If only Britain had joined the Euro? [1]

Written by **Ben Southwood** [2] | Monday 17 June 2013

Will Hutton tells us, in last Thursday's Guardian [3], that widespread consensus on the UK's staying out of the EU is wrong-headed?joining would have kept our exchange rate low, which in turn would have meant no financial boom and an economy based (more) around producing manufactures. To add to this, our entry would have meant a more activist European Central Bank, which would have been willing to intervene when necessary. There is more wrong with his article than I could possibly tackle in one post, so I will focus on the key elements I've summarised above. None of what I say implies it necessarily would have been bad to have been in the Euro over the past ten years?such an alternative history is almost impossible to conclusively support?just that the arguments Hutton uses are extremely weak.

Pretty much all of his argument is bizarre, utopian and uneconomic. Devaluations work not because they make a country's products cheaper to foreigners, adding to net exports and driving GDP growth. Devaluations work because they boost inflation [4], which gets around nominal wage stickiness, allowing markets (particularly labour markets) to clear and giving relative prices the space to adjust. They make no difference to the price of a country's goods to foreigners, and in practice often boost imports as much as or more than exports, due to improved conditions. This is even true if we devalue by decree, as Hutton's desired artificially low €-£ exchange rate would be?it's just that the inflation could take slightly longer to come as firms and households bid up prices.

What's more, this is a Good Thing. We don't want to spend energy, time, labour and capital hours, as well as space, producing valuable things only to sell them in exchange for artificially few foreign goods. If countries are happy to send us desirable stuff in exchange for less of our stuff then that's great, and in any case it sows the seeds of its own balance, as consistent deficits (ceteris paribus) will drive down the exchange rate. This may eventually force the UK to run surpluses, but this would not be a Good Thing. Running surpluses means lower social welfare because we are consuming less leisure or goods or services than we would otherwise be able to enjoy. And we may never even have to run one if we keep creating loads of property or financial wealth to pay for our imports.

But let's imagine that Hutton could have subverted economic rules as basic as gravity and magically have kept the exchange rate at his desired low rate without any of the obvious expected balancing effects from wages and prices. And let's imagine that we want to send more goods abroad to get less in return. Would this have supported the manufacturing industries he wants? It's difficult to see how. If the City was providing the best financial services options for the world at £1 = €1.25 then it's not obvious that a cheaper pound, and cheaper financial services, would make them less attractive. The UK's economy contains a relatively large contribution from financial services because the UK is relatively good at financial services?as well as hi-tech manufacturing, advertising, and many service sector areas. These are the UK's comparative and in some cases absolute advantages.

And would the UK be better under the ECB (albeit with some British influence) rather than its own Bank of England? It's hard to see why Hutton thinks this. The BoE let inflation rise to hit 5.2% on the CPI measure, and has consistently allowed inflation to stay above target?the ECB has inflation below its 2% target, despite the obscene jobs crises in Spain, Greece and other crisis-hit countries. It is basically refusing to do any monetary stimulus. There is essentially no debate in Europe over whether the ECB should actually meet its inflation target, or indeed consider other economic variables, or go yet more radical and drop inflation targeting altogether. Would the UK's input really outweigh the massive consensus there, especially when the UK is divided on the issue itself? Again, I am sceptical. Strangely, Hutton seems to think that pointing to the UK's own situation and reminding us we're not living in "a land of milk and honey" is sufficient to gloss over the fact that most of the Eurozone is doing so much worse!

This laughable logical leap is nothing compared to his claim that both sides of the political divide are "united only in their belief, against all the evidence including Britain's export performance, that floating exchange rates are a universal panacea." As might be expected, he doesn't give the tiniest shred of evidence that the consensus view holds that floating exchange rates are not only the best exchange rate policy, but a panacea for all types of economic ills. But really, that's not the point. Even if everyone did?ridiculously?think that floating exchange rates were actually a panacea for economic problems, that wouldn't go any way to implying that they weren't better than fixed exchange rates.

Will Hutton's argument is completely invalid, though perhaps he gets some points for making such an outlandish and unpopular case. If it would have been good for the UK to enter the Euro 10 years ago, then it is not because it would have allowed us to permanently rig all markets to send off more of our stuff for cheaper than it is worth. And it seems completely implausible that the UK could have influenced the ECB enough to see it ditch its destructive hard money policies during the crisis, instead it seems more likely the UK would be just another country suffering under its negligence.

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