Putting politics before jobs, growth and prosperity

In the third of his series on the Chancellor's famous five tests Anthony Scholefield argues that the Treasury's position is confused as well as superficial

TEST 5:

In summary, will joining EMU promote higher growth, stability and a lasting increase in jobs?

The 1997 Treasury announcement stated that "sustainable and durable convergence with Europe" is the touchstone.

Yet, surprisingly, in the examination of Test Five, it is stated that "the fundamental test is whether joining EMU would overall be good for growth and jobs."

One would have thought that the determination of this test would have been made before the political decision to join the euro. If the government is not sure about the answer to this question one must wonder why it has made "the political decision" to join the euro.

But, in any case, the test of being good 'for growth and jobs' is quite different from 'sustainable and durable convergence with Europe' (sic) so one must ask which is the 'touchstone'.

To make a political decision to subsume one's currency in another, without finding out in advance whether or not it would promote growth, stability and jobs, seems to be getting the question back to front. What were the reasons the government took the political decision to join the euro?

For what is described as the fundamental test, the Treasury devotes one side of paper to discussing the issues as whether joining EMU would be good for growth and jobs.

Unemployment rates one part of a page. The analysis is sketchy to the point of insulting. Its chief point is: "*By giving a boost to the Single Market, and improving price transparency, EMU could help to create the conditions in which structural unemployment falls.*"

As for the Treasury discussion on growth, the most important economic point of all, this takes up the grand total of three lines and is worth reading in full:

"*5.4 Growth and investment should also be encouraged by EMU. For example, the level of inter-European trade can be expected to increase as a result of increased transparency and reduced transaction costs.*"

These are tiny factors in increasing growth and investment. While trade is one engine of growth what about productivity, entrepreneurial skill, improvement in the performance of low growth regions, deregulation, education, demographic change?

For example, Britain's biggest export to the EU is oil and gas products. How will these be increased by "increased transparency and reduced transaction costs" when they are denominated in dollars anyway? Do Shell, BP and Total really need 'increased transparency' to carry out their oil business?

An analysis by *eurofacts* in December 2001 of Customs & Excise figures of the currency of invoicing of UK goods only trade in 2000 shows that some 15% of UK trade exports and imports with the EU was conducted in US dollars. Thus a considerable minority of UK-EU trade would be completely unaffected as there would be no 'reduced transaction costs'. There are no figures for the currency of invoicing for services but it is generally thought that the dollar percentage is higher than for goods invoicing.

Pound steady against the dollar - but joining the euro would put economy into a spin

Over the last few weeks the pound has weakened against the euro, from roughly £1 buys euros 1.61 to (at the date of writing) £1 buys euros 1.55. In "old" money, £1 today buys about DM 3.02 or FF 10.2. What's going on?

Against the dollar, the pound has been pretty steady, oscillating around £1 buys $1.46. The arithmetical explanation for the pound having weakened against the euro is that the dollar has weakened against the euro, from roughly $1 buys Euros 0.89 to $1 buys euros 0.94.

The economic fundamentals of the eurozone versus the UK have not suddenly tilted in the eurozone's favour, nor have the prospects of the UK adopting the euro suddenly improved. The pound/euro exchange rate is a bit of a side-show, merely a by-product of two other exchange rates: pound/dollar and euro/dollar. Pound/dollar has remained pretty steady, reflecting the far greater importance of the dollar to the UK economy than the euro, while dollar/euro has been volatile. Pound/euro has wobbled a bit in the slipstream of dollar/euro volatility.

The moral of all this is that abandoning the pound for the euro would increase the British economy's overall financial and commercial volatility vis-à-vis the rest of the world outside the eurozone, since far more of British trade is dollar-linked than is euro-linked.