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Carry on borrowing

Record levels of mortgage approvals, yet again!

Unexpected twist in housing market this summer

The great mortgage boom has become a fixture of the UK political and economic scene. As in the Ealing comedies of yesteryear, the boom is constantly entertaining and its best jokes are unexpected. The British homebuyer has certainly taken commentators by surprise in recent months. Early 2003 saw numerous newspaper reports about the slowdown in the housing market, often accompanied by warnings about how excessive debt had to be corrected by a reduction in consumer spending. The Bank of England responded to these worries by cutting interest rates, with base rate coming down to 3¾% on 6th February and 3½% on 10th July. For a few months these moves to cheaper money looked sensible, as Iraq-related uncertainties hit consumer confidence. But, with Iraq now being eclipsed by other news, mortgage borrowing has responded to the drop in interest rates. Estate agents have been reporting exceptionally high levels of business, and the Bank of England has just published the mortgage approvals figure for September. It was yet another all-time record. At £30.9b. it was 10% above the August figure, which had itself been an all-time record when it was announced. September 2003 was no less than 64.8% up on September 2002!

High mortgage credit risks rapid monetary expansion,

Rapid growth in banks' mortgage portfolios carries the risk of runaway money supply expansion. When a bank makes a new mortgage loan, it credits identical sums to the borrower's loan account (ie., it has an extra asset) and to the borrower's deposit (i.e., it has an extra liability). The new deposit is money. So how are the money numbers behaving? M4 rose by 0.7% in the month of September, while M4 growth in the three months to September ran at an annualised rate of 5.8% and in the year to September at 7.4%. Broad money growth of 7% - 8% was predicted in the January 2003 issue of the *Lombard Street Research Monthly Economic Review*, and described there as being "rather high" and likely to be associated with above-trend growth in domestic demand. The remarks in the January *MER* have proved largely correct.

but too early to be warning about sharply higher inflation

But – for the time being – it would be unjustified to give warnings of inflation rates climbing to 4% or 5%. That would only be warranted if the annual rate of M4 growth were to rise towards or above 10%. If companies start to borrow heavily from the banks, and if the Government were to have increasing difficulties financing its deficit outside the banking system, the mortgage boom would lead to unacceptably high monetary growth. The Bank of England would have to raise interest rates in order to dampen the demand for mortgage credit. It would be most surprising if mortgage approvals in September 2004 were to be 64.8% up on September 2003!

Professor Tim Congdon **31st October, 2003**

Summary of paper on

'The single currency and Europe's constitution'

Purpose of the paper

The central political question raised by the euro is, "can monetary union work without political union?". The recent appearance of proposals for a new constitution from the Giscard d'Estaing Convention signals that political union is necessary for the euro to be a success.

Main points

* Early in the debate on European monetary union British euro-sceptics claimed that the advent of the single currency would lead to a new constitutional dispensation in which the UK, along with other EU members, would lose its independence. The Giscard d'Estaing constitutional proposals substantially validate these claims.

* One-size-fits-all monetary policy has caused divergent macro-economic outcomes in different EU member states. Inflation has been continuously higher in Spain and Ireland than in Germany since 1999.

* The macro-economic divergences have provoked calls for a more active fiscal policy *at the national level*, but this is outlawed by the Stability and Growth Pact.

* Another possibility would be for fiscal policy to be conducted *at the union level*, presumably by Ecofin (i.e., the Council of Ministers, when the council is attended by finance ministers).

* The Giscard d'Estaing proposals include centralised guidance on national fiscal policies, but - ultimately - the EU has no power to coerce delinquent finance ministers. The "excessive deficits procedure" could not be enforced against Germany or France.

* The Constitution's proposals for the EU to have its own "legal personality" and its own foreign minister (supported by an "external action service") are significant. The next step would be an EU finance minister.

* The statement "monetary union cannot work without political union" may be too forthright, but in essence it is correct.

This paper was written by Professor Tim Congdon. It will appear as a Bruges Group pamphlet in the next few months.

The single currency and Europe's constitution

Can monetary union work without political union?

Euro-sceptics argued, when single currency first mentioned, that monetary union would end UK's constitutional independence

The fundamental constitutional question raised by the single European currency has always been, "can monetary union work without political union?". When the single currency was first touted, the answer for many euro-sceptic politicians and commentators in the United Kingdom was "no". (1) They saw the single currency as part of a larger and essentially political project which would end the independence of their nation and reduce it to the status of a region or province inside a federal United States of Europe. Despite the undoubted benefits of a single currency in lowering the costs of intra-European transactions and in simplifying business planning, they regarded the end of British independence as unacceptable.

New European Constitution, with undoubted integrationist intent, proposed as monetary union was being completed

For much of the 1990s the debate about the relationship between monetary and political union was a matter of conjecture, because the single currency had not been introduced. As the single currency does now exist, the debate ought to be easier to resolve. In one sense events tell their own story. Barely was the ink dry on the new euro notes, just ahead of their introduction in January 2002, than Europe's leaders started to discuss further political unification. In November 2001 the leaders of France and Germany held their 78th summit at Nantes and called for a European Constitution. In the words of their joint statement, "The European Constitution that both Germany and France wish will be an essential step in the historic process of European integration." Less than a month later at a meeting in Laeken, Belgium, the European Council endorsed another phase of constitutional reform. It announced a new European Convention, under the chairmanship of Giscard d' Estaing, to prepare a treaty incorporating the proposed Constitution. The Convention held its first meetings in March 2002 and published the draft treaty in July 2003.

But isn't the question posed too sharply? How are "monetary union" and "political union" to be defined?

The vital work on a fully-fledged political union therefore took place at almost exactly the same time that monetary union was completed. The passage of events seems to endorse the euro-sceptics' anticipations and fears. Monetary and political union are inter-related, just as they thought. However, that does not settle the question finally. It could be argued that the question "can monetary union work without political union?" is posed too sharply. What is meant by the idea of the single currency "working"? Of course, it may work in the technical sense that new euro notes circulate and completely replace the old national-currency notes, and yet its wider economic consequences may be disappointing or downright intolerable. The concept of "political union" is even more awkward. Some people would claim that the European Union was already a political union, if of a rather special kind, before the new currency was first broached back in the late 1980s. It is possible to imagine different levels of political union, just as it is possible for the currency to operate with different degrees of success or failure.

The discussion has be taken forward in less trenchant terms. The statement "monetary union cannot work efficiently without a high degree of political union" is not as emphatic as the statement "monetary union cannot work without political union", but it may be quite enough to cast doubt on the wisdom of adopting the new currency. As the euro now has almost five years of history as a currency, an initial assessment can be made about both how well it is working and the degree of political union that might be needed to make it work better. The purpose of this paper is to provide that assessment.

Euro-sceptic warning was that a one-interest-rate-for-all monetary policy would aggravate macroeconomic divergence

A common criticism of monetary union before its inception was that the application of one monetary policy, and in particular one interest rate, to several countries would be misguided. As Europe's nations have different housing markets, banking systems, inflation expectations, labour market institutions, demographic structures and so on, the interest rate appropriate in one of them is unlikely to be appropriate in the others. The loss of the interest rate weapon implied a decline in the efficiency of monetary policy at the national level. Unemployment rates and inflation rates would diverge.

The validity of this warning has been amply confirmed in practice, with marked divergence between stagnant core economies and growing economies on the periphery

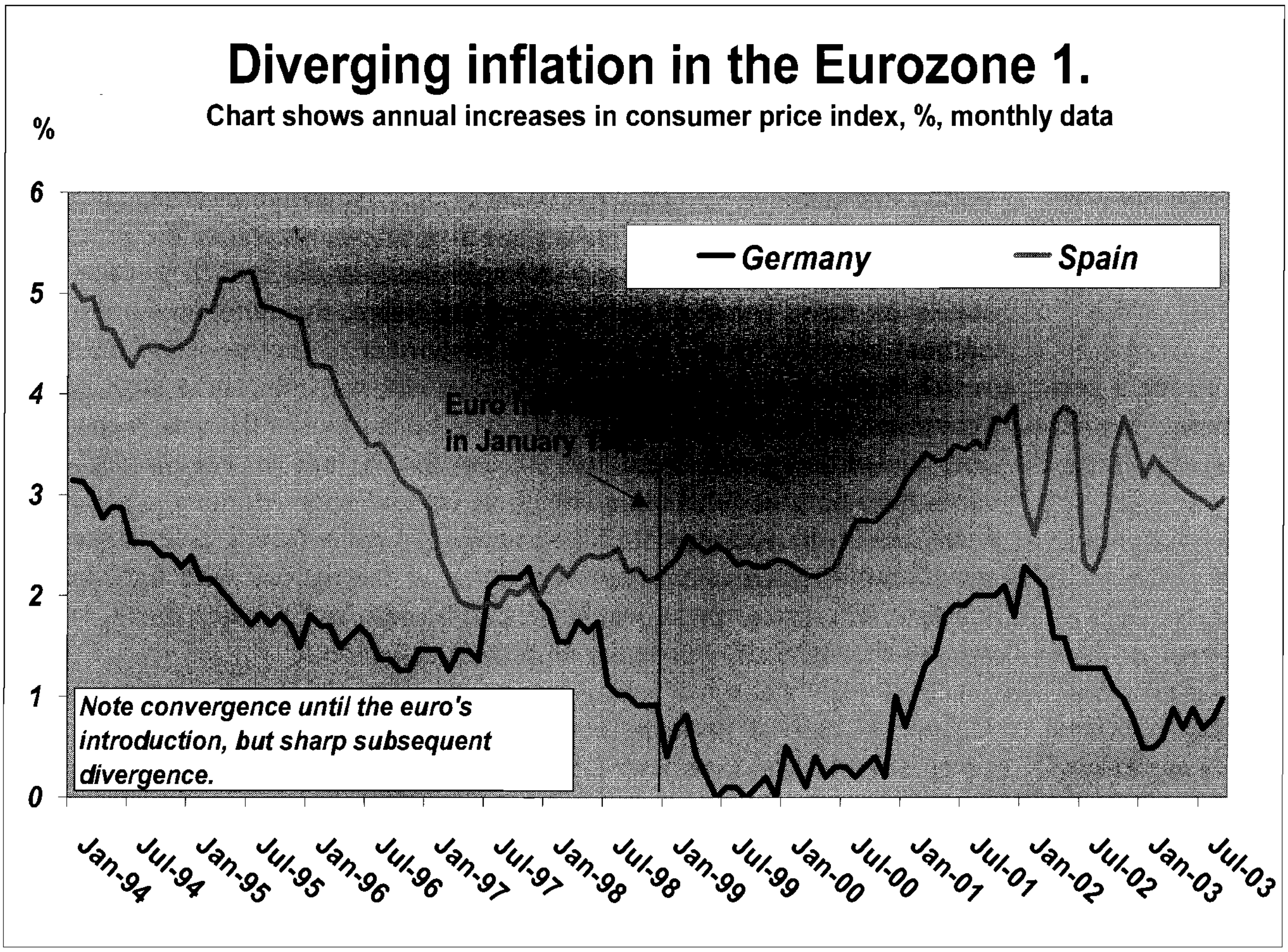
The validity of this criticism has been fully confirmed in practice. The surprise has been the pattern of the winners and losers, and the severity of the divergences that have emerged. In the early 1990s, at the time of German re-unification and high deutschemark interest rates, the almost universal view was that Germany would cope easily with monetary union. Other nations, such as Spain and Ireland on the periphery, were expected to struggle even if they qualified for membership. (At the time they were not expected to qualify.) The outcome has been quite different. Spain and Ireland have growing populations, and largely as a result they also have buoyant property values, busy construction sectors and inflation rates above the European average. They need higher interest rates. By contrast, Germany is increasingly worried about the decline in its working-age population that will begin in the 2010s, house prices have been falling for several years and the construction sector is in a slump. It needs lower interest rates. (2)

Real interest rates have changed perversely in different nations,

With monetary policy centralised in Frankfurt and set in accordance with the state of the Eurozone economy as whole, it is impossible both for Spain and Ireland to get higher interest rates, and for Germany to get lower interest rates. At the time of writing (autumn 2003), the upward pressures on inflation in Spain and Ireland, and the downward pressures on inflation in Germany, persist. Part of the trouble is the effect of the interaction between inflation and nominal interest rates on real interest rates. With a common interest rates in all three countries, the relatively high inflation in Spain and Ireland implies a low real interest rate (which stimulates more borrowing and investment) and the relatively low inflation in Germany implies a high real interest rate (which depresses borrowing and investment). By having a common nominal interest rate, these European nations have aggravated the differences in the real interest rates relevant for borrowers within their borders.

and real estate markets and banking systems have sharply contrasting experiences

But that is not the end of the matter. The real estate appreciation in Spain and Ireland has helped their banks, which have benefited from the rising value of the collateral for loans and suffered only a light incidence of bad debts. Spanish and Irish banks are profitable and well-capitalised, and are keen to expand. By contrast, the slide in real estate values in Germany has caused a record level of loan losses, undermined the capital of the banking system and led to a credit squeeze. In short, the behaviours of real interest



rates and banking systems have aggravated the dis-equilibrium between monetary conditions in the winners and losers.

Equilibrating mechanisms ought to be at work, such as transfer of money balances and bank capital to weak economies

The gap between monetary conditions in the winners and losers should not widen indefinitely. A wide variety of equilibrating mechanisms ought to be at work. The depressed economies ought to have weak imports and hence a balance-of-payments surplus, and the balance-of-payments surplus ought to boost the quantity of money. Conversely, the buoyant economies are likely to drag in imports and suffer a balance-of-payments deficit, which reduces the money balances their citizens hold. Despite the credit boom in Spain and Ireland, and the credit squeeze in Germany, payments surpluses and deficits between the economies should go a long way to equalise monetary conditions. Even the contrast in the capital adequacy of the different banking systems may prove transient. Competition between the well-capitalised Spanish and Irish banks should drive down profit margins, while the capital weakness of the German banks results in less competition and wider profit margins. Some of the Spanish and Irish banks may be tempted to re-deploy their capital in Germany, either by starting new operations or by acquiring German banks. The transfers of bank capital between nations ought to prevent markedly different rates of credit growth. (3)

But such mechanisms have not been strong enough

But so far have the equilibrating mechanisms have been trounced by the disequilibrating mechanisms. The upset, in the first five years of the euro, has been the failure of the equilibrating mechanisms to neutralise the pressures for divergent inflation rates and unemployment levels in different member states. As many commentators warned years ago, the Eurozone is not "an optimal currency area". This has led supporters of the monetary union to search for another policy instrument to deal with the imbalances between the countries. As monetary policy is ruled out by the fact of the single currency and single interest rate, fiscal policy seems the obvious answer. Some economists have proposed that taxes should be cut and/or government expenditure increased in the nations with high unemployment, whereas taxes should be raised and/or government expenditure cut in the nations with tight labour markets. The prescription would be fairly traditional Keynesianism, but in the novel context of a monetary union. (4)

Search for a new instrument, such as fiscal policy

But activist fiscal policy *at national level* proscribed by Maastricht Treaty

Unhappily, activist fiscal policy *at the national level* is not allowed. It is precluded by the Maastricht Treaty and, in particular, by the Stability and Growth Pact which accompanied it. The most important sponsor of the SGP in the early negotiations on monetary union was the German government, heavily influenced by the Bundesbank. Twice in the 20th century, in the years following the two world wars, Germany suffered a drastic decline in the value of money through hyperinflation. Hyperinflation was interpreted – correctly – as the result of the over-issue of money because the central bank was forced to provide overdraft finance to a deficit-prone government. These experiences made the architects of the post-war German *wirtschaftswunder* hostile to high money supply growth, overdraft finance to the state from the central bank and large budget deficits. (5) The Bundesbank's orthodoxies of sound finance were incorporated in the Maastricht Treaty and the SGP. In its early years the European Central Bank regarded money supply targeting as a vital "pillar" in policy making (6); the Maastricht Treaty outlaws overdraft finance from the ECB to any government or public sector body; and the treaty also restricts budget deficits to a maximum of 3% of gross domestic product.

Anglo-American Keynesians sneer at restrictions on national fiscal policy contained in Maastricht Treaty

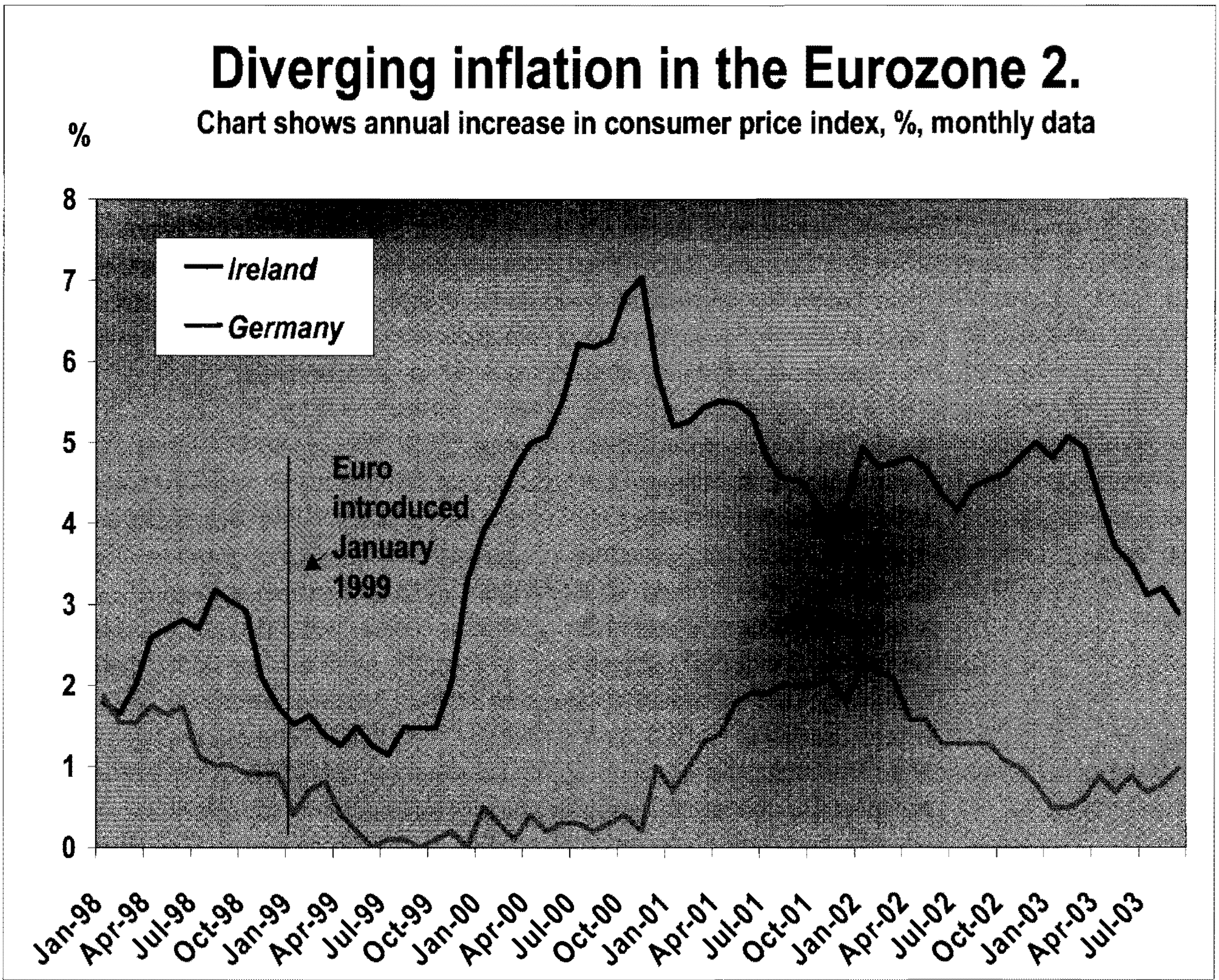
The Bundesbank orthodoxies may or may not be sensible macroeconomic principles. Anglo-American Keynesians may vilify and dismiss these orthodoxies as hag-ridden central European nonsenses which have no place in modern economic theory; their critique may have been one influence on Signor Prodi's characterisation of the Stability and Growth Pact as "stupid". But – for present purposes – that is not the point. Whether the Keynesians and Prodi like it or not, the limits on the budget deficits are enshrined in an international treaty. Activist fiscal policy at the national level is not available to policy-makers. According to the rules laid down in the treaties, fiscal policy must be geared to approximate balance over the medium term, while deficits above 3% of national income can be allowed only in exceptional circumstances and certainly must not become recurrent.

But the new Constitution reiterates these restrictions,

There has been some speculation that the SGP rules may be re-drafted or even relaxed. It is therefore striking that the proposed new Constitution not only reiterates the rules, but also spells out in some detail the so-called "excessive deficits procedure". This is the sequence of steps that are to be taken – by the Council of Ministers and the European Commission – to assess the economic situation in a nation with a large deficit, to admonish it for letting the deficit emerge and, eventually, to fine it for its transgressions. Ironically, one victim of these parts of the Constitution could be Germany, where the fiscal deficit has exceeded 3%of GDP for two successive years and where the deficit may again be too high in 2004. A most surprising prospect lies ahead. The nation most committed in the early 1990s to the sound finance orthodoxies in the Maastricht Treaty is also the nation most likely to be damaged in the first decade of the 21st century by the application of the rules based on them.

although the "excessive deficits procedure" (to sanction the fiscally improvident) is unlikely to be enforceable, particularly in the German case

Of course, if Germany were to be fined, that would aggravate the imbalance in its public finances. Indeed, if this situation were to arise, the Keynesians might remark that action to reduce the budget deficit, taken in response to pressure from EU institutions, would be worsen the weakness of domestic demand and so would be perverse. Another potential source of instability here is that Germany is, and always has been, the largest net contributor to the EU's funds. If the excessive deficits procedure were to be taken to its limits,Germany's taxpayers would be paying the rest of Europe *in the form of both fiscal transfers which constitute much of its large budget deficit and a fine imposed because that deficit was excessive*. This would be paradoxical, to say the least. The Council of Ministers (i.e., Ecofin, in this case) would surely be foolish to press ahead with the excessive deficits procedure. In the extreme Germany might turn nasty and retaliate by cutting back on the large sums of money it pays to the EU, sums which are basic to the viability of the whole European construction. (7)



But - if the excessive deficits procedure became unforceable - the fiscal basis of the monetary union would have disintegrated

But, if Germany and France cannot be fined, would Ecofin have the moral legitimacy to fine any nation? It is possible that the finance ministers will never, by a qualified majority vote, endorse a fine on a particular nation. (Qualified majority voting invites coalition formation and bargaining, and nations may well vote to protect their interests rather than to apply an impartial set of rules.) But, if fines are never to be imposed, the excessive deficits procedure would be null and void. Admirers of the EU's institutions might ask themselves whether monetary union could work without some constraint on nations' budget deficits; sceptics might comment that the whole situation had become ridiculous, that the excessive deficits procedure could not be enforced and that this key element in the monetary union had lost all credibility. Both admirers and sceptics might well agree on one proposition, that monetary policy cannot work well in an incomplete political union where fiscal policy has not been centralised.

What, then, about the pursuit of an activist fiscal policy *at the union level*?

What would the Eurozone's governments do about the mess? One response would be to recognise that the monetary union had been a mistake and to consider how it might best be unravelled. But that seems unlikely in the next few years. A far more probable outcome is that the leaders of the Eurozone member states will take steps to deepen their economic and financial integration, and to involve the three non-Eurozone EU members (i.e., the UK, Sweden and Denmark) in the process. If this attempt were successful, activist fiscal policy might be conducted *at the union level*, even though it were still outlawed at the national level. Newly-centralised fiscal policy would complement already centralised monetary policy, in the hope that it would overcome the defects of the one-size-fits-all interest rate.

The new Constitution does indeed propose "multilateral surveillance" of policies - including fiscal policies - pursued by governments at national level

The new Constitution does not promise (or threaten) this in precise and unambiguous language. However, the general notion is clearly adumbrated in Article III-71, on "Economic policy", in Title III ("Internal policies and action"). According to paragraph two the Council of Ministers is to set "broad guidelines" for the economic policies of member states. In the pursuit of "closer coordination of economic policies and sustained convergence of the economic performances of the Member States", paragraph three of Article III-71 says that the Council of Ministers, using reports prepared by the Commission, "shall monitor economic developments in each of the Member States and in the Union, *as well as the consistency of economic policies with the broad guidelines referred to in paragraph 2.*" (Italics added.) In other words, Ecofin – with the full authority of the EU – is to implement "multilateral surveillance" of every nation's economic policies. Indeed, paragraph four goes further. If a nation's policies are deemed inconsistent with "the broad guidelines", "the Commission may address a warning to the Member State concerned" and Ecofin "may address the necessary recommendations to the Member State concerned". (8)

These proposals signal the centralisation of fiscal policy under Ecofin, to follow the centralisation of monetary policy under the European Central Bank

The phrases "broad guidelines", "multilateral surveillance", "a warning" and "the necessary recommendations" all appear in the text of the Constitution. On the face of it, these are stern words, and the paragraphs have not been included as a joke or a piece of decoration. They mean something. But, as monetary policy is the task of the ECB, what is it that they mean? The only possible interpretation is that they signify a further centralisation of fiscal policy. Indeed, the Commission's warning given to Ireland in 2000 – when its budget delivered large tax cuts in a boom – was justified on the basis that it breached the "broad guidelines" agreed by the Council. If Article III-71 of Title III has any substance, it is that the determination of fiscal policy guidelines is to be centralised under Ecofin just as monetary policy has been centralised under the European Central Bank.

Ecofin might agree an aggregate fiscal position for the union and then apportion a share of the deficit or surplus to member nations,

The extent of the centralisation is not yet clear. It would be wrong to think that a particular key bureaucrat or politician has a definite agenda widely understood, assimilated and respected by other key bureaucrats and politicians. One possibility is that Ecofin might agree a target deficit for the Eurozone as a whole and then apportion slices of the aggregate deficit to member states. But the difficulty is that the EU still would not have an enforcement mechanism against member states which violate the deficit (or surplus) guidelines agreed within Ecofin. While the ability to raise taxes and the administration of public expenditure remain at the national level, Ecofin is ultimately powerless. Without the excessive deficits procedure (or something like it), its only sanction is moral and consists essentially in peer group pressure between the political leaderships of the 12 European nations involved. Ecofin can warn, cajole and verbally chastise the ministers from fiscally delinquent member states, but it cannot dismiss them. The EU does not have a civilian police force, any riot or military policy, a secret service or an army.

but it could not ultimately control the nations

Union control over the nations would come only if the EU had an army, a police force and an

Or, rather, the EU does not yet have a civilian police force, any riot or military police, a secret service or an army. To say that the EU does not at present have these ingredients of a nation state does not mean it will not acquire them (or at any rate attempt to acquire them) in future. Indeed, the precise purpose of certain parts of the Constitution is either to introduce them now or to facilitate their introduction at a later date. A meaningful "European army" is not in being, but France and Germany have for many

intelligence (or "secret") service, and the Constitution makes proposals to establish institutions of this kind

years tried to establish a joint military force. In this context the new Constitution's proposal for a Common Foreign and Security Policy is fundamental. As noted in article III-97, "For matters relating to the common foreign and security policy, the Union shall be represented by the Union Minister for Foreign Affairs." Further, in "fulfilling his or her mandate", this individual "shall be assisted by a European External Action Service". The size of the staff and budget of this "External Action Service", and the terms of its remit, are not discussed in the Constitution, but information gathering – including espionage – is the work of every such organization in a nation state. Sharp questions have to be asked about the service's ultimate loyalties. These cannot be to the member governments of the EU, as they have their own security forces; the loyalties must instead be to the EU as such.

EU's proposed acquisition of "legal personality" very important

In this context the Constitution's provisions to give the EU its own "legal personality" are of great potential importance. The EU's proposed acquisition of legal personality has been presented as a largely technical matter, to help it in the negotiation and adoption of international agreements. In fact, the EU's new legal status would be a revolutionary change. The EU would become a power in its own right; over time it could transcend the nations of which it was originally composed.

With its own legal personality EU could have debts and tax-raising powers separate from those of the member nations, as in the USA

In the economic sphere the attachment of legal personality to the EU itself would have a drastic consequence. *The EU could have its own debt and tax revenues as well as a budget.* True enough, the Constitution is firm on the need to avoid budgetary imbalance and does not envisage the transfer of tax powers to the EU. For the time being the EU has its "own resources", but these are not "EU taxes"; they are obtained from the member nations and reflect agreements between governments. However, with the EU having legal personality and expenditure in its own name, only one more treaty would be required for it to obtain a revenue-raising authority and its own tax receipts. The current batch of constitutional proposals includes one for an EU foreign minister; the next batch might go further, with a proposal for an EU finance minister. Indeed, the appointment of a finance minister would follow logically from the centralisation of fiscal policy in Ecofin. If so, fiscal policy would be centralised to the same extent as in acknowledged federal political unions. The situation would increasingly resemble that in the United States of America, where both the federal government and the state governments have legal personality, and have expenditure, tax revenues and debts in their own names. Indeed, in the USA the relative size of federal and state tax revenues is a live political question and has been so for decades.

In early drafts of the Constitution the union was to be re-named the United States of Europe

Obviously, if Europe's fiscal institutions were to evolve in this way, monetary union would have led to a political union. (No one denies that the United States of America is a political union!) The widespread endorsement of the new Constitution by Europe's political elites has a clear message. It is that the tensions and squabbles generated by the Stability and Growth Pact are likely to be followed by greater centralisation of fiscal powers not by a retreat from monetary union. To repeat, only one more treaty – with relatively minor changes to the words in the existing *acquis* – would be necessary for the EU itself to have tax-raising powers and its own finance minister (9). The EU might then quite reasonably be re-named "the United States of Europe". As it happens, the possible re-naming of the EU along these lines was indeed suggested in early versions of Giscard d' Estaing's constitutional proposals. The proposals had the transparent and unequivocal intention that monetary union evolve into a political union.

Mr. Brown has claimed that USA shows that single currency can be reconciled with tax competition, but - emphatically - the USA is a fully-fledged political union

In evidence to the Treasury Committee of the House of Commons on 27th February 2003 Mr. Gordon Brown, the Chancellor of the Exchequer, commented on the American position. He claimed that the important role of local taxation in the USA refuted the notion that monetary union would not work without tax harmonisation. While reiterating its support for the single currency in principle, he insisted that, "As a United Kingdom Government we oppose tax harmonisation...There is no need for there to be tax harmonisation and the experience of the United States of America is one demonstration of that". But this was – to say the least – a disingenuous and unsatisfactory argument. The USA does have differing levels of local taxation and, in that sense, tax competition. However, this tax competition takes place within a unified nation-state where a powerful federal government raises substantial amounts of tax, charges identical tax rates across the whole country and has a well-established tax-raising authority (the Internal Revenue Service). The American example demonstrates, emphatically, that monetary union entails fiscal centralisation and political union.

Unsatisfactory operation of monetary union in a half-baked political union shows that a fully-fledged political union needed to make it work better,

Perhaps the assertion "monetary union cannot work without political union" is too forthright. Experience in the EU since 1999 shows that monetary union can work in a multi-nation political entity, even though that entity does not know what to call itself, is riddled with uncertainty about the location and enforceability of fiscal prerogatives, and may not be a fully-fledged, all-singing-and-dancing "political union". But that experience also shows that – insofar as a single currency "works" in these circumstances – it does so inefficiently and divisively. Events since late 2001, and in particular the proposal of a new Constitution with the frankly-stated objective of mak-

but that would end the member nations' political independence

ing the EU resemble the USA, argue that key European policy-makers are worried about the long-run sustainability of monetary union without much greater centralisation of fiscal and other powers. To say that "monetary union cannot work without political union" may over-simplify matters, but to say that "monetary union cannot work well without a degree of political integration akin to that now found in such federal states as the USA" is amply justified by recent European developments. Lord Hurd was right to warn in 1998 that the single currency project was Europe's "Maoist leap forward". (10) Nations that wish to resist their absorption in a new European super-state must keep their own currencies.

Notes

(1) The point was made at an early stage in the debate about the single currency by Mr. Nigel (later Lord) Lawson who said in 1990, "It is clear that European Monetary Union implies nothing less than European government – albeit a federal one – and a political union: the United States of Europe." In a pamphlet on *EMU now?: the leap to European money assessed* the author also concluded that the debate was ultimately "about politics...not in a narrow party sense, but in the larger sense of how people, communities and nations live together and relate to each other...Indeed, it is about the very definition of the 'nations' to which the constitutional arrangements apply." (Tim Congdon *EMU now?* [London: Centre for Policy Studies, 1990], p. 29.)

(2) In August UBS published an analysis of interest rates in the Eurozone, seeing whether the 2% set by the European Central Bank was in line with the level implied by a Taylor rule in any of the member nations. The 2% rate was in fact inappropriate for every nation.

(3) In mid-2003 the Tier 1 capital of banks in Spain was 9.1% of assets, whereas in Germany it was 4.8%. (Source: ECB)

(4) The idea was broached by Mr. Christopher Allsopp, a member of the Bank of England's Monetary Policy Committee from 2000 to 2003, in a talk earlier this year to the Society of Business Economists.

(5) The principle of a balanced budget was incorporated in the Basic Law of May 1949. The notion of Keynesian deficit financing was explicitly rejected by Fritz Schäffer, the Federal finance minister from 1949 to 1957. (See p. 169 of *Fifty Years of the Deutsche Mark* [Oxford: Oxford University Press for the Deutsche Bundesbank, 1999].) The strictness of the balanced-budget provision in the Basic Law was qualified by the Stability and Growth Act of 1967. Article one of the 1967 Act obliged the Federal and Lander governments to implement economic and fiscal policies so that "they contribute concurrently to the stabilization of prices, to a high level of employment, and to external equilibrium with steady and adequate economic growth". (See p. 180 of *Fifty Years of the Deutsche Mark.*) Note the similarity of the title of the 1967 Act in the then West Germany and that of the Stability and Growth Pact attached to the Maastricht Treaty in 1992.

(6) This "pillar" has now (October 2003) been dropped, although the ECB's research department continues to analyse trends in money supply growth in far more detail than the research departments of other leading central banks.

(7) Germany's net contribution to the EU has in fact been falling in recent years, reflecting low economic growth and consequently reduced VAT revenue (on which EU contributions are largely based). Germany's net transfer to the EU in 2002 was 11.2b. euro, compared with a net transfer by the UK of £3.8b. (These numbers are drawn from balance-of-payment statistics.)

(8) Ecofin includes the UK, Denmark and Sweden, although these nations retain their own currencies. There is some ambiguity about whether Ecofin can reprimand them even while the euro is not their currency and about the validity of their involvement in Ecofin, if and when Ecofin admonishes Eurozone members.

(9) The likelihood that the single currency would lead to the appointment of an EU finance minister was noted by John Redwood in *The Death of Britain?* In his words, the single currency leads "in the continental mind" to "a single Finance Minister, a single economic policy and single taxation". (See John Redwood, *The Death of Britain?* [Basingtoke and London: Macmillan, 1999], p.170.)

(10) Lord Hurd used this phrase about the single currency project in his Jubilee Lecture to the Institute of Actuaries in 1998.