Global Britain Briefing Note

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The Euro Two Years On

Monetary union is fundamentally a political rather than an economic issue.

The Rt Hon Sir Eddie George, Governor of the Bank of England,

speech in Basle, 12th September 2000.

The analysis contained in Global Britain's 4th June 1999 Briefing Note No 1 (Revised Edition), Britain and the Single Currency continues to be valid. The present Briefing Note updates the economic data it contained and reviews developments since then.

Britain in the Global Economy

93% of the world's independent states are situated **outside** the euro-zone.

94% of the world's independent states have **not** joined a "single" currency.

95% of the world's population lives **outside** the euro-zone.

Of the world's approximately 200 independent states, **only three**developed nations - the USA, Japan and Germany - **have economies which are significantly bigger than Britain's**. Japan and Germany have deep-seated structural problems.

The Continental EU is in **long-term economic and structural decline**1**.**

Euro-zone GDP shrank by 8% between 1997 and 2000 while that of the rest of the developed world grew by 14%2.

Since the UK left the ERM (the test-bed for the euro) in September 1992 she has enjoyed **the longest period of uninterrupted economic growth**since records began some 45 years ago3.

In 2000, measured by GDP per capita, **the UK was wealthier than any euro-zone**

80% of the world's financial transactions and close on 60% of the world's commercial transactions are **denominated in US dollars**8.

Around **60% of British exports worldwide are dollar-linked**, compared to only around 35% for the euro9.

As a currency of invoicing, **dollar usage is more than double that of the euro** for British exports of goods worldwide10. The same is almost certainly true of British exports of services.

More British goods exports to Germany, her biggest euro-zone market, **are invoiced in dollars than in euros or DM**10.

Three-fifths of worldwide British exports go **outside** the euro-zone11.

Britain has **increased** her share of world exports of goods and services between 1989 and 1999. German and French shares **have fallen sharply**12.

NAFTA (comprising the USA, Canada and Mexico) **increased** its share of world exports of goods and services between 1989 and

country except Luxembourg4. (In 1992, eight of the twelve countries now in the euro-zone were wealthier than the UK).

The three EU countries **not** in the euro-zone, Britain, Sweden and Denmark, as well as Norway and Switzerland (not even EU members) **were all wealthier**, measured by GDP per capita in 2000, **than any euro-zone countr**y except Luxembourg4.

Unemployment: the average euro-zone rate is 60 per cent higher than that of the UK5.

Inflation: the average euro-zone rate is **over double** that of the UK6.

Nine British jobs out of ten are **not** linked to exports to the euro-zone7.

1999; the euro-zone **lost** share12.

Since 1996, British exports of goods worldwide have grown almost **twice as fast** as those of the euro-zone12.

Since 1996, British exports of services worldwide have grown almost **four times as fast** as those of the euro-zone12.

Exports of British goods and services to NAFTA **are growing significantly faster** than to the euro-zone13.

English-speaking countries account for **73% of all inward Foreign Direct Investment** ("FDI") into the UK, compared with 20% from the euro-zone14.

65% of all outward British FDI goes to English-speaking countries, compared with less than 19% to the euro-zone14.

Exchange Rate Volatility

The euro's value against the world's benchmark currency, the US dollar, has been highly volatile. By 26th October 2000 the dollar was buying 43% more euros than it did on the euro's launch. The euro has strengthened somewhat recently, but on 4th May 2001 the dollar still bought 32% more euros than it did on the euro's inception. Meanwhile, sterling's volatility against both the dollar and the euro has been approximately half that of the euro versus the dollar15.

More than half of the UK's exports, and an even higher proportion of her imports, are linked to the dollar. Had she joined the euro at the outset, the impact on the British economy of such euro/dollar volatility would have been severe.

The Euro-zone Economy

Despite the **biggest competitive devaluation in recorded history**

Opinion polls suggest that support for the euro is declining across Europe18, though in the euro-zone itself more people than not still support it - just. Opinion polls in Sweden and the UK suggest that referendums to join would be lost. It remains to be seen whether support will drop further once the familiar guilders, francs, deutschemarks and so on disappear forever in the first half of 2002 and euro notes and coins are substituted.

Conclusion

Will the euro survive? Yes: at least in the medium term. Technically, so far, it has "worked". Assuming a satisfactory introduction of euro notes and coins in the first few months of 2002, with the conversion of all hardware (cash registers, cash dispensing machines etc) and associated software throughout the euro-zone, its denizens will be stuck with it for years to come. As the Deputy Governor of the Bundesbank said recently, "it is doomed to (measured by the amount of money in circulation multiplied by the percentage drop in value against the dollar), the euro-zone recovery has been modest. GDP growth has been less than in the rest of the developed world[2]. In its biggest economy, Germany, unemployment has risen in each of the last three months[16].

Sustainable convergence (real as distinct from nominal) between the twelve euro-zone economies themselves (Greece joined on 1st January 2001, adding less than 2% to euro-zone GDP) has been hard to detect. So has convergence between the British economy and that of the euro-zone as a whole.

The only significant pan-euro-zone industry to have switched to the euro for quotations, dealing and settlement is that of trading in listed euro-zone shares. The dominant share of that business is executed outside the euro-zone, in the City of London[17].

Public Opinion

Only two referendums have been held in Europe during the lifetime of the euro. Denmark, an EU member, voted decisively against joining the euro on 28th September 2000. Switzerland held a referendum on 4th March 2001 on whether to open negotiations with a view to joining the EU: the "No" vote was an overwhelming 77 per cent. Although not specifically about the euro it was symptomatic of the poor regard in which both the EU and the euro are held.

succeed" [19].

Will the euro "strengthen" ? The financial markets are only too aware that the euro is an artificial political construct whose designers chose to disregard its economic drawbacks[20]. This may be why conventional economic analysis has difficulty explaining the euro's "weakness" against sterling and the dollar. The euro may well "strengthen" – but it is just as likely to "weaken". Either way, it will continue to be volatile.

Will it lead to a single European state? Chancellor Schröder, in his long closely-argued paper for the SPD Congress in November 2001[21], proposes that the Commission become the single European government. A single European government can only mean a single European state. The euro is an integral part of the project. It is not unreasonable to assume that the leader of the most powerful party in the most powerful nation in Europe actually means what he says.

Should the UK join? Events have weakened the economic arguments for British membership. The UK, overall, has suffered no ill-effects from keeping the pound, while the euro-zone economies have done less well than expected, and, in many respects, less well than the UK. These economic phenomena are almost certainly structural, not transient.

However, the economics are irrelevant. The choice, as it always has been, is political. Does the UK want to become a subordinate province of a country called "Europe"? Or does she want to remain independent ?

1. **Sources**

2. *eurofacts*, 20th April 2001, page 4.
3. OECD Main Economic Indicators, April 2001 and *eurofacts*, 18th May 2001, page 3.
4. Sir Eddie George, speech in Basle, Switzerland, 12th September 2000.
5. Eurostat, quoted in "How is the Euro Working?", HL Paper 124, 21 November 2000.
6. ECB Monthly Bulletin, March 2001 and ONS; ESA95/ILO basis.
7. ECB Monthly Bulletin, March 2001; HICP basis.
8. Hansard Written Answers, House of Lords, 3rd April 2001, quoted in *eurofacts*, 4th May 2001, page 5.
9. Interviews in Capital, December 1998, with Yves Thibault de Silguy, the European Commissioner then responsible for the single currency.
10. *eurofacts* 5th May 2000, page 1.
11. HM Customs & Excise/ONS, 23rd February 2001, summarised in *Global Britain Briefing Note No 13* of 2nd March 2001.

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13. *eurofacts*, 19th November 1999, page 1 and 5th May 2000, page 4; Global Britain pamphlet *UK Trade in 1999 and Growth 1993-1999,*October 2000.
14. *eurofacts*, 16th February 2001, page 4, based on WTO International Trade Statistics 2000.
15. Global Britain pamphlet *UK Trade in 1999 and Growth 1993-1999*, October 2000, Table 18.
16. Global Britain Briefing Note No 9, *Foreign Direct Investment*, 30th June 2000.
17. BMDF *Currency Volatility Against the Dollar*, 3rd May 2001.
18. Federal (German) Labour Office.
19. Bank of England *Practical Issues Arising from the Euro*, November 2000 .
20. European Commission: Eurobarometer Survey No 54, 8th February 2001; and newspaper polls.
21. Dr. Jürgen Stark, speech in Amsterdam, 2nd April 2001 (translation by BMDF).
22. The drawbacks were clearly spelt out in Sir Donald McDougall's magisterial study for the Commission, published in 1977.