

# Into EMU without the UK: Managing the Consequences

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## **Abstract**

These notes begin by explaining the rationale behind EMU, and the criteria which many economists argue should govern who joins. These relate mainly to how economically similar prospective members states are. They stand in contrast to the criteria actually adopted in the Maastricht Treaty, a contrast which is a useful way of understanding the nature of Ireland's Sterling problem. The stance of the current UK government is assessed, as is our possible policy responses to a Sterling shock. It is argued that social partnership arrangements will come under intense pressures in such an eventuality. More positively, the development of a large integrated set of European capital markets may help Irish firms hedge their Sterling exposures efficiently. More generally, enterprises may be increasingly able to by-pass banks and other intermediaries and source their financing directly in private capital markets, a prospect which is not immediately dependent on the UK's participation in EMU.

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For suppose you go to an alehouse with that base money, and the landlord gives you a quart for four of these halfpence, what must the victualler do? His brewer will not be paid in that coin, or if the brewer should be such a fool, the farmers will not take it from them for their beer, because they are bound by their leases to pay their rents in good and lawful money of England, which this is not, nor of Ireland neither, and the 'squire their landlord will never be so bewitched to take such trash for his land, so that it must certainly stop somewhere or other, and wherever it stops it is the same thing, and we are all undone.

Jonathan Swift, *Letter to the Tradesmen, Shop-Keepers, Farmers, and Common-People in General of Ireland*, 1724

## 1 Introduction

The quotation above is part of Swift's contribution to the 'Wood's halfpence' controversy in which the unfortunate Mr Wood was accused of abusing a patent for minting farthings in Ireland, and inflicting substandard coinage on the long-suffering Irish business community. However trivial the issue seems at this distance, it is a salutary reminder of how easily what appear to be abstruse, narrow and technical issues of monetary economics can inflame public passions, and engender irrational, chauvinistic debate. Ireland's EMU debate, so far confined mainly to a relatively small group of economists, and a rather more influential group of policy-makers, seems set to become more lively, though it is to be hoped, not irrational, as the prospect of EMU becomes more real. This debate will focus in part on the consequences for Ireland of joining EMU at least initially without the UK.

In these notes, I propose to take what I hope is a pragmatic and positive approach to this debate. By this I mean that I do not propose to revisit the question as to whether joining EMU without the UK is in Ireland's economic interests. This is not because that question has in any sense been settled. Rather, it is partly because it is difficult to see how it can be settled in the abstract, or given an unconditional answer. The success or failure of Ireland in EMU, with or without the UK, will still depend to a large extent on factors which are still very much within our control. The policy agenda now consists overwhelmingly of recognising this, identifying those factors, and acting accordingly. The real worry about EMU for Ireland is that the desire of the policy-making establishment to play down the 'Sterling factor' has prompted a minimisation of the degree to which adjustment in policies will be necessary. This in turn, carries the risk that if and when the logic of our position becomes clear, it will do so eventually in the form of a painful surprise, and then "... we are all undone".

## 2 Understanding EMU

This section sets out, in a non-technical way, some of the major economic issues which are a necessary background to understanding the EMU project in general, and its possible consequences for Ireland. Inevitably, much of the focus of activity in the business world will be on the logistics of the changeover. Such practicalities are clearly of importance, whether in terms of the costs involved in the changeover, or in terms of the benefits conferred after it, in the form of reduced transactions costs. If these were the only issues in determining membership of a single currency area, there would be no economic debate: the changeover costs are once-off, however significant, whereas the reduction in transactions costs is a permanent benefit, accruing each year for as long as the single currency persists. In principle, there would then be no theoretical reason to argue against a single currency for Europe, nor indeed one for the global economy. It is natural that some public discussion should centre on the most visible consequences of a new currency, but also misleading. The underlying economic consequences, and so the balance of costs and benefits, are considerably more complicated.

### 2.1 The imperative for a single currency

Clearly, part of the rationale for the EMU project was to realise the practical potential gains from a single currency just mentioned. The European Commission's 1990 study on the costs and benefits of a single currency saw it as the next step in completing the Single Market. Separate currencies were perceived in part as just as much impediments to trade between member states as differences in standards, customs barriers and different tax régimes. However, some deeper considerations were at play here.<sup>1</sup> Part of the 1992 Single Market programme involved removing barriers to the free flow of capital between Member States. This meant that in trying to achieve the broad macroeconomic goal of price stability in Europe post-1992, policy makers could no longer rely on the system of 'fixed but adjustable' exchange rates which was the Exchange Rate Mechanism (ERM). Unless Central Banks co-ordinated their responses to financial markets, in a way which was not institutionally provided for, the ERM exchange rates were not defensible at an acceptable cost in the face of internationally mobile capital. The default option was that the currency perceived to be the strongest in this system, the Deutschmark, set the terms for others' participation i.e., monetary policy for Europe was effectively determined by the Bundesbank, who are legally obliged to consider German economic conditions, and not the consequences of their actions further afield. Arguably, German monetary policy directed at averting the inflationary risks of *German* Economic and Monetary Union in 1990, was an example of this 'asymmetry'

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<sup>1</sup>This section draws upon Wyplosz (1997) and references therein.

in European monetary arrangements, prompting an unnecessary recession in the wider European economy.

If continuing the ERM was not an option (as events showed), what was left? Logically, there was nothing in theory to prevent EU members allowing their currencies to float freely against one another, without any pretence of co-ordinating monetary policy. Given that international empirical evidence on the adverse effects of exchange rate instability on investment and trade is not at all one-sided, this option is less bizarre than it might sound. However, a key stage in the argument is the idea that such freely floating exchange rates might have the potential to undermine the Single Market, and by extension, the wider political goals of the European movement. In particular, if member states were to engage in a round of competitive devaluations against one another, this could prompt political demands for protectionist measures against foreign imports and subsidies for industries perceived to be at risk. To a large extent, the benefits of the EU arise because it provides a legal framework which constrains ever-present protectionist instincts. This role could have been fatally threatened, so it was argued, by the existence of separate currencies and the temptation of policy makers to use them as instruments of ‘beggar thy neighbour’, trade-destroying policies.

Given this, monetary union was a logical imperative for the EU. Technically, a monetary union can consist of separate currencies which are exchangeable at irrevocably fixed exchange rates: a new single currency, physically replacing the existing currencies is one sense the political icing on the economic cake. The sort of argument sketched here is in part what underlies the oft-repeated notion that there is an inevitability about EMU, and has prompted plenty of more-or-less appropriate metaphors comparing the project for example to a train leaving the station whether we are on board or not<sup>2</sup>.

## **2.2 Who should join EMU?**

If EMU is accepted as a good idea in principle, one then has to decide which countries will participate, how the transition to EMU is to be undertaken, and how the new system is to be managed. I focus on the first of these issues here, as it is central to understanding the ‘Sterling question’.

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<sup>2</sup>The notion that a train necessarily has forward momentum is not immediately obvious to regular ‘customers’ of the Galway-Dublin railway line.

### **2.2.1 The optimal currency area criteria**

Many economists would argue that the decision as to who should join EMU, should be on the basis of selecting countries which constitute, in the jargon, an ‘optimal currency area’. As we will see, this gives a rather different set of guidelines from those which are actually being applied.

Broadly speaking, countries in an optimal currency area are sufficiently alike in terms of their economic structure that they require the same set of monetary conditions (e.g., the same level of interest rates) in order to ensure macroeconomic stability, growth and employment, at any given point in time. Countries are alike in terms of economic structure if for example, they have roughly the same sorts of industries in the same proportions, so that they respond to events in the world economy in the same way. Countries may also be considered alike in this sense if their markets for goods and services and for labour and capital are not distinct national markets, but can be considered as one market, so that imbalances in demand or supply in one country are rectified for example, by movements between countries of labour or capital. One could also consider two countries to be sufficiently alike if they share a common system of transfer payments, whereby rich regions of one country automatically compensate poorer regions during a downturn e.g., via a common social welfare system.

The general argument here is that if countries are sufficiently similar in these terms, then at any point in time, the same monetary conditions are appropriate in each country, and so the same exchange rate against the rest of the world is appropriate. In such circumstances, one country would not be giving up a useful policy instrument in giving up its exchange rate against the other, and would presumably benefit from the consequent reduction in transactions costs. The message this theory seems to give is ‘look for countries with similar economic structures’.

### **2.2.2 The Maastricht criteria**

Whatever the merits of the optimal currency area view, it forms no part of the actual way in which membership of EMU is to be determined. The criteria for membership as set out in the Maastricht Treaty, do not relate to ‘economic similarity’ as sketched above, but to something quite distinct, which would go by the name of ‘nominal convergence’, that is, similarity in terms of inflation rates, interest rates, low deficits and low public debt. On one view, the Maastricht criteria can select a set of countries for whom monetary union and the consequent common monetary policy would be quite inappropriate. They might, and probably will, put Ireland, growing at a rate of 7–8% per annum, with the risk of asset price inflation at the top of the monetary policy agenda, into the same monetary policy area as Germany,

which has five million people unemployed, and France, which is also experiencing mediocre economic performance. If Mrs. Thatcher could claim that Belfast was as British as Finchley, the Maastricht criteria are saying that Mervue is as German as Munich.

### 2.2.3 Limits to our knowledge

To be less facetious on this issue, it is important to note a number of facts, some of which can help mitigate this discrepancy between what might be considered economically sensible criteria for selecting members of EMU and the ones which are actually being applied. The other issues below simply make the point that economists' concerns on these questions, at least in Ireland, do not in general reflect any underlying hostility towards EMU, but a genuine recognition that no easy, unconditional and comforting answers are available.

1. The Maastricht criteria are designed to select a 'low inflation group' of countries, in order to reassure Germans that the new euro will be as stable a store of value as the Deutschmark which they will give up, as part of the political trade-off, to ensure a 'European Germany', rather than a 'German Europe'. To a large extent, the benefits which are expected to accrue to Ireland from EMU depend on the success of this strategy, in that a low-inflation, strong-currency régime should deliver lower interest rates than would be the case for us outside EMU.
2. The 'optimal currency area' criteria do not unambiguously select countries at any given time: some judgement inevitably needs to be applied as to what precisely it means to say that two countries, or more than two, have economic structures which are 'sufficiently alike'.
3. The degree to which countries are sufficiently alike in economic terms to form a monetary union in part depends on whether they are members of such a union in the first place! Furthermore, we cannot even say in theory whether membership of EMU will make countries more or less alike economically.

For example, by definition, countries in EMU will experience the same monetary conditions, and so in this sense, immediately become economically more alike once they join. Separating this sort of effect from more fundamental differences is not an easy matter. It is conceivable that membership of EMU will hasten the integration of markets for goods and services across the member states concerned, making them further alike economically. On the other hand, a single currency could increase the degree to which economic activity in Europe concentrates in specific distinct regions, rather than being spread out amongst countries in a balanced fashion, making countries *less* similar to another in economic structure.

4. The degree to which any of this matters depends crucially on whether one thinks that the exchange rate is an appropriate instrument of macroeconomic policy in the first place. Much of above discussion, with its contradictory possibilities, is moot, if changes in the exchange rate do not lead to changes in employment and growth, or more broadly to changes in competitiveness. Such a situation is conceivable, in the minds of many economists, if labour markets and markets for goods and services are characterised by a high degree of flexibility, and in particular, of flexibility in wages and prices. In such a scenario, a devaluation on the part of a trading partner would lead to downward adjustments in prices and wages domestically to the extent that macroeconomic equilibrium would be restored. To the extent that such flexibility in wages and prices would be available without the exchange rate also, the loss of the exchange rate is no loss at all. This is Classical, orthodox notion of ‘money neutrality’; monetary arrangements are a veil through which we perceive the workings of the real economy. A ‘middle-of-the-road’ economist might concede that this would characterise an economy in the long-run, but not in the short-run (leaving open as to how long is long, and how short is short).

The various possibilities considered especially in (3) above make two important points about how we assess EMU. First, economists do not know very much, but they at least know what it is they don’t know. Promoters and opponents of EMU tend to make unqualified predictions of what will happen, which are simply not justified in terms of our understanding of how macroeconomies work. Economists are generally mindful of certain theoretical arguments, which go by the name of the ‘Lucas Critique’, which caution us against making predictions about macroeconomic outcomes when structural changes in the economic environment, such as EMU, take place. As an economist by the name of Little once noted, it is not economists who are too abstract—it is generally those who are not aware of economic reasoning who tend to simplify too much in the face of complex reality.

The second, and more positive point, is that to some extent the success or failure of EMU depends upon the policy stance adopted in Ireland. The argument here is that the consequences of joining, and in particular, joining without the UK, are consequences which recognise the uncertainties and difficulties raised above.

## 3 Into EMU without the UK

### 3.1 UK policy towards EMU

Irish governments have consistently regarded entry into EMU as a central goal of policy, irrespective of the intentions of the UK government. This political determination was understandable, given that the alternative for a while was to allow Ireland's position to be contingent on the incoherent macroeconomic policy making of the previous UK government. The current UK government's position was summarised by Chancellor Gordon Brown in October 1997:

... we believe that, in principle, British membership of a successful single currency would be beneficial to Britain and to Europe; the key factor is whether the economic benefits of joining for business and industry are clear and unambiguous. If they are, there is no constitutional bar to British membership of EMU.

Applying the economic tests, it is not in this country's interest to join in the first wave of EMU starting on 1st January 1999 and, barring some fundamental and unforeseen change in economic circumstances, making a decision, this Parliament, to join is not realistic.

But in order to give ourselves a genuine choice in the future, it is essential that the Government and business prepare intensively during this Parliament, so that Britain will be in a position to join a single currency, should we wish to, early in the next Parliament.

(Brown 1997)

The UK government is distinguishing in effect between two decisions about EMU. First, there is the general issue of whether EMU is a good thing in principle. The UK's answer is that a 'successful' single currency would be worth joining. This may appear to be circular logic, but in fact is significant. If the euro does not prove to be a stable store of value, and if members suffer real costs from the loss of the option to devalue, the UK will take it as evidence that the particular design of EMU arrived at was flawed. Also, this UK government does not see any constitutional problem in joining, unlike (parts of) the last government.

The second issue is one of timing of entry to a successful EMU. This is to be decided by a set of 'economic tests' referred to in the above quotation which are a number of questions about EMU and the UK which structured a Treasury Report on the issue. Their relevance here is that they are the sorts of questions which arise from an analysis of EMU using the concept of optimal currencies areas discussed earlier. The two tests that are particularly important are:

Are business cycles and economic structures compatible so that we and others could live comfortably with euro interest rates on a permanent basis?

If problems emerge is there sufficient flexibility to deal with them?

(HM Treasury 1997)

Even though the UK government decided that the economic tests were not met unambiguously, what is significant here is that they are pragmatic, economically informed questions, rather than criteria set by an ideological agenda.

At face value, taken together with the Labour government's institutional commitment to a low-inflation régime by granting a degree of monetary policy independence to the Bank of England, this policy stance is certainly more benign for Ireland's EMU prospects than heretofore. No-one can forecast the political and economic contingencies which may impel the UK in one direction or another, but Irish policy makers understand now that the UK's membership of EMU to some extent depends on how the project works out for members over the next few years. It is a curious twist that if we can demonstrate that we can participate successfully without the UK, that will add, however marginally, to the case for the UK's entry!

### **3.1.1 Ireland in EMU without the UK**

The Irish government commissioned the Economic and Social Research Institute to report on the economic implications of EMU for Ireland, given that the decision to seek membership had been taken (Baker, FitzGerald and Honohan 1996, Honohan and FitzGerald 1997). The report's terms of reference included an evaluation of the scenario under consideration here, namely that of entry without the UK. The report's authors are careful throughout to qualify their results, and indicate the limitations of the techniques adopted, given the intrinsic difficulties of understanding behaviour in macroeconomies after a régime change. The ESRI considered the impact of a 20% Sterling devaluation and concluded that (a) employment losses under such a scenario would be offset by the benefits of a lower interest-rate environment (b) the interaction of wage adjustments both in Ireland and the UK would mean that the difficulties associated with a Sterling depreciation would dissipate relatively quickly.

The virtue of this sort of exercise is not in the precise estimates arrived at, which will always be open to doubt, but in that its framing of the issues is open to disciplined criticism. Thus it is possible, as Neary and Thom (1996) do, to question for example, whether interest rates will converge sufficiently to deliver the anticipated benefits to Ireland. One might imagine, from some pro-euro political statements, that the convergence in interest rates to low levels is something mandated by a

European Union Treaty; it is of course something which depends on how EMU is managed and how financial markets react to it. In particular, one underlying assumption is that the new European Central Bank (ECB) will have credible anti-inflation credentials, obviating the need for interest rates higher than would have been the case pre-EMU. It is equally possible that the new ECB will need to establish its anti-inflation credentials by firming up interest rates from the outset. The idea that interest rates will converge to the same level implies that financial markets will believe that (i) the exchange rate régime is credible and (ii) that governments in EMU have more or less similar credit ratings.

These assumptions might appear reasonable now, at least for the majority of prospective members, but if Ireland's trade relationship with the UK does cause us problems, neither will apply. In short, it may not necessarily be valid to balance the costs of a Sterling devaluation against the benefits of a low interest rate régime; the existence of the former may mean that the latter do not materialise.

The other major economic issue here is the extent to which adjustments in wages and prices, both in Ireland and the UK, could mitigate the impact of a devaluation, and the timescale over which this might happen. The ESRI study did perform the valuable service of pointing out that it is wage and price developments in both countries which determine the overall impact: a Sterling devaluation will not confer a competitive advantage on the UK to the extent that wages and prices there rise to reflect increased import prices. However, and especially given the remarks above about interest rates, there is clearly an outstanding set of issues here for Irish policy makers.

Frank Barry has argued that the ESRI's assumptions about the degree of wage flexibility are implausible (Barry 1997). In particular, he considers the possibility that the wage adjustment process here has tended to be unbalanced or 'asymmetric' in respect of exchange rate changes: in the face of a devaluation against Sterling, wages and prices rise, but an appreciation against Sterling (or a Sterling devaluation) has not prompted downward pressures on wages (our post ERM experience being a case in point). This yields estimates of the cost of a devaluation much higher in employment terms than the ESRI's modelling exercise. Barry regards this as providing support to Ireland remaining outside EMU until the UK enters.

A paper by Jozef Konings and Patrick Wash (1997) examined the effect of exchange rate changes on the life expectancy of manufacturing plants in Ireland from 1973–94. Their results point to the structural, competitive inadequacies of indigenous industry. These authors do not interpret their results as arguing for staying out of EMU, but do insist that these structural inadequacies are a source of risk for the Irish economy and need to be tackled.

## 4 Managing the Consequences

In a sense the preceding material sets the agenda for managing the consequences of being in EMU without the UK: ensure that there is sufficiently flexibility in wage determination here to make our exchange rate commitment credible in the eyes of financial markets. How can this be done? The remarks so far should indicate that short-term palliatives to paper over our exposure to Sterling will not suffice. Indeed, in certain respects, they will not be possible.

For example, the possibility that the government could have the resources to bail out the exposed sectors of the economy should now be dismissed, for a number of reasons. First, the Maastricht public deficit and debt criteria continue to be enforceable through the Stability and Growth Pact, negotiated in Dublin. Member states face the possibility of sanctions in the event of breaching these tight fiscal parameters. More than this, it appears doubtful whether a response similar to the Market Development Fund put in place during the last currency crisis is advisable. This would be yet another attempt to solve a problem best left to markets with a political/bureaucratic set of instruments. The notion that the comparative advantage of public servants is in assessing the exchange rate exposure of enterprises and further in assessing their strategies to overcome this, is to me at least, bizarre, although entirely consistent with the instincts of some policy makers. Furthermore, as soon as a government indicates the total amount of such a fund, financial markets would presumably interpret it as equivalent to the maximum amount we are prepared to spend to defend our place in the euro, and act to test that commitment.

### 4.1 Wage determination

The system of social partnership, of which wage determination is but one part, has been credited with much of Ireland's recent strong economic performance. It is doubtful as to whether it will be an appropriate mechanism for managing any Sterling problems which may arise. In the first instance, social partnership deals on wages represent political compromises. The influence of public sector trade unions may be to see a Sterling devaluation against the euro as an opportunity to realise real wage increases for their members, who are not in general exposed to the same competitive pressures as firms and workers in the market sectors. In this context, striking an overall deal for wage rates for say, a three year period, which would satisfy all constituencies, might prove to be a 'deal too far'.

One proposal made in 1995 envisaged national wage agreements which would consist of no normal wage increases but would include an annual bonus which would depend on the evolution of sterling over the year. (de Buitléir, Halpin and McArdle 1995). Such a proposal at least had the merit of recognising that Sterling's ab-

sence from EMU could have implications for competitiveness in Ireland.<sup>3</sup> It seems doubtful that such a proposal would be perceived as fair or rational. In any event, many economists would regard it as ill-conceived, in that it forces workers to bear this macroeconomic risk, when they are presumably less able to diversify away risks than are owners of capital.

In short, it would seem that the very idea of centralised wage bargaining itself will come under severe pressure in the event of a Sterling problem for Ireland. The firm-specific decisions as to how much adjustment needs to be undertaken, and to what extent wages should take the brunt of adjustment, do not appear to me to be capable of being addressed by social partnership arrangements, although this judgement will presumably not find much political support in a system accustomed to seeing these national deals as good in themselves.

## **4.2 Hedging exchange rate exposure**

Part of any firm's response to exchange rate uncertainty could be risk management, in the form of real diversification away from the source of uncertainty e.g., by seeking alternative markets and/or suppliers. Again, there is a difference between adopting such a strategy at the level of a firm, with its own knowledge of its products and markets, and one mandated by central policy, which appears to be the current response. Policy makers have become so accustomed to apparently directing success in the last few years, that perhaps some arrogance has crept in, as evidenced by the notion that industrial policy agencies are appropriately directing enterprises in their export strategies. This is another case where the success or failure of EMU will be determined not by treaty provisions, but by market responses. In particular, Irish firms with a Sterling exposure might increasingly consider hedging that exposure in financial markets, particularly during the initial transition period. Hedging in the foreign exchange markets has been possible for Irish firms to a relatively limited extent up to now, in terms of the liquidity and range of market instruments available. However, the relevant market in EMU will not be the Sterling/Irish pound forward market, but the Sterling/euro market. Sterling's continuing role as a reserve currency, as well as the fact that 50% of the UK's trade is with the EU, will presumably mean that this forward foreign exchange market will offer a range of instruments and options to Irish firms, in a liquid and efficient market.

While hedging against foreign exchange rate exposures is not a panacea, these last remarks lead to more general point, which has been often neglected in Irish discussions on EMU; perhaps the most significant impacts will be on the full development of European capital markets. Over time, this may prove very positive

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<sup>3</sup>A much more extensive discussion of the issues here is in Geary and Honohan (1997).

for Irish enterprises, irrespective of whether the UK joins or not. The next section amplifies this argument.

## 5 European capital markets in EMU

EMU should see, eventually, the development of a large, deep and liquid set of European capital markets (Prati and Schinasi 1997, McCauley and White 1997). There are two main aspects to this, integration and disintermediation.

By **integration** we mean the end of distinct segmented national capital markets, whether at the wholesale or retail level, as exchange rate risk is eliminated. Estimates for 1995 put the value of outstanding public and private bonds, equities and bank loans for the EU11 and the United States at roughly the same level, at about \$22 trillion. There are still significant regulatory hurdles in ensuring that Europe's capital markets operate as one, but the single currency is bound to advance the process considerably. The full development of the market will take time, as the relevant universe of assets for investors ceases to be national in nature, but European. It will be helped to the extent that European governments have in general got their finances under control, private funds are no longer being soaked up to the same extent by government bond issues, and so will be looking for other homes.

**Disintermediation** is the related process by which banks will be supplanted by private securities markets as sources of finance for European business. In 1995 banks loans in the EU11 were 57% of all financial assets outstanding, compared with a 22% share in the United States. One-third of European firm's borrowings are from private securities markets, compared with two-thirds in the United States. The firms which do issue bonds in Europe are mainly financial institutions. In short, there is huge potential for the development of European corporate bond markets, as well as equity markets. There is also the corresponding potential for intense competitive pressures on European banks. As the infrastructure of this market develops, firms will increasingly seek to bypass banks as sources of finance and borrow directly in the capital markets. The competitive pressures to which European banks are to be exposed are reflected in the wave of restructurings and mergers currently underway in a number of continental markets.

The extent to which Irish banks have or have not met the financing needs of Irish business is not at issue here, one way or the other. The real point is that the full development of European capital markets may herald the end of that particularly sterile debate. To some extent, policy makers here have sought to impose on Irish banks a venture capital role for which their balance sheets, as deposit-taking institutions, are not suited. In EMU, enterprises will have access to a much wider range of financing options. This aspect of EMU is not dependent on the UK's par-

ticipation; the City of London will most likely continue to function as Europe's major financial centre, relying on its stock of expertise and regulatory environment to retain that role. It is of course a pity that the European member state with the most developed financial infrastructure is not a participant, which is one example of a more general point which I wish to make in conclusion.

## **6 Conclusion**

In the past, the reluctance of Irish people to link our economic fortunes to that of the UK was understandable. In monetary affairs particularly, one hundred and fifty years of the link to Sterling proved to be of no great benefit to this country, as Ireland tracked the UK's relative decline and generally poor macroeconomic performance. But to extrapolate this argument is to miss the obvious; the UK has undergone a dramatic, if painful, process of structural, market-driven reform, and one which, given the policies of this Labour government, is unlikely to be reversed. It is a voice and experience which deserves increasingly to be heard in Europe. Up to now EMU has been mainly a project for politicians and policy makers; its evolution from now on will depend not on the niceties of treaty negotiations, but on market mechanisms, and on how well policy makers allow them to work. The UK has learned the lesson of the limits of government control of the macroeconomy, and is partly for that reason, wary of EMU, or more precisely, the thinking which informs this version of it. One of the consequences therefore of Ireland going into EMU without the UK is that we have again aligned ourselves implicitly with the European model of economic policy which is looking increasingly complacent and vulnerable, and turned away from a more pragmatic British view. In more than one sense, therefore, we need to think about what we've left behind, and how long that can continue.

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