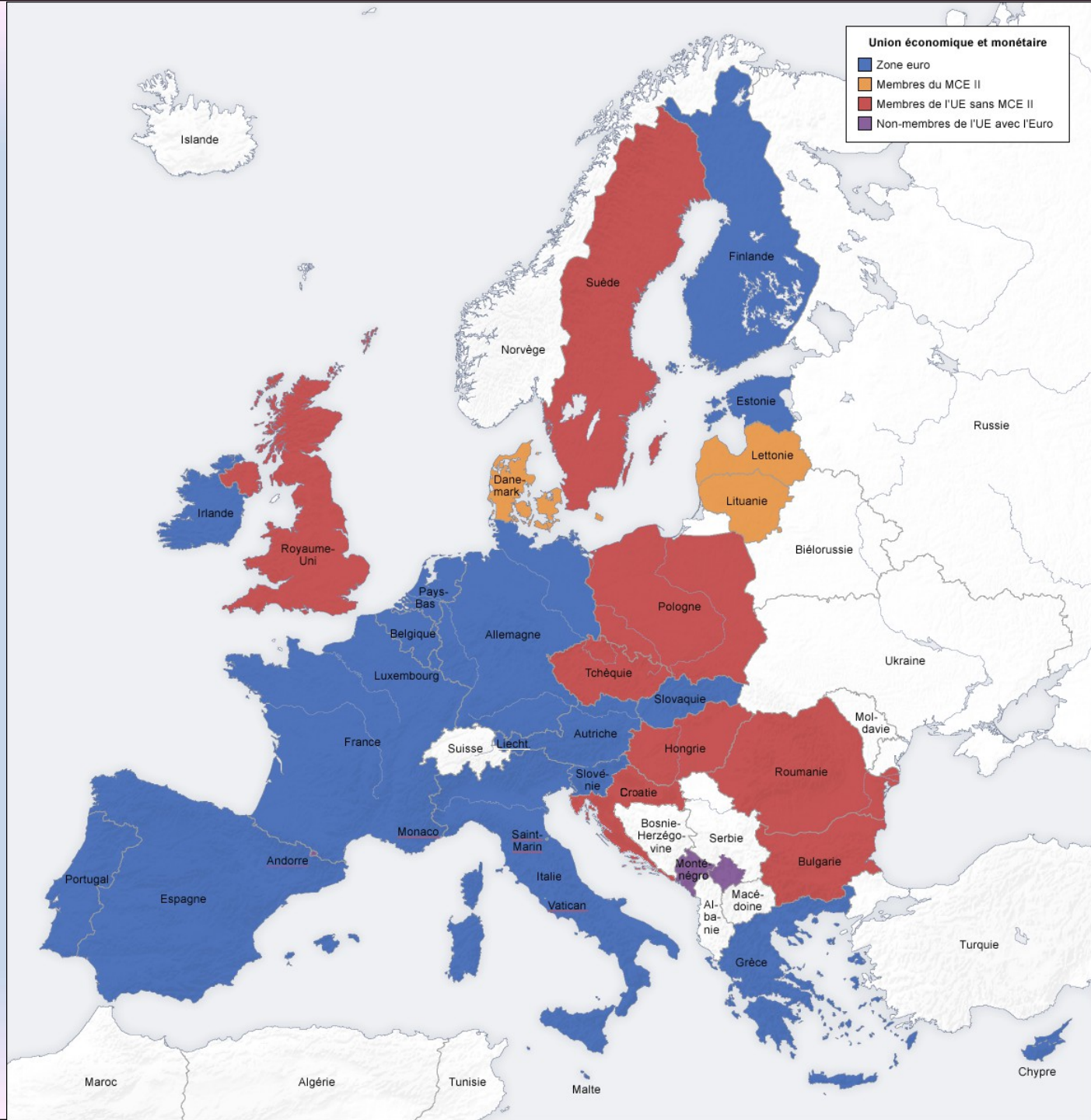




The UK & The EURO

Dr David Rees



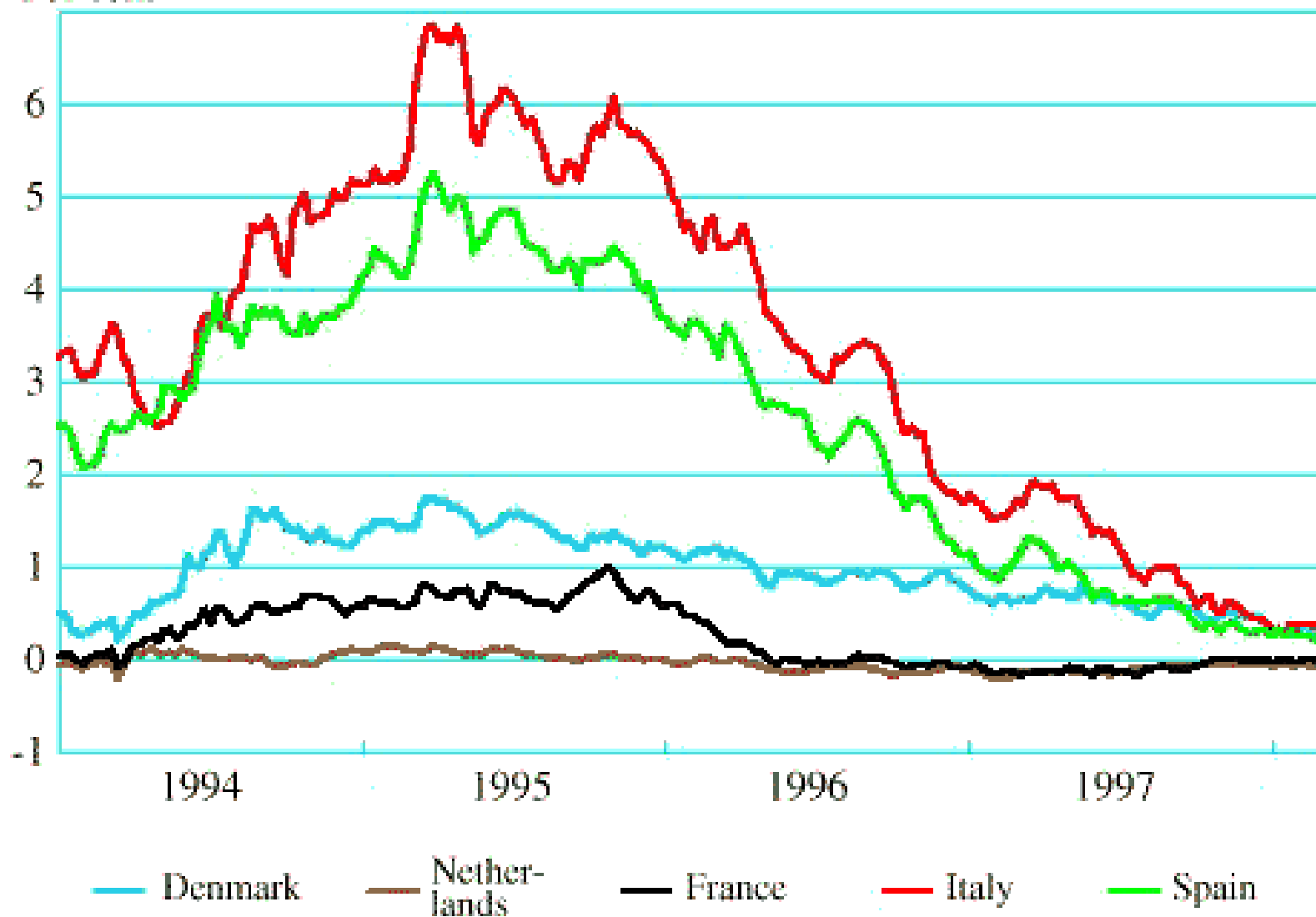
The Maastricht Criteria

1. Price stability (Inflation) (average of best 3 + 1.5%)
2. Fiscal Prudence – annual deficit (max. 3%)
3. Fiscal Prudence – total dept (max. 60%)
4. EMS Membership (EuroSnake)
5. Interest-Rate Convergence (average of best 3 for inflation + 2.5%)

Chart 12

Long-term yield differential to Germany

Per cent



Note: Yield on 10-year government bonds. Weekly averages.

Maastricht Criteria (UK)

1. Price stability (Inflation)

2013: 2.6 (> 2.5%) **Fail**

2. Fiscal Prudence – annual deficit

2013: - 6.3 (>3%) OK! **Fail**

3. Fiscal Prudence – total dept

2013: 90% (>60%) **Fail**

4. EMS Membership

NO, they were member from 1990 to 1992. **Fail**

5. Interest-Rate Convergence

– 2013: 1.7 (< 4.8%) OK!

Why did the UK drop out of the ERM?

- ERM: Exchange Rate Mechanism
- Designed to minimise exchange rate variability and achieve monetary stability.
- UK wanted to attain economic stability and low inflation.
- Black Wednesday:
 - 16th January 1992
 - UK government increased interest rates to increase the value of the pound
 - Failed to keep the pound above the allowed level, and were forced to leave the ERM

Black Wednesday, UK, 1992

UK was in the ERM (European Rate Mechanism)

George Soros made £1bn

Bank of England lost £3.3bn

Could have made a £2.4bn profit by keeping foreign currency reserves



Advantages and Disadvantages of Adopting a Single Currency

Advantages

- Ends currency instability between the UK and the EU
- Increases Price Transparency
- Eliminates currency hedging
- Encourages travel
- Encourages Fiscal Responsibility

Disadvantages

- Loss of Macroeconomic Policy
- The fluctuations of Economic cycles/Economic differences
- The one off cost

The Advantages

Currency Instability Ended

- Benefits foreign firms working inside the UK & may increase FDI into the UK
- Currency speculation would be difficult to achieve, benefiting anyone moving capital to and from the UK (such as Dr Rees)

Price Transparency

- Benefits both UK consumers and existing Euro-zone consumers
- May lead to cheaper prices in the long run due to increased competition

Currency Hedging Ended

- Benefits businesses operating throughout the single market
- Small companies in particular will benefit due to their large costs associated with the currency cost of exports

Advantages continued

Encourages Travel

- Travellers between the UK and the Euro-zone would not have to pay any foreign currency conversion fees , benefiting the consumer

Encourages Fiscal Responsibility

- The UK will have to adhere to the guidelines of the Stability and Growth Pact .
- This could direct more FDI into the country as Investor's view these aspects of the economy as stable and predictable.

The Disadvantages

Loss of Macroeconomic Policy

- The Government would lose the power to set interest rates, and would need to maintain their government debt
- This could lead to recession and unemployment in the short term

Economic Fluctuations/Differences

- Not all economies of the Euro-zone experience the same economic cycles and fluctuation. For example the UK has tended to have a closer cycle to the US than the EU
- One Central bank for so many economies can cause numerous problems such as inflation/deflation

The one off cost

- It is estimated the one off cost for the UK to convert to the Euro would be £3.5 billion
- This includes educating consumers, changing labels ect...

UK government and public opinion

Government

- Why did the UK drop out of the ERM?
- Under what conditions will the UK government adopt the euro?

Public opinion

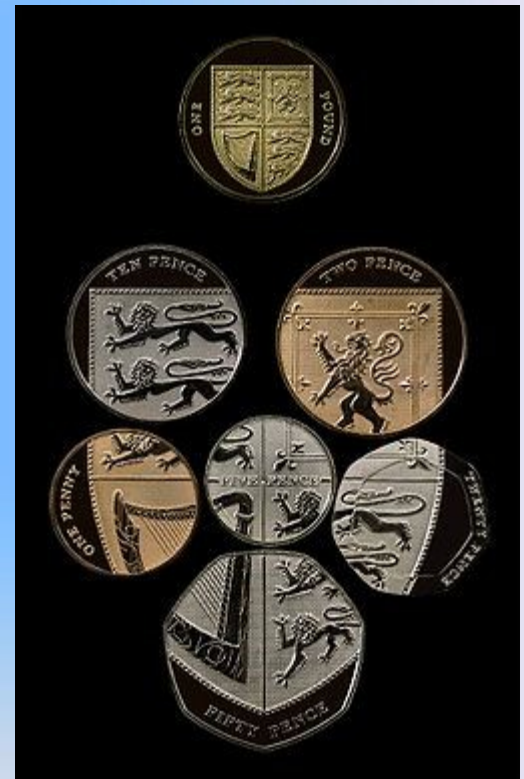
- The pound is a symbol of UK sovereignty
- Does the UK public want to adopt the euro?
- Does the UK public want to be part of the EU?

The five tests for the adopting the euro

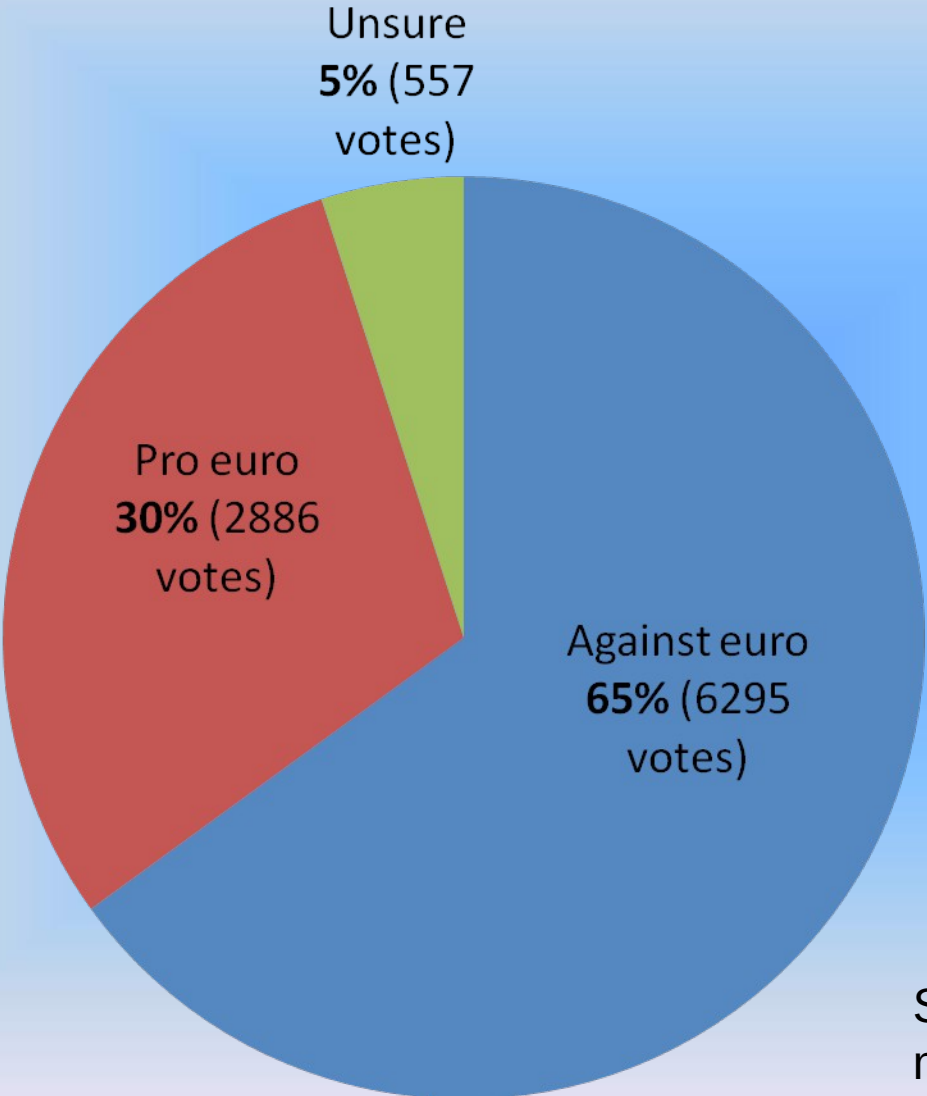
1. Convergence with eurozone
2. Enough flexibility to adapt
3. Impact on foreign investment
4. Impact on financial services
5. Impact on jobs

The pound a symbol of national sovereignty

- World's oldest currency still in use.
- Dates back to around 1300
- The first international base currency
- A historically strong currency

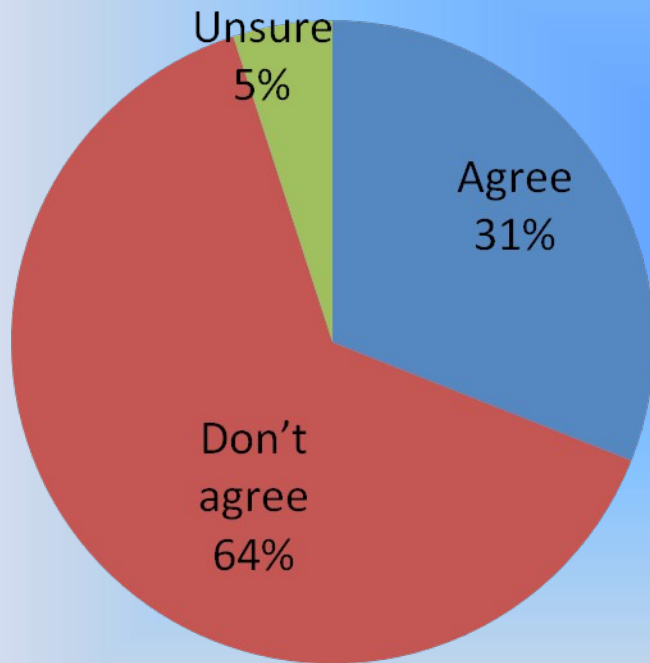


Do the British people want to adopt the Euro?

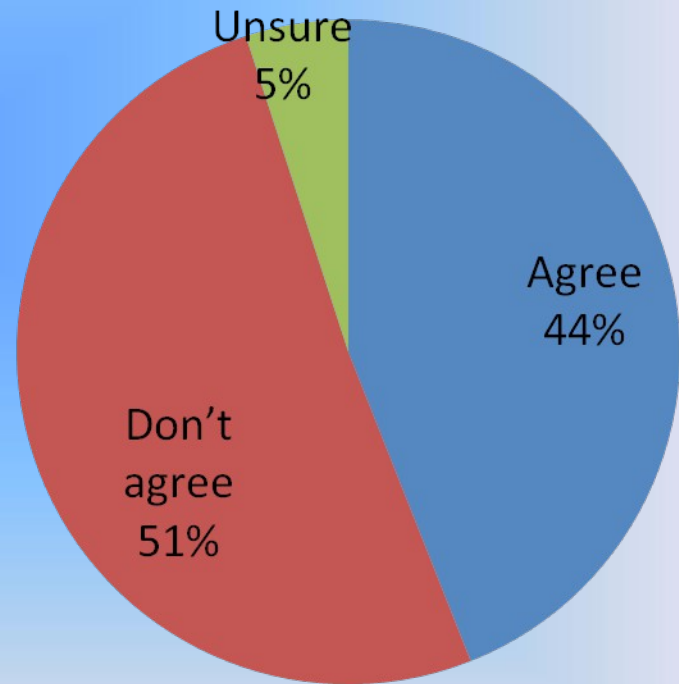


Source:
moneysavingexpert.com
October 2009

“The current economic crisis has made me more likely to support Britain joining the Euro”

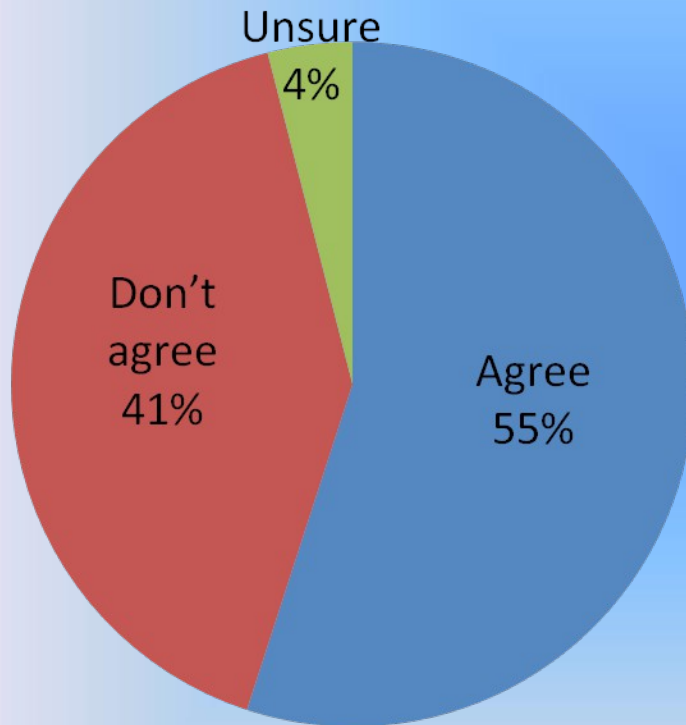


“Britain benefits overall from membership of the European Union in terms of jobs and trade”

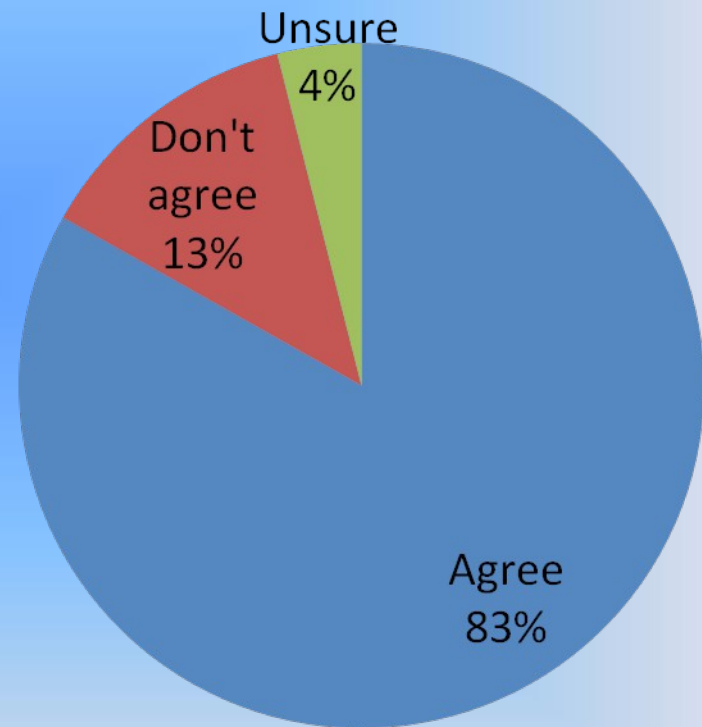


Poll conducted by ComRes in March 2009 (1004 voters)

"Britain should leave the EU but maintain close trading links"

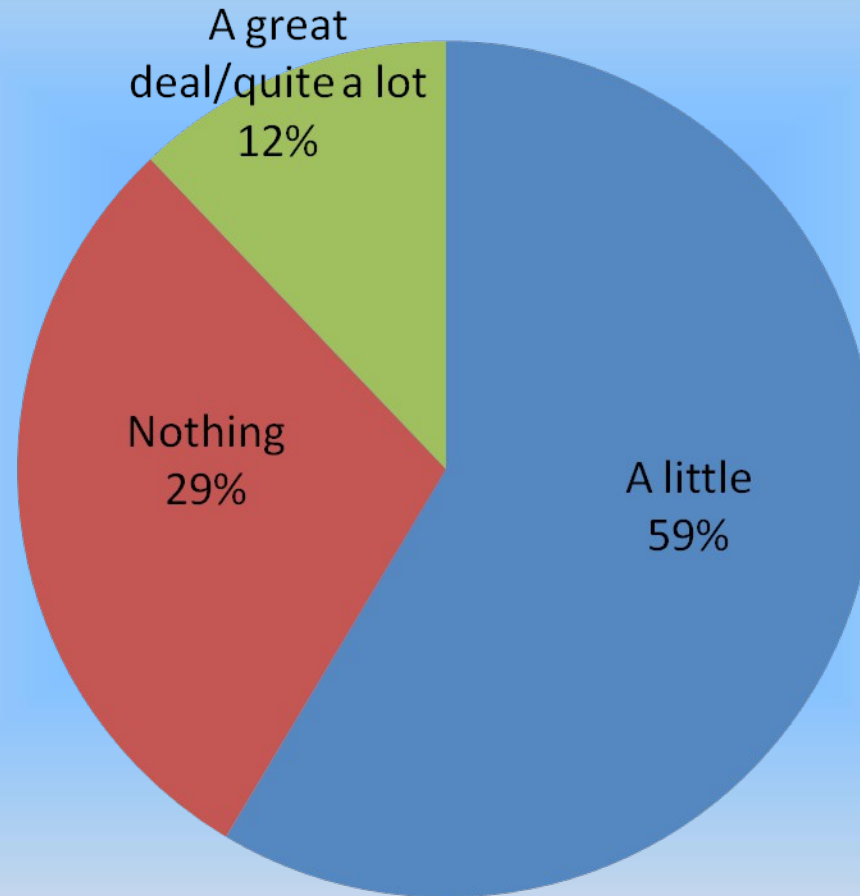


"The British people should decide in a vote before Britain transfers any further power to the European Union"



Poll conducted by ComRes in March 2009 (1004 voters)

"How much do you know about the European Union as an institution"



Source: The UK & The European Union Report – ICM Research (2002)