist in his most recent column for UPI.

Bennett points out that in recent decades a relatively narrow political intellectual class has been able to control the political agenda throughout the Western world in accordance with what has been termed "trans-national progressivism."

He writes: "In pursuit of this agenda, the transnational progressives have had the advantages of controlling the governments, major political parties, and academic-media institutions of most of Western Continental Europe. This has permitted them to use the institutions of European unification, almost entirely unaccountable to electorates, to create a model of trans-national progressivism to hold up as an example elsewhere..."

But now the views of this elite are under threat: "It was the advent of George W. Bush in 2001 that signalled an end to the seeming global unanimity on the progress of the trans-national progressive agenda.

"By withdrawing from or refusing to ratify a number of highly visible international structures, including the

Kyoto Agreement, the Anti-Ballistic Missile Treaty, and the International Criminal Court, the Bush administration presented the first substantial threat to the trans-national progressive agenda.

"They [the progressives] enjoy painting America as the lone holdout against an otherwise unanimous consensus of democracies. This ignores the fact that this supposed consensus is actually quite thin. In fact, public opinion in most of the rest of the Anglosphere tends to track American opinion closely on most of the issues that supposedly reflect a values gap between America and the world.

"And now cracks are beginning to appear in the wall. Australia is the only other principal Anglosphere nation beside the United States in which a party is in power which is not controlled by trans-national progressives. Thus Australia joined the United States in a principled rejection of the Kyoto agreement and has recently rejected international interference in its handling of asylum applicants.

"Once the crack in the wall begins, it will spread because it depends on the illusion of world consensus..."

"Similarly, trans-national progressivism is a popular ideology in

the British Foreign and Commonwealth Office, but it no longer reflects an all-party consensus of opinion, and is a debated, rather than settled issue, in the press.

"Other potential cracks in the facade are likely. Several Eastern European states remain uneasy about the full trans-national progressive agenda; having only recently re-established their independence from one trans-national Union, they are not entirely happy at the prospect of surrendering it again to another one, no matter how democratic it proclaims itself.

"Other defectors may be surprise: France is at heart divided in its support for the trans-national progressive agenda. On the one hand, it has always hoped to use trans-national institutions to balance and contain the threat to its internal arrangements from globalisation and the [American] 'hyperpower.' On the other hand, it alone of Continental Western Europe still has ambitions to be in the nation-state business, ambitions which will eventually be constrained by the trans-national progressive agenda. If enough other nations drop out, France too could begin to demur.

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means the 'exchange risk against the dollar' will increase as time goes on.

Patrick Minford is also right to draw attention to the danger of Britain having to underwrite state-financed pensions in the euro zone. Even if there is no direct charge to Britain, (which is very unlikely), we will inevitably be affected by the 'economic convergence' provisions of EMU. *Business for Sterling* has been among those pointing out that heavy borrowing by one EU country spreads the cost to other EU countries by raising yields on euro-denominated bonds. Minford most aptly labels this

phenomenon as 'contamination of credit'. If these countries decided not to borrow but to pay for pension and health costs by taxation this would depress euro zone economies even further.

As Tim Congdon has argued, the combination of adverse demographics and low productivity growth will lead to virtual stagnation in living standards in Germany and Italy over a thirty year period. Yet it is the Government's objective to converge with these countries.

It is when one factors in the uncertainty about the future

composition of the EU, plus the effects of the demographic implosion, that one sees that the idea of forcibly converging the British economy with that of the eurozone is the stuff of which economic nightmares are made. Both Milton Friedman and Patrick Minford end up being too polite about the euro because they have concentrated on narrowly defined economic phenomena, and because they take a static view of the EU, thus ignoring a dynamic and ongoing process of change whose consequences will be profound.