IT'S TIME TO JOIN THE EURO

BRITAIN'S RELUCTANCE TO JOIN THE EURO WILL COST IT DEARLY IN THE FUTURE, NOT ONLY IN BUSINESS TERMS BUT POLITICALLY TOO, WARNS **CHRISTOPHER HUHNE**.

The big debate between the Chancellor and the Prime Minister over Britain's euro membership is still unresolved. Within the Treasury, some influential voices argue that Britain does not lose out by delaying. Surely it makes sense, they say, to see how the system survives in bad times, as well as good, before deciding to go in – especially since we have a carefully negotiated opt-out. This is always a tempting argument. It combines the Whitehall doctrine of unripe time with the natural instinct of the cautious politician to delay any decision that will alienate someone. However, it is surely wrong. There are real economic and political costs in Britain's delay.

First, British consumers will continue to miss out on the benefits of lower continental prices. The euro completes the single market for the 12 countries and 301 million people in the euro-area. Businesses are aligning their prices, generally at the levels of the lower-priced markets. So much is clear from a recent survey by Dresdner Kleinwort Wasserstein, which showed that we pay 16% more for a basket of branded goods. But businesses in the euro-area know that, if they do not not align prices, wholesalers will set up supply lines from cheaper sources in the euro-area.

This is a powerful force. The internet is no substitute, because the uncertainty of foreign exchange movements stops businesses from exploiting those price opportunities fully. One recent study, in the *American Economic Review*, showed that a Canadian province trades 20 times as much with another Canadian province as with an equidistant US state, despite free trade and a common language. Currencies are an obstacle to trade.

Second, British businesses are losing market opportunities. That price alignment within the euro-area is forcing efficiency improvements to protect profits. Large companies are able to centralise production without adding to exchange rate risks. Invoicing for the entire euro-area can happen in one place. For the first time, European companies can begin to operate with US-style scale advantages.

CHANGING FACE OF EUROPE. There are dramatic changes happening within European companies, and between them. The euro has been a key contributory factor in what is becoming a vast restructuring of the European economy. In the past three years since the launch of the euro in January 1999, the total value of European company mergers has exceeded $3.7trn, more than in the cumulative total of the previous decade. Indeed, both 1999 and 2000 saw merger volume at more than six times the annual rate of the peak year of the previous European merger boom in 1990.

THE DANGERS FOR BRITAIN. Some of the largest British businesses, often participants in the mergers boom, may slowly emigrate to their largest market in the euro-area, effectively becoming euro-area companies. But medium-sized British businesses will not have that option: they will continue to suffer the disadvantage of incurring costs in a currency different from that of their biggest export market. Although these businesses can hedge their revenue – selling future euro revenue for sterling – they cannot hedge their costs. If sterling rises, they become less competitive, even if they make a profit on their forward contract. It still makes sense for them to lay off workers, which is why we have lost more than 400,000 jobs in manufacturing in just four years. Far from being a useful policy lever, sterling is buffeted by footloose capital flows that make the currency more like a wrecking ball.

Even if sterling now falls to a sustainable level – over or under €1.50, in my judgement – there will be another problem. British businesses will not face the gradually intensifying pressure of competition within the euro-area as the 12 economies integrate fully. When sterling is stable, it acts like a tariff barrier. That is comfortable in the short term. But in the long term, it is disastrous. Remember the price we paid in accumulated inefficiency when we stayed outside the liberalising European Union from 1958 to 1973.

Any US or Japanese company, examining the advantages of investing in Britain or the euro-area, is going to assess many factors such a labour flexibility, skills and language. But if they are producing for the whole European market – as most in manufacturing do – the euro-area now has a huge advantage as a location. Costs are in the same currency as revenues. For many, this will tip the balance. This is why the recent Ernst & Young investment survey showed a third year of decline in Britain's proportion of investment in the EU, and why non-EU manufacturers intend to invest more in France than in

'IF OUR CONTINENTAL PARTNERS SEE A GOVERNMENT WITH A MAJORITY OF 167 DUCKING THE DECISION, THEY ARE UNLIKELY TO BELIEVE THAT MR BLAIR AND MR BROWN ARE TRULY COMMITTED AS THEY CLAIM'

Britain for the first time. All these factors – migrating big companies, protected medium-sized companies, discouraged foreign direct investors – are costs that are already beginning to accumulate. The longer Britain stays outside, the greater the adjustment euro-area companies will have made by the time we join. The further ahead companies in the euro-area will be. And the nastier the cold shower when we join. Since the costs of joining will increase, and the benefits are available immediately, it makes no sense to defer the investment.

THE POLITICAL COSTS. The much greater cross-border integration of business in the euro-area – for example, as companies shop around for cheaper bank loans in euros – will mean that business reality in Britain increasingly diverges from that of our partners. And that in turn increases the risk that they will want some EU law that reflects their needs, rather than ours.

They will have no trouble legislating for that law, since single market legislation, thanks to Margaret Thatcher's Single European Act, can be passed with 71% of the votes in the Council of Ministers and the assent of the European Parliament. Both necessary majorities exist within the 12 EU members of the euro-area. We may find it increasingly uncomfortable being in the EU – which regulates much of the private sector's single market – but outside the euro-area.

If our continental partners see a government with a majority of 167 ducking the decision, they are unlikely to believe that Mr Blair and Mr Brown are truly committed, even to the principle of euro membership, as they claim. As the discussions on the final shape of the European Union are due to begin in 2004, this would be a fatal impediment to our negotiating position. Why make concessions to a country that is not a full participant? And if our needs and desires are ignored, what would be the impact on opinion in this country?

That is why I have never believed there is a fence to sit on when it comes to the euro. We cannot, on any medium term perspective, be in the European Union but fail to participate in this key and central project. If we miss the opportunity for a referendum in this parliament, we will find ourselves left behind economically and marginalised politically. Eventually, the politics of isolation may have provocative effects at home. We may find that those who secretly want to get out of the European Union altogether – the position that Iain Duncan-Smith publicly espoused before he was elected leader of the Conservative party – are back in the driving seat. Out of the euro, we will be out of the EU.

That would be a disaster for Britain and British businesses, which need the political representation of British ministers on the council of ministers and British MEPs in the European Parliament. We are a big country with big interests, and cannot afford to take a Norwegian or Swiss view of European integration. In Oslo, they call it fax democracy because they have incorporated no fewer than 3,000 EU directives and regulations into Norwegian law without having any influence over the decisions. That is certainly not sovereignty. We should not exchange the illusion of sovereignty for the reality of power within the EU.

SHAPE UP OR SHIP OUT. The history of Britain's relations with the European Union has repeatedly been characterised by delay. Our failure to join in 1958 meant we did not shape the Common Agricultural Policy and the Common Fisheries Policy, and had to accept them when we joined. Our delay in joining the exchange rate mechanism (ERM) led to entry at the wrong rate, at the wrong time, and in the wrong way. Our failure to join the euro-area meant that Frankfurt, not London, became the seat of the European Central Bank. Delay has real costs even for myopic politicians. It is not a soft option.

Chris Huhne, MEP, is Chair of The City In Europe and the Economic Spokesman of the European Liberal Democratic and Reformist group in the European Parliament.

The revised second edition of his book *Both Sides Of The Coin: The Case For The Euro* (with James Forder writing the case against) was recently published (Profile £8.99).
www.chrishuhnemep.org

Christopher will be making a keynote speech at the ACT's UK Treasurers' Conference organised in association with EuroFinance Conferences at the Birmingham Metropole on the 16-18 April 2002.
For further details see **www.uktreasurers.com**