THE ECONOMIC COSTS AND BENEFITS TO THE UNITED KINGDOM'S JOINING THE EUROPEAN ECONOMIC AND MONETARY UNION

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List of Abbreviations

CAP	Common Agricultural Policy
CB1	Confederation of British Industry
CP1	Consumer Price Index
EC	European Community
ECB	European Central Bank
ECSC	European Coal and Steel Community
ECU	European Currency Unit
EEC	European Economic Community
EFTA	European Free Trade Area
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
ERP	European Recovery Program
EU	European Union
GDP	Gross Domestic Product
1GC	Inter-Governmental Conference
IoD	Institute of Directors
NATO	North Atlantic Treaty Organization
OECD	Organization of Economic Cooperation and Development
OEEC	Organization for European Economic Cooperation
SEA	Single European Act
TARGET	Trans-European Automated Real Time Gross Settlement Transfer
WEU	Western European Union

1. Introduction

In January of 1999, eleven of fifteen members of the European Union (EU) irrevocably locked their currencies together to become the European Economic and Monetary Union (EMU). Their new common currency, the euro, is now the currency for most of Western Europe. Britain was one of four EU countries that decided not to join. Now at the turn of the Twenty-First Century, one of the biggest questions on the minds of the population of Britain is: *Should the UK join with the rest of Western Europe in monetary union*? This question can be debated from many different angles: politically, socially, economically etc. Every person studying this issue can come up with many reasons why Britain would be hurt and helped by joining the European Economic and Monetary Union. But what is the best method for judging all these costs and benefits? The British government has decided to use only economic criteria to decide how the welfare of Britain would be affected by joining the union. This paper aims to explore the economic effects joining the EMU would have on the UK economy. This analysis will show whether or not it would be in Britain's economic interest to join the union.

There are many issues to consider besides all the costs and benefits. One must understand how Britain's history with the rest of Europe affects her current decision about the monetary union. Sovereignty has played a large role in British history for centuries. Much of the UK's reluctance to join the EMU has stemmed from her fear of losing her economic independence. Britain's relationship with Europe since World War II clearly shows this reticence. Loss of economic independence would be a huge cost to Britain if she joined the union. Many opponents to joining believe that if Britain becomes part of the monetary union, she will lose part of her national identity.

> The main constitutional issue involved in economic and monetary union is that of economic sovereignty - loss of which would mean the government, the Governor of the Bank of England and the Chancellor of the Exchequer having to surrender control of the British economy to central European institutions. For the pubic, however, a much more relevant issue, because it is an emotional one, is the question of whether a common currency would mean having to give up the pound and the penny.[2]

[2] Colin Pilkington, *Britain in the European Union Today* (New York: St. Martin's Press, 1995) 110.

This quotation reveals some of the many issues with which Britain must deal while making this decision. Loss of sovereignty is a critical issue for the people of the UK.

It is also necessary to look at the feasibility of Britain's joining the EMU. The 1992 Maastricht Treaty establishing the European Union set up specific convergence criteria which countries must pass before being admitted into the monetary union of Europe. Can Britain pass all these criteria? The UK economy has always been on the edge of Europe and not fully integrated into the European economy. It is definitely possible that Britain could have trouble passing some of the Maastricht Treaty requirements.

Joining the EMU would bring various costs and benefits to Great Britain as a whole. One must take into account how these changes would affect different segments of the population. There are many benefits that would improve the overall economy of the UK while there are costs that would affect only small sectors of the population. Consumers would be affected differently than businesses. Some businesses would benefit while others would suffer. The changes in financial markets would have effects throughout the entire economy. The time frame of the costs and benefits is also important to take into consideration. Some of the costs associated with joining the monetary union would be onetime costs while others would affect the economy constantly. Many of the effects from these advantages and disadvantages would depend on how well integrated with the European economies the UK economy becomes before the UK joins the union. One must also consider what costs Britain would incur if she does not join. Would these costs or losses be worse than the ones associated with actually joining the union?

Many of these costs and benefits are hard to quantify. The analysis becomes very subjective. It is difficult to weigh one side against the other. One must take the opinions of the government and economists into consideration. What issues do they think are most important? One problem is that so many of the effects to the UK economy can only be seen if the UK does indeed join the EMU. It is only then that one can truly see how detrimental shocks would be to the economy or how much businesses would save with the elimination of transactions costs. Again, many of these effects will depend upon the integration of the UK economy. But who judges this integration? Who will say when the integration has reached the proper stage?

This cost/benefit analysis aims to show how the British economy would be affected by joining the European Economic and Monetary Union. The decision on whether or not to join will

ultimately be made by the government and the British populace probably in the next few years. This paper allows readers to understand what economic factors will be used to make the decision and attempts to show where the burden of proof lies in this important debate over the possibility of the British pound becoming part of the new European currency, the euro.

2. Historical Background

Since the end of the Second World War, many of the countries of Western Europe have embarked on a series of plans to integrate themselves both economically and politically in order to improve their economies and living standards. Throughout the latter half of the Twentieth Century, Britain played both integral and peripheral roles in the consolidation of Western Europe. In order to examine whether or not Britain should eventually become part of the Economic and Monetary Union of Europe in the Twenty-First Century, Britain's role in the history of Western European integration needs to be explored. The decades following World War II were filled with conferences, debates and committees which formed numerous organizations made up of various Western European countries. These organizations aimed to secure goals such as economic cooperation and defense protection. Many people played critical roles in bringing parts of Europe closer together while others were striving to keep their countries sovereign and unattached from their neighbors. Despite these variations of opinion and diversity of the organizations, many of the countries of Western Europe succeeded in tying their economic systems and political outlooks closer together. The United Kingdom had doubts about consolidation, and she protested on many occasions to certain policies and refused to participate in many conferences and organizations. Britain's views throughout this early period reveal both her hesitation and gradual acceptance of European integration and show how her historical relationship with Western Europe can offer insight into whether or not Britain can eventually benefit from joining her continental neighbors in economic union.

At the close of World War II, the United States Secretary of State George Marshall set up an economic recovery program, the Marshall Plan, which distributed money to those European countries ravaged by the war. The Organization for European Economic Cooperation (OEEC) was established to administer the European Recovery Program (ERP) with Marshall Plan money.

The British Foreign Secretary, Ernest Bevin, was instrumental in setting up the OEEC.[3] The plan required the countries of Western Europe to work together in order to organize how the money was to be used most efficiently. The OEEC reduced the trade tariffs between member countries, fixed their currency exchange rates and helped Europe to recover by the mid 1950S.[4] Though many OEEC countries wanted to set up a customs union, the British refused,[5] showing their initial reluctance to become entrenched in European economics. A customs union is composed of a group of countries who agree to trade freely with each other, without tariffs, and agree to set common external tariffs on other countries.[6] It is clear that at this time, Britain only cooperated with Europe in order to expedite recovery from the war. In 1960, the OEEC expanded to include the United States and Canada and was renamed the Organization of Economic Cooperation and Development (OECD),[7] and therefore, this organization did not contribute to further European consolidation because it became an international as opposed to simply a European body. However, the OEEC was an important first step that demonstrated to western European nations the economic benefits of working together. Britain's reluctance to expand the OEEC shows her early fears about consolidating economically with the rest of Western Europe.

In December of 1947, the International Committee of the Movements for European Unity or "European Movement" was created as a forum in which European countries could discuss their problems. In May of the following year, the first of many congresses was held to discuss Western European cooperation. 663 delegates attended from countries including Belgium, the Netherlands, Luxembourg, Denmark, France, Great Britain, Ireland, Italy, Norway and Sweden. All these countries signed the Statute of the Council of Europe in May 1948, creating the Council of Europe, a body that facilitated discussion between countries but did not have strong decision-making powers. During this period, Britain was intent on Europe becoming part of an Atlantic community in organizations such as the North Atlantic Treaty Organization (NATO), established in 1949. She wanted the Council of Europe to remain inter-governmental and not supranational.[8]

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[3] Miriam Camps, *Britain and the European Communi1y 1955-1963*, (Princeton: Princeton University Press, 1964) 6.
[4] Colin Pilkington, *Britain in the European Union Today* (New York: St. Martin's Press, 1995) 11-12.
[5] Camps 7.
[6] Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy* (New York: Addison-Wesley, 1997) 242.
[7] Pilkington 12.
[8] Pilkington 13-15

To Britain, European cooperation and discussion was sufficient. Britain did not want to be involved in any kind of exclusive European body that would compromise her independence.

There were others in Europe outside the sphere of British influence who were eager to see Western Europe consolidate further. Jean Monnet, the director of the French Reconstruction Program, originated the economic agreement for the European Coal and Steel Community (ECSC) which integrated the heavy industry of France and Germany.[9] These industries had caused much animosity between the two countries for many previous decades, and this agreement showed the willingness of these countries to mutually discard their hostility for economic benefits. The ECSC was certainly a large step in promoting good economic relations in Europe. Monnet wanted his plan for the ECSC to eventually lead to political union. Robert Schuman, the French Foreign Minister, also encouraged European integration, and he announced the launch of the ECSC in May of 1950 in the Schuman Declaration.[10] Britain had originally been asked to participate in the drafting of the ECSC treaty, but she refused. In 1954, Britain decided to sign an "association" agreement with the ECSC (a very loose economic agreement),[11] again showing her unwillingness to become closely involved with European institutions. The ECSC was officially established in 1951 with the signing of the Treaty of Paris, Its goal was to eliminate barriers to trade and increase competition between the signing countries: France, West Germany, Belgium, the Netherlands, Luxembourg and Italy.[12] The ECSC became a great economic success to the countries involved, but Britain did not want to be part of an institution that could eventually lead to further economic integration and even political union.

However, the British did want to participate in defense pacts. Anthony Eden, the United Kingdom's Foreign Secretary set up the Western European Union (WEU) which included the UK, France, Belgium, the Netherlands, Luxembourg, Italy and West Germany. The Council of Europe became the WEU's Assembly while NATO became the organization's defense policy.[13] The WEU never wielded much power and was connected to an international organization - NATO. Britain did not become part of an integrated European institution. Instead, she organized

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[9] Pilkington 15.
[10] Pilkington 15.
[11] Camps 7, 11.
[12] Loukas Tsoukalis, *The New European Economy Revisited* (Oxford: Oxford University Press, 1987) 11.
[13] Pilkington 19.

a group of countries to act in mutual defense of each other. The WEU did nothing to promote European consolidation.

In 1957, a European body was formed which took the biggest step up to that point in bringing Europe closer together. For many Europe enthusiasts, the Treaty of Rome was a way to further integrate Europe economically in order for an eventual political union to take place. In March, the six ECSC countries signed the treaty establishing the European Economic Community (EEC) which later became known simply as the European Community (EC).[14] Since the ECSC had been so successful, the involved countries sought more complete integration to reap more economic benefits.[15] By 1968, the EEC sought to remove all internal tariffs and restrictions between the countries in a customs union, establish a common market, establish a common external tariff, outlaw any barriers to free competition and outlaw any barriers to movements of goods, people, capital or services.[16] The introduction of the treaty lays out its foundations and objectives. The signers of the Treaty of Rome,

> Determined to lay the foundations of an ever closer union among the peoples of Europe, Resolved to ensure the economic and social progress of their countries by common action to eliminate the barriers which divide Europe, Affirming as the essential objective of their efforts the constant improvement of the living and working conditions of their peoples, Recognising that the removal of existing obstacles calls for concerted action in order to guarantee steady expansion, balanced trade and fair competition, Anxious to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions, Desiring to contribute, by means of a common commercial policy, to the progressive abolition of restrictions on international trade ... Have decided to create a European Economic Community.[17]

The treaty includes provisions concerning the movement of agricultural goods, rules on competition and directives for economic and monetary policy, the environment and research and development. This treaty was a comprehensive economic agreement that led the way to future consolidation in Europe.

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[14] Pilkington 21.
[15] Tsoukalis 12
[16] Pilkington 21
[17] Treaty Establishing the European Community as Amended by Subsequent Treaties" Mar. 1957, 23 Jul. 1999 <http://www.tufts.edu/departments/fletcher/multi/texts/BH343.txt>.

Unsurprisingly, Britain did not join the EEC with the other European nations in 1957, mostly deterred by the political implications of the Treaty of Rome. To Britain and other European nations who feared supranationalism, the Rome treaty seemed worse that the Paris treaty. In November of 1959, Great Britain formed the European Free Trade Area (EFTA) with Austria, Denmark, Norway, Portugal, Sweden and Switzerland. EFTA countries removed all tariffs and quotas between member countries and instituted origin controls that regulated goods from their points of embarkation. It is interesting that Britain would reject the EEC and then immediately join another European organization. The EFTA countries were uncomfortable with the political implications of the EEC. By joining they believed they would eventually be forced into a political union of which they could not extricate themselves. They believed joining the EEC would force them to give up some of their political independence. EFTA had the "economic and commercial freedom" of the EEC without its "political strait-jacket."[18] EFTA created a bloc to rival the EEC and split Western Europe in half. The members of EFTA wanted to avoid the economic and political integration upon which the EEC-Six seemed so intent.

By the early 1960s, the UK began to change her policy towards European integration. She decided to join the EEC. Britain realized that firstly, her long-tern priority was with Europe. Secondly, the Treaty of Rome was the only way to establish that relationship (as long as a few concessions were made). And finally, Britain wanted a closer relationship with Europe for political reasons - protection, decision-making etc.[19] Britain did not want to be left out of a community that was becoming economically prosperous and powerful.

> British politicians watched the EEC creating a series of political and economic institutions, which could be used for the future direction of the Community, while building a very secure boundary fence against outsiders. There was a feeling that one day it would become necessary to join the European Community and, when that day came, Britain would have to face a Europe that had been formed without any British input whatsoever.[20]

The British decision to join the EEC became both economic and political. The United Kingdom wanted to participate in the economic benefits of a common market and common external tariff. She realized that future economic decisions would be made in Europe to benefit the countries

[18] Pilkington 23.
[19] Camps 293.

involved in the EEC, and the UK wanted to be a part of those decisions. (The decision with which Britain was faced in the early 1960s is very similar to the one now faced by Britain regarding whether or not to join the EMU. Many of the same economic and political considerations must be taken into account.) It is interesting to understand the impetus behind the British change in policy in the early 1960's. In previous decades, Britain was opposed to joining any organization that would promote European consolidation such as the EEC. She believed her prominence and stature as a Great Power would be compromised and her economic and political power would be diminished by becoming a member of such a community. She did not want to be one of many states in a union.[21] Sovereignty has been one of the most important and integral aspects of British culture throughout her history. Losing even a small part of her sovereignty was unthinkable. But in the 1960s, the British outlook changed. Relations with the United States had deteriorated since the incident with the Suez Canal in 1954. Her empire had mostly disappeared by this time, and the United Kingdom was forced to reevaluate her presence in the international community. The EEC had been very prosperous since its inception, and Britain's economy was lagging behind.[22] So in 1961, Britain applied for membership in the EEC.

There was intense debate in Britain about whether or not to join this integrated European organization. The people of Britain recognized the implications of joining the EEC, and they were unsure about taking a step to join so closely with Europe.

> In the summer of 1961, when the British Government applied for membership in the Community, it fully recognized and accepted the fact that it was applying to join a Community which would -at the end of a transition period - act as a unit in its commercial relations and would possess many of the attributes of a full economic union.[23]

This step by the British was one of the turning points in British thought towards her role in European integration. Britain decided that from then on, she would become part of Europe.

The negotiations between Britain and the EEC in the 1960's concerned the replacement of British national policies by community ones.[24] Again, Britain was loathe to give up any more of

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[20] Pilkington 24.
[21] John Kendle, *Federal Britain: A History* (New York: Routledge, 1997) 152.
[22] Kendle 153-54.
[23] Camps 514.
[24] Camps 515.

her sovereignty than necessary. The French President at this time, General Charles de Gaulle, vetoed Britain's bid for membership in the EEC both in 1961 and then again in 1967. Britain finally joined the EEC in October of 1972.[25] Unfortunately, directly after the British joined the community, a series of oil crises hit the world, and a recession consumed Europe. This timing was an unhappy coincidence for Britain who had expected an economic boost when joining the Community. The economic growth for which the UK had joined the EEC stopped abruptly. Although policy makers in the UK understood that these oil shocks were not the fault of the EEC, without the economic benefits of the EEC, the Community did not have much to offer Britain. The negative aspects of joining the EEC such as the Common Agricultural Policy (CAP) and budgetary constraints were harder to justify to British policy makers and the British populace without the economic growth.[26] The economic hardships in Europe in the 1970s affected each region of Europe differently. Consequently, each region reacted separately and differently to solve the problems through actions such as monetary and fiscal policy. These countries did not seem to want any broad European macroeconomic solutions to their problems. Any Europe-wide directives would have affected each region differently, benefiting some and hurting others. (Robert Mundell's 1961 paper on optimum currency areas delineates this topic in detail and will be examined in a later section.) The different effects and different policy responses of Europe during the 1970s reveal that broad monetary solutions and a monetary union may not benefit Europe during far-reaching economic crises. This situation revealed to Britain and many other European countries some of the potential costs to European economic integration. Britain never reaped the economic benefits of the EEC and was never fully happy in this European scheme. Her first foray into European integration was unsuccessful.

In March 1973, Europe made its first attempt at monetary integration. A currency snake was established in which all the currencies of the EEC were fixed together and allowed to float within a very narrow margin. The snake was totally unsuccessful and was quickly abandoned.[27]

The second attempt at monetary consolidation occurred in 1979 with the European Monetary System (EMS). France, Germany, Italy, Belgium, Denmark, Ireland, Luxembourg and the Netherlands all pegged their exchange rates within a ± 2.25% band. Spain, Portugal and

[25] Pilkington 25-28.
[26] Pilkington 30.

Britain later joined the EMS within a ± 6% band.[28] This fixed exchange rate system was called the Exchange Rate Mechanism (ERM). Also at this time, the European Currency Unit (ECU), a weighted basket of the ECC currencies, was established.[29]

Britain did not participate in negotiations for the ERM. In 1979, Margaret Thatcher, a Conservative, was elected Prime Minister of the United Kingdom. She held very negative views toward the consolidation of Europe and Britain's role in a united Europe. At various European Councils, Thatcher fought against the rest of the EEC regarding the Common Agricultural Policy and the budget contributions of Britain. Other EEC leaders loathed Thatcher for her demands and succeeded in alienating Britain from the rest of Europe.[30] There was a general British pessimism concerning European integration in the early 1980s, and Britain again reverted back to her policy of staying out of European integration efforts.

Jaques Delors became president of the European Council in 1985 and set Europe on the way to further consolidation. He set up a commission, the Delors Commission, to create a report on a possible European single market. In March 1985, the Delors Commission published the White Paper that delineated a clear timetable for the completion of the internal market. The Paper was very successful and garnered support from governments and businesses across Europe.[31] This support led the way for an Inter-Governmental Conference (IGC) in Milan in June of 1985 proposed by the European Council to revise the existing treaties.[32] The IGC created the Single European Act (SEA), establishing the internal market. The SEA defined an internal market as "an area without internal frontiers, in which the free movement of goods, persons, services and capital is ensured.[33] The SEA was signed by all 12 EC members: France, Germany, Italy, Belgium, the Netherlands, Luxembourg, Great Britain, Denmark, Ireland, Greece, Portugal and Spain in February of 1986.[34] This act was very significant in establishing the free flow of goods in Europe not only by breaking down tariffs and quotas but also by making the effort to break down nontariff barriers. Nontariff barriers are hindrances to trade such as import quotas and export

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[27] Tsoukalis 28.
[28] Krugman and Obstfeld 616-17.
[29] Tsoukalis 38.
[30] Pilkington 33-40.
[31] Tsoukalis 43.
[32] Tsoukalis 44-45.
[33] Tsoukalis 45.
[34] Tsoukalis 45.

restraints.[35] The SEA also increased the powers of the European Parliament and the Council of Ministers. European legislation increased dramatically in the period after the SEA to promote European integration. Later, Thatcher said that she would not have signed the SEA if she had realized the consolidating impact it was to have on Europe.[36] Thatcher opposed the integration while Delors tried to spur it on. Thatcher thought the EC was trying to impose socialism upon all of Europe with the SEA and voiced her opposition vehemently.[37] Through the voice of Thatcher, the UK revealed her renewed skepticism about a united Europe in the 1980s.

In 1989, Delors came out with a plan for even further European economic integration. The plan detailed the coordination of economic policies of all the EC countries in the ERM, the creation of a European Central Bank (ECB) without political ties and the introduction of a single European currency. By 1990, John Major had replaced Margaret Thatcher as Prime Minister of the United Kingdom. Major was more willing to compromise with Europe than Thatcher had been. The UK agreed to Delors' plan mostly through the encouragement of Geoffrey Howe, the UK Foreign Secretary, and Nigel Lawson, the Chancellor of the Exchequer. The UK joined the ERM on October 5, 1990. IGCs in 1990 and 1992 drafted a treaty that was presented at Maastricht on February 7, 1992. The Treaty of European Union or the Maastricht Treaty came into effect in January of 1994. The signers of the Maastricht Treaty, France, Germany, Italy, Belgium, the Netherlands, Luxembourg, Great Britain, Denmark, Ireland, Greece, Portugal and Spain became the European Union. The Maastricht Treaty laid out an official timetable for the EMU as well as criteria to which countries had to comply in order to join the monetary union. The United Kingdom did not agree to the entire treaty, so Major negotiated two protocols to the treaty. The UK, though now a member of the EU, did not have to move toward EMU, and the UK did not need to comply with the social policy of the treaty which required a country to work towards improving employment, living conditions, working conditions and developing human resources. Great Britain had a historic objection to European social policies in the EC. She believed social policies, such as the one required by the Maastricht Treaty, would put too many requirements on British industry, stifling competitiveness. Britain had always had a relatively inactive social policy compared to other member states such as Belgium, France and Germany.

[35] Krugman and Obstfeld 188.
[36] Pilkington 43.

Britain believed unemployment would rise as a result of the higher employment costs stipulated by the Maastricht Treaty social policy requirements. The British also felt this policy to be another infringement upon their sovereignty. They did not want the Community to have power over their social policies.[38] These "opt-out" provisions regarding the EMU and the social policy allowed the UK to join EMU at a later date if she desired and if she met the criteria. Though there was much opposition to the Maastricht Treaty in the UK, she ratified it on August 2, 1993.[39]

The UK was certainly not the only country that expressed doubts about the Maastricht Treaty. In a 1992 referendum, the people of Denmark rejected the treaty with a vote of 50.7% against. This result spurred doubts about the ERM and EMU all over Europe. France passed the treaty by a slim margin, 51.05%, later that year. In 1993, the Danes passed the treaty in a second referendum.[40] All this controversy over the passing of the Maastricht Treaty showed the varying opinions of the countries of Western Europe on the subject of European integration. Supporters of further integration and eventual monetary union believed the EMU was the key to creating a "federal Europe" that could not be reversed and which would give participants enormous economic benefits. Opponents of the integration scheme feared losing their national sovereignty and feared becoming a "faceless entity" in a larger union. Other countries sat halfway between these two groups, fearing the loss of independence but also not wanting to be left out of an integrated Europe.[41] The Benelux countries were eager to join the EMU to open up markets and gain a voice in monetary issues. Their economies were highly integrated with those of France and Germany who were spurring integration efforts, and these small countries followed the lead of the bigger ones.[42] Both Sweden and the UK feared losing their long histories of independence. They recognized the economic benefits of economic consolidation with Europe, but they were not willing to sacrifice political sovereignty.[43] The Danes held the same fears as the British and Swedes, but on top of these, they also feared losing their language and their religion (the

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[37] Pilkington 44-45.
[38] Anthony Forster, *Britain and the Maastricht Negotiations*: (New York: St. Martin's Press, 1999) 79-80.
[39] Pilkington 45-50.
[40] Ruth Pitchford and Adam Cox, eds., *EMU Explained: Markets and Monetary Union*_(London: Reuters Limited, 1997) 72-73.
[41] Pitchford and Cox 88.
[42] Pitchford and Cox 105-07.
[43] Pitchford and Cox 113.

Lutheran sect of Protestantism) to the Catholicism of France and Germany.[44] Greece also hesitated in joining the EMU because of its weak economy. The Greeks were eager to join if they met the Maastricht Treaty requirements.[45] The controversy over the Maastricht Treaty divided the EU into the countries who supported integration and were preparing for full monetary union and those who were more reluctant and decided to postpone their decision on whether or not to join the EMU.

Britain was one of the countries that decided to delay the decision about joining the EMU. Britain's time in the ERM was unsuccessful. When she joined in 1990, the pound sterling was overvalued against the other ERM currencies like the German Deutschmark. The UK was forced to raise interest rates until she finally dropped out of the mechanism altogether in September of 1992. The economy recovered immediately after the withdrawal.[46] This experience showed the UK the economic costs of pegging her currency to those of Europe and will be taken into account when evaluating the potential costs of the UK joining EMU. By 1995, the UK had not met all the requirements to join the EMU with some of the other EU countries. Her deficit was too large, and she did not meet the exchange-rate criteria.[47] (All the requirements and criteria set by the Maastricht Treaty for the joining of EMU will be delineated in the next section.) Therefore, the UK did not embark onto the next stages of EMU.

On January 1, 1999, eleven European Union countries - France, Germany, Belgium, the Netherlands, Luxembourg, Italy, Spain, Ireland, Austria, Finland and Portugal - all fixed their exchange rates in one of the last steps to adopting the common currency of the euro. Great Britain along with Sweden, Denmark and Greece were the four EU countries to decide not to adopt the euro at this time. The reticence of Britain, Sweden and Denmark stems from their fear of losing political and social independence. Part of Britain’s reluctance stems from her history with European consolidation from her experience in the EC to her failed attempt at the ERM. In the years since World War II, Britain has both refused to join with Europe and integrated herself at various times. At first, she was adamant about simply cooperating with the rest of Europe without becoming involved in a full union. Later in the 1960s and again in the 1990s, the United

[44] Pitchford and Cox 116.
[45] Pitchford and Cox 121-22.
[46] Pilkington 51.
[47] Tsoukalis 179.

Kingdom realized the importance of her joining with Europe. All these experiences showed Britain both costs and benefits to integrating with Western Europe. These factors will certainly play a role in determining whether or not the British economy would benefit by becoming part of the Economic and Monetary Union of Europe in the near future.

3. Britain & the Maastricht Treaty Convergence Criteria

Before one can assess the economic costs and benefits of Britain's joining the European Economic and Monetary Union, one needs to explore whether or not Britain can pass the convergence criteria delineated in the Treaty on European Union, more commonly known as the Maastricht Treaty, which determines which countries can enter the European common currency. The Treaty, which was signed by 15 European countries to form the European Union, states that any EU country can apply for EMU membership at any time. Eleven of the fifteen EU countries, the "first-wave" countries, France, Germany, Ireland, Italy, Austria, Belgium, the Netherlands, Luxembourg, Spain, Portugal and Finland decided to immediately embark on the path to the EMU when they signed the Treaty. They irrevocably fixed their exchange rates on January 1, 1999, beginning the final stage of becoming a monetary union. With the "opt-out" provision in the Maastricht Treaty that Prime Minister John Major negotiated, Britain did not embark on the path to the EMU as most of the EU did at that time. The five criteria in the treaty to which all countries must adhere in order to join the EMU include macroeconomic variables such as price stability, government budget deficits, total government debt, interest rates and exchange rates. To join the EMU, a country must conform its economy to these specific guidelines. If Britain decides to apply for membership, her economy will be evaluated in the two years before her admittance into the union, and therefore analyses performed now are immature. However, analyzing the macroeconomic variables at this time will help determine the feasibility of Britain adhering to the Maastricht criteria in the future if she decides to apply for EMU membership.

The writers of the Maastricht Treaty specified the economic criteria to which all countries in the European Economic and Monetary Union must adhere upon joining. In order to be objective, the criteria were made as quantitative as possible. Therefore, the factors are legally

unambiguous and easily enforceable.[48] These criteria protect countries in the EMU as they ensure the financial stability of all countries involved. The euro's position in world financial markets would be compromised by countries in financial difficulties, thus adversely affecting all EMU countries.[49] The Monetary Committee of the EU originally identified the necessary criteria to which all countries would need to conform to ensure financial stability.[50] Between 1990 and 1994 when the first-wave EU countries embarked on the first stages of joining the EMU, many of the countries who originally spurred the effort toward monetary union did not fit all the Maastricht criteria. Countries such as Italy, Germany, Finland and France had to work to improve their government budgets and deficits before they could gain entry into the EMU. These countries demonstrated that even if an applying country does not initially conform to all the economic specifications of the Treaty, changes can be made so they can eventually join the union. Many of the countries who may decide to apply for membership later, such as the UK, may have to make changes in their economies to fit these criteria.

Article 109j and a corresponding protocol of the Maastricht Treaty contain the specifications of the convergence criteria. The first criteria concerns price stability. Each member state of the EMU must meet "the achievement of a high degree of price stability; this will be apparent from rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability.[51] A protocol of the treaty specifies that price stability is to be evaluated by the Consumer Price Index (CPI). The CPI of the applying country may not exceed the CPIs of the three best performing members of the union in terms of price stability.[52] The wording of the Treaty states that an applying country is held to the standard of the three best performing EMU countries and may even be held to the standard of the best performing state in terms of price stability, as determined by the Council. The EU Council evaluates the statistics and economic performance, eventually deciding whether or not a country can join the EMU. This first criteria aims to prevent high inflation in member countries.

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[48] Lorenzo Bini-Smaghi, Tooaso Padoa-Schioppa and Francesco Papadia, "The Transition to EMU in the Maastricht Treaty" Essays in International Finance 194 (1994): 21.
[49] Christian N. Chabot, *Understanding the Euro* (New York: McGraw-Hill, 1999) 21.
[50] Bini-Smaghi et al. 24.
[51] "Treaty on European Union" (Luxembourg: Office for Official Publications of the European Communities, 1992) 41.
[52] Treaty on European Union" 185.

One must evaluate if Britain fits the criteria for price stability in order to join the EMU. The protocol of the Maastricht Treaty referring to Article 109j containing the convergence criteria states that price stability will be determined by the Consumer Price Index. Any applying country must have a CPI within one and a half percentage points of, at most, the three best performing states in terms of price stability. An applying country's CPI would be evaluated in the year prior to actual examination. For example, if the UK applied for membership into the EMU in 1999, the UK's CPI in 1998 would be evaluated. To get a sense of the overall inflation in the UK, one can look at the Consumer Price Indices of Britain since 1995. For all the EU states, the harmonized CPI is used which is compiled in accordance with certain methodological and sampling standards set by the European Commission. There are many institutional differences within the EU, so expenditures on certain goods and services such as medical care are excluded from the harmonized CPI.[53] 1995 is the base year, so the British CPI was 100. In 1996, the CPI was 102.5. In 1997, the CPI was 104.4. In 1998, the CPI was 106.0. These numbers are the period averages during the year.[54] Therefore, inflation was 2.5% from 1995 to 1996,1.85% from 1996 to 1997, and 1.53% from 1997 to 1998. Over the course of 1998, the UK's CPI went from 105 in the first quarter (average) to 106.7 in the fourth quarter (average)[55] - an inflation rate of 1.62%.

Table 3.1 UK CPI and Inflation 1995-1998

Year	UK CPI	UK Inflation Rate
1995	100	1.85%
1996	102.5	1.53%
1997	104.4	1.53%
1998	106	1.62%

Source: International Financial Statistics Jan. 2000

In order to see if the UK meets the first Maastricht Treat criteria in terms of price stability, one must look at the three best performing states in the EMU. The three best states in terms of price stability in 1998 were Austria, Germany, France and Luxembourg. Austria had a zero inflation rate in 1998.[56] Germany had an inflation rate of 0.097% during 1998 from the first quarter average

[53] International Financial Statistics" (Washington: International Monetary Fund, Jan. 2000) xxi.
[54] "International Financial Statistics" Jan. 2000, 919.
[55] "International Financial Statistics" Jan. 2000, 781.
[56] "International Financial Statistics" Jan. 2000, 111.

to the fourth quarter average.[57] France's inflation rate over 1998 was 0.29%, and Luxembourg's rate was also 0.29%.[58]

Table 3.2 EU CPI and Inflation 1997 & 1998

Country	1997 CPI	1998 CPI	1998 Inflation Rate
Austria	103	103.8	0%
Belgium	103.3	104.2	3.9%
Finland	102.3	103.7	0.78%
France	103.4	104.1	0.29%
Germany	102.7	103.4	0.097%
Ireland	NA	105.6	2.11%
Italy	106	108	1.02%
Luxembourg	102.6	103.6	0.29%
Netherlands	103.3	105.1	0.47%
Portugal	NA	107.2	2.5%
Spain	105.5	107.4	1.12%
Average of Best Four Countries	102.9	103.7	0.0725%

Sources: International Financial Statistics Jul. 1999 & Jan. 2000

When compared to France and Luxembourg, Britain would certainly pass the Maastricht Treaty criteria for price stability. However, if Britain was held to the best performing members, Austria and Germany, or held to the average of the top four countries, she would not fit the criteria. However, it is unlikely that the Council would prevent the UK from joining on such a slim margin.

The next criteria of the Maastricht Treaty involves government debt and budget deficits. The Treaty states that member countries must have "the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 104c(6).[59] Article 104c(6) grants the decision of whether or not a country has achieved a stable government financial position to the Council of the EU. Countries applying to the EMU are not allowed government deficits exceeding three percent of their respective gross domestic products (GDP). Also, a country's overall debt to GDP ratio must not exceed sixty percent.[60] Many countries consider this budget issue to be very sensitive because it can endanger political sovereignty. Every country has different budgetary concerns, and many states do not want budgetary

[57] "International Financial Statistics" Jan. 2000, 335.
[58] "International Financial Statistics" Jan. 2000, 321 & 481.
[59] "Treaty on European Union" 41.
[60] Bini-Smaghi et al. 29.

constraints imposed upon them by a European governmental body.[61] The Maastricht Treaty loosens these constraints somewhat by granting the Council the ability to make decisions concerning deficits. For example, if a country at the time of application for EMU membership has a deficit exceeding three percent of its GDP, but the Council sees that the country's deficit has been steadily decreasing towards three percent, the Council can accept the country for membership. The discretion of the Council allows flexibility in this criteria of the Treaty.

Great Britain essentially passes the second criteria of the Maastricht Treaty concerning budget deficits and government debt, examining the previous few years as reference. In 1996, the UK deficit was 25,259 million pounds while the GDP was 754,601 million pounds at 1996 prices.[62] The deficit was 3.35% of the GDP, only 0.35 percentage points from the required amount. In 1997, the UK government budget deficit was 14,145 million pounds while the GDP was 803,889 million pounds at 1997 prices.[63] The deficit was only 1.76% of the GDP, fulfilling the Maastricht Treaty requirement. In 1998, the UK government ran a surplus of 1,496 million pounds with an 843,735 million pound GDP.[64] When looking at these years, the UK seems to fulfill this budget deficit requirement of the Maastricht Treaty with increasing ease. In terms of government debt, the UK also adheres to the criteria. From 1992 to 1998, the general government gross debt as a percentage of GDP has been 40.1%, 45.8%, 48.9%, 52.5%, 53.1%, 51.5% and 48.7% respectively.[65] These percentages are well under the 60% debt to GDP ratio required by the Maastricht Treaty.

The third convergence criteria of the Maastricht Treaty concerns exchange rates. A country joining the EMU must successfully adhere to the Exchange Rate Mechanism for two years prior to admission without devaluating. The Treaty states that a country must observe "the normal fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State.[66] The ERM is simply a system of fixed exchange rates in which member countries cannot fluctuate from the other member countries' currencies by more than ±15%. Beginning in

[61] Bini-Smaghi et al. 27.
[62] *Economic Trends* 550 (1999): T2 &T70.
[63] *Economic Trends* T2 &T70.
[64] *Economic Trends* T2 &T70.
[65] *Financial Statistics* 449 (1999) 227.
[66] "Treaty on European Union" 41.

January 1999, applicant countries are evaluated against the euro currency. This criteria must be met for obvious reasons. It would be impossible for a country to join a common currency if it could not fix its national currency within ±15 % bands for two years prior to the changeover.

This third criteria might cause trouble for the UK if she wishes to join the EMU. Britain left the ERM in September of 1992 because she could not keep the pound tied to the other European currencies in the ERM. John Atkin, the Economic Advisor for Citibank and published author of EMU economic research, said that the ERM criteria may be the only Maastricht criteria to which the UK might not adhere. He believes Britain will refuse to join the ERM, but this refusal will not prevent her from joining the EMU if she wishes. The UK does not want to join the ERM because of her previous experience and because she is loathe to give up exchange-rate policy unless absolutely necessary. However, it would seem that if Britain decided to apply to join the EMU and eventually incorporate the pound into the euro, she would be willing to fix her exchange rate within certain parameters for the period prior to joining. Since exceptions were made for other countries upon entry into the EMU such as Belgium and Italy, Atkin thinks an exception would be made for the UK if she does not want to join the ERM. Atkin also points out that the Maastricht Treaty states that members must be part of the ERM, but at the end of 1998, the ERM was replaced by the ERM II.[67] The ERM II is simply the same system of fixed exchange rates as its predecessor, but applicant countries must keep their currencies tied to the recently formed euro currency instead of a basket of EU currencies as countries did under the ERM. Since the ERM no longer exists, the UK argues that she cannot be forced to join a mechanism that is no longer in operation. The British could use this legal discrepancy to avoid this third criteria of the Maastricht Treaty. However, one must look at the exchange rate of the pound to the euro in the past few years to assess the feasibility of the pound joining the common currency.

[67] John Atkin, personal interview, 22 July 1999.

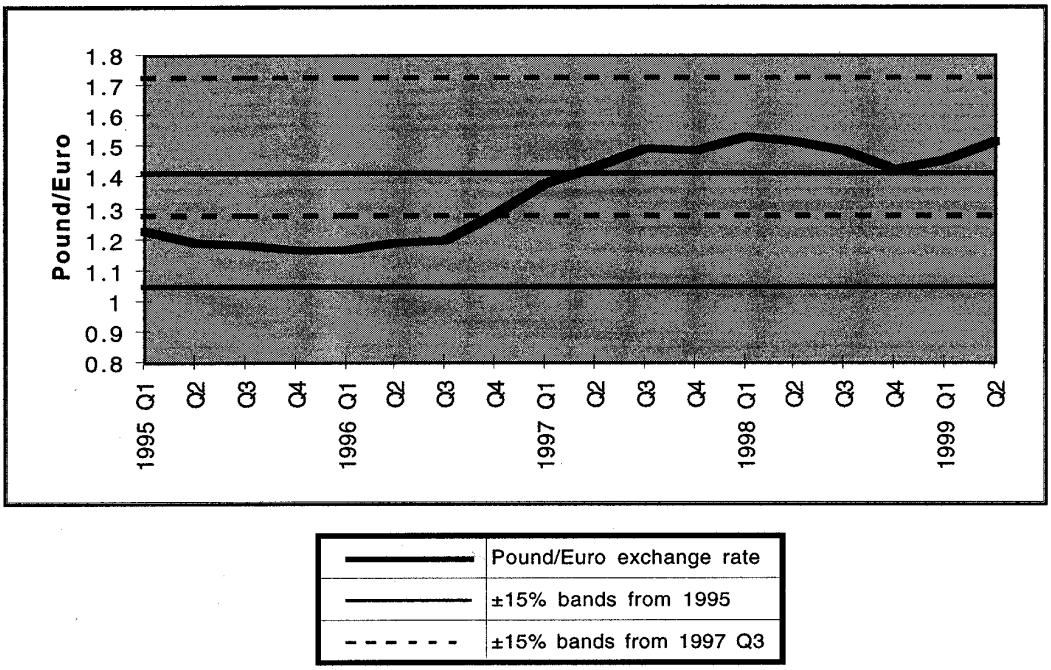
Table 3.3 Pound/Euro Exchange Rate 1995-1999

Year		Pound/Euro	Year		Pound/Euro
1995	Q1	1.2289	1997	Q2	1.432
	Q2	1.1869		Q3	1.4962
	Q3	1.1811		Q4	1.4855
	Q4	1.1656	1998	Q1	1.5294
1996	Q1	1.1676		Q2	1.5149
	Q2	1.1927		Q3	1.4875
	Q3	1.1974		Q4	1.4247
	Q4	1.2805	1999	Q1	1.4574
1997	Q1	1.3793		Q2	1.5209

Source: Economic Trends Sep. 1999.

From 1995 through the first two quarters of 1999, the exchange rate between the British pound and the euro fluctuated between 1. 1656 pounds/euro to 1.5294 pounds/euro, a fluctuation of 23.79%. This fluctuation is well above the 15% band of the ERM. However, looking at the two year period from the third quarter of 1997 through the second quarter of 1999, the exchange rate has fluctuated from 1.4247 to 1.5294, a fluctuation of only 6.85%, well within the ERM requirement.

Figure 3.1 Pound/Euro Exchange Rate with 15% Bands



Source: Economic Trends Sep. 1999

This graph illustrates the pound/euro exchange rate, including the ±15% bands. The solid, straight lines at 1.045 and 1.413 pound/euro represent the ±15% bands from the beginning of 1995

through the second quarter of 1999. It is clear that the pound/euro exchange rate did not stay in the bands in this entire time period. The dashed lines represent the ±15% bands from the third quarter of 1997, showing that the pound/euro exchange rate has remained within the bands for the previous two years. Since the euro has only been in existence since January 1, 1999, the statistics from the years prior to this date were compiled using a synthetic euro composed by geometrically averaging the bilateral exchange rates of the 11 countries in the EMU.[68] Looking at the most recent statistics, it seems as if the UK would be able to join the ERM and keep the pound fixed to the euro within the required bands with little difficulty.

The fourth convergence criteria involves long-term interest rates. For entry into the EMU, the Maastricht Treaty requires a country to fulfill "the durability of convergence achieved by the Member State and of its participation in the Exchange Rate Mechanism of the European Monetary System being reflected in the long-term interest rate levels.[69] The protocol of the treaty clarifies this criteria by saying that a country must have average nominal long-term interest rates which do not exceed by more than 2 percentage points the rates of, at most, & three best performing Member States.[70] As with the price stability criteria, applying countries must meet the criteria according to the decision of the European Commission. They may be held to the rates of the best performing member state if the Commission decides. Long-term interest rates would be evaluated in the year prior to application.

In order to assess Britain's ability to meet this fourth criteria, one must look at her long-term interest rates in the past few years. The most accessible statistic for long-term interest rates in the EMU countries is long-term government bond yields. Although this statistic takes into account capital gains and losses, it is the best available indicator of long-term rates. Looking at the average percentage per annum of long-term government bond yields from 1996 to 1998, Great Britain's yields were 8.1%, 7.09% and 5.45% respectively.[71] In 1996, the three best performing states (the states in the EMU with the lowest long-term government bond yields) were Luxembourg with 5.21 %, Austria with 5.3% and Germany with 5.63%.[72] Compared with these three states and compared with the average of the three, the UK would not have fulfilled the

[68] Economic Trends T64.
[69] "Treaty on European Union" 41.
[70] "Treaty on European Union" 186.
[71] International Financial Statistics (Washington: International Monetary Fund, Jul. 1999) 919.

interest-rate requirement in 1996. In 1997, the three best performing states in terms of long-term interest rates were again Austria with 4.79%, Germany with 5.08% and Luxembourg with 5.39%.[73] With the rate of 7.09%, the UK would have fulfilled the criteria compared to Luxembourg and the average rate of the three but not in comparison to Austria and Germany. The Council would have used its discretion in this situation to determine whether or not the UK met this criteria. In 1998, the three best performing member states were Portugal with a rate of 4.09%, Austria with a rate of 4.29% and Germany with a rate of 4.39%.[74] The British rate of 5.45% in this year is well within the 2 percentage points allowed by the Maastricht Treaty criteria. Britain has exhibited a decreasing trend of long-term interest rates in the last few years that would allow her to fill this last criteria if she decides to apply.

Table 3.4 Long-Term Rates in the European Union 1996-1998

Country	1996 Long-term Rate	1997 Long-term Rate	1998 Long-term Rate
United Kingdom	8.1%	7.09%	5.45%
Austria	5.3%	4.79%	4.29%
Belgium	6.45%	5.74%	4.72%
Finland	NA	NA	NA
France	6.39%	5.63%	4.69%
Germany	5.63%	5.08%	4.39%
Ireland	7.48%	6.49%	4.99%
Italy	8.93%	6.47%	4.55%
Luxembourg	5.21%	5.39%	5.29%
Netherlands	6.49%	5.81%	4.87%
Portugal	7.25%	5.48%	4.09%
Spain	8.18%	5.84%	4.55%
Average of 3 Best Performing States	5.38%	5.09%	4.26%

Source: International Financial Statistics Jul. 1999

The criteria delineated by the Maastricht Treaty to which applicant countries to the European Economic and Monetary Union must adhere are specific economic guidelines that help determine whether or not a country can sustain financial stability in the EMU. Some of these guidelines are restrictive, but they are necessary requirements that every country must meet. However, the discretionary powers of the European Commission allow for some flexibility. These powers enable the Commission to make exceptions for countries. When evaluating Britain in terms of all these criteria, one can see that she certainly does not meet all of them in the time

[72] International Financial Statistics Jul. 1999, 223, 457 and 609.
[73] International Financial Statistics Jul. 1999, 223, 457 and 609.
[74] International Financial Statistics Jul. 1999, 223, 457 and 761.

period examined. However, all the statistics show that the UK is moving toward convergence. This convergence will probably continue, indicating that the UK would have little trouble meeting the criteria in the future. If the UK decides to apply to become a member of the EMU, these economic variables will be assessed in different years with different results. Presumably, if the UK government supports British membership in the EMU, it will do everything possible to conform the economy to the criteria. Also, the EMU would certainly welcome the strong economy and powerful state of Britain into the union, and concessions would probably be made if necessary. These criteria might have been problematic for the UK in previous years, perhaps influencing the British decision not to become one of the first-wave countries, but recent statistics reveal that the UK could join the EMU now with little trouble. It is also possible that the UK hesitates to join the EMU because she does not want to fully conform her economy to the guidelines of the Treaty, believing it would threaten her economic sovereignty and strength. In the past few years, the UK has made a conscious decision not to join the EMU. The Maastricht criteria would not pose a huge problem to the UK, and therefore, one must look at other factors influencing the UK decision. Whether or not the British pound is incorporated into the euro will not be a question of feasibility as determined by the Maastricht Treaty. Instead, the UK will weigh certain economic costs and benefits.

4. Economic Costs & Benefits to the British Economy

Joining the European Economic and Monetary Union would exert many costs and benefits on the entirety of the British economy. Looking at these general advantages and disadvantages can help one understand whether or not it would be economically practical for the UK to incorporate the British pound into the euro. By joining the monetary union, the UK would reap such benefits as higher economic growth, macroeconomic stability, lower interest rates, greater price transparency within the EMU, more investment opportunities and the elimination of exchange rate risk and transaction costs when making transactions with other EMU countries. But with these advantages come many disadvantages such as transition costs, job losses, opportunity costs, the effects from the loss of independent monetary and exchange-rate policies, the possible effects from the UK economic cycle not corresponding with the cycles of the rest of

the EMU and the possible effects from asymmetric shocks as explained by Mundell. A later section of the paper weighs all the costs and benefits against each other in order to come to a conclusion about the practicality of the UK joining the EMU. There are many general advantages and disadvantages resulting from a UK decision to become part of the monetary union that would have far-reaching effects on all areas of the domestic economy.

Higher economic growth and a higher GDP are the largest economic benefits the UK would see upon joining the EMU. This growth would stem from the increase in trade within the single market, the decrease in cross-border transaction costs, lower interest rates, higher investment and greater price transparency and product competition.[75] First, exporters in the UK and importers to the UK would increase their business because exchange-rate risk would be eliminated. Trade would definitely increase with other EMU countries as businesses would no longer need to hedge currencies and be faced with uncertain profits. Companies would experience sure bets on trades that would increase confidence and increase trade. A single currency would lower exporting costs into the UK and importing costs out of the UK and would make profits consistent and predictable.[76] 32% of the British GDP results from exporting profits.[77] With a GDP of 871.32 billion pounds in 1994,[78] exports accounted for 261.4 billion pounds. The single currency would most likely increase the amount of exports from the UK, greatly increasing her GDP. With more products coming into the UK, British consumers would benefit from greater product variety, increased competition and greater efficiency, leading to lower costs of goods.[79] This benefit would translate into real savings for residents of the UK. If the UK adopted the euro, there would be increased price transparency on goods in all the EMU countries. It is harder for producers and retailers to charge different prices to consumers in different countries that share a single currency. This price transparency would lead to greater competition and a decrease in price discrimination between countries.[80] The laws of supply and demand would still determine amounts and prices in the UK, but a single currency would certainly contribute to lower prices due to increased competition. Britain has always been

[75] Christopher Johnson, *In with the Euro. Out with the Pound* (London: Penguin Books, 1996) 36.
[76] Johnson 44.
[77] Christian Chabot, *Understanding the Euro* (New York: McGraw-Hill, 1999) 39.
[78] *European Econmy* 68 (1999): 107.
[79] Johnson 45.
[80] Chabot 43.

concerned with the degree of competition in the country, believing that lower competition would hamper economic growth. The increased competition due to the single currency should be seen as a significant benefit to Britain.

Another real advantage to joining the European common currency is the savings from reduced transaction costs. Britain does much of her trade with the EMU countries and would save a lot of money by sharing a currency with them. British citizens and tourists constantly change currency when trading and traveling, losing money every time a transaction is made. By joining the single currency, Britain would eliminate bid-ask spreads and all other commissions on foreign exchange transactions between EMU countries at banks, *bureau de changes* and the like. Transaction costs would be eliminated on bank notes, traveler's checks and credit cards. The buyers and sellers of these currencies would save money by only having to deal with the euro instead of having to change British pounds back and forth. The in-house costs incurred by banks changing money would also decrease. The European Commission estimated that the savings from transaction costs would equal 0.33% of GDP.[81] With a 1999 GDP of 871.32 billion pounds,[82] Britain would have saved about 3 billion pounds in 1999 alone. British importers, exporters, travelers and tourists would reap most of this benefit.

If Britain joined the EMU, there would also be economic advantages in the investment sector. With one currency across most of Western Europe, investment products such as stocks and bonds would be easier to compare. There would be savings from the elimination of comparison costs. Markets would become wider and more accessible. With Britain incorporated into this expanded market, more investors would see and understand British investment products and prices, increasing the demand for these products and increasing investment activity in general. The market for money would expand.[83] Because of increased competition, rates on investment opportunities would decrease, benefiting investors. Also, the lower inflation resulting from the actions of the European Central Bank would spur investment further.[84] The ECB has stated that low inflation is one of its main priorities, and it will use its monetary policy to achieve this goal. The ECB was modeled after the German Bundesbank with much German influence.

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[81] Johnson 39.
[82] *European Economy* 107.
[83] Chabot 44.
[84] Johnson 55.

Ever since Germany's period of hyperinflation following the World War II, it has concentrated on keeping inflation as low as possible. Because of the independence of the ECB, it will seek to keep inflation low without incurring political consequences. The ECB is under no political pressure to finance government expenditure as many central banks of sovereign nations are.[85] By joining the EMU, Britain would gain macroeconomic stability through the low-inflation policies of the ECB, eventually leading to economic growth. Lower inflation coupled with the stability would increase investment because investors would be able to plan more easily. Investors would be more confident because the macroeconomic stability would prevent swings in economic growth, making investments easier to plan. In the longer term when inflation has been consistently kept low, inflation expectations would decrease and lower real interest rates by a small amount.[86]

Increased investment caused by lower inflation and lower interest rates would benefit all members of the EMU because business would increase and more money would flow through the economy. Currently, Britain has higher nominal interest rates compared to the EMU countries. If Britain joined the EMU and if the ECB succeeded in lowering inflation, nominal rates would decrease in Britain as lenders would require lower inflation premiums. With rates closer to the level of the rest of the EMU countries, the British economy would become more similar to those in the EMU. If the UK joined the common currency, there would be more competition between banks across borders, producing lower bank lending rates. British lending rates would synchronize with those of the rest of the EMU. Currently, most mortgages in the UK are flexible-rate mortgages, unlike most of the EMU. Only 15% of British mortgages are fixed rate while Germany has as much as 75% of its mortgages fixed rate and France as much as 90%. Currently, the UK is more sensitive to short-term interest-rate fluctuations.[87] This factor has often been cited by those not in favor of the UK joining the common currency because they believe this asymmetry would pose to be a problem for the British economy if the UK joins the EMU. But if the UK joins, real and nominal interest rates would fall, causing home owners to switch to the

[85] Chabot 45.
[86] "UK Membership of the Single Currency An Assessment of the Five Economic Tests," Oct. 1997, HM Treasury, 13 Jun. 1999 <http://www.hm-treasury.gov.uk/pub/html/docs/emumenVpdfmain.html>25-28.
[87] David Miles, "The options for the UK," *The Euro*, ed. Paul Temperton (New York: John Wiley & Sons, 1998) 101-102.

lower, fixed-rate mortgages.[88] The UK economy would become more similar to those in the EMU.

Besides spurring investment, lower inflation in Britain as a result of joining the EMU would also give the nation the benefit of price stability. With low inflation, the UK growth rate would certainly increase because the value of money becomes more stable and certain. Money would retain its purchasing power better, increasing the value of workers' wages and giving savers a huge advantage.[89] With high inflation, the value of money is eaten away at a rapid pace, providing little incentive to save. With low inflation, more people will save their money, providing more money for investors to use and further increasing the flow of money. The entire British economy would benefit from stable prices produced by low inflation.

All these issues reveal how advantageous it would be for the UK to join the EMU. However, if disadvantages did not exist, there would not be a debate as to whether or not Britain should incorporate the pound into the euro. There are many costs that the British economy would incur if the UK joined the monetary union. Many of these costs stem from the structural differences between the UK economy and the economies of the rest of the EMU while other costs are simply a result of joining a monetary union such as the EMU. In many ways, the British economic cycle is very different from those of the EMU, forcing British economists to question the practicality of Britain joining the monetary union. The UK is an exporter of oil and other primary sources of energy while most of the rest of the EMU imports most of its energy. On average, the amount of household debt in the UK is higher that the EU average. British companies tend to borrow less than their continental counterparts, issuing fewer government bonds and relying more on short-term bank loans. The UK government spends less than most EMU governments, and taxes are lower in the UK.[90] These factors show obvious differences in the industries and spending patterns of the UK and the EMU. However, it is practically impossible to tell if these differences would disappear if Britain joins the EMU. Perhaps her economic cycle would fall more into the pattern of the rest of the EMU. The potential costs associated with the differences in the UK economy cannot fully be assessed until one can ascertain how the economy would behave as part of the monetary union.

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[88] Johnson 53.
[89] Johnson 60.

There are many costs that Britain could incur as a result of such structural differences. Robert Mundell explores this topic in his 1961 paper entitled "A Theory of Optimum Currency Areas." He explains what can happen when a currency area has structural differences between different parts of it in terms of industries, natural resources etc. Certain parts can have different demands and needs than other parts, and when the monetary authorities act to curb inflation in one area, they can produce unemployment in another.[91] Mundell recognizes the danger of having one monetary authority and one set of monetary rules across a diverse economic area. Remedies instituted to cure problems in one part may exacerbate problems in another part. Mundell goes on to say that most nations are not optimum currency areas nor can flexible exchange rates between countries with their own monetary authorities always correct shocks that hit a particular region.[92] In a currency area, demand or supply shocks that hit a specific region could pose large problems for the currency area if there is not a large degree of factor and labor mobility. According to Mundell, in order to assess the potential costs of Britain joining the EMU, one must determine how different the UK economy is from the rest of the EMU and how high the degree of factor and labor mobility exists between the two areas to see if a particular crises would affect Britain differently from the EMU.

In order to ascertain how different the UK economy is, one needs to look at a few variables. Firstly, one must compare the energy output of the UK compared to the rest of the EU. Primary production of energy includes all the extraction of energy from a natural source: coal, lignite, crude oil, natural gas, geothermics and nuclear energy produced from fission.

Table 4.1 Primary Production of Energy (1000 Tons):

EU 1995-1997

	1995	**1996**	**1997 (Jan-Oct)**
Belgium	11021	11523	10243
Denmark	13952	16073	14995
Germany	137084	137256	112321
Spain	26896	28071	22425
France	114102	117527	95236
Ireland	3268	3233	2436
Italy	27215	27617	23657
Britain	7861	8373	6931

Source: Eudorstat 1999.

[90] Miles 94.
[91] Robert Mundell, "A Theory of Optimum Currency Areas," *American Economic Review* 51.4 (1961): 658-9.

Only eight of the fifteen EU countries produce a significant amount of primary energy, Britain among them. To get a sense of how these countries compare to one another, it is useful to compare their primary production of energy to their GDPs.

Table 4.2 EU Primary Energy/GDP (1000 Ton/Billion ECU) 1995-1997

	1995	1996	1997 (Jan-Oct)
Belgium	66.88	69.04	59.58
Denmark	117.50	131.20	118.46
Germany	97.54	96.43	77.21
Spain	69.94	66.17	51.06
France	114.77	116.41	92.19
Ireland	67.73	61.89	42.15
Italy	29.89	30.13	25.42
Britain	9.35	9.71	7.77

Sources: Eudorstat 1999 and Eurostatistics no. 1, 1999.

This chart shows that of all The EU countries that produce energy, the United Kingdom has, by far, the lowest production/GDP ratio. Unfortunately, statistics for energy production in 1997 were only available through October, but this figure was compared to GDP of all of 1997 for all countries. Britain depends less on energy production than the other countries. But considering that seven of the fifteen EU countries do not produce any energy, Britain's ratios do not seem too off base. Britain's economy depends less on energy production than the EU countries who produce energy, but Britain's energy production is not too different compared to the EU as a whole. Next, one must see how Britain's agricultural output compares to the rest of the common currency area.

[92] Mundell 660.

Table 4.3 EU Final Agricultural Output (Millions of ECU) 1994-1996

	1994	1995	1996
Belgium	6873	6625	6817
Denmark	6332	6816	6900
Germany	31392	32502	33348
Greece	8752	8493	8357
Spain	23463	23353	27523
France	44093	45644	46897
Ireland	4281	4391	4404
Italy	32385	31353	35694
Luxembourg	185	197	185
The Netherlands	16758	16940	16966
Austria	4794	3734	3637
Portugal	4174	4526	4837
Finland	3573	2337	2274
Sweden	3329	3213	3484
Britain	18317	18480	18185

Source: Eudorstat 1999.

Compared with the rest of the EU, Britain has a relatively high agricultural output. To really see how these output numbers compare to each other, one must look at agricultural output as a share of each county's GDP.

Table 4.4 EU Agricultural Output/GDP 1994-1996

	1994	1995	1996
Belgium	0.043	0.040	0.041
Denmark	0.055	0.057	0.056
Germany	0.023	0.023	0.023
Greece	0.125	.0119	0.114
Spain	0.058	0.056	0.065
France	0.045	0.046	0.047
Ireland	0.099	0.091	0.084
Italy	0.037	0.034	0.039
Luxembourg	0.018	0.019	0.017
The Netherlands	0.069	0.068	0.066
Austria	0.035	0.027	0.026
Portugal	0.073	0.077	0.079
Finland	0.036	0.023	0.021
Sweden	0.019	0.017	0.019
Britain	0.022	0.022	0.021
EU Avg.	0.050	0.048	0.050
EMU Avg.	0.051	0.049	0.050

Source: Eudorstat 1999 and Eurostatistics no. 1, 1999.

Compared to the rest of the EU and compared to the EMU, Britain relies relatively little on agricultural output. Not much of her income comes from the agricultural sector. If Britain joined the EMU, her economy could react differently to shocks, positive or negative, in the agricultural sector than other European countries.

Perhaps if the UK joins the monetary union, the asymmetric shocks of which Mundell speaks would not be as pronounced and would not have too many costs. Economic cycles would be less pronounced because of the controlled, low inflation. The British government would no longer need to worry about keeping inflation under control. There would be less variation in inflation and growth between the UK and the rest of the EMU. Economic cycles would be defined by industry instead of by country because of increased trade.[93] Although the lack of labor mobility may be problematic, labor mobility is not necessary for a common currency area to run smoothly. Many individual nations have little labor mobility, and their currencies are strong. Factor mobility would improve due to the increased trade stemming from economic union. An asymmetric shock usually occurs in a particular region of a country, making exchange-rate adjustment a worthless policy tool. Government spending is usually used to counteract such shocks, a tool unavailable to the European government because of its small budget. It cannot transfer money from one region of the EMU to another. Although individual countries are able to use fiscal policy, their budgets are constrained by the Growth and Stability Pact which states that all member of the EMU (all members of the EMU must sign the pact upon joining) must keep their budgets within a certain percentage of their GDPs.[94] Though asymmetric shocks might have adverse effects on Britain, becoming part of the monetary union will, most likely, lessen the likelihood and severity of such shocks.

By joining the EMU, the UK must not only give up exchange-rate policy, she would need to give all monetary authority to the ECB. The Bank of England, a long-time source of national pride and sovereignty, would become a puppet of the European Central Bank. A single currency requires a single monetary authority and a single central bank or system of central banks. It will be interesting to see how Britain reacts to giving up her central bank. This issue is more about sovereignty and politics than it is about economics, but giving up the tool of monetary policy could be significant depending on certain situations. Again, one must wait to see how the British economy reacts to the EMU in order to fully evaluate the effects of this consequence of joining the EMU.

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[93] Johnson 90.
[94] "A Primer in Economics," *The Economist* 11 Apr. 1998: S5.

Though low inflation is certainly a benefit of joining the common currency area, Britain may face costs associated with this factor as well. With very low inflation, it is harder to carry out real pay cuts. With higher inflation, the inflation can carry out pay cuts without the monetary amounts of pay checks declining. Workers rarely condone pay cuts without a fight, and the economy can suffer at times if these pay cuts are not carried out. Low inflation also makes price cuts on goods more difficult to carry out. These price cuts benefit consumers but hurt producers, but when they are not carried out, prices will be too high and resources may not be allocated correctly around the economy, eventually leading to recessions. The British government would also lose the ability to finance their debt by issuing notes and coins with no interest and relieving some of its debt burden.[95] Overall, these negative effects due to low inflation could have negative consequences on the UK economy as a whole.

Just as the UK economy would benefit from the elimination of transaction costs by joining the EMU, she would also incur transition costs in order to make her economy ready to make the change into a new currency. Unlike all the other previously mentioned costs, these transition costs are one-time costs that Britain would only have to incur upon her joining the EMU. Invoices, price lists, price tags, office forms, payrolls, bank accounts, databases, keyboards, software programs, vending machines, automated teller machines, parking meters, phone booths, postage meters and the like would all have to be changed. Many of these expenses would be incurred by individual businesses. Christopher Johnson estimates that transition costs will be approximately 0.36% of GDP.[96] With a 1999 GDP of 871.32 billion pounds,[97] the UK would incur a cost of 3.14 billion pounds. A full analysis of the costs and benefits faced by British businesses if the UK joins the EMU is examined in the next section. The UK government would incur the costs of printing euro notes and coins. People must be trained to deal with the new currency as well. There would be some job losses associated with the changeover to EMU including foreign exchange traders who deal with pound/euro exchanges and workers at currency changing institutions.[98] Although these transition costs would affect much of the population, they are one-time costs. When looking at the costs of joining the EMU, Britain must also consider the

[95] Johnson 66-67.
[96] Johnson 228.
[97] *European Economy* 107.
[98] Chabot 50.

costs of not joining. Currently, the UK benefits from much foreign direct investment in her country. This investment might decrease if she decides not to join as investors may prefer to invest in the larger EMU market.[99] The British might slowly be denied access to the single market. EMU countries might prefer to trade with each other because of the lower costs, hurting competition and growth in the UK.

Would staying out of EMU deny Britain full access to the single market? That would be a big blow to British exporters and would threaten Britain's positions as one of the EU's leading recipients of foreign direct investment.... Foreign investment has been a boon to the British economy, helping to revive the car and electronics industries, and boosting manufacturing productivity. Brian Morgan, chief economist at the Welsh Development Agency, argues that Britain's relatively low employment costs, flexible facility with the English language would maintain its appeal to foreigners if it stayed outside EMU - unless this reduced access to the European single market, or at least make loss of access seem a serious risk.[100]

Denied access to the single market might cause prices to increase and product variety to decrease all over Britain. It is impossible to speculate on whether or not these situations would come into effect, but they must be taken into account when evaluating the economic costs and benefits of Britain's joining the EMU. When deciding whether or not to apply to the European Economic and Monetary Union, the British government will, more that anything else, evaluate the potential costs and benefits to the UK economy as a whole. Most of the benefits will be realized upon Great Britain's joining the EMU while many of the costs will depend upon whether or not the UK economy conforms to those in the EMU. One must consider who benefits and who loses. Stating all these advantages and disadvantages clearly allows one to understand the effects on the different parts of the economy and the different parts of the population. Many of these effects are difficult to measure and will only be apparent and consequential if Britain actually decides to join the EMU.

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[99] Johnson 58.
[100] "A single European currency. Britain's many options," *The Economist* 6 Apr. 1996: 58.

5. Costs & Benefits to British Businesses and Financial Markets

Two sectors of the domestic economy that would be greatly affected if Great Britain joined the EMU are businesses and financial markets. Influences on individual businesses would depend upon their sizes and upon their degrees of integration with the international economy. Costs and benefits would differ widely between particular companies. Joining the euro would also profoundly impact British financial markets by consolidating some aspects of foreign exchange while widening the market for financial products. With the launch of the European Economic and Monetary Union in January of 1999, many British businesses and financial sectors prepared to do business with the new currency. They have already begun to reap some of the benefits such as reduced transactions costs. However, if the UK does join the union, these businesses and financial markets will see many additional costs and benefits. One needs to look at this portion of the economy in order to fully evaluate how the entire British economy would react to incorporating the pound into the newly formed euro.

There is a wide variety of sizes and types of businesses in the British economy, and each company would be affected by joining the EMU depending upon a variety of factors. Some companies would reap huge benefits from joining the common currency while others would incur much hardship. Many companies would flourish while others would be forced into bankruptcy. Certain types of companies would greatly benefit from the actual changeover of the pound to the euro. Businesses dealing with software, printing, financial and marketing advising and the like would see large increases in volume of production and work.[101] Any company that would be able to aid other companies in the changeover process would definitely benefit from Britain's joining the EMU. On the other side, all businesses would have to pay these one-time conversion costs. All companies would have to incur costs including converting computer systems, publishing euro financial accounts, reviewing legal contracts, creating and communicating euro price lists, reviewing cash management practices, training staff to handle euro, transactions, reviewing sources of funding and banking relationships, and communicating

[101] Christian N. Chabot, *Understanding the Euro* (New York: McGraw-Hill, 1999) 128.

and paying euro salaries.[102] Obviously, different types of companies would have varying amounts and kinds of costs depending on their business practices and on their sources of revenue.

There are many benefits associated with joining the euro that companies would be able to take advantage of, depending upon their business. These advantages include: lower transaction costs (elimination of bid/offer spreads on foreign exchange transactions with other EMU countries, elimination of hedging when dealing with other EMU countries), the elimination of foreign-exchange risk when making transactions with other EMU countries, faster money transmission between Britain and the rest of the EMU (TARGET payment system – Trans-European Automated Real Time Gross Settlement Transfer - same day settlement of high value euro payments), more competitive banking services, improved supply of finance and downsized treasury departments.[103] British businesses dealing with international trade and transactions with the EMU would attain many benefits if the UK decides to join the union. Small firms who make international transactions can save large amounts on hedging costs which can sometimes amount to as much as two percent of a small firm's sales and purchases.[104] The corporate sector would reap most of these benefits while purely domestic firms which do not export or import with the EMU and do not perform any foreign exchange transactions will reap few of these benefits. However, all types of firms whether or not they deal with international business would see benefits. Every type of market in Britain would be affected by joining the EMU in terms of greater competition and consolidation. So in this sense, small, domestic firms would get benefits because they are part of the entire national economy even though they would not reap many of the benefits stemming from reduced transaction costs because they are not dealing with international transactions. All types of companies would benefit from lower borrowing costs and banking service costs as financing and financial services would become less expensive with the greater competition. Companies from all sectors of the economy would be able to raise money with greater ease because of the broader markets. Different companies would see different benefits from Britain joining the EMU.

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[102] John Atkin, *EMU Challenge and Change - the implications for business* (London: Thorogood Limited, 1998) 115-16.
[103] Atkin 104-14.
[104] Chabot 42.

Some small, domestic companies would also incur many disadvantages if Britain decides to join the EMU. Many of these firms would not be able to afford the conversion costs associated with the changeover to the euro while others might be merged with other companies or bought out by larger firms. Companies would increase in size, and economies of scale would be fully exploited. Consolidation would occur across all sectors of the economy, and the average size of companies would increase. Some firms would gain market-share at the expense of others.[105] This conversion would hurt small companies, but at the same time, the economy would be expanding and competition would be increasing. Some people may lose their jobs, but the changes and growth resulting from the conversion to the common currency would benefit the whole economy in the long run.

The retail sector would be especially vulnerable to costs if Britain joined the EMU. Retailers would bear the burden of having to changeover all their accounting practices and changeover all aspects of their businesses dealing with consumers and pricing. Restaurants would have to print new menus and purchase new cash registers. Clothing stores would be forced to change price tags and all price advertising. Large chains with many locations throughout the EMU would see large advantages to Britain changing over to the euro.[106] They would be able to compare prices more easily and transfer items from one country to another without being burdened by having to change currencies and prices. These large retailers would see economies of scale benefits as they could make one product for use across all of Europe with one price tag. In all probability, these companies would be able to grow and expand when faced with lower costs and larger markets. The retail sector shows how large, international businesses could reap many benefits from Britain's joining the euro.

Another sector that would be hit particularly hard with costs would be banking. Banks would have to incur much of the monetary conversion costs associated with the common currency. They would be forced to change all their systems and all their processes for banking services. The following chart demonstrates the general costs of all the UK banks as estimated in 1996.

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[105] 'David Miles, "Fundamental Implications of EMU," -TheEuro, ed. Paul Temperton (New York: John Wiley & Sons, 1998) 53.

Table 5.1 UK Banks' Costs of Transition to Single Currency

Function	Cost (millions of pounds)	%	Product	Cost (millions of pounds)	%
Systems	437	48.0	Notes & Coins	74	8.1
Marketing & PR	153	16.8	ATMs	38	4.2
Legal	21	2.3	Cards	107	11.7
Audit & Security	67	7.4	Payment Systems	120	13.2
Acct. & Management	35	3.8	Forex & Treasury	92	10.1
Staff Training	44	4.8	Loans	62	6.8
Stationery	132	14.5	Deposits	64	7.0
External Reporting	4	0.4	Capital Markets	63	6.9
Other	18	2.0	Correspondent Banking	8	0.9
			Branch Accounting	211	23.2
			Bancassurance	47	5.2
			International	23	2.5
			Other	2	0.2
Total	**911**	**100.0**	**Total**	**911**	**100.0**

Source: Christopher Johnson, *In with the Euro. Out with the Pound.*

Though these numbers were compiled in 1996, it is apparent that banks would have to expend large amounts of money to complete the conversion process if Britain decides to join the EMU sometime in the early Twenty First Century. This chart demonstrates, in two different ways, what types of costs banks would incur if the UK joined the EMU. On the left side of the chart, the costs associated with all the different types of bank functions are shown, totaling 911 million pounds. The right side of the chart shows the costs that would stem from each type of bank product. Each product is considered part of one of the bank functions. Each side of the chart shows a separate method of breaking down the 911 million pounds of UK bank costs. Banks would have to change nearly every aspect of the way they do business. 911 million pounds would be a low estimate of the total amount banks would need to spend. The banking sector is one of the main areas of the British economy that would be negatively affected by Britain's joining the common currency area.

All kinds of financial institutions, including banks, would be profoundly affected by the changeover. These businesses would incur changeover costs as well as reap benefits from the changes occurring to British financial markets. If Britain decides to share a currency with most of Western Europe, equity markets across the whole area would expand, consolidate and become more sophisticated and more competitive. Since exchange-rate risk would be eliminated and there would be common prices for equities across Europe, more Europeans would be likely to

[106] Atkin 103.

buy British equities.[107] With more equities available, investors would be more likely to diversify their portfolios, reducing the amount of investment risk in general. With most of Western Europe having one currency, investors would be able to easily compare investment opportunities over the entire area. However, if Britain opts out of the single currency, many investors may be discouraged from setting up businesses and expanding their current businesses in the UK because they would not be able to transact business in euros. British businesses would also be able to finance ventures with greater ease by issuing stocks and bonds in a larger market.

The City of London does an incredible amount of foreign money transactions and accounts for twenty-two percent of British GDP.[108] The UK financial industry accounts for half of the total finance industry of the entire EU. This share has increased since the euro was launched in January 1999.[109] The City is currently the leading financial center of Europe, and if the pound joins the euro, the City of London would be able to take a large role in expanding the money market of Britain and the rest of Europe. Any business lost from the elimination of foreign exchange between the pound and the euro would be made up in the enlarged market.[110] With Britain in the EMU, the City would handle a larger portion of European money flows because of the sophistication of its financial processes and systems. If Britain remains outside the monetary union, the City would lose this profitable opportunity and also lose some of the market share of European financial products it currently has. Many City bankers fear that much British financial business would move to continental banking centers such as Frankfurt and Paris, leaving London behind and causing many job losses in the City.[111] By staying out of the EMU, Britain would prevent the City from having access to European payments systems and liquidity. London would have very restricted access to the TARGET payments system and would find making payments between Britain and the EMU countries difficult. Bond trading would also become increasingly difficult because London would have trouble buying large amounts of government bonds from countries in the EMU.[112] Its position as the leading financial center of Europe would

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[107] Chabot 114-15.
[108] Johnson 169.
[109] 'The Lord Levene of Portsoken KBE, address, The Bankers & Merchants Dinner, Mansion House, London, 10 June 1999.
[110] Johnson 168.
[111] "The Train Now Stranded in the City of London," *The Economist* 3 Aug. 1996, 61.
[112] "The Train Now Stranded in the City of London" 61.

deteriorate.[113] Even if Britain permanently opts out of joining the EMU, the City would still continue to be an immensely profitable and successful part of the British economy, but it is hard to estimate how much the City would lose by Britain's not joining.[114]

Although the City of London might lose business if Britain does not join the EMU, the financial structures already in place in London will encourage businesses to remain in London. The British markets are the most competitive in Europe because of "the critical mass of financial markets; firms and professional support services in London already; the innovative, skilled and large labor force; the efficient technological infrastructure; the level playing field for foreign firms; low personal and corporate taxation; flexible labour laws; English as the language of international finance; and an attractive environment in which to live."[115] London is the most competitive financial center in the world.

According to a recent report on financial services' productivity, if one unit of output costs £100 in London, the comparable figures are £117 for New York, £143 for Tokyo, £1 55 for Paris, and £163 for Frankfurt. That is the clearest and most visible evidence we have of [Britain's] competitive position.[116]

These factors will ensure that the London financial markets will keep much of their business even if the UK opts out of the common currency.

Looking at the business and financial markets of Britain, one can see that joining the European Economic and Monetary Union would affect specific sectors in different ways. Each would have to deal with particular costs and benefits depending on individual circumstances. It is no secret that some businesses would benefit more than others. The expansion of the financial markets due to the inclusion of the pound in the euro would provide benefits to the entire British economy. However if Britain does not join the EMU, the financial sector of the economy would certainly be hurt. These factors show that when evaluating the overall economic costs and benefits to Britain's becoming part of the monetary union, one must also consider the costs associated with *NOT* joining. This presentation of the costs and benefits to the British businesses

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[113] Ruth Pitchford and Adam Cox, eds., *EMU Explained Markets and Monetary Union* (London: Reuters Limited, 1997) 168.
[114] Johnson 169.
[115] "Practical Issues Arising from the Euro," Jun. 1999, Bank of England, 25 Mar. 1999<http://www.bankofengland.co.uk/euro/piq.htm> 14-15.
[116] The Lord Levene of Portsoken KBE.

and financial markets if the UK decides to join the EMU is only one part of the analysis of the effects on the entire economy. All these pieces must be evaluated together to see which parts of the British economy and population would be affected, positively or negatively, by a decision to join the EMU.

6. British Government Opinion on Britain's Joining the EMU

When evaluating whether or not the UK would benefit from joining the EMU, it is important to consider the opinion of the British government. In order for the UK to join the monetary union, the British government must decide in favor of it. One must look at the economic criteria the government uses to determine whether or not the UK should join. When looking at the general cost/benefit analysis for the British economy, the position of the government makes a difference to the outcome of the analysis. The government looks at many of the same economic criteria evaluated in the previous sections of this paper with particular emphasis on the importance of economic convergence. The UK government must also take public opinion into account when making its final decision. Economics cannot be their sole concern. Though this paper is mainly concerned with the economic considerations of the possibility of Britain joining the European Economic and Monetary Union in the near future, it is important to understand how politics and government play a role in this decision.

The economic decision Britain must make regarding the EMU will ultimately be made by politicians and elected officials. During the 1980's when Margaret Thatcher, a Conservative, was Prime Minister of Great Britain, the government was wary to become part of any kind of European monetary union. John Major, also a Conservative, replaced Thatcher and was more willing to discuss the idea of joining a European monetary union, but he still expressed doubts. Major ultimately signed the Maastricht Treaty, but he also negotiated Britain's "opt-out" policy, giving Britain the chance to decide whether or not she wanted to become part of the EMU. Many of the other countries who signed the Treaty were forced to continue on the path to the EMU. In 1997, Tony Blair of the Labour Party was elected Prime Minister. The Labour government has been much more willing to entertain ideas of joining the EMU. In all likelihood, the British

government will decide to join EMU, after the next general election which will be held no later than May 2002.

Tony Blair has stated his desire to remain an active member of the EU and his desire to bring the UK into the EMU when economic conditions are right, meaning when the UK economy has sufficiently converged with those of the EMU countries. He believes it is in Britain's economic and political interest to join the monetary union and wants to have a voice in European decision-making. According to Blair, the EMU will succeed in its goal of creating jobs, a benefit of which the UK could take advantage if she joins. If she does not join, Blair fears that Britain would lose influence over investment and economic decisions in Europe.[117] The government will probably not make a final decision on whether or not to incorporate the pound into the euro until after the next election for Prime Minister. If Blair is reelected and the economy is in the right position, it is very likely that the British government will decide to join the EMU.

Now one must try to understand how the government will decide if the British economy is in the right stage to benefit from becoming part of the monetary union. In 1997, Her Majesty's Treasury published a paper delineating five economic tests the government will use to decide if Britain should join. Tony Blair hopes Britain will conform to these criteria sooner rather than later.[118] Gordon Brown, Chancellor of the Exchequer, set out the five economic tests as follows: firstly, "Are business cycles and economic structures compatible so that we and others could live comfortably with euro interest rates on a permanent basis?"; second, "If problems emerge is there sufficient flexibility to deal with them?"; third, "Would joining EMU create better conditions for firms making long-term decisions to invest in Britain?"; fourth, "What impact would entry into EMU have on the competitive position of the UK's financial services industry, particularly the City's wholesale markets?"; fifth, "In summary, will joining EMU promote higher growth, stability and a lasting increase in jobs?"[119] These questions are familiar as this paper has discussed many of these issues in previous sections, but now one must understand which areas the government finds to be most important.

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[117] 'Tom Buerkle, "Blair, Defending EU Ties, Is Firm on Joining Euro," *International Herald Tribune* 28 Jul. 1999, 1 & 4.
[118] "The Single Currency. Nearer to the Altar," *The Economist*, 27 Feb. 1999 U.S. Ed., 54.
[119] "UK Membership of the Single Currency An Assessment of the Five Economic Tests," Oct. 1997 <http://www.hm-treasury.gov.uk/pub/html/docs/emumem/pdfmain.html> 5.

Looking at the first economic test relating to interest rates, the Treasury paper cites the structural differences between the economy of the UK and the economies of the rest of the EMU. Differences in trade patterns, oil, company finance and the housing market could cause the British economy to have different responses to external shocks and interest-rate changes.[120] Though Britain does much of her trade with the EU, her percentage of intra-EU trade is below the EU average. However, with the broadening of the Single Market with the introduction of the euro in 1999, trade patterns will most likely become more synchronized.[121] GB would most likely increase the amounts of trade she does with the rest of the EMU if she joined the monetary union. Unlike most EMU countries, the UK exports oil, making her economy more sensitive to oil price changes. Companies in the UK tend to finance themselves differently than continental businesses. Large UK businesses use more equity finance than large continental businesses, and small UK businesses use more variable-rate loans than their continental counterparts. Also, a higher percentage of people in the UK own their own homes compared to the rest of Europe.[122] Overall, the government believes these differences will be obstacles over which Britain can overcome. It thinks the UK economy will converge enough with the expansion of the single market so that structural and interest-rate differentials will decrease.

The second economic criteria involves economic flexibility. This issue is crucial for the UK as it examines how the diverse British economy would deal with the changeover to the common currency. If the economy does not have the right mechanisms in place, the entire economy could suffer as a result of joining the European Economic and Monetary Union. The Treasury recognizes the downfalls Britain would face with the loss of monetary policy and recognizes the possibility of external shocks. British businesses must have the flexibility to deal with new methods of pricing and new demands for goods.[123] The amount of flexibility is difficult to gauge, and the real test will occur only if Britain joins the union. However, the Treasury believes there is a certain amount of preparation businesses will need to do before the decision to join is made. The government has already taken a variety of steps to help businesses and the rest of the economy prepare for the possible changeover to the common currency. The Treasury also

[120] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 5-6.
[121] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 14.
[122] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 14-15.
[123] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 6.

cites the need for labor-market flexibility in the economy, an area in which Britain is weak. There is not enough wage bargaining to allow labor costs to correspond to new production patterns.[124] Though there is employment flexibility in the UK (people changing jobs as necessary), the real wage rigidity could cause trouble if the UK joins the EMU.

The third criteria concerns possible changes in UK investment with the joining of the EMU. If the EMU brings macroeconomic stability and low inflation to Britain as expected, investment in the UK will most likely increase due to the increase in investor confidence. Investors will find it easier to plan and manage investments. In order for this increased investment to take place, economic convergence must become a reality before the UK joins, according to the Treasury. Also, joining the EMU would allow British firms to take advantage of benefits such as more competition, reduced transaction costs, reduced exchange-rate uncertainty and greater price transparency.[125] Again, the Treasury recognizes these benefits but understands that economic convergence must occur in order for these benefits to be realized.

In terms of the fourth criteria dealing with financial services, the Treasury says the City and the rest of the UK financial industry will benefit from the consolidated EMU market whether or not the UK joins. However, the City will be able to take advantage of greater opportunities if the UK is part of the EMU.[126] Business and capital transactions would gravitate to the liquid markets of London.[127] For the financial sector, the Treasury sees few drawbacks to joining the EMU because the City will be sufficiently prepared for the changeover to reap all the benefits.

The fifth criteria discusses what kind of overall economic benefits the UK would get upon joining the union. The Treasury says that if the economy has converged to those of Europe, Britain would see economic growth and greater employment opportunities. In 1997, the Treasury concluded that the British economy had not converged sufficiently to join the EMU with the first-wave countries. This opinion weighed heavily on the government decision not to join with the rest of the EMU countries in early 1999. The economy did not, at that time, meet the first economic criteria. The other four criteria are basically subjective and will allow the government to

[124] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 6-7.
[125] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 7.
[126] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 8.
[127] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 34.

claim that the economy has met them whenever it wants.[128] Since 1997, the UK has been working hard toward convergence. The government has set up many committees and processes to prepare businesses and the rest of the economy for a possible entry in the EMU. The Treasury states that convergence is possible with these government structures working and with the cooperation of the economy. Therefore, it is feasible to believe that in the first years of the Twenty First Century, the British economy will have converged sufficiently for the UK to be prosperous in the EMU.

The government has taken many steps to help the British economy to converge with the economies of Europe. In 1997, the following procedures were taken.

- Establishing a standing committee on preparations for EMU;
- extending Lord Simon's Treasury responsibilities to include European Business Preparations in the government;
- monitoring over inflation target and inflation measure in the light of the practices of the ECB;
- ensuring that over fiscal rules, and our deficit reduction plan, continue to be consistent with the terms of the Stability Pact, thus underlining our commitment to avoiding an excessive deficit under Article 104c of the Treaty, and supporting greater economic coordination in Ecofin;
- promoting greater flexibility in the UK economy and in Europe through our "Getting Europe to Work" initiative;
- introducing new competition legislation, which draws on the best of European and wider international policy and practice;
- commencing work on the detailed transition arrangements for the possible introduction of the euro in Britain, including notes and coins;
- stepping up the work on what business should do now to prepare for the introduction of the euro in 1999;
- working with the Business Advisory Group on what government must do to prepare the economy for EMU whether we are in or not;
- continuing to negotiate to secure the best interests of our financial sector and for opening up the Single Market in financial services.[129]

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[128] John Atkin, "Britain and EMU, "*Economic Perspective* 46, Nov. 1997, 1.
[129] "UK Membership of the Single Currency An Assessment of the Five Economic Tests" 40.

The UK government has also published many publicly accessible pamphlets and manuals to aid businesses and individuals with the possible changeover. It published a national changeover plan after the Treasury published the economic criteria and then published an updated version in March of 2000. The plan shows people the government's commitment to joining the EMU, an explanation of what the changeover will mean in the UK and a possible timetable for the changeover. It discusses how the UK would make the changeover and, specifically, how businesses would be affected. The document is easy to read and understand and is meant for the British public to read to get more information about how the changeover process would work if the UK decides to join. The national changeover plan also shows the extensive preparations the government has made and is currently making to allow for a smooth transition, and it shows readers how they can get access to all the materials and programs the government has set up. The plan will help all kinds of companies deal with and prepare for a possible UK entry into the EMU.[130]

The Bank of England has also aided the government in dispensing information to the public about the possible changeover. Since 1996, the Bank of England has published a pamphlet entitled "Practical issues arising from the euro" to help people prepare. This publication has been updated about twice a year since it was first published. The most recent pamphlet, printed in December 1999 concentrates on the details of the changeover by the first-wave EMU countries, how the London financial markets have handled the changeover, how euro payment systems function and how the UK should plan for possible entry in the future.[131] The Bank of England also published "The Euro: What Does it Mean for Business?" in April 1997 to give businesses a sense of what kind of preparations are needed for the launch of the euro in January 1999 and to prepare for possible UK entry at a later date.[132] These publications are only a small sample of the volumes of material and extensive preparations the UK government is making for a possible UK entry into the EMU. These preparations should serve to converge the UK economy as the five

[130] "Outline National Changeover Plan," 1999, HM Treasury, 8 Jul. 1999 <http://www.euro.gov.uk/oncop.pdf>.
[131] "Practical Issues Arising From the Euro," Jun. 1999, Bank of England, 25 Mar. 1999 <http://www.bankofengland.co.uk/euro/piq.htm>.
[132] "The Euro: What Does it Mean for Business?" Apr. 1997, Bank of England, 15 Jun. 1999 <http://www.bankofengland.co.uk/smeu4.pdf>.

economic tests of the Treasury demand. With all these preparations, it seems as if the government is likely to decide in favor of joining the monetary union sometime in the near future.

The government must also take public opinion into account when making its decision. If the UK government decides to formally adopt the euro, a public referendum would be held across Britain. If this referendum has a majority in favor, the UK would begin steps to join the EMU. Industrial and large businesses are largely in favor of Britain joining the EMU. They fear that if the UK does not join, their businesses will not be competitive with those of Europe. Foreigners who currently invest in the UK are also pressuring the government to make the decision to join the EMU as soon as possible.[133]

However, the business world holds a different opinion from the majority of the UK public. Many polls have shown that the public wants no part in the monetary trap of the EMU. Compared to the rest of the EMU, the UK population is much less in favor of joining the monetary union.

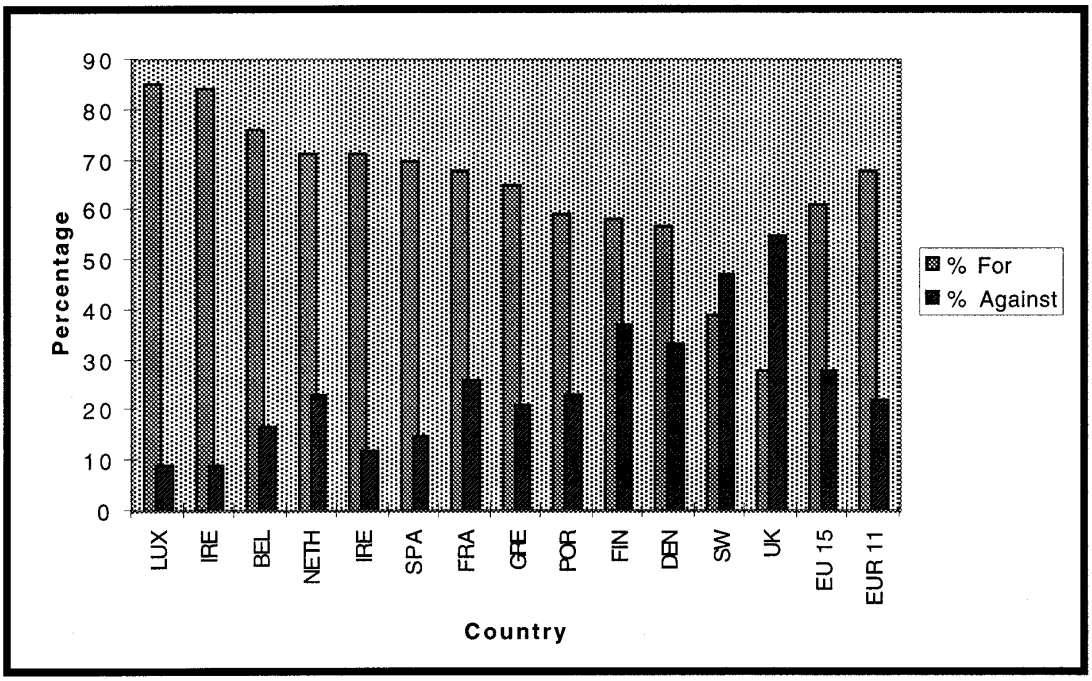
Table 6.1 The Euro: for or against? Spring 1999

Country	% For	% Against
Luxembourg	85	9
Italy	84	9
Belgium	76	17
Netherlands	71	23
Ireland	71	12
Spain	70	15
France	68	26
Greece	65	21
Portugal	59	23
Finland	58	37
Denmark	57	33
Sweden	39	47
United Kingdom	28	55
EU 15	61	28
EUR –11	68	22

Source: Eurobarometer Jul. 1999.

Figure 6.1: The Euro: for or against? Spring 1999

[133] "Inward investors press for vote on euro," *Financial Times* 7 Jan. 2000, 1.



Source: Eurobarometer Jul. 1999.

In terms of public opinion, the UK numbers are well below both the EU and the EMU averages as well as well below all the countries currently in the EMU. The UK public is the most skeptical about joining the EMU of every EU country. According to this opinion poll, the UK public is in no position to agree to joining the EMU in a referendum anytime soon. Perhaps if the government decides in favor of the UK joining the monetary union, more of the public would be in favor. In a MORI poll taken in the UK in July 1999 when asked the question "If the government were to strongly urge that Britain should be part of a single European currency, how would you vote?," 32% of the population surveyed were in favor of joining while 54% were against.[134] These results show that the UK government may have a difficult time convincing the public to vote to join the EMU, if and when the British government officially decides to take part in the EMU. Because the British opinion polls of the past few years have shown such a low percentage of the public in favor of joining the EMU, the government has realized it needs to wait

[134] Michael Saunders, "Public Sentiment Remains Cautious on EMU," *Sterling Weekly*, Salomon Smith Barney, 16 Jul. 1999, 3.

to decide to join in order to have time to make voters more sympathetic to joining the common currency.[135]

When making the decision about whether or not the UK should join the EMU, the government must take many different factors into account. Not only must it consider various economic factors such as the convergence of the economy, it must look at political ramifications and public opinion. The government must understand not only what Britain can gain by joining the EMU but also what Britain could lose if she does not join. If Britain does not become part of the EMU, she could lose a lot of political influence in Europe which could negatively impact the UK. Economic considerations are the most important factors in the government decision. It has stated that if and when the UK economy converges with those of the EMU, Britain would be prepared to join. The opinion of the British government on the economic costs and benefits of the UK joining the EMU is an important factor in the weighing of evidence on both sides of the issue. Now, one must look at how these economic advantages and disadvantages weigh on the entirety of the UK economy.

7. Conclusion: Weighing the Costs & Benefits

After looking at the various costs and benefits to the British economy resulting from the UK joining the European Economic and Monetary Union, one must weigh all these advantages and disadvantages against one another. There are many different elements of the economy that would be affected by a possible changeover to the European common currency. Some people and some organizations would benefit more than others. Many economists, politicians and organizations have opinions on whether or not it would be in Britain's best economic interest to join the EMU. All these people use different criteria to judge the benefits and costs to the economy. It is necessary to synthesize all these opinions by taking all elements into account to understand what kind of impact joining the monetary union would have on the entire British economy. This extensive research on the UK economy and the opinions from many groups within the British population produce conflicting views upon the subject. However, the evidence seems to be on the side of those who believe that Britain's economy and the nation as a whole

[135] Atkin 1.

would benefit greatly from joining in economic and monetary union with the members of Western Europe in the EMU.

It is paramount to consider how British economists believe a changeover to the euro would influence the general economy of Britain. John Atkin gives many advantages and disadvantages that he believes would have the greatest effect on the economy. The most wide-reaching advantages include lower borrowing costs, the elimination of foreign exchange-rate risk and uncertainty, price transparency and lower costs of goods, the integration of financial markets and the realization of the single market program that would be formed across Europe. Joining the EMU would finally remove all kinds of barriers to trade between Britain and the EMU. In terms of disadvantages, Atkin cites the rigidities in economic management from not being able to change interest and exchange rates and not being able to have a flexible enough fiscal policy to deal with shocks. Since the EMU does not have a central budget, shocks could have very negative effects on some regions of the EMU. Atkin thinks that all the disadvantages to the UK economy outweigh the advantages. Not realizing the economic benefits would not be a large loss to the UK. However, Atkin believes the UK should join the EMU because the EU is the main export market of British goods and because the EU is the main site of investment for the UK. If Britain does not join the monetary union, the EMU would begin to make decisions on the European economy without the UK's influence. Many rules would be made about Britain's largest trading area without her having a say.[136] All things considered, Atkin thinks the UK should join the EMU because of the negative economic effects she would incur if she did not join. Therefore, economically speaking, it is in Britain's best interest to join the monetary union of Europe.

Paul Home, the European Equity Economist for Salomon Smith Barney in London, also supports Britain joining the EMU. In terms of advantages to the UK economy, Home emphasizes the decrease in long-term nominal and real interest rates, the increase in competitiveness to bring prices down, the improvement in consumer and social protection such as pensions, water standards and medical benefits, and the smoothing of the UK economic growth cycle which has been erratic. In terms of disadvantages, he cites the loss of monetary policy and the loss of exchange-rate variability. He does not think joining the EMU would make too much of an economic or financial difference to the UK, but the loss of a voice in European economic

decisions would be detrimental to the country.[137] Overall, it is better for the UK to be a part of the monetary union of Europe.

William Buiter, a professor of international macroeconomics at the University of Cambridge and a member of the Bank of England's monetary policy committee, also has specific views on the subject of whether or not the UK should join the EMU. At the beginning of his article from *The Financial Times* in the summer of 1999, he writes: "It is time to restate the economic case for participation, a case I consider to be self evident and overwhelming." Since the UK has a small economy greatly influenced by trade and international financial flows, it makes sense for her to join a monetary union and not remain outside the union simply to demonstrate her sovereignty. He believes that even though there are structural differences between the economy of the UK and the economies of the EMU, these differences would not be harmful if the UK were to join the monetary regime. "Real economic performance would be equally good or bad with a floating exchange rate, a common currency or a system of bilateral barter." Buiter believes the loss of monetary policy would be a benefit and not a cost because cyclical convergence would be faster and easier with one monetary authority. He also does not think exchange-rate policy has been effective in the past, and the loss of it would not harm the UK economy.

> A flexible exchange rate, often driven more by asset market fancies than by fundamentals, cannot be manipulated effectively to serve the needs of the real economy. Nor can it be relied upon to provide a spontaneous adjustment mechanism following a fundamental economic shock.

Buiter believes it would be in Britain's best interest to join the EMU because of the financial stability that would come as a result of joining the monetary union.[138]

An article in *The Economist* in the Spring of 1999 asked some of the top academic economists of Britain whether or not they believed the UK should join the EMU and of the 164 who responded, almost two-thirds favored joining. Most European economists, macroeconomists and international economists were in favor of joining while only about a third of monetary economists were in favor of joining. These economists cited the benefits of Britain's

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[136] John Atkin, personal interview, 22 June 1999.
[137] Paul Horne, personal interview, 13 July 1999.
[138] William H. Buiter, "Price of independence," *Financial Times* 17 Jun. 1999, London ed.: 24.

gaining a stable exchange rate, greater ease of capital flows between the UK and the rest of Europe, the potential loss of foreign direct investment were the UK not to join, the exclusion of the UK from the capital markets of the EMU were the UK not to join, the savings in foreign exchange transactions and the increased price transparency. Those not in favor of joining cited costs such as the ECB's too heavy bias towards low inflation, the democratic unaccountability of the ECB, the inability of the euro-wide monetary policy to work for all the countries in the EMU and the inability of EMU countries to have flexible fiscal policies. The economists on each side of the issue recognize the arguments of the opposing side, but there are more people who believe that the economic benefits will outweigh the economic costs if the UK decides to join the EMU.[139]

In general, British economists favor the UK joining the European monetary union sometime in the near future. They believe the entire economy would benefit in the long run, but one must also consider individual components of the population. Some would benefit more than others. The costs and benefits of the single currency would be distributed unevenly. The distribution of welfare shows why there are varying opinions about the UK joining the EMU.

Consumers are the first major category that must be taken into account when looking at the effects of the EMU on the entirety of the British economy. Since the EMU would undoubtedly spur competition, lower prices and create greater product variety, consumers would spend less money on items that they would already be buying, lowering their overall costs of goods in the long run. Loans would also be cheaper, allowing more people to get access to money, furthering economic growth. These lower costs produce real benefits to the entirety of the UK population.

The gains and losses to business are not as clear-cut. Some businesses would definitely benefit more than others. Larger, more international businesses would be able to reap more benefits from Britain's joining the EMU. Smaller businesses might not be able to afford the transition costs of the euro and would be in danger of being merged or taken over by larger companies. It is not surprising that the Confederation of British Industry (CBI), representing large businesses, is in favor of Britain's joining the EMU. Sir Clive Thompson, the President of the CBI, said, "UK membership of a successful EMU would enable British firms to participate fully

[139] "Economists for EMU," *The Economist* 17 Apr. 1999: 59-61.

in a more complete and competitive single market, and remove the harmful impact of exchange-rate volatility against the euro." The CBI has formed 19 committees to discuss the EMU and its implications. The 431 members voted in 1999 on whether or not Britain should join the monetary union in the future. 19%thought Britain should join the euro as soon as possible. 3 1% believed Britain should join the euro between 2002 and 2005. 28% thought Britain should be committed to joining the EMU in principle but should not set a specific timetable at this time. 20% believed a decision should not be made until everyone sees how the euro develops. Only 1% thought that Britain should decide not to join the euro in either this Parliament or the next one. Only 1% believed that Britain should never join the euro. The CBI is committed to joining the EMU at some point, but it recognizes that the UK economy needs to converge to those of the EMU before entrance.[140] Big businesses are in favor of joining the EMU.

The Institute of Directors (IoD), representing small British firms, is less in favor of joining the EMU. Ruth Lea, Head of the IoD Policy Unit, said in a July 1999 press release,

> IoD members clearly feel that early membership of the euro would be wrong for their businesses and wrong for Britain. This is unsurprising given the current lack of economic convergence between Britain and core Euroland, which would lead to the ECB's one size fits all" interest rate destabilising the British economy. Much more surprising was the very substantial percentage (30%) of directors who believe that we should never or probably never join the euro.

The directors of small companies find many more costs to joining the EMU. A poll was taken of 500 directors in the IoD. 13% were in favor of joining the euro as soon as possible. 30% were in favor of joining in the next five years. 25% wanted to join sometime but not in the next five years. 30% did not want Britain to ever join the EMU.[141] It is clear that smaller businesses are much less in favor of the UK's joining the common currency area than large companies.

Sometime in the near future, the British government has a very difficult decision to make. It must look at the entire British economy and judge whether or not the welfare of the population of the UK will benefit, as a whole, from membership in the EMU. It must take into account who would be hurt and who would be helped. It must take into account the opinions of politicians,

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[140] "CBI Members Reaffirm Support for EMU Membership in Principle," Jul. 1999, Confederation of British Industry, 24 Jul. 1999 <http://www.ebi.org.uk/home.shtml>.
[141] IoD Press Release, Jul. 1999, Institute of Directors, 24 Jul. 1999 <wysiwyg:H55/http://www.iod.co.uk/referendum.html>.

economists and organizations. The government has stated that it will make its decision based entirely on economic criteria. Therefore, it must evaluate how the welfare of the population would be affected economically. The government will look at the potential economic gains and losses as well as the degree of convergence or integration the UK economy has achieved with the economies of the EMU.

In many ways, the whole population would benefit. Effects such as price transparency, lower prices and lower transactions costs would effect all of the population positively. These are real gains that are certain to occur if the UK decides to join the EMU. Though many smaller businesses might be hurt in the near term if the UK joins, the higher growth and increased competition would make the economy more efficient. Some people might lose their jobs, but if the UK economy grows and expands under the new monetary regime, people would be able to find better jobs. These opinions are optimistic and maybe partly unrealistic, but it is clear that the gains from joining the EMU would be large and real.

On the other hand, many of the costs associated with joining the common currency are vague and based on events that might never occur. It is almost impossible to determine what the costs would occur from the loss of monetary and exchange rate policy. Transition costs might prove to be large burdens on many companies, but these would be one-time costs. The following chart gives an estimate of the potential gains and losses, in monetary terms, of the UK's joining the EMU.

Table 7.1 Single currency gains and losses for UK

	Billions of Pounds	% of GDP
1999 GDP=871.32 billion pounds		
Gains in level of GDP		
Transactions savings on foreign currency	2.79	32
Business	0.35	4
Tourism	0.35	4
Transactions savings by switch from $	0.44	5
Seignorage from issue of Euro notes	0.78	9
Extra net exports of goods and services	1.83	21
Lower personal interest rates	6.19	71
Lower corporate interest rates	2.53	29
Total	**15.26**	**170**
Losses in level of GDP		
Bank foreign exchange losses	0.35	4
Band and building society profit squeeze	2.09	24
Total	**2.44**	**30**
Net change in level of GDP	***12.82***	***140***
Annual gain in GDP growth rate of 0.5%	4.36	50
Cumulative after 10 years	52.28	600
Net present value of permanent 0.25% increase in GDP growth	622123	71400
One-off costs		
Bank conversion costs	1.22	14
Other conversion costs	1.83	21
Total conversion costs	3.05	36
Transfer payments		
Public sector debt interest saving	8.71	100

Source: Johnson (1996) 228.

It is clear from this table that the monetary gains outweigh the monetary costs. But again, it is impossible to estimate most of the potential losses to the UK economy. One reason they are so hard to estimate is that the costs might never happen. There is no telling what kinds of asymmetric shocks might hit Europe ten or twenty years from now. No one can accurately know how integrated the UK economy must be with the rest of Europe in order for her to reap all the benefits of the EMU. No can know if the UK ever reaches that unknown point. In terms of integration, it is well known that of all the European countries, the UK is one of the least integrated into the European economy. Using trade as the criteria for integration, the following chart estimates the degree of integration of the EU countries.

Table 7.2 Degree of integration in the EU, 1999

	1 Goods & services trade % GDP	2 Trade with EU % of total goods trade	3 =1*2/100 Degree if Integration	4 Ranking of integration
Belgium-Luxembourg	79.58	54.98	43.75	1
Denmark	33.6	45.54	15.3	7
Germany	26.45	48.77	13	9
Greece	20.5	53.66	11	12
Spain	29.25	51.28	15	8
France	25.6	50.39	13	9
Ireland	76.6	53.59	41.05	2
Italy	24.3	46.3	11.25	10
Netherlands	52.1	52.5	27.35	3
Austria	44.15	45.41	20.05	6
Portugal	35.35	62.38	22.05	4
Finland	34.6	21.68	7.5	13
Sweden	42.6	49.65	21.15	5
United Kingdom	27.75	40.54	11.25	10

Source: *European Economy*, no. 68, 1999.

Note: Cols 1 & 2 = average of imports and exports

This chart shows that the UK is not as integrated as many other European countries, but it does not show that the UK is not integrated at all. The EU is the UK's largest market for trade. The transactions savings alone would be a huge boost to the British economy if she joining the EMU. Perhaps the UK has further integration to accomplish before she joins the EMU. But she is moving towards convergence with the aid of government programs. It is still unclear just how much convergence must take place. The government must address this dilemma when it makes its decision about the UK and the EMU.

Looking at the issue of whether or not the UK should merge its currency with the rest of Europe, there are a plethora of economic costs and benefits. Many of these factors are hard to define and even harder to quantify. These factors would affect all sectors of the population differently. A decision benefiting one group could be detrimental to another. Everyone has his or her own opinion about which path Britain should take. The government and then the public will make the ultimate decision. What should be the factors in this decision making? They need to look at how the economic costs and benefits will affect the welfare of the British population. What conclusions can be drawn from the preceding analysis? Overall, there are more concrete benefits that Britain can realize as a result of joining the euro. Many of the costs are *potential* costs that may never be realized. Many of the benefits, such as the increase in growth rate, are

long-term benefits. Many of the costs, such as transition costs, are short-term costs. Is it worth finding out if the UK would benefit as a result of joining the monetary union? Absolutely. It is also important to consider what kinds of costs Britain would incur if she did *not* join the monetary union. These effects could prove costlier than the costs associated with joining the union itself. This paper has shown that the UK not only *can* join the EMU as a result of her history with Europe and her ability to pass the criteria of the Maastricht Treaty but that she should join. In economic terms, Britain would reap many benefits by joining and would incur costs if she did not join. Although the costs of joining the EMU could harm the UK economy, the benefits of the common currency would outweigh those costs and bring prosperity to the entirety of the United Kingdom.

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