RESEARCH PAPER 03/53
4 JUNE 2003

The euro: background to the five economic tests

This paper is intended to provide an overview of the Government's five economic tests that it has declared must be met in order for it to recommend that the economic conditions are right for UK entry into the European single currency.

It summarises the origin of and background to the five tests and provides an analysis of public opinion polls in the UK and eurozone countries, along with some key economic indicators.

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ISSN 1368-8456

Summary of main points

The euro is the single currency used by twelve of the fifteen member states of the EU. The introduction of the euro is the final stage of EMU (European Monetary Union).

In 1997, the Chancellor set out five tests which would determine whether it would be in the UK's economic interest to join the single currency and adopt the euro. The Treasury tested the economy against these in 1997 and the economy failed. The tests have been assessed by the Treasury once again and the results will be announced in a statement to the House by the Chancellor on 9 June 2003.

Opinion polls show consistent net opposition to the UK joining the euro. However, they also show that a significant proportion of respondents could be persuaded to change their mind if entry would be good for the economy.

This paper sets out the five tests, covers the Treasury Select Committee enquiry on the euro, the approach the Treasury has taken to assessing the five tests, and the results of current public opinion polls.

The appendices provide economic indicators for the UK, US and the eurozone.

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I The five tests

A. Introduction

The euro, the EU’s single currency, was created on 1 January 1999, and by the time notes and coins were issued in January 2002, twelve of the fifteen EU states were members. On entering office in 1997 the Labour Government set out, through a statement by the Chancellor, its policy on the single currency and EMU (European Monetary Union):

> When we came into government, I asked the Treasury to carry out an assessment of the economic tests that have to be met [to join the single currency]. Accompanying my statement is a detailed and comprehensive Treasury assessment, which I am publishing today, copies of which are available in the Vote Office.
>
> I start with the question of principle. The potential benefits for Britain of a successful single currency are obvious in terms of trade, transparency of costs and currency stability. Of course, I stress that it must be soundly based. It must succeed. But if it works economically, it is, in our view, worth doing. So in principle, a successful single currency within a single European market would be of benefit to Europe and Britain. Secondly, it must be clearly recognised that to share a common monetary policy with other states represents a major pooling of economic sovereignty.
>
> There are those who argue that this should be a constitutional bar to British participation in a single currency, regardless of the economic benefits that it could bring to the people of this country. In other words, they would rule out a single currency in principle, even if it were in the best economic interests of the country.
>
> This is an understandable objection, and one argued from principle, but in our view it is wrong. If a single currency would be good for British jobs, British business and future prosperity, it is right in principle to join. The constitutional issue is a factor in the decision, but it is not an overriding one. Rather, it signifies that, in order for monetary union to be right for Britain, the economic benefit should be clear and unambiguous.
>
> I therefore conclude on the question of principle that if, in the end, the single currency is successful and the economic case is clear and unambiguous, the Government believe that Britain should be part of it.
>
> There is a third issue of principle--the consent of the British people. Because of the magnitude of the decision, we believe, again as a matter of principle, that, whenever the decision to enter is taken by Government, it should be put to a referendum of the British people. Whenever this issue arises, under this Government there will be a referendum. Government, Parliament and the people must all agree.

> We conclude that the determining factor as to whether Britain joins a single currency is the national economic interest, and whether the economic case for doing so is clear and unambiguous.
>
> I turn now to the Treasury's detailed assessment of the five economic tests that define whether a clear and unambiguous case can be made. These tests are, first, whether there can be sustainable convergence between Britain and the economies of a single currency; secondly, whether there is sufficient flexibility to cope with economic change; thirdly, the effect on investment; fourthly, the impact on our financial services generally; and fifthly, whether it is good for employment.[1]

The Chancellor went on to state that the UK economy had not passed these tests and so the Government concluded that joining the single currency with eleven other EU member states[2] in 1999 was not in the UK's interests.

During 2001, the Government set a new deadline for assessing the five tests again within two years of the beginning of the new Parliament. The Treasury comments:

> The Chancellor will present the Government's statement on the assessment on the euro on Monday 9 June. The Government's preliminary and technical analysis supporting the five tests assessment and comprising 18 supporting studies will be published alongside the assessment.
>
> On the basis of the assessment, the Government will take a decision on whether the Five Tests have been met. If the Government recommends UK entry, it will be put to a vote in Parliament and then to a referendum of the British people. Government, Parliament and the people must all agree.[3]

In light of the forthcoming statement, this paper outlines the five tests and the economic rationale behind them. The appendices contain key economic indicators for the UK, the eurozone, and the US.

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1 HC Deb 27 October 1997 cc583-4

2 Greece joined in 2001, completing the twelve original members of the euro

3 HM Treasury Website as at 4 June 2003 http://www.hm-treasury.gov.uk/documents/the_euro/euro_index_index.cfm

B. The five tests

The Chancellor outlined the five economic tests in detail in the Treasury's assessment of them in October 1997. They 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?
- Would joining EMU create better conditions for firms making long-term decisions to invest in Britain?
- What impact would entry into EMU have on the competitive position of the UK's financial services industry, particularly the City's wholesale markets?
- In summary, will joining EMU promote higher growth, stability and a lasting increase in jobs?[4]

These tests are also known as the convergence test, the flexibility test, the investment test, the city and financial services test and the growth, stability and jobs test.

As part of the work underpinning the assessment of the five tests, the Treasury will also be publishing eighteen supporting studies which consider specific economic issues in the UK and the euro debate. These will cover:[5]

- The monetary transmission mechanism;
- The housing market;
- National business cycles;
- The exchange rate;
- Labour markets;
- Adjustment mechanisms and how the UK economy responds to shocks;
- Using fiscal policy as a stabiliser;
- The cost of capital;
- Impact of joining the euro on business in the manufacturing and service sectors of the economy;
- Financial services and the City;
- Trade;
- The experience of the US as a monetary union;
- Fiscal and monetary policy in the eurozone, including the Stability and Growth Pact;
- Price differentials;
- The transition to the euro;

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4 HM Treasury, *UK Membership of the Single Currency : An Assessment of the Five Economic Tests*, October 1997

5 Treasury Committee, *The UK and the euro*, 24 April 2003, HC 187-I 2002-03, para 60-1

- A selection of specially commissioned papers by international academics on aspects of British membership of the euro; and
- The overall framework for the assessment of the five economic tests.

C. Treasury Select Committee report, Session 2002-03

The Treasury Select Committee produced a report on the UK and the euro in April 2003.[6] This followed previous reports produced in 1998 and 2000 on the same subject. A section of the 2003 report considers the five economic tests and extracts are reproduced below.

1. Convergence test

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

> 69. Convergence is one of the most significant of the five tests. The Treasury stated, at the time of the first assessment, that "we need to demonstrate sustainable and durable convergence, before we can be sure that British membership of EMU would be good for growth and jobs". As already stated, if the UK joins the euro, responsibility for fixing interest rates for the UK economy will pass to the European Central Bank, which sets rates according to the economic conditions in the eurozone as a whole. Although the UK would account for around 20% of the eurozone economy and would have some input into the determination of the rate through a seat on the Governing Council of the ECB, if the UK economy has not converged with the economies of the eurozone then the interest rates set might be inappropriate for the UK. This could lead to instability in the economy, and in the short term to excessive inflation if interest rates were too low or increased unemployment if interest rates were too high, threatening a return to 'boom and bust'. What does convergence mean in practice? The test divides convergence into two main issues which seek to determine both whether the UK is currently converged with the eurozone and also whether the convergence is capable of being sustained. The first issue is whether the UK is at a similar point in the economic business cycle to the eurozone economies—this is known as 'cyclical' convergence. The second issue is whether the convergence is capable of being sustained, which will involve analysing whether there is 'structural convergence'—i.e. whether the structures of the UK and eurozone economies are similar. This will establish if there are particular features of the UK economy that could lead it to react differently to changes in eurozone interest rates or to other types of economic shock.[7]

[6] Treasury Committee, *The UK and the euro*, 24 April 2003, HC 187-I 2002-03
[7] ibid., para 69

> 72. There was broad agreement amongst witnesses that there had been some convergence between the UK and eurozone since the Treasury's previous assessment in 1997. Mr Weale told us that the economies were "much more converged than in 1997". At the time of the previous assessment there was a difference of around 4 percentage points in UK and eurozone interest rates and the difference is currently 1.25 percentage points. Mr Taylor believed that "we are more convergent, the question is whether we are convergent enough". Structural obstacles to sustainable convergence such as labour markets, the housing sector, and trade linkages were identified, although the importance of these was disputed by Britain in Europe. Some witnesses believed that the act of joining the euro could increase convergence. Professor Moore believed that "convergence is a feature of countries that are already in monetary union, it is not something that takes place beforehand". **There has been substantial convergence between the UK and the eurozone economies since 1997. In some respects the level of convergence is greater than that between some of the eurozone members themselves before 1999. However, the Treasury assessment must include examination of whether convergence to date is cyclical or structural. It must also examine the implications of the recent imbalances in the economy for achieving sustainable and durable convergence and whether these imbalances would have arisen had the UK been in the eurozone from the outset.**[8]

The report also comments on the importance of how the UK economy reacts to interest rate changes, the importance of the exchange rate and the influence of the housing market on the economy in general.[9] It also considers the degree of convergence required for entry:

> 78. Present members of EMU joined on the basis of satisfying broad convergence parameters set out in the Maastricht Treaty covering price stability; sustainability of government finances; long term interest rates and exchange rate stability (discussed further at paragraphs 97-98 below). For some years the UK has satisfied the Maastricht criteria, except membership of the ERM. The question now is how much further convergence there needs to be before normal economic forces, by a process of adaptation and adjustment, can be relied on to bring about sufficient convergence without jeopardy to growth and stability. To demand total convergence before joining EMU is likely to be an impossible condition to fulfil and indeed not all present EMU members fulfil it. The judgement of whether the present degree of convergence is enough for any adverse consequences of post entry adjustment to be outweighed by the benefits of membership is more political than economic.[10]

8 ibid., para 72
9 ibid., para 73-77
10 ibid., para 78

2. Flexibility test

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

> 81. We asked our witnesses what types of flexibility it was important for the UK to have if it was to join the euro. Mr Bootle interpreted the test as being "mainly about labour market flexibility" and "the ability of [the] wage and price structure to adjust". To the TUC flexibility meant workers "being agile, ...capable of change, ...well rewarded, well trained and well educated and ...able to adjust without their wages being adjusted downwards rapidly or their hours being chopped and cut around". Mr Dicks regarded this as a symmetrical test requiring flexibility both for the UK and the eurozone. The Chancellor confirmed this saying that the "test looks at whether there is sufficient flexibility to enable us to withstand shocks. In other words, it is movement in achieving greater flexibility that we have been looking for both in the UK economy and in the euro area." **Labour market flexibility is important for the UK economy, if it is to respond efficiently to shocks. We ask the Treasury to clarify and define the ways in which there has to be flexibility amongst the eurozone countries and the UK for this test to be passed. We note the Chancellor's statement in Budget 2003 in respect of achieving greater labour cost flexibility in the regions of the UK. We hope the Treasury assessment will say more about the context for this reform.**[11]

If problems emerge, a Government may seek to use policy to correct it. Under EMU, monetary policy control is no longer available for an individual country. The report goes on to discuss the importance of fiscal policy in relation to the flexibility test.[12]

3. Investment test

Would joining EMU create better conditions for firms making long-term decisions to invest in Britain?

The Committee discussed the importance of exchange rate risk for business and whether joining the euro would facilitate less currency risk.[13] They went on to look at foreign direct investment (FDI):

> 86. The Treasury has said that "Evidence suggests that foreign direct investment into the UK can raise the productivity of UK firms through technology and skills spillovers. The preliminary and technical work is considering how EMU would affect FDI inflows to the UK". The UK has a well established track record of attracting much higher levels of foreign direct investment than other countries in the EU. Several different sources of statistics were presented to us including those from Eurostat, Ernst & Young and the UN. Dr Coyle told us that "it is impossible

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[11] ibid., para 81
[12] ibid., para 82
[13] ibid., para 83-5

to draw strong conclusions about FDI flows given that they have suffered globally and that much UK inward investment has come from the US in the past. Nevertheless the UK's share of EU inward FDI has fallen". Mr Bootle cautioned that that FDI is "imagined as being some foreign company moving to a greenfield site and building a car factory" whereas it is sometimes "essentially a financial transaction where a company is taking over another company's shares". Ms Lea believed that swings in FDI had a lot to do with mergers and acquisitions and that figures could be distorted by big takeovers such as Vodafone's takeover of Mannesman (which was was a factor in the large increase in Germany's share of intra European FDI to over 30% in 2000, from 10% in 1999). Dr Coyle believed that there will be a clearer picture of whether the UK's share of FDI has declined as a result of being outside the eurozone when global investment flows start to increase.[14]

87. **Membership of the single currency is likely to provide the conditions for more and better investment if there has been sufficient convergence between the UK and the eurozone and sufficient flexibility exists. In this way the third test is to some extent a consequence of whether the first two tests have been satisfied. We received evidence from a number of firms that over time investment decisions would increasingly favour the eurozone at the expense of the UK. The assessment must cover the extent to which volatility against the dollar could be increased if the UK joined the eurozone and what effect this could have on inward investment to the eurozone from the US. The accuracy and significance of the large volume of inward investment statistics needs to be assessed, if possible with the effects of mergers and acquisitions identified and separated out.**[15]

They also considered the potential impact on public investment and concluded:

We welcome the examination within the assessment of whether the Stability and Growth Pact would place any constraints on the level of public investment in excess of those of the Government's fiscal rules. While the recent proposals allow a temporary deviation in the short term from the close to balance requirement to fund public investment, it is important to estimate whether investment projections in Budget 2003 could be constrained because overall deficits would breach the 3% limit of the Stability and Growth Pact.[16]

14 ibid., para 86
15 ibid., para 87
16 ibid., para 88

4. City and financial services test

What impact would entry into EMU have on the competitive position of the UK's financial services industry, particularly the City's wholesale markets?

The Committee recognised the conclusions of the 1997 Treasury report:

> 89. The Treasury has stated that "given the importance of the financial sector to the UK both in terms of employment and indivisible earnings, it is vital that the decision on whether to join the single currency does not damage the sector's competitiveness". The assessment of the five tests in 1997 concluded that "EMU offers benefits to the UK financial sector whether the UK is in or out. But the benefits and the opportunities from the single currency will probably be easier to tap from within the eurozone". Mr Lascelles of the Centre for the Study of Financial Innovation told us that "nonmembership of the eurozone has not damaged the City in any way" and that "fears at the time of the euro launch that the City would lose out to continental centres, particularly Frankfurt, ... have not materialised." Mr Rake believed that the threat to the City from the UK being outside the eurozone was "longterm rather than shortterm" but that in the "increasingly competitive environment, remaining outside the euro risks putting the City at a unique disadvantage to its European competitors".[17]

They concluded:

> **Many witnesses stated that the financial services sector had not yet been adversely affected by being outside the eurozone, but that it would wrong to be complacent about the position of the City as Europe's dominant financial centre. We believe that as well as assessing the recent performance of the financial services industry the test also needs to reflect a forward looking approach examining both potential opportunities and threats. It is also important to examine any possible effect on the UK's influence on European financial regulation from being outside the eurozone.**[18]

5. Growth, stability and jobs test

In summary, will joining EMU promote higher growth, stability and a lasting increase in jobs?

> 92. This, the final and most fundamental test, will draw on all the preceding analysis to assess whether joining the euro would overall be good for growth and jobs. The technical analysis "is—as in 1997—analysing the potential benefits of EMU for the longer term performance of the economy. The assessment will compare these against the potential costs of joining". As noted above, we believe it is important to recognise that remaining outside the euro has costs as well as

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[17] ibid., para 89
[18] ibid., para 90

> benefits and that this test should be assessed against a scenario of the possible future performance of the UK economy outside the eurozone.[19]

The Committee concluded:

> **As the Treasury itself admits, this crucial fifth test rests on judgements about long term effects. They cannot be known with certainty in advance. The assessment is therefore a judgement and the balance of evidence which informs it needs to be clearly set out.**[20]

The Treasury submitted a paper to the Committee setting out their approach to the five tests. The paper considered in some detail each test and also summarized fourteen of the eighteen supporting studies the Treasury will be publishing. Extracts from the paper are in the next section.[21]

D. HM Treasury's technical work

1. Convergence test

For the convergence test, the preliminary and technical work updates the evidence presented in the 1997 assessment on the cyclical behaviour of the UK economy by considering how the UK economy compares to other euro area economies, and how they respond to common and country specific shocks. The Treasury paper notes:

> The 1997 [Treasury] assessment went on to spell out that sustainable convergence means that the British economy:
>
> - Has converged with Europe;
> - Can demonstrably be shown to have converged;
> - That this convergence is capable of being sustained; and
> - That there is sufficient flexibility to adapt to change and unexpected economic events.
>
> As the Chancellor said in his 2002 Mansion House speech, the Treasury's preliminary work in this area includes study of the output gap, inflation, interest rates and the real effective exchange rate, to analyse not just short-term cyclical factors but also long-term structural issues to assess whether convergence is sustainable and durable.

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19 ibid., para 92

20 ibid., para 93

21 HM Treasury, *Paper for the Treasury Committee on the Treasury's Approach to the Preliminary and Technical Work* , September 2002 on HM Treasury Website as at 28 May 2003 : http://www.hm-treasury.gov.uk/documents/the_euro/euro_index_index.cfm

To that effect, there are a number of supporting analyses - part of the technical and preliminary work - of key features of the UK and euro area economies that might be a source of asymmetric cyclical responses in the future. These will be published at the same time as the assessment, and include studies:

- Assessing whether the monetary transmission mechanism differs substantively in the UK compared with the euro area. This study will examine what the main channels of monetary transmission are. It will consider whether there are institutional or structural features which suggest the UK transmission mechanism could differ significantly from those of the euro area economies; whether the empirical evidence suggests that the transmission mechanism is different in the UK; and how the UK transmission mechanism would be affected if the UK were to join the single currency.
- Assessing the behaviour of the housing market, and its impact on consumption. This study will focus on the evidence for the claim that the structure of the housing markets and housing finance in the UK is substantially different to that in the euro area. If they are different, the study will look at the reasons for specific UK characteristics, both on the demand side and supply side; whether the differences between the UK and euro area would persist if the UK were to join the single currency; and whether the features of the UK market are sufficiently distinctive to affect sustained convergence if we were to adopt the euro.
- Reviewing and updating various empirical studies of national business cycles, including what drives them and how they respond to different economic shocks. This study will concentrate on what the stylised facts are concerning the relative magnitude and synchronicity of UK and euro area cycles. It will look at the extent to which past differences between the cycles have been caused by different underlying shocks, and the extent to which they appear to have been caused by differences in monetary policy stance and / or exchange rate shocks. Also, the study will examine what is meant by the distinction between core and periphery euro area economies; and how robust these results are to a change in policy regime, such as UK adoption of the single currency.
- Analysing different approaches to the sustainable real exchange rate - as this is a key indicator of convergence and of obvious importance to this and all of the tests.

The preliminary and technical work under the convergence test is also revisiting and deepening analysis of a range of relevant issues which were highlighted in the 1997 assessment including: trade and investment linkages, the sectoral composition of output, and generally analysing whether there are structural differences which could lead to the UK reacting asymmetrically to a single euro area monetary policy.

2. Flexibility test

This test looks at the degree of flexibility in the UK and euro area economies and is closely related to the convergence test. The Treasury paper notes:

> Even with a high degree of sustainable convergence, individual economies will continue to be affected by shocks and changes to the internal and external economic environment. So the preliminary work for the flexibility test is compiling evidence on the mechanisms by which labour, capital and product markets adjust, how well and how quickly they work, and the extent to which the mechanisms differ across countries. It will look at the example of the US as well as the euro area and will consider the role played by labour and capital mobility, as well as wage and price flexibility, in allowing economies to adjust to changes in the economic environment.

It goes on to say:

> A key area, as reflected in the 1997 assessment, is the behaviour of the labour market, including the degree of wage and employment flexibility. The 1997 assessment concluded that, in labour markets particularly, the UK had not yet achieved sufficient flexibility to meet the challenges of EMU membership. EMU membership would also place a greater premium on the success of domestic instruments of policy as an adjustment tool, in particular, fiscal policy and fiscal frameworks. In view of these priorities, supporting studies will be published on the following:
>
> - The role of labour markets - and how labour mobility might complement movement in wages and prices. This study will consider, in particular, what we mean by labour market flexibility in the context of the EMU decision; what the relevant characteristics are of a flexible labour market; and what institutional features promote or hinder labour market flexibility. It will also look at whether UK labour market performance since 1997 indicates that the UK labour market now has sufficient flexibility to function effectively as part of the single currency, how UK flexibility compares with existing euro area economies and whether adoption of the single currency would encourage or discourage labour market flexibility.
> - How the various adjustment mechanisms might operate for the UK including how the economy responds to different shocks, modelling how, in an environment in which UK interest rates were the same as euro area ones and there was a fixed nominal exchange rate with other euro area economies, the UK economy would respond to shocks, particularly asymmetric shocks. It will also look at how market mechanisms and fiscal policy can compensate and what the implications would be for output and inflation if the UK were to join the single currency.
> - Fiscal policy as a stabiliser. Further work will include looking at the role of the automatic stabilisers and the potential for strengthening them, and the potential for use of discretionary fiscal policy instruments, focusing on issues such as: the advantages and disadvantages of using fiscal policy as a demand management tool; whether the use of fiscal policy for macroeconomic stabilisation should be confined to "automatic" stabilisers; and how the stabilisation properties of the existing UK fiscal arrangements compare with other countries.

3. Investment test

The third test, on investment, examines how EMU membership will affect public and private investment in general, and foreign direct investment in particular. The paper points out the strong link between investment in capital (FDI) and growth in productivity as well as improved economic performance. On the test the Treasury paper notes:

> Firms will decide to invest if the expected returns from the investment exceed the cost of the investment and the stability of the macroeconomic environment is a key factor affecting expected returns.
>
> One of the key drivers of the cost of investment is the cost of capital. Macroeconomic stability is a key influence of the cost of capital, as lenders will typically require a higher rate of return to compensate them for the risk of inflation. The size and liquidity of financial markets will also affect the cost of capital.
>
> Evidence suggests that foreign direct investment into the UK can raise the productivity of UK firms through technology and skills spillovers. The preliminary and technical work is considering how EMU would affect FDI inflows to the UK. One important issue is whether exchange rate volatility constrains FDI.
>
> Increasing market integration in the EU, of which EMU is a part, could lead to significant industrial restructuring, as firms adapt to an evolving market and new competitive pressures. This could have important implications for the pattern of industrial location in the EU, which the preliminary and technical work is considering.

The paper also comments on the detailed studies being produced on the test:

> Because of the importance of the EMU decision for business in the UK and its contribution to investment, productivity and growth, more detailed studies will be published on:
>
> - The cost of capital. This study will focus on the main determinants of the cost of capital for firms, as well as looking at how EMU has affected the cost of capital for firms from the euro area countries and how the cost of capital for UK firms would be affected were the UK to join the single currency.
> - The impact of EMU on business in different manufacturing and service sectors of the UK economy. This study will examine how certain features of single currency membership - such as the elimination of exchange rate volatility and foreign exchange transaction costs for trade within the currency area, and increased price transparency between national economies within the common currency area - impact on firm behaviour. For example, it will examine the extent to which EMU will cause firms to relocate or to change their scale of operations and whether

> there is any evidence of such changes already happening in the existing euro area.

4. City and financial services test

The Treasury paper notes the importance of financial services to the UK economy and suggests that it is vital that any decision to join the single currency does not damage the sector's competitiveness. The paper states:

> The last five tests assessment in October 1997 concluded that "in summary, EMU offers benefits to the UK financial sector, whether the UK is in or out. But the benefits and the opportunities from the single currency will probably be easier to tap from within the eurozone."
>
> The dynamic nature of the sector means there is no room for complacency, so the preliminary work for the financial services test will include a detailed analysis of the effect of the single currency on financial services, including monitoring the changes that have occurred in this sector in the UK and the euro area since the start of the single currency in 1999.

Further work on this area is also described:

> The preliminary work therefore includes a supporting analysis that will consider:
>
> - The drivers of the location of activity in the financial services sector, and the changes which have taken place since the start of EMU. This study will examine questions such as what determines the location of financial markets and, more specifically, what are the factors that have encouraged the clustering of financial services in the UK and especially the City of London, but also regional centres such as Edinburgh. It will also look at the factors that might threaten to unwind such clusters, what trends are currently affecting the distribution of financial service activity, and what this suggests for the future distribution of activity.

5. Growth, stability and jobs test

This test analyses the potential benefits of EMU for the longer-term performance of the economy against potential costs. The studies will cover:

> - The likely impact of EMU on UK external trade with the euro area and the rest of the world. This study will consider the range of estimates for the influence of monetary union on trade and assess the econometric studies that suggest the effects on trade could be very large. It will also examine what the data suggest has been the experience of the euro area economies since the formation of the single currency.
> - What lessons can be learned from the experience of the US as a monetary union. The US economy is broadly similar to the euro area in terms of overall size of market, and in terms of its balance between domestic and

foreign demand. Some of the issues that this study will look at include: the extent of regional divergence within the US; how large and how persistent regional divergences are in key measures such as output, inflation rates and unemployment rates; how different US regions adjust to asymmetric shocks with the same interest rate; and the role of relative price changes, factor mobility and fiscal policy in resolving regional divergences. It will also consider the evidence for the potential benefits of a single currency area such as increased trade, competition and productivity. And look at the extent of regional divergences in fiscal policy in the US.

- The robustness of the arrangements for macroeconomic stability - including the Stability and Growth Pact - and their contribution to overall economic performance. This study will look at the current arrangements for fiscal policy, monetary policy, and policy coordination in the euro area - how they deal with shocks, and how they contribute to the credibility and conduct of economic policy.
- Price differentials. This study will examine what impact joining EMU might have on UK prices, what explains relative price level movements between European economies in the 1990's and what has happened to euro area prices since the introduction of the euro - whether they have converged and how euro area price dispersion compares with dispersion in other monetary unions such as the US.

E. Recent press comment

The issues surrounding the five tests, along with the five tests themselves have received significant press coverage.

The Economist has covered the subject in detail and recently provided an assessment of whether they thought the five tests will be met. On the first test, they suggest recent house price movements are causing problems and the test will probably be failed. Wages, competitiveness and European labour market flexibility cause doubts for the second test. They also suggest the fifth test will fail because the UK is growing faster than the euro area.[22] They suggest the third and fourth tests may be passed and conclude:

> So on at least three of the five tests, the decision will be: not yet. But this judgment leaves a lot to play for. Given the clear and stable majority in the opinion polls for staying out, that is clearly the safer option politically. But Mr Blair still wants to go in. Paradoxically, a period when Britain's economy is under-performing the euro area would help him make the argument.[23]

[22] "Five Tests and a Funeral", *The Economist*, 1 May 2003
[23] ibid.

The *Financial Times* also considered each of the tests in a recent article, assessing the issues involved in each test also claiming a "not yet" verdict is due. In concluding they note:

> The Treasury believes that delay could help make the fine balance of costs and benefits more favourable. The benefits will be greater if the ECB and the stability and growth pact can be reformed. The costs will be lower if UK and eurozone interest rates converge further, minimising the problems of transition, and if the British economy can be made more flexible and more like other European economies in its response to shocks. One way to do this would be to make greater use, for example, of long-term fixed-rate mortgages, as is now being studied by the Treasury.[24]

The Times recently commented on the likely contents of the assessment:

> Of the five tests, Cabinet sources said it appeared that the greatest barrier to entry was the lack of convergence between Britain's economy and those in the eurozone. The housing market, with about 70 per cent of households owning their property and sensitive to floating mortgage rates, is an important structural impediment. In Germany only about 19 per cent of households own their homes and the majority have borrowed the money at a fixed-rate.[25]

F. Other issues

1. Exchange rates and reform

There are other issues which are regularly discussed in the context of the five tests and any future euro membership, two of which are: the sterling-euro exchange rate and possible reform of Stability and Growth Pact.

The issue of exchange rates is important to the UK as exchange rates will determine any final conversion rate from sterling to euros that may be set if the country enters the euro. There are potential costs of setting this value incorrectly, the main one being that entering with the value of sterling too high would mean UK exports became less competitive with the result of low growth while it adjusts. Overall, if the exchange rate was not correct then the UK would go through a period of adjustment as prices and wages corrected themselves.

The graph below shows exchange rate movement between both the euro and the dollar against sterling since January 1999:

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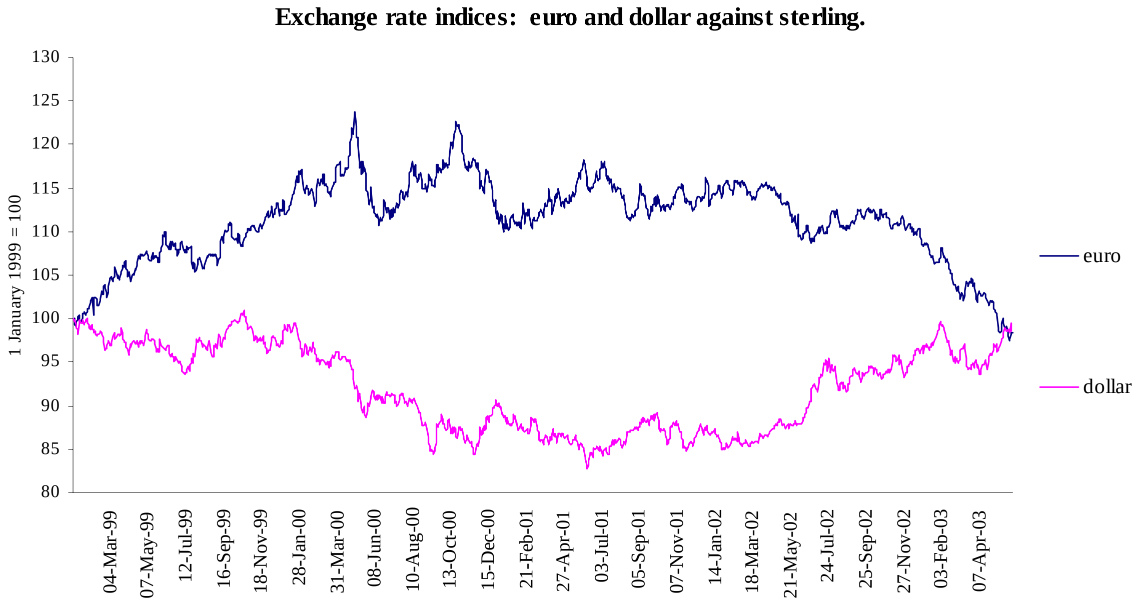
[24] "The five tests: if Gordon Brown says 'no' to the euro now, can Britain say 'yes' in a few years time?", *Financial Times*, 3 May 2003

[25] "Brown's five tests put pro-euro minds at rest", *The Times*, 31 May 2003



The Treasury Select Committee noted:

> **It is of fundamental importance that entry to the euro, should this take place, is at a viable and appropriate exchange rate. Although there is no unanimity on what the precise appropriate rate would be, we note that a number of expert witnesses are now of the view that the exchange rate is close to such a rate.**[26]

It is also worth noting that the Treasury Select Committee report was completed in April 2003, with evidence being taken from December 2002 and there has been significant exchange rate movement over recent months, as shown in the graph above.

Much of the economic analysis that is available has a focus on the degree of price/output adjustment that would be implied by different rates of entry. For example, the National Institute, in a recent review[27] examined the impact on the UK of entry rates from €1.38 to €1.78, and suggested a rate of €1.50 would not cause any major problems. Under their model simulation, a comparison by the OECD in a recent UK Economic Survey suggested that a "fair value" for sterling could be anywhere between €1.23 and €1.63, a 25% range around the euro:sterling exchange rate while an article by Simon Wren Lewis at Exeter University claimed that the rate would "need to fall by 30% to hit its fundamental equilibrium rate".[28]

Issues also remain concerning the Stability and Growth Pact. This currently requires members of the single currency to meet rules regarding annual government deficit as well

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26 Treasury Committee, *The UK and the euro*, 24 April 2003, HC 187-I 2002-03, para 100

27 NIESR, "The UK and EMU: Choosing the Regime", *Economic Review* , April 2002

28 Sunday Times 26 March 2002

as total government debt. The purpose of the Stability and Growth Pact is to ensure a stable and orderly monetary area; excessive government spending in one member may cause instability in the eurozone. The Pact therefore sets targets for annual deficit and total debt, while the Council has powers to ask Member states who are not meeting targets to correct their positions and possibly impose penalties. The way monetary policy is formed is also under debate and the Treasury Select Committee noted:

> 102. The influence that the UK would have on the process of reform of the Stability and Growth Pact and the announced review of the European Central Bank's monetary policy framework and the voting procedures was discussed by a number of witnesses. Professor Giavazzi believed that "an important window for reform—in monetary policy, financial regulation and fiscal design—is now opening" and "it will be of finite duration".
>
> 103. Opinion was divided on this point. Some witnesses suggested that the UK would in a sense gain by waiting to see if the reforms change in an optimal manner. On the other hand, Dr Coyle cautioned that if the UK says that it is "going to wait to join" until reforms have been resolved satisfactorily then the UK may be less likely to secure a satisfactory outcome. The example of the Common Agricultural Policy was put forward by both sides: as a demonstration of doubts about the grounds for assuming the UK would be able to secure reform from the inside, and as a demonstration of the fact that a country outside when something was originally negotiated would find it being structured in a disadvantageous and inferior way. John Monks of the TUC believed that there was the opportunity for the UK to "provide the catalyst...for some necessary changes in the Stability and Growth Pact". The Chancellor told us, regarding the Pact, that "there is a growing recognition that you cannot simply look at fiscal policy on an annual basis, but you have to look at it over the economic cycle" and that "people are coming to accept...the view that we have consistently put forward about the importance of debt being taken into account and the importance of investment being distinct from consumption". The Governor told us that the Bank had a technical relationship with the ECB which he thought likely to continue regardless of the nearterm decision, although he confirmed to us that there had been no Bank of England input into the review of the ECB's monetary policy strategy.
>
> 104. **In this period, when the eurozone's monetary policy and institutions are bedding in, there is clearly a greater 'window of opportunity' for British influence in negotiating reforms within the system, than would be the case later if there is a decision not to join the euro in the foreseeable future. The Government should continue to play an active role in the debate over reform of monetary and fiscal policy and structural reform. The analysis of the five tests and the accompanying studies will be of value to the eurozone states in this respect. Encouraging reform which improves the performance of the eurozone economy will also help to improve the performance of the UK's main export markets, whether or not the UK joins the euro.**[29]

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[29] Treasury Committee, *The UK and the euro*, 24 April 2003, HC 187-I 2002-03, para 102-4

2. The future

On 9 June 2003 the Chancellor will announce whether the five tests have been met, and if the Cabinet has decided to recommend entry into the euro. This government is committed to holding a referendum on any UK euro entry:

> If the government recommends UK entry, it will be put to a vote in Parliament and then to a referendum of the British people.[30]

If a referendum produced a "yes" vote then legislation would be necessary in the UK to permit the adoption of the euro. The Government would also have to apply to the EU to join the single currency. This would require the ECB and Commission to report to the European Council on the UK's economic position, and for the Council to agree to admit the UK into the single currency.[31] The ECB and Commission will comment on the convergence criteria (know as Maastricht Criteria). Once the Council has approved entry (and some negotiation on terms and timing is likely) the UK can join.

If the five tests are not passed, the media has speculated that the Chancellor may also outline future assessments in his statement, and when the five tests will be considered again.

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[30] 10 Downing Street Website as at 4 June 2003 http://www.number-10.gov.uk/output/page1468.asp

[31] Official Journal of the European Communities *"Consolidated Version of the Treaty establishing the European Community"*, C325, Article 122

II Public opinion on the euro

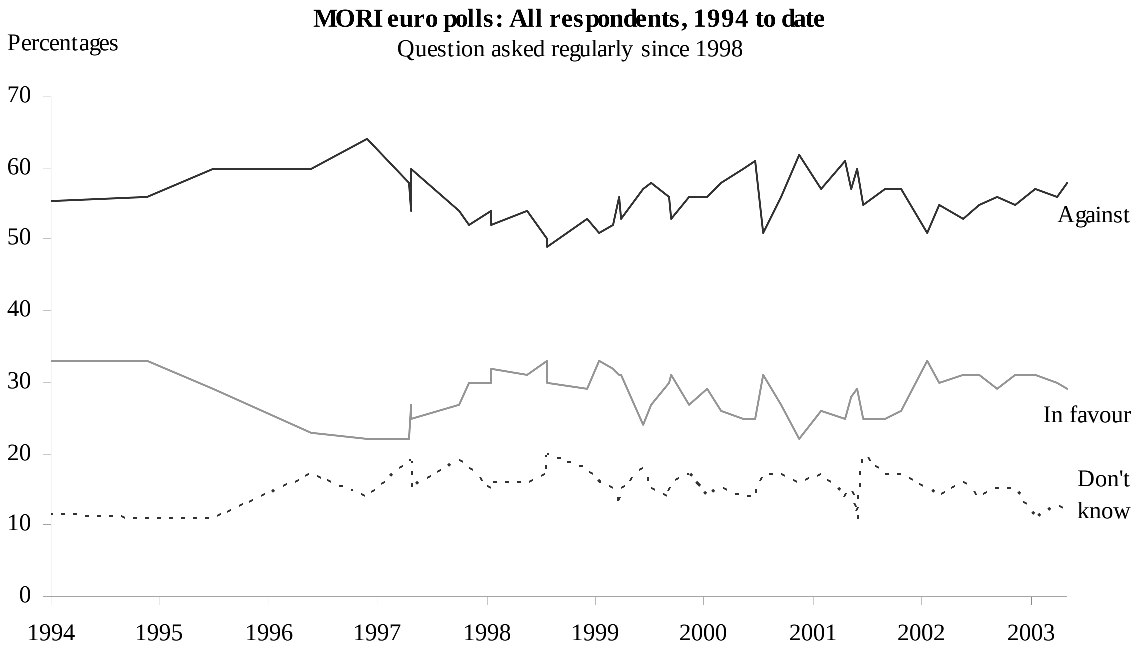
A. Public opinion in the UK

a. MORI

The chart below shows trends in responses to MORI polls on the euro since 1994. Two variant question wordings have been used:

To June 1995: *There have been calls for a national referendum on the issue of a single European currency to replace the pound sterling. If you voted in such a referendum, would you vote for or against Britain joining a single European currency?*

From June 1995: *If there were a referendum on whether or not Britain should be part of a single European currency, how would you vote?*



- The latest MORI euro poll, in May 2003, showed 29 percent in favour of UK entry, 58 percent against and 12 percent don't know. The net opposition rating of 29 percentage points is the highest since October 2001.
- Net opposition has fluctuated between 17 percentage points (July 1998) and 42 percentage points (November 1996).
- The highest in favour rating was 33 percent, a level last reached in January 2002. The highest opposition rating was 64 percent in November 1996, while the highest don't know rating was 20 percent, last recorded in June 2001.

Full MORI poll results are shown in the table below:

MORI opinion polls on euro entry, 1991-2003
Percentages of respondents

		All				All expressing an opinion		
		In favour	Against	Don't know	Net against	In favour	Against	Net against
Question 1								
1991	22-23 Nov	33	54	13	+21	38	62	+24
1994	17-21 Nov	33	56	11	+23	37	63	+26
Question 2								
1995	26-27 Jun	29	60	11	+31	33	67	+34
1996	23-26 May	23	60	17	+37	28	72	+44
	27-29 Nov	22	64	14	+42	26	74	+48
1997	15 Apr	22	58	19	+36	28	72	+44
	22-23 Apr	27	54	19	+27	33	67	+34
	25-28 Apr	25	60	15	+35	29	71	+42
	2-7 Oct	27	54	19	+27	33	67	+34
	30 Oct-4 Nov	30	52	18	+22	37	63	+26
1998	15-20 Jan	32	52	16	+20	38	62	+24
	12-17 March	30	54	15	+24	36	64	+28
	14-19 May	31	54	16	+23	36	64	+28
	23-28 July	33	50	17	+17	40	60	+20
	24-30 Sep	30	49	20	+19	38	62	+24
	3-9 Dec	29	53	18	+24	35	65	+30
1999	14-20 Jan	33	51	16	+18	39	61	+22
	25 Feb-3 Mar	32	52	15	+20	38	62	+24
	19-22 Mar	31	56	13	+25	36	64	+28
	29 Apr-4 May	31	53	15	+22	37	63	+26
	10-11 Jun	24	57	18	+33	30	70	+40
	8-13 Jul	27	58	15	+31	32	68	+36
	2-7 Sep	30	56	14	+26	35	65	+30
	10-13 Sep	31	53	16	+22	37	63	+26
	11-18 Nov	27	56	17	+29	33	67	+34
2000	13-18 Jan	29	56	14	+27	34	66	+32
	24 Feb-2 Mar	26	58	15	+32	31	69	+38
	11-16 May	25	60	14	+35	29	71	+42
	22-27 Jun	25	61	14	+36	29	71	+42
	13-18 Jul	31	51	17	+20	38	62	+24
	14-19 Sep	27	56	17	+29	33	67	+34
	16-21 Nov	22	62	16	+40	26	74	+48
2001	25-30 Jan	26	57	17	+31	31	69	+38
	19-23 Apr	25	61	14	+36	29	71	+42
	10-12 May	28	57	15	+29	33	67	+34
	31 May-2 June	29	60	11	+31	33	67	+34
	14-19 Jun	25	55	20	+30	31	69	+38
	30 Aug-4 Sep	25	57	17	+32	30	70	+40
	25-30 Oct	26	57	17	+31	31	69	+38
2002	17-22 Jan	33	51	15	+18	39	61	+22
	28 Feb-5 Mar	30	55	14	+25	35	65	+30
	16-21 May	31	53	16	+22	37	63	+26
	11-16 Jul	31	55	14	+24	36	64	+28
	12-17 Sep	29	56	15	+27	34	66	+32
	7-12 Nov	31	55	15	+24	36	64	+28
2003	16-21 Jan	31	57	11	+26	36	64	+28
	27 Mar-1 Apr	30	56	13	+26	35	64	+29
	1-7 May	29	58	12	+29	33	66	+33

Source: MORI, http://www.mori.com/europe/mori-euro-ref.shtml

A further MORI question, not asked as regularly, considers the extent to which respondents are in favour of, or against, UK participation in the euro. Results are shown in the table and chart below:

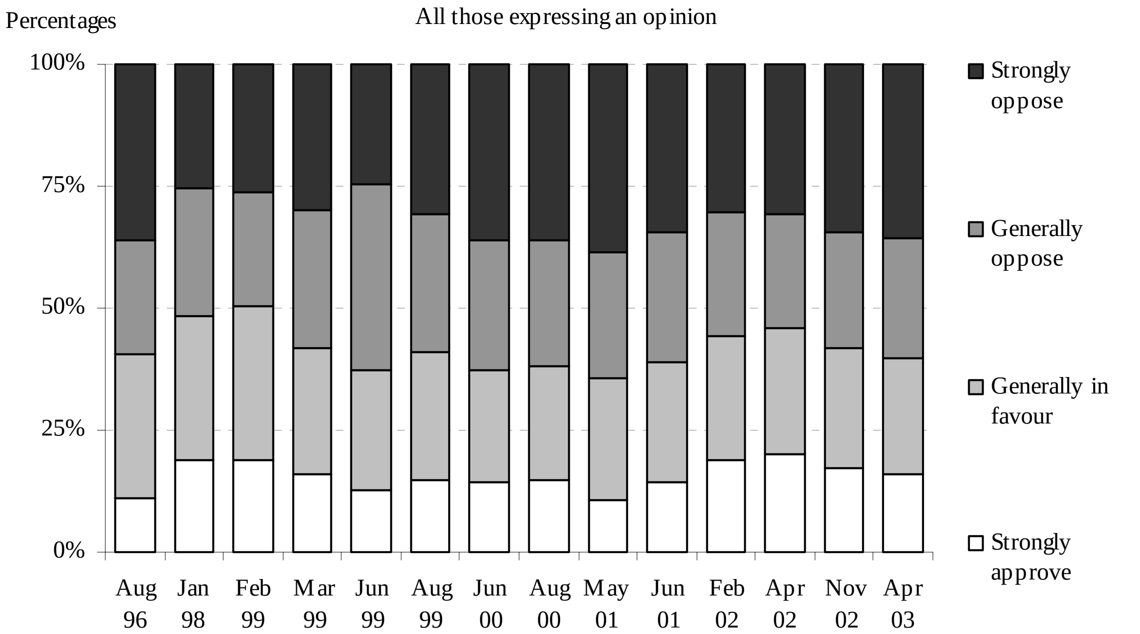
MORI opinion polls: views on euro entry, 1996 to date
Percentages of respondents

	A	B	C	D	Don't know	Support (A+B)	Oppose (C+D)	Net support	"Waverers" (B+C)
20-25 Aug 1996	10	27	21	33	9	37	54	-17	48
23-26 Jan 1998	17	27	24	23	9	44	47	-3	51
19-22 Feb 1999	17	29	21	24	9	46	45	1	50
19-22 Mar 1999	15	24	26	28	7	39	54	-15	50
10-11 Jun 1999	12	23	36	23	6	35	59	-24	59
26 Aug-1 Sep 1999	13	23	25	27	11	36	52	-16	48
22-27 Jun 2000	13	21	24	33	9	34	58	-24	45
3-7 Aug 2000	13	21	23	32	10	34	55	-21	44
29 May 2001	10	23	24	36	6	33	60	-27	47
14-19 Jun 2001	13	22	24	31	9	35	55	-20	46
1-3 Feb 2002	18	24	24	29	5	42	53	-11	48
19-21 Apr 2002	19	24	22	29	6	43	51	-8	46
14-19 Nov 2002	16	23	22	32	7	39	54	-15	45
10-15 Apr 2003	15	22	23	33	5	37	56	-19	45

Source: MORI, http://www.mori.com/europe/index.shtml

A. I strongly support British participation
B. I am generally in favour of British participation, but could be persuaded against it if I thought it would be bad for the British economy
C. I am generally opposed to British participation, but could be persuaded in favour of it if I thought it would be good for the British economy
D. I strongly oppose British participation

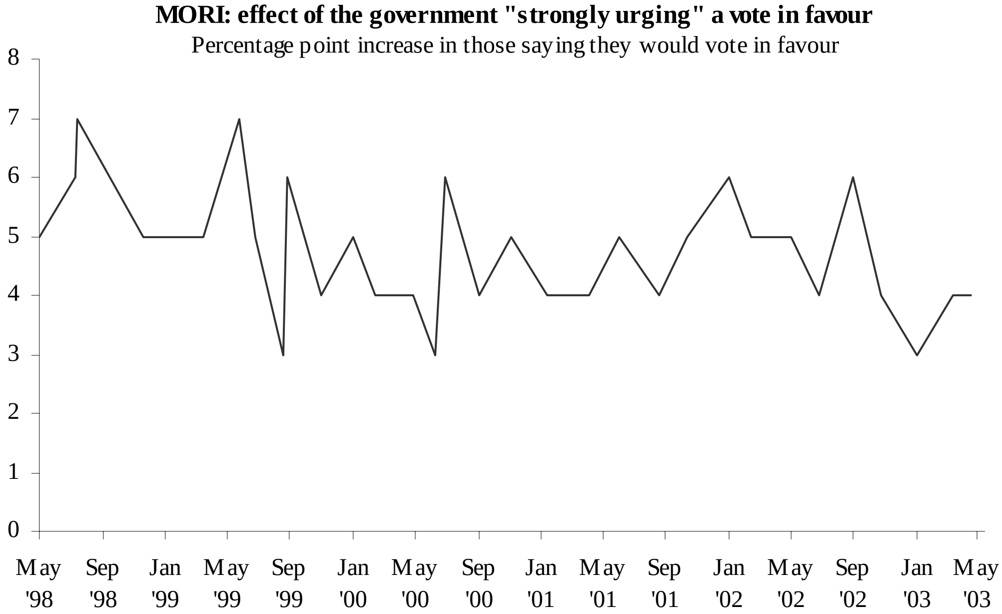
MORI views on British participation: 1996 to date
All those expressing an opinion



Perhaps the most striking aspect of these results is the share of respondents that do not have strongly held views. A combined 45 percent in the April 2003 poll could be persuaded to change their opinion if they thought it would be good for the British economy.

One third of respondents in April 2003 were strongly opposed to UK entry, over double the proportion strongly in favour.

MORI also ask "*if the government were to strongly urge that Britain should be part of a single European currency, how would you vote?*" The chart below compares results in this poll with those from their standard poll, giving an indication of the net effect of such a "government urge."



This "government urge" effect has added between 3 and 7 percentage points to the proportion who would vote for euro entry. In May 2003, 4 percentage points more respondents were in favour of the euro in response to the "government urge" question in comparison to the standard poll.

Comprehensive MORI data, together with various one-off polls can be found on their website at:

http://www.mori.com/europe/index.shtml

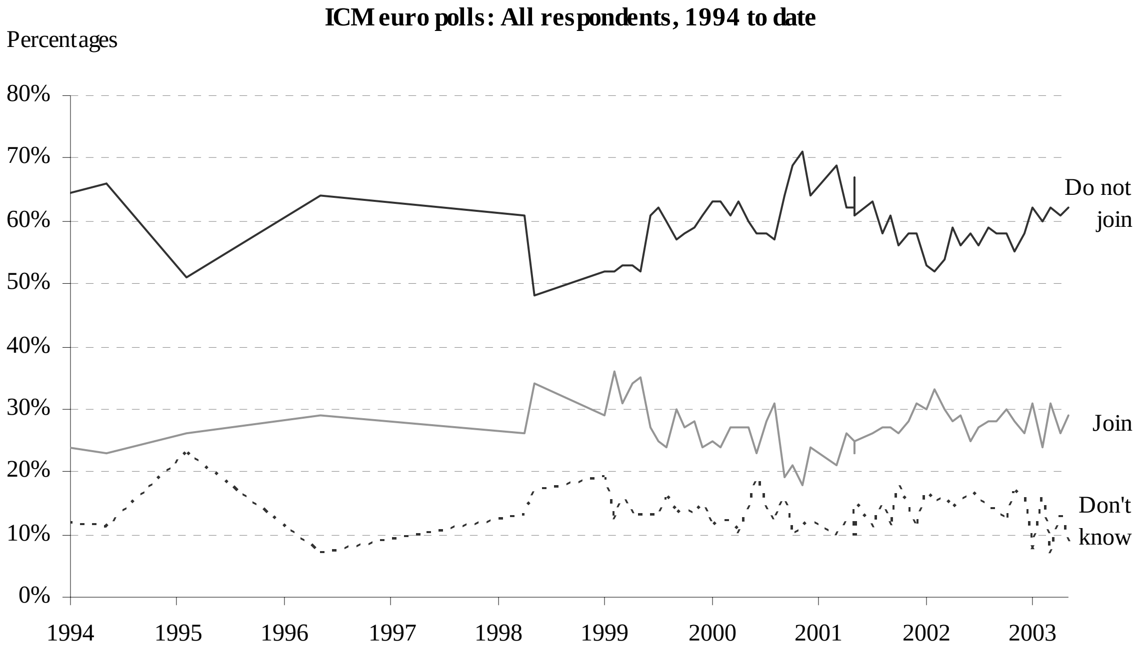
MORI also keep a table showing the results of euro entry opinion polls from all polling companies. This can be found by following the link below:

http://www.mori.com/europe/eurotrend.shtml

b. ICM

The chart below show trends in results of ICM's euro entry question:

"If there were to be a referendum, would you vote to join the European single currency (the euro) or would you vote not to join?"



- ICM's polls have tended to show higher net opposition to euro entry than those conducted by MORI.
- The latest ICM euro poll, in May 2003 showed 29 percent in favour of UK entry, 62 percent against and 9 percent don't know. The net opposition rating of 33 percentage points is lower than those in February and April but higher than that in March.
- Net opposition has fluctuated between 14 percentage points in May 1998 and 53 percentage points in November 2000.
- The highest in favour rating was 36 percent in February 1999. The highest opposition rating was 71 percent in November 2000; excluding don't knows, this amounted to 80 percent of those who expressed an opinion.
- The don't know rating has been as low as 7 percent three times, most recently in March 2003. It was, however, as high as 16 percent in February 2003.

The table overleaf shows full ICM euro poll results. The link below is to the ICM website, where regular updates can be found:

http://www.icmresearch.co.uk/reviews/vote-intention-reports/single-currency-trends.htm

ICM euro polls: 1992-2003
Percentages of respondents

	Join	Do not join	Don't know	Net do not		Join	Do not join	Don't know	Net do not
Oct-92	27%	59%	14%	+32%	Jan-01	24%	63%	13%	+39%
May-94	23%	66%	11%	+43%	Feb-01	26%	63%	10%	+37%
Feb-95	26%	51%	23%	+25%	Mar-01	21%	69%	10%	+48%
May-96	29%	64%	7%	+35%	Apr-01	26%	62%	12%	+36%
Apr-98	26%	61%	13%	+35%	May-01	25%	62%	12%	+37%
May-98	34%	48%	17%	+14%	May-01	23%	67%	10%	+44%
Jan-99	29%	52%	19%	+23%	May-01	25%	61%	15%	+36%
Feb-99	36%	52%	12%	+16%	Jul-01	26%	63%	11%	+37%
Mar-99	31%	53%	16%	+22%	Aug-01	27%	58%	15%	+31%
Apr-99	34%	53%	13%	+19%	Sep-01	27%	61%	11%	+34%
May-99	35%	52%	13%	+17%	Oct-01	26%	56%	18%	+30%
Jun-99	27%	61%	13%	+34%	Nov-01	28%	58%	14%	+30%
Jul-99	25%	62%	13%	+37%	Dec-01	31%	58%	11%	+27%
Aug-99	24%	60%	16%	+36%	Jan-02	30%	53%	17%	+23%
Sep-99	30%	57%	13%	+27%	Feb-02	33%	52%	15%	+19%
Oct-99	27%	58%	14%	+31%	Mar-02	30%	54%	16%	+24%
Nov-99	28%	59%	13%	+31%	Apr-02	28%	59%	14%	+31%
Dec-99	24%	61%	15%	+37%	May-02	29%	56%	15%	+27%
Jan-00	25%	63%	11%	+38%	Jun-02	25%	58%	17%	+33%
Feb-00	24%	63%	12%	+39%	Jul-02	27%	56%	16%	+29%
Mar-00	27%	61%	12%	+34%	Aug-02	28%	59%	14%	+31%
Apr-00	27%	63%	10%	+36%	Sep-02	28%	58%	14%	+30%
May-00	27%	60%	14%	+33%	Oct-02	30%	58%	12%	+28%
Jun-00	23%	58%	19%	+35%	Nov-02	28%	55%	17%	+27%
Jul-00	28%	58%	14%	+30%	Dec-02	26%	58%	16%	+32%
Aug-00	31%	57%	12%	+26%	Jan-03	31%	62%	7%	+31%
Sep-00	19%	64%	16%	+45%	Feb-03	24%	60%	16%	+36%
Oct-00	21%	69%	10%	+48%	Mar-03	31%	62%	7%	+31%
Nov-00	18%	71%	11%	+53%	Apr-03	26%	61%	13%	+35%
Dec-00	24%	64%	12%	+40%	May-03	29%	62%	9%	+33%

Source: ICM, http://www.icmresearch.co.uk/reviews/vote-intention-reports/single-currency-trends.htm

ICM's poll data have been used to examine opinion on euro entry by social group and voting intention.[32] To summarise these results:

- Men are significantly more likely to be in favour of euro entry than women. This gender gap has been over 20 percentage points, although it has recently narrowed.
- People aged under 35 have consistently been more likely to be in favour of UK entry than their older counterparts.
- Those in the higher social classes, ABC1, are significantly more likely to be in favour of the UK joining the euro than those in social classes C2DE. The gap in terms of net opposition was almost 30 percentage points in March 2003.
- Those that intend to vote Labour and Liberal Democrat in a general election are more likely to favour euro entry than those that intend to vote Conservative.

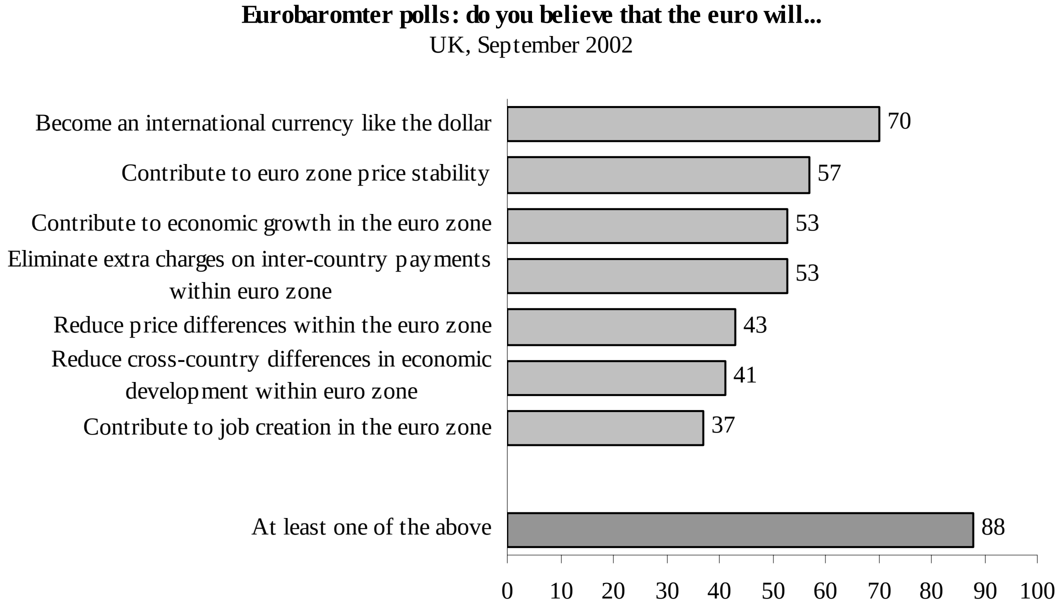
[32] http://www.icmresearch.co.uk/reviews/2002/goldman-sachs-charts.htm

c. Eurobarometer

The European Commission *Eurobarometer* regularly asks people in all 15 EU countries about their opinions towards the euro. The website can be found by following the link below:

http://europa.eu.int/comm/public_opinion/euro_en.htm

The chart below shows UK responses to a question about possible economic effects of the euro in eurozone countries:



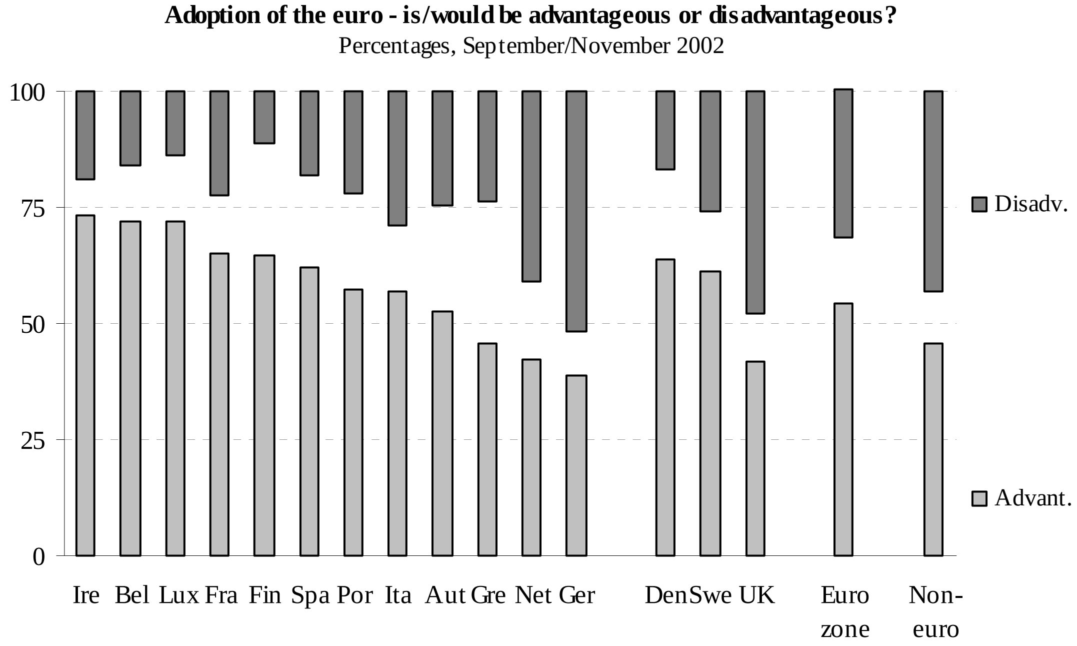
Almost 9 in 10 respondents thought that the euro would have at least one of the economic effects. 70 percent thought that the euro could become an international currency to rival the dollar, almost double the number that thought the euro would result in job creation.

B. Public opinion across the EU

The following analysis compares responses to *Eurobarometer* questions in all 12 eurozone countries, together with some results from the non-euro countries, Denmark, Sweden and the UK. In all cases, the overall eurozone and non-eurozone figures are weighted to reflect national populations, using 2001 Eurostat population estimates.[33]

The chart below shows responses to the question of whether the adoption of the euro is/will be "*advantageous overall and will strengthen us for the future or rather the opposite, an operation that is disadvantageous overall and will weaken us?*"

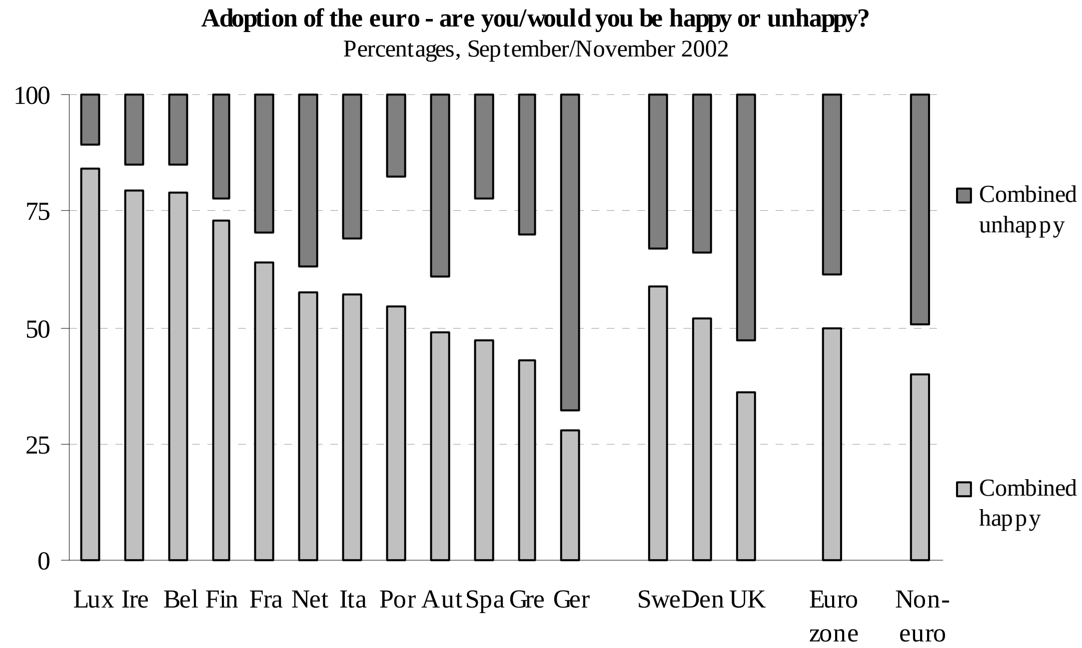
"Don't know" or "neither one nor the other" responses make up the differences between the two bars.



- 54 percent of people in the eurozone thought the adoption of the currency will prove advantageous for their country, compared to 46 percent of people in EU countries outside the zone.
- 73 percent of Irish people thought the euro will prove advantageous for their country, with 8 percent saying it will be disadvantageous.
- 52 percent of Germans said that the euro will disadvantage their country. Germany was the only country within the eurozone with a majority of such responses.
- 42 percent of respondents in the UK said joining the single currency would prove advantageous for the country, while 48 percent said it would be disadvantageous.

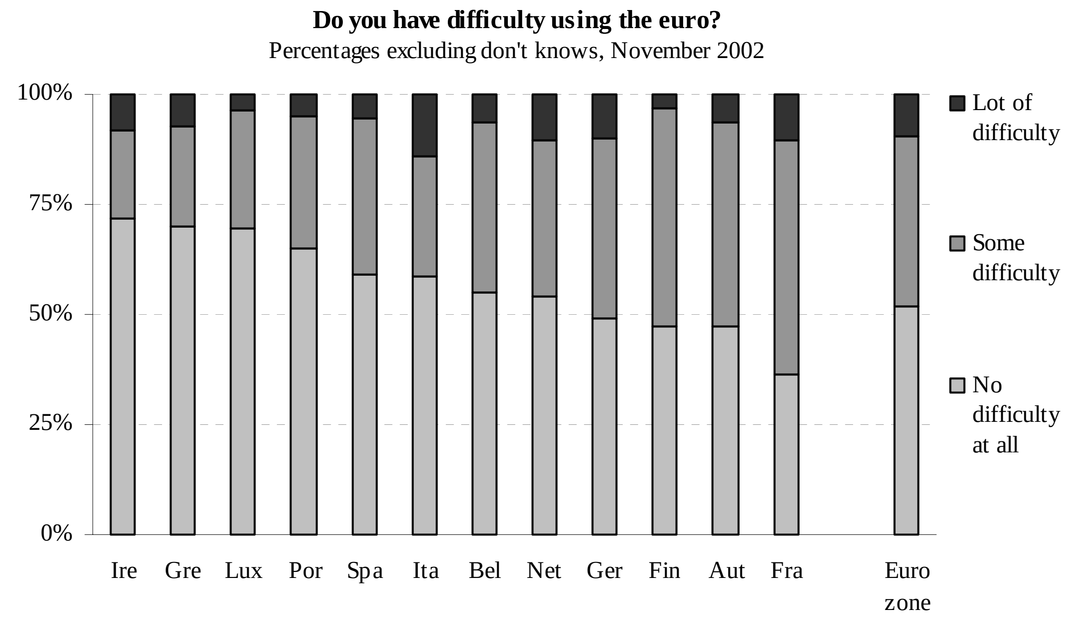
[33] http://www.europa.eu.int/comm/eurostat/Public/datashop/print-catalogue/EN?catalogue=Eurostat

Are you/would you be, personally, very happy, quite happy, or very unhappy that the euro has/had become our currency?



- 50 percent of respondents across the eurozone were happy about their country joining the euro, while 39 percent were unhappy. Outside the zone, people in the UK were generally unhappier about the prospect than those in Denmark and Sweden.
- People in Luxembourg were most likely to be happy, while 68 percent in Germany were unhappy.

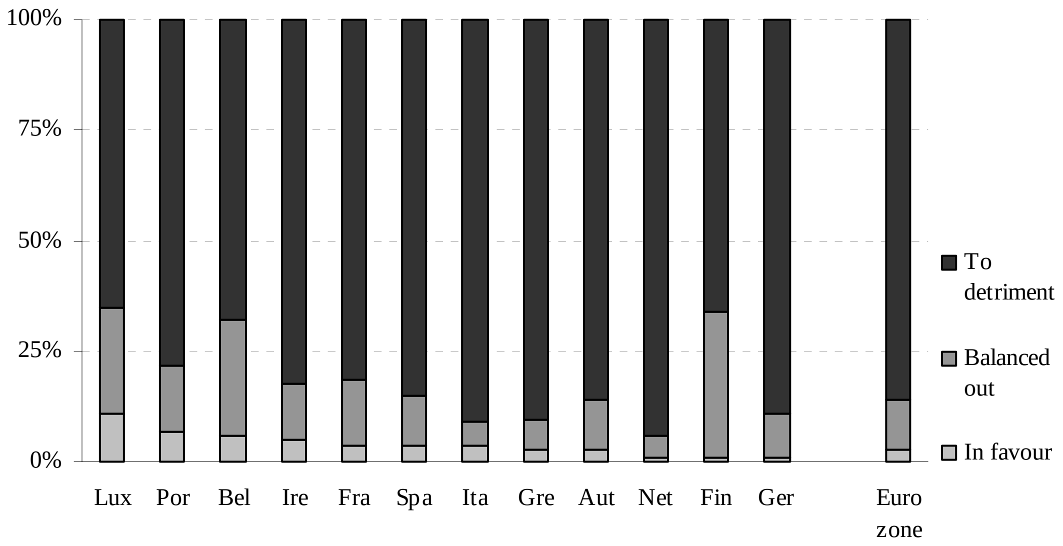
[In eurozone countries] *Would you say that the euro continues to cause you a lot of difficulty, some difficulty or no difficulty at all?*



- 10 percent of respondents across the eurozone in November 2002 said they had continued difficulty using the euro, while over half said they had no difficulty at all.
- People in Ireland were most likely to say they were having no difficulty. Italy had the highest share of “lot of difficulty” responses, 14 percent.

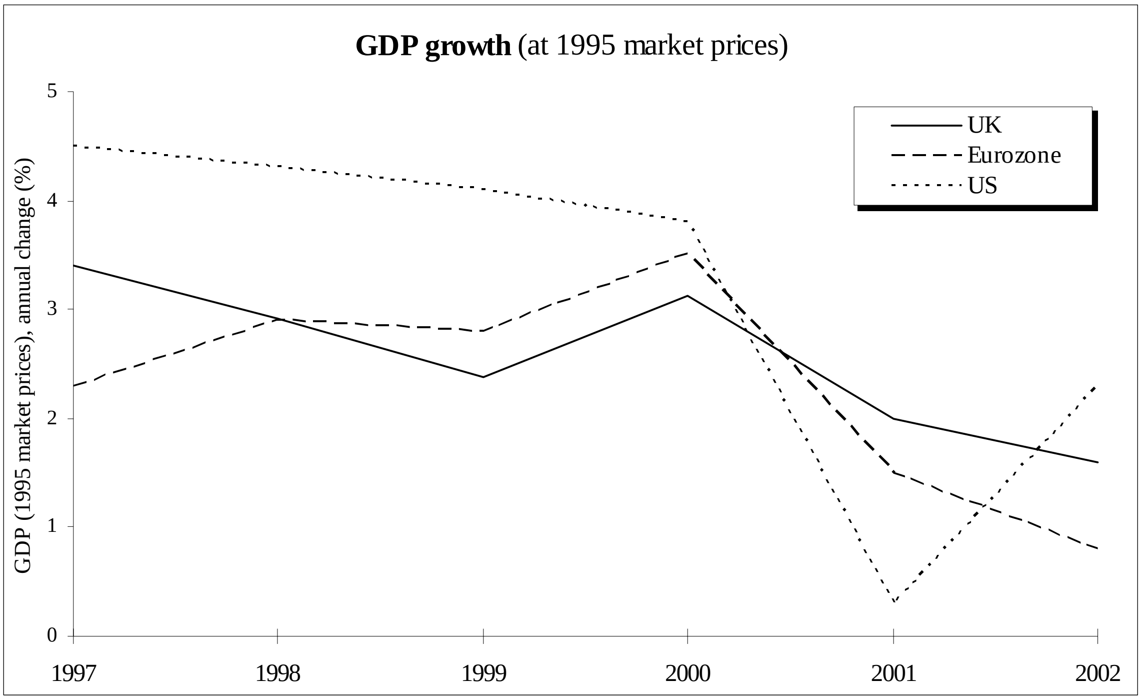
Did you notice that, in [eurozone country] *when converted into euro, prices have been: rather in favour of consumers; rather to the detriment of consumers; or one way or another the rises and falls balanced out?*

Perceived price effect of conversion to euro on consumers
Percentages excluding don't knows, November 2002



- 86 percent of respondents, including 94 percent of those in The Netherlands, thought that conversion to euros had resulted in price changes detrimental to consumers.
- 3 percent thought that the effect had been in the opposite direction, including 11 percent of respondents in Luxembourg.

Appendix 1: Gross Domestic Product



Gross domestic product at 1995 market prices

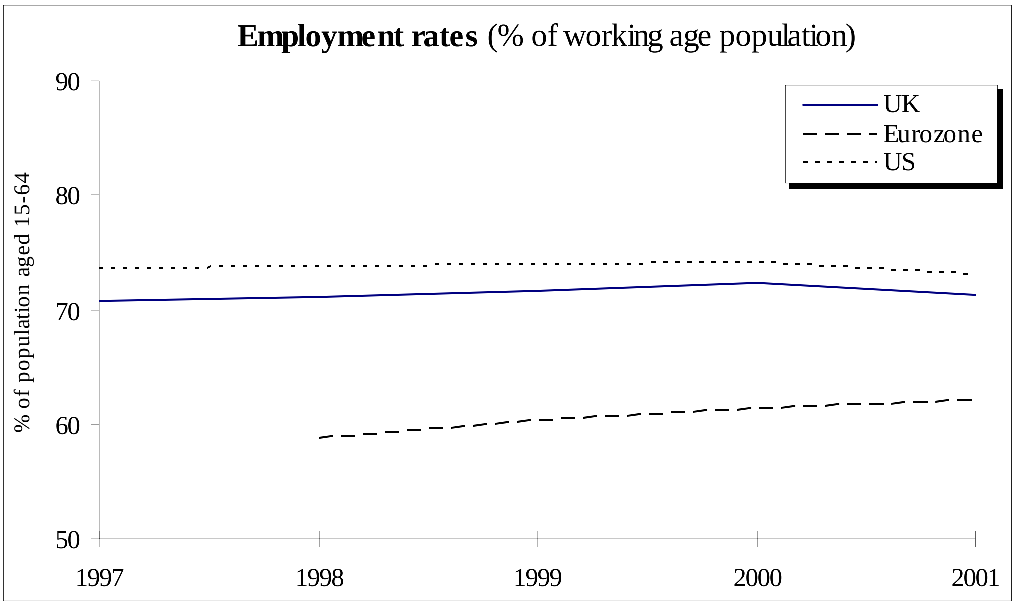
Annual percentage change

	1997	1998	1999	2000	2001	2002
Austria	1.6%	3.9%	2.7%	3.5%	0.7%	0.7%
Belgium	3.6%	2.0%	3.2%	3.7%	0.8%	0.7%
Denmark	3.0%	2.5%	2.3%	3.0%	1.0%	1.7%
Finland	6.3%	5.3%	4.1%	6.1%	0.7%	1.4%
France	1.9%	3.4%	3.2%	3.8%	1.8%	1.0%
Germany	1.4%	2.0%	2.0%	2.9%	0.6%	0.4%
Greece	3.6%	3.4%	3.6%	4.2%	4.1%	3.5%
Ireland	10.9%	8.8%	11.1%	10.0%	5.7%	3.3%
Italy	2.0%	1.8%	1.6%	2.9%	1.8%	0.4%
Luxembourg	7.7%	7.5%	6.0%	8.9%	1.0%	0.1%
Netherlands	3.8%	4.3%	4.0%	3.3%	1.3%	0.2%
Portugal	3.9%	4.5%	3.5%	3.5%	1.7%	0.7%
Spain	4.0%	4.3%	4.2%	4.2%	2.7%	1.9%
Sweden	2.1%	3.6%	4.5%	3.6%	1.2%	1.6%
United Kingdom	3.4%	2.9%	2.4%	3.1%	2.0%	1.6%
EU15 (a)	2.5%	2.9%	2.8%	3.4%	1.5%	1.0%
Eurozone (a)	2.3%	2.9%	2.8%	3.5%	1.5%	0.8%
US	4.5%	4.3%	4.1%	3.8%	0.3%	2.3%

Note: (a) weighted in common currency

Source: EC, *European Economy: The EU Economy 2002 Review* , May 2003

Appendix 2: Employment



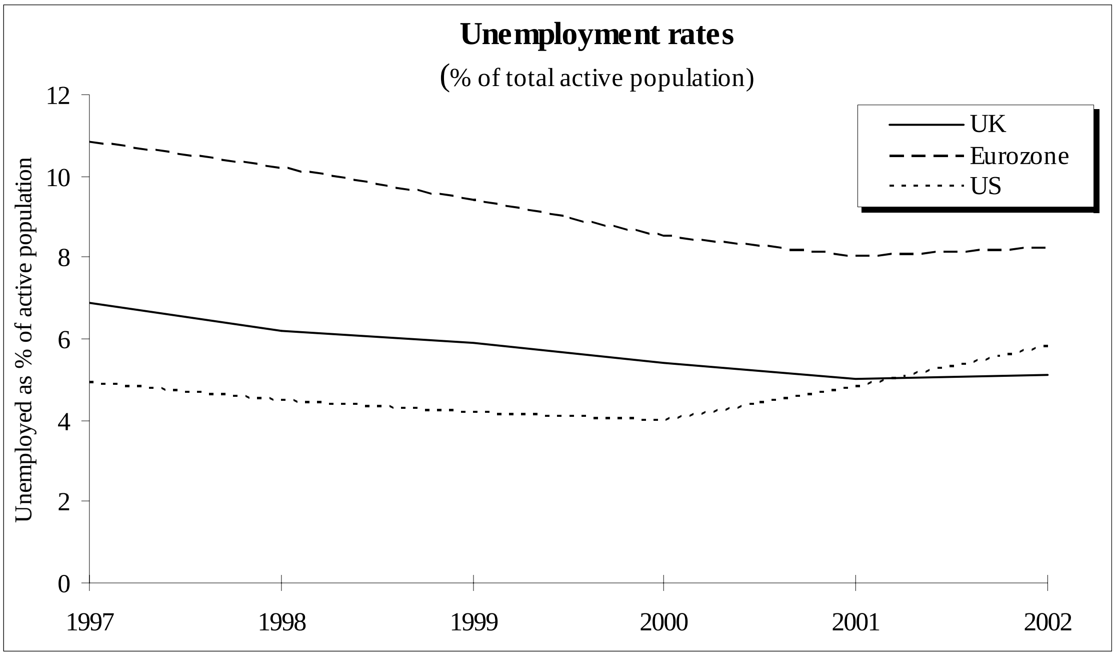
Employment

Employed persons aged 15-64 as % share of the total population of the same age group

	1997	1998	1999	2000	2001
Austria	67.2	67.4	68.2	67.9	67.8
Belgium	57.0	57.3	58.9	60.9	59.7
Denmark	75.4	75.3	76.5	76.4	75.9
Finland	62.8	64.0	66.0	67.0	67.7
France	58.9	59.4	59.8	61.1	62.0
Germany	63.8	64.7	65.4	66.3	65.9
Greece	54.8	55.6	55.4	55.9	55.6
Ireland	56.3	59.6	62.5	64.5	65.0
Italy	51.6	52.2	52.9	53.9	54.9
Luxembourg	59.9	60.2	61.6	62.7	63.0
Netherlands	67.5	69.4	70.9	72.9	74.1
Portugal	64.7	66.4	67.3	68.1	68.7
Spain (a)	50.7	52.4	55.0	57.4	58.8
Sweden (a)	70.7	71.5	72.9	74.2	75.3
United Kingdom (a)	70.8	71.2	71.7	72.4	71.3
EU15	60.5	61.2	62.3	63.2	63.9
Eurozone (b)	..	58.7	60.3	61.4	62.0
US	73.5	73.8	73.9	74.1	73.1

Notes: (a) - persons aged 15-64; (b) - eurozone data excludes Greece 1998-2000
.. - not available
Sources: OECD & Eurostat

Appendix 3: Unemployment



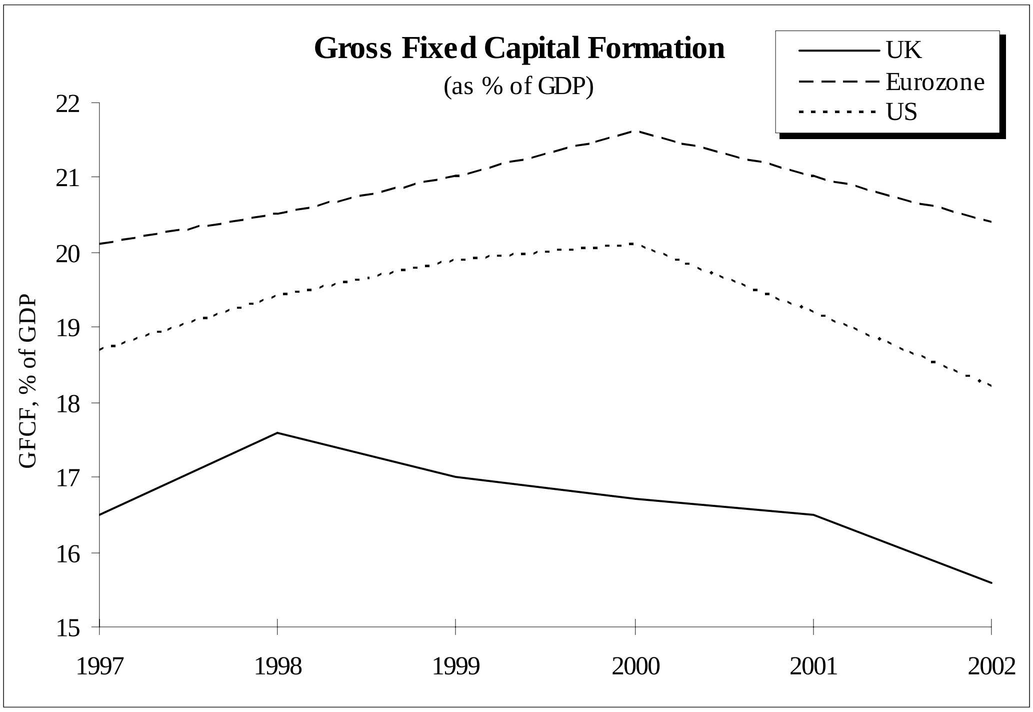
Unemployment

Unemployed persons as a percentage of the total active population

	1997	1998	1999	2000	2001	2002
Austria	4.4	4.5	3.9	3.7	3.6	4.3
Belgium	9.2	9.3	8.6	6.9	6.7	7.3
Denmark	5.2	4.9	4.8	4.4	4.3	4.5
Germany	9.7	9.1	8.4	7.8	7.7	8.2
Greece	9.8	10.9	11.8	11.0	10.4	9.9
Spain	17.0	15.2	12.8	11.3	10.6	11.4
France	11.8	11.4	10.7	9.3	8.5	8.7
Ireland	9.9	7.5	5.6	4.3	3.9	4.4
Italy	11.6	11.7	11.3	10.4	9.4	9.0
Luxembourg	2.7	2.7	2.4	2.3	2.0	2.4
Netherlands	4.9	3.8	3.2	2.8	2.4	2.7
Portugal	6.8	5.1	4.5	4.1	4.1	5.1
Finland	12.7	11.4	10.2	9.8	9.1	9.1
Sweden	9.9	8.2	6.7	5.6	4.9	4.9
United Kingdom	6.9	6.2	5.9	5.4	5.0	5.1
EU15	10.0	9.4	8.7	7.8	7.3	7.6
Eurozone	10.8	10.2	9.4	8.5	8.0	8.2
US	4.9	4.5	4.2	4.0	4.8	5.8

Source: Eurostat

Appendix 4: Investment



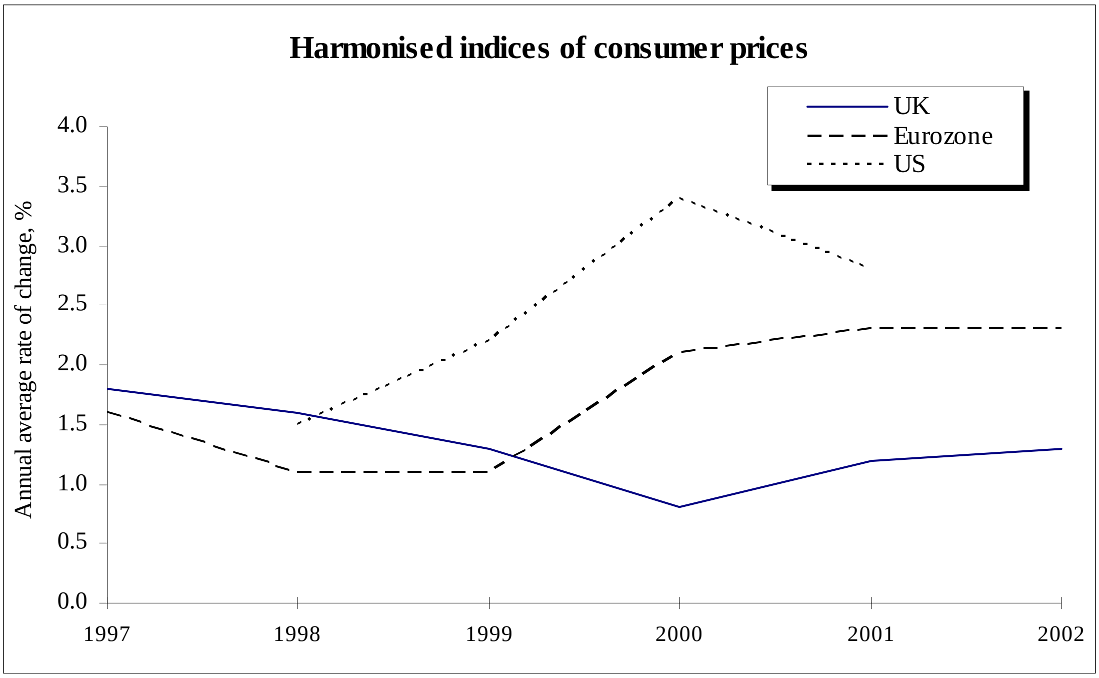
Investment

Gross fixed capital formation (total economy) as % of GDP

	1997	1998	1999	2000	2001	2002
Austria	23.5	23.6	23.5	23.9	23.2	22.4
Belgium	20.4	20.6	20.9	21.2	20.8	19.7
Denmark	19.6	20.6	20.3	21.6	21.0	21.2
Finland	18.0	18.7	18.9	19.1	19.8	19.4
France	18.0	18.4	19.2	20.1	20.2	20.0
Germany	21.4	21.4	21.5	21.6	20.1	18.8
Greece	19.8	21.1	21.7	22.6	22.8	22.8
Ireland	20.7	22.2	23.7	24.1	23.3	22.8
Italy	18.3	18.5	19.1	19.8	19.8	19.3
Luxembourg	22.3	22.6	24.0	20.5	21.7	21.2
Netherlands	21.5	21.5	22.5	22.5	21.9	20.9
Portugal	25.6	26.9	27.4	28.6	27.5	25.8
Spain	21.9	22.9	24.1	25.3	25.4	25.4
Sweden	15.2	16.0	17.0	17.3	17.5	17.0
United Kingdom	16.5	17.6	17.0	16.7	16.5	15.6
EU15	19.4	19.9	20.2	20.6	20.1	19.4
Eurozone	20.1	20.5	21.0	21.6	21.0	20.4
US	18.7	19.4	19.9	20.1	19.2	18.2

Source: EC, *European Economy: The EU Economy 2002 Review*, May 2003

Appendix 5: Inflation



Inflation

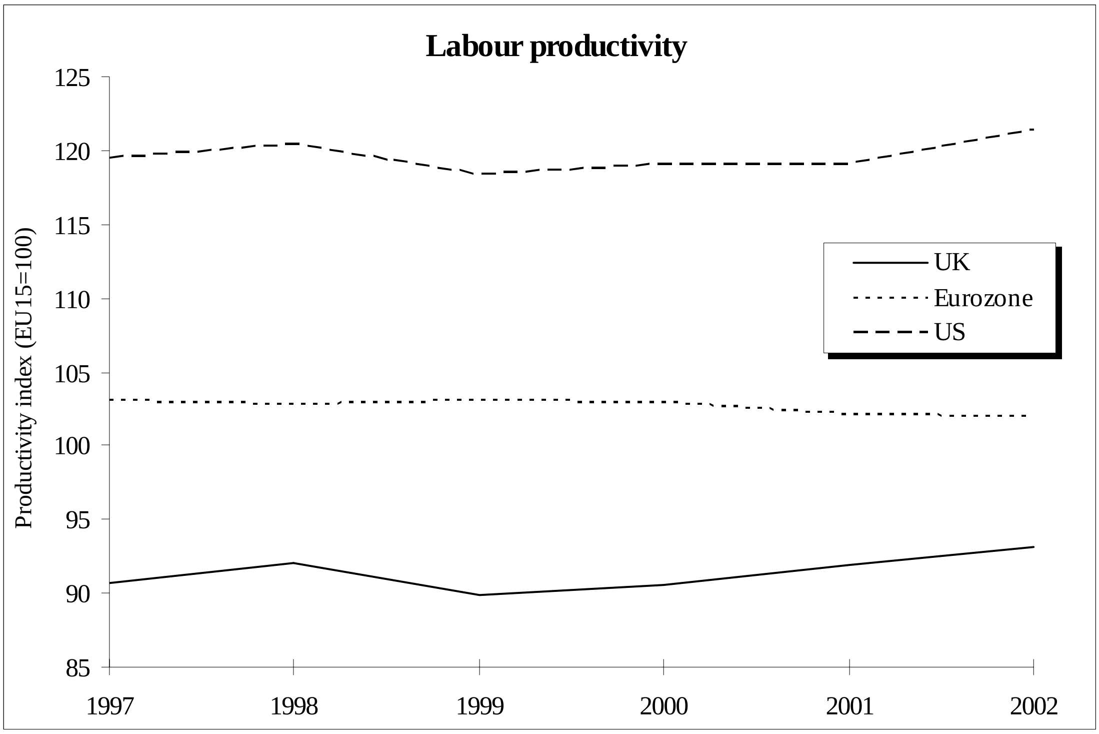
Annual average rate of change in Harmonized Indices of Consumer Prices (HICPs)

	1997	1998	1999	2000	2001	2002
Austria	1.2	0.8	0.5	2.0	2.3	1.7
Belgium	1.5	0.9	1.1	2.7	2.4	1.6
Denmark	1.9	1.3	2.1	2.7	2.3	2.4
Finland	1.2	1.4	1.3	3.0	2.7	2.0
France	1.3	0.7	0.6	1.8	1.8	1.9
Germany	1.5	0.6	0.6	1.4	1.9	1.3
Greece	5.4	4.5	2.1	2.9	3.7	3.9
Ireland	1.2 (a)	2.1	2.5	5.3	4.0	4.7
Italy	1.9	2.0	1.7	2.6	2.3	2.6
Luxembourg	1.4	1.0	1.0	3.8	2.4	2.1
Netherlands	1.9	1.8	2.0	2.3	5.1	3.9
Portugal	1.9	2.2	2.2	2.8	4.4	3.7
Spain	1.9	1.8	2.2	3.5	2.8	3.6
Sweden	1.8	1.0	0.6	1.3	2.7	2.0
United Kingdom	1.8	1.6	1.3	0.8	1.2	1.3
EU15	1.7 (a)	1.3	1.2	1.9	2.2	2.1
Eurozone	1.6 (a)	1.1	1.1	2.1	2.3	2.3
US	..	1.5	2.2	3.4	2.8	..

Notes: (a) - estimate; .. - not available
National consumer price index for the US not strictly comparable with HICPs for the EU

Sources: Eurostat

Appendix 6: Productivity



Labour productivity

GDP in PPS per person employed relative to EU15 (EU15=100)*

	1997	1998	1999	2000	2001	2002 (a)
Austria	96.5	96.1	97.4	101.2	98.3	98.6
Belgium	123.2	122.3	118.1	19.1	120.0	120.8
Denmark	99.6	98.2	99.4	99.4	98.1	98.2
Germany	100.5	99.3	99.8	99.8	97.3	97.5
Greece	77.3	76.6	79.5	80.3	80.3	83.0
Spain	94.0	91.3	93.2	92.3	93.5	93.5
France	109.5	109.7	110.5	111.8	113.6	113.2
Ireland	114.3	110.9	113.4	114.1	115.5	120.0
Italy	111.6	113.9	114.2	112.8	112.7	110.9
Luxembourg	137.4	139.3	143.0	145.2	135.7	130.7
Netherlands	98.3	100.4	99.1	96.4	99.0	97.7
Portugal	67.8	66.2	66.2 (a)	62.6 (a)	63.1 (a)	63.1
Finland	100.4	102.4	100.6	102.7	103.1	101.1
Sweden	98.7	98.0	97.3	98.0	93.1	92.7
United Kingdom	90.7	92.1	89.9	90.5	91.9	93.1
EU15	100.0	100.0	100.0	100.0	100.0	100.0
Eurozone	103.0	102.7	103.1	102.9	102.1	101.9
US	119.5	120.4	118.4	119.0	119.0	121.4

Note: * - Purchasing Power Parities (PPP) are currency conversion rates that convert national currencies to a common currency called Purchasing Power Standards (PPS). This eliminates differences in price levels between countries, thus allowing meaningful comparisons of economic variables between countries.

(a) - forecasts

Source: Eurostat, *Structural Indicators*

Appendix 7: Contacts for further information

Members and their staff requiring further information are encouraged to talk to the statistician specialising in the relevant area. The statisticians and researchers dealing with the subjects covered by this Research Paper are shown below. (After 6pm there is a statistician on duty until the rise of the House who can be contacted via the Oriel Room of the Main Library – extn 3666.)

Subject	**Subject Specialist**	**Extn**
EC finance & the euro	Ed Potton	2883
GDP	Grahame Allen	4324
Employment	Dominic Webb	2464
National accounts	Grahame Allen	4324
Opinion polls	Adam Mellows-Facer	6969
Prices & interest rates	Grahame Allen	4324
Public expenditure	Grahame Allen	4324
Referendums	Chris Sear	4321
Taxation	Ian Townsend	4904
Unemployment	Dominic Webb	2464
Wages & earnings	Dominic Webb	2464

A comprehensive guide to the subject coverage of specialists in the Research Service is available from the Library – *Who Does What in Research*.