How the EMF is shaping up

Gold remonetization moves forward

After one month of unofficial but sweeping operations, the European Monetary System (EMS) is coming into its own on all fronts of its self-defined tasks: currency stabilization, redirection of world credit flows, and industrial development initiatives.

The EMS was created last June at the Bremen summit meeting of European Community (EC) heads of state. Its sponsors were the West German and French governments; its other members include Italy, Denmark, the Benelux nations, and Ireland—the EC Nine minus the United Kingdom, which fiercely opposed the EMS's creation as a threat to London financial weight and International Monetary Fund policy control. Both publicly and behind the scenes there has been close EMS coordination with Japanese authorities and with the member nations of the Arab Monetary Fund, especially through the Saudi-West German "special relationship" consolidated last summer.

Efforts have also persisted to recruit Washington, D.C. and the U.S. business community to EMS alignment; the most recent open diplomatic mission was West German Finance Minister Hans Matthöfer's trip to the United States the week of Jan. 29. His core message was that economic phenomena are subject to the will of men and governments — the principle of the EMS's "dirigism." He also said he expects the EMS to go into official effect this month.

The EMS itself now shapes up as follows:

1. Current Stabilization

The EMS founders said their first aim was to stabilize EC crossrates and the dollar. They have succeeded. On Dec. 5 they adopted fixed internal rates with a 2.25 percent fluctuation up or down permitted each currency vis-à-vis the others. Temporarily, the problematic Italian lira is allowed 6 percent.

This killed the British-inspired counterproposal that rates be set in reference to a fluctuating basket of currencies in a sort of infinite regress. Within the "grid" system adopted, the European Unit Currency (ECU), a weighted amalgam of European currencies, is used simply as a switchboard numeraire, signaling what will already be apparent, that some component is out of line. The ECU's more interesting accounting function is noted below.

The past two months' implementation of this "grid" parity structure has been smooth and tight. January's crossrates confirm this, with Business Week noting the phenomenon as proof that the EMS is already in effect. Spinoffs of increased West German growth to its trading partners have made the fixed rates somewhat easier to achieve.

A DM 1.86-level floor under the dollar has also been enforced, especially in the latter part of January. Speculators have been forced by EMS intervention and threats of EMS intervention to substantially withdraw their dollar "sell" orders (effects on the Eurodollar markets detailed in our Economics report). Apart from this publication, no commentator has explained how this dollar stabilization could occur in the midst of the Iranian-Mideast crisis, and persistent economic-policy bungling in Washington. The analysis ventured by those who prefer to leave the EMS out of account is that low 1979 growth is expected to cut the U.S. trade deficit, and that this has bolstered the dollar!

2. Concentration and transformation of dollar-gold reserves

In the official EMS communiqúes of July and December, the European Monetary Fund was established, with an initial capitalization of 20 percent of each member's gold and dollar reserves. The funds — roughly $35 billion — go into an already existing EC institution, the FECOM (European Monetary Cooperation Fund). Over a two-year period, the EMF is to be turned into a full-blown replacement for the International Monetary Fund, the European Commission's economic directorate, and the Bank for International Settlements. It will have the formal mandate and administrative and planning cadre to act as a nexus of a global international development bank — institutionalizing and expanding the West German-Soviet 20-year economic development agreement as well as the Arab Monetary Fund and Bank of Japan links. And, given a realistic administration in the White House in 1981, it will draw the U.S. into the new world monetary system.

Remonetization of gold

Meanwhile, Chancellor Helmut Schmidt of West Germany and President Valéry Giscard d'Estaing of France are speeding up the mechanisms of the EMF as a reserve pool and a clearing mechanism that is remonetizing increasing amounts of gold.

A profound step to this end was taken in mid-January, when the EMS governments instructed the central banks to start implementing gold remonetization for credit backup. As reported in the last issue of **Executive Intelligence Review,** instead of simply assigning a flat monetary value to gold, the EMS adopted an ingenious transitional measure that will uniformly upvalue the 20 percent of members' gold reserves in the EMF to essentially the market price (see table) — and will also incrementally upvalue and monetize the remainder of their total gold reserves.

Every three months, each central bank is expected to square its accounts so that the original balance of its gold and dollar deposits with the EMF is restored. If Italy, for example, has drawn credits from the fund, it must pay in dollars and/or gold.

The creditor countries — above all, West Germany, will take the fund's remittances and replace the surplus over the 20 percent with the Bundesbank. But, the paid-in gold will not be valued at the Bundesbank's low level, which presently accounts its $30 billion in gold as only about $17 billion. The difference between the two valuations will be monetized and placed in a special fund. Thus this transitional measure increasingly upvalues the majority of Bundesbank gold and allows the government to centrally and deliberately control the surplus created. It also bypasses the presently tortuous process of political and legal ratification of full gold remonetization.

The EMF's clearing operations, in which ECU's serve as accounting channels for these transfers of gold and dollars, are thus the opposite of the post-World War II series of European Payments Unions created by Robert Triffin and the Marshall Plan. Then, the purpose was to provide small margins of European-currency balances-of-payments credits in order to "stretch" gold and dollar holdings and make them less and less consequential. These credits were allocated in a situation of overall credit constriction on the IMF model, which drastically prolonged postwar austerity. The EMS is designed to make the dollar, with gold backing, a prized and potent world currency precisely as a vehicle for long-term expanded credit.

The EMS idea is to begin issuing gold-backed bonds through the West German and French governments and increasingly through the fund itself. These instruments will attract resources out of the large proportion of the $700 billion Eurodollar markets which is not serving trade or other useful purposes, since although the bonds will have only 3 to 5 percent interest rates they will be inflationproof. As the funds finance targeted industrial development projects inside and outside Europe, they will in fact countervail inflation by gearing up production and productivity relative to monetary aggregates.

The gold capabilities of the EMF would be amplified beyond their already formidable level if South Africa joins. Finance Minister Owen Horwood had said Jan. 24 that the government is closely watching the European "zone of monetary stability" and considering whether to link its currency, the rand, to the EMS, now that it has been decoupled from the dollar. South African brokers say a "yes" decision may have already been taken.

Joining the currency "grid" would not necessarily mean that South Africa would commit its large gold reserves to the EMF,

European Monetary Fund Assets (by country)

(in billions of dollars)

EMF MEMBER COUNTRY	DOLLAR RESERVES late 1978	GOLD RESERVES Dec. 5, 1978 valued at $230 a troy ounce	20% of gold-dollar reserves
BRD	$40.5	$30.1	$14.3
France	7.6	26.5	6.8
Italy	9.6	21.4	6.2
Holland	3.6	14.0	3.5
Belgium-Luxembourg	2.6	10.8	2.8
Denmark	2.7	.46	.6
Ireland	2.4	.14	.5
TOTAL	$69.0	$103.4[3]	$34.7
Switzerland[1]	12.8	20.0	6.6
United Kingdom[2]	15.8	5.75	4.3

but in practice South African coordination of the gold markets — which the European central banks already guided to the $235 per ounce level — and eventual involvement in the EMF would follow.

Norwood's statement came in the midst of a shift in South African foreign exchange policy. A "financial rand" will be created, replacing the more limited "securities rand." The latter was involved chiefly in gold mining shares transactions, and sold for more than 40 percent discount, permitting London speculative networks to buy into the shares cheaply. The "financial rand," managed at a lesser discount, is intended to facilitate direct foreign investment in South African industrial capacity expansion.

The London allies in South Africa have been advocating a major rand devaluation to boost the mining sector's "export competitiveness" at the expense of other industry's import costs, and a "free enterprise" dismantling of state-controlled enterprises. They say they would like to see a gold craze tick off a run against the dollar and isolation of the U.S. (This is why Robert Guy of N.M. Rothschild, who chairs the London gold price fixing committee, among others, is now touting remonetization of gold and a sharply fluctuating $260-$290 per ounce price this year. The fact that the EMS authorities have the market increasingly under control, however, was expressed by his colleague, Allan Jeffrey of American Express's London-based International Banking Corporation, who said "The currency, gold and money markets no longer have their destinies in their own hands. Regrettably, the markets are becoming paws of a political game."

With the Jan. 24 currency reforms, the opposing South African faction won a rejection of a devaluation. The best people in this group are proponents of "the Ponto Plan" for collaboration with Europe to industrialize the African continent and shove out the drug-linked gold and diamond networks of the de Beers-Oppenheimer power center. Under conditions of a blow to mining-share speculators, the government may move toward nationalization of the mines and capitalization of currently marginal mines to supply the new gold-backed monetary system.

Dresdner Bank spokesman Jürgen Ponto, it should be noted, was one of the guiding West German minds behind the EMS; his assassination by Baader-Meinhof terrorists in July 1977 was intended, in fact, to obstruct the EMS. Now, the African French-speaking nations will attend a briefing by French President Giscard on the EMS at the beginning of this month, coinciding with the South African shift. The IMF, according to Washington sources, has given up trying to throw gold out of the world monetary picture altogether, and instead is hoping to end the embarrassing practice of valuing it at $43 an ounce — perhaps, in pharisaical fashion, simply accounting it by weight instead of dollars or Special Drawing Rights!

Eurodollar cômmand

Phase one of this transformation began long before Schmidt and Giscard announced the formation of the EMS, as Europe and Japan continued to soak up dollars in the currency markets to protect the U.S. currency; Phase two was the Nov. 1 success in forcing Washington, D.C. to officially join in this effort. Phase three, actual control over the flow of Eurodollar credits beyond the sphere of the currency spot and futures markets, has now begun. As detailed in our ECONOMICS report, the EMS central banks — especially the Bundesbank — are debating the creation of a two-tiered international credit market — that is, lower-interest productive credits on the bottom tier, made possible by low-cost central bank dollar allocations to the private banking sector, as well as direct government gold-backed bond issuance. The upper tier is the old speculative interest-rate structure. Parallel developments are being guided for the domestic economies.

3. Development commitment

The September 1978 summit meeting between Giscard and Schmidt at Aachen with its plans for joint scientific and technical education and nuclear power development showed the world what all these currency and credit arrangements are intended to accomplish. A new level of efforts to politically prepare the population for the EMS at large has ensued. The French UDF (Union pour la democratie francaise), the coalition on which Giscard's presidency is based, has not only proposed a $100 billion five-year program for continental-scale development projects in Europe and the Third World, but is running its campaign for the Strasbourg European Parliament on this platform

[1]Switzerland is already a de facto EMS member regarding currency stabilization, as expressed in the formal mid-November agreement to peg a cross-rate with the deutschemark. Swiss bankers say with greater or lesser enthusiasm that fuller EMS membership is inevitable. This would increase EMF assets by about one-fifth. The Swiss government has publicly stated its interest in membership.

[2]The London press has for several weeks been urging the Callaghan government to reconsider its rejection of EMS membership when, in December, it did not get the concessions it sought. Nominally this is an effort to obtain credits for the UK without the rigors of a pound parity dictate entailed by full EMS membership. In or out, both the City of London and the UK as a national entity are increasingly subject to the EMS "environment."

[3]U.S. gold reserves, at this valuation, would be worth about $60 billion.

of "a development plan for employment" — outflanking the demagogic "class struggle" wing of international Social-Democrats and Communists. It will also help educate business, with its plan for half the funds to come from coordinated national reserve deployment, half from borrowing against reserves — the gold-backed bond principle. The UDF's idea of administering the program through the European Community's Council of Ministers means that Schmidt and Giscard would have direct oversight, rather than the European Commission bureaucrats dominated by pro-British, anti-EMS elements.

The EMS governments are meanwhile dealing with the raw-materials question by setting up a transition to the transfer of high technology and nuclear power that will end the Third World's "Third" status. French doubling of aid to uranium-rich Zaire is one specific effort; More broadly, the EMS effort to "globalize" Lomé Agreement income guarantees to commodity producers has been analyzed (see Executive Intelligence Review, Jan. 30-Feb. 5) as a holding action for the industrialization plans Schmidt discussed in December with developing-sector leaders in Jamaica. In terms of mass education along these lines, the most important recent effort is probably the book "La guerre de l'energie est commencée" ("The Energy War Has Begun") by Electricife de France director Lionel Taccoen, which poses the paradox that the Third World is too poor for any energy form but nuclear power.

In Northern Africa, Technip of France and the Italian ENI will build a third liquefied natural gas complex for the Algerian state firm Sonatrach, raising $1 billion in capital through the French banks. This shows the U.S. what public-private sector alliances can do — and contrasts illustratively with the less than $500 million U.S. commercial banks have been dangling to Turkey with IMF deindustrialization conditions attached.

Other aspects of the EMS-Mediterranean rim and Mideast development plans include:

•A probable interim compromise on the EC's Common Agricultural Pricing and farmer subsidy provisions, which, under Franco-German guidance, will phase out the latter while shelving the British demand for a price freeze. France is working toward extending to southern Europe its own ambitious plans for turning its farmers into advanced agrobusiness exporters to the developing sector, as Spain, Portugal, and Greece join the EC and EMS. The EMS's credit resources will permit a fairly painless abandonment of the current rattletrap CAP and subsidy system. A Franco-German victory in this sphere at the Feb. 5-6 agricultural ministers' meeting will quickly be followed by the full official inauguration of the EMS that was delayed Jan. 1 by British maneuvers around this issue.

•Spain held the first joint Ibero-American Conference on Science and Technology in Madrid Jan. 30-31, with Mexico serving as an EMS "bridge" to Latin America on behalf of industrialization.

•The German-Saudi Arabian Capital and Investment Commission announced an array of agreements, following development ministry and private banking negotiations last month, including a $16 billion Herms export credit guarantee from West Germany.

— *Susan Johnson*