

SPEECH BY THE RT HON LORD OWEN TO THE 5<sup>TH</sup> BERLIN CONFERENCE HELD BY THE BRITISH CHAMBER OF COMMERCE IN GERMANY, HAUS DER COMMERZBANK, BERLIN, THURSDAY, 29 JANUARY 2009

## TEN YEARS OF EURO

There is no escape from the fact that an improvement in competitiveness, due to a rise in productivity, is far, far preferable to a statistically equivalent rise in competitiveness either from persistent depreciation or a step like devaluation. One of the good arguments for membership of the ERM and later of the eurozone is that companies, who use the euro, know that if their costs rise they will not be saved from bankruptcy by devaluation.

What now challenges the eurozone's credibility is will political forces dictate "bail outs" or will the eurozone governments' nerve hold and discipline be demanded from its weaker members economically and politically?

Harsh experience in post war Britain has repeatedly shown how difficult it has been for the British economy to live within internal disciplines inherent in fixed exchange rates. This reality is what drove me to establishing New Europe to campaign both for the UK not joining the eurozone but remaining a fully committed member of the EU.

In 1949 and 1967, under Labour governments, the UK devalued after long and painful resistance. These are now widely recognised as mistaken attempts to avoid an inevitable devaluation. In 1973, under Edward Heath, we only lasted six weeks in the so-called "Snake". In 1976 the IMF put a floor under the gathering depreciation of sterling. As Foreign Secretary, in 1978, I was fully behind the decision of the Prime Minister, James Callaghan, to stay out of the ERM while paying our dues into EMS.

In December, 1980 Treasury officials wanted to devalue but Ministerial resolve, under Margaret Thatcher, insisted on high interest rates to squeeze inflation. In John Major's words, on 5 October, 1990, we entered the ERM "to general applause". On Wednesday, 17 September, 1992 we left it "to general abuse".

Now in January, 2009 we face a situation where the pound sterling has depreciated substantially on a trade weighted basis 27% since mid 2007. The percentage of that depreciation due to the global banking crisis is not yet clear, but probably there is room for an appreciation of the pound. If – and it is a big if – we put the internal disciplines in place to put a floor under its present fall. As the world's fourth largest reserve currency we can recover from this weakness and our exporters and foreign currency earners can start to fill the gap in revenues left through an almost inevitable downsizing of London as a financial centre. It is a reality that if our banks become more boring they will be taking less risk and the stellar returns of the boom years will

be balanced by lower returns, but at least no bankruptcies or banks being bailed out by taxpayers. Would that the Blair/Brown government had taken more notice of some of the Commission's warnings about the fragility of the economy and also Chancellor Merkel's prescient warnings within the G8 of the exuberant excesses of global finances.

Yet even so, had the UK been inside the eurozone, the UK's 15 year boom would have been even bigger. Now inside the eurozone we would have far higher unemployment substituting for sterling depreciation. We would also be paying a large margin over the bund rate as Portugal, Greece, Spain, Ireland and Italy are likely to increasingly experience. The spreads over the German "Bunds" were, as of 26 January, 2.8 percentage points for Greece, 2.8 points for Ireland and 1.6 points for Italy. The spread for the UK was - interestingly enough - only 0.3 points against 0.5 for France and 0.8 for Netherlands. Denmark, also outside the eurozone, had yields of only 0.4 points over "Bunds" while Sweden had yields 0.2 points below Bund yields.

The lesson from all this is not that the UK should have joined the eurozone during the Blair/Brown period of government. Rather the lesson is that we should have had the internal political discipline to build up Treasury finances and our underlying competitiveness. That would have given us now more freedom to manoeuvre. A country operating a floating exchange rate needs more self discipline than one within a fixed system, if it is to avoid periodic devaluations or persistent depreciation.

Today the UK has to be very wary of so-called "quantitative easing". The Bank of England's new Asset Purchase Facility could and should be directed primarily to helping corporate exporters and foreign exchange earners but if it just prints money, it could contribute to current indiscipline and see the pound slide even further.

Within the eurozone the German economy, under Chancellors Schroeder and Merkel, had the self discipline and cooperative framework to improve its competitiveness. But only a few other eurozone countries have been able to do the same. The predictable, but revealingly deep, differences between at least five eurozone economies and the rest are manifest. The international market is increasingly drawing attention to those differences reflected in the rising spreads. Social pressures within these countries are building up and political demands to be bailed out are mounting. Merging eurozone countries' bonds in the longer term might make sense, but for now it is unrealistic.

Economics is a natural science for human behaviour is a huge and unavoidable factor in economic decision making. Lecturing people against personal saving when in the midst of a recession is like forcing water uphill. Saving more is instinctive, and what is more in human terms a good instinct. Managing one's own currency without factoring in the appeal of other currencies is like fighting with one's eyes shut. We must stop in the UK pretending that the UK response to the world banking crisis can be exactly the same as the US. That position ignores the many differences between the intrinsic strength of the dollar as against the pound.

Only a fool outside the eurozone wishes it to collapse, but only a fool within the eurozone believes that it could not collapse. Only a fool within the UK wishes the pound to go on depreciating but only a fool outside the UK believes that this cannot continue. Foreign lenders and investors are bound to watch sterling more apprehensively than they do the dollar. This is not anti-UK sentiment – it is reality.

If a currency substantially depreciates or devalues, it is a defeat, and let us admit it, but it is also an opportunity. For the UK, now, a considerable opportunity. Only one priority follows such falls in the currency - to maximise export-led growth. To that end public expenditure and economic policy has to be ruthlessly orientated towards fulfilling this priority. I see all too little of that orientation within the UK so far and too great an emphasis on increasing overall public expenditure levels as a counter cyclical global investment. The UK has to be far more discriminating in *what* our public expenditure is *doing*, and *where* our expenditure and national effort is being spent.

It is not for me, an opponent of British membership of the eurozone at present, but not necessarily forever, to prescribe for you in the eurozone. But I suggest you too admit a defeat in that the present model of the European Monetary System is locking too many of your countries into an unrealistically high exchange rate. For example, Italy has lost today, I suspect, close to 40% of its competitiveness (in 2007 the OECD put the figure at 34%) since the start of the euro. The eurozone needs to facilitate substantial improvements in competitiveness soon in nearly half of the eurozone countries. This should mean a radical reorientation of European public expenditure spending and far greater discrimination on *what* is spent and *where*. The Lisbon reform programme was meant to address this but has so far largely failed. I suspect it means changing some of the basic structures within the eurozone. For just as the ERM proved to have within it, at least for the UK, some basic flaws so in 2009 the eurozone looks flawed in some of its essentials. Some say Germany will always pay up. I detect a determination in Germany not to fall into this trap. Entry to the eurozone, in effect, despite Treaty language, is voluntary; its members have to be ready to pay the price of being within the Club, and the price is national self discipline, perhaps as compensation slightly less self discipline than choosing to remain outside while avoiding significant depreciation or devaluation.

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