Europe deciding that Schmidt is right?

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A hastily convened meeting of European finance ministers reluctantly agreed on Sunday, Feb. 21, after much bickering to allow Belgium to devalue its besieged currency by an 8 percent margin. Belgian Prime Minister Willy Martens had just returned from an overnight visit to Washington. His attempt to convince President Reagan, on behalf of the entire European Community (EC), that the only way to avoid a worldwide depression was to cut U.S. interest rates, had met with stubborn if polite stonewalling by the blinded U.S. President.

On Feb. 24 and 25, Chancellor Helmut Schmidt of West Germany and French President François Mitterrand will meet for the regular Franco-German summit and Schmidt will try to rally his French counterpart to support his personal campaign to free Ronald Reagan from the grip of monetarist advisers and the dictates of Federal Reserve Chairman Paul Volcker.

A review of recent monetary events shows the profound difference between the vain efforts of various European leaders, central bankers, and finance ministers to "decouple" from the United states to solve the crisis, and Schmidt's passionate attempt to educate the President of the United States concerning his international responsibilities.

Can U.S. rates be kept at bay?

Since mid-1981, various European spokesmen, starting with French Socialist Finance Minister Delors, have tried to define some "joint European initiative" capable of circumventing the deadly repercussions of the usury being practiced by Washington, spreading recession from America throughout the world.

The common political denominator of these efforts has been the illusion that the crisis of political leadership in the United States could somehow be ignored, or simply bypassed by way of some technical arrangement. The European Community's administrative body, the supranational European Commission and its vast bureaucratic establishment, have worked tirelessly on plans to devise a "third way" pitting Europe against the United States, and paving the way for the darling scheme of European oligarchs, the "regional currency blocs" made popular by Belgian theorist Robert Triffin of the University of Louvain, among others.

Willy Martens's dash to Washington was conceived within that framework. Sources at the U.S. State Department as well as the French Treasury revealed that Martens "went there to set the record straight within the alliance—the Americans cannot ask us for special efforts in one field, sanctions against the East, while refusing any efforts in another field, interest rates," said the French source. The source at the State Department confirmed this by describing an American proposal for quid pro quo: We'll alleviate our pressure on sanctions if you stop yours on interest rates.

It is difficult to speak of an Atlantic alliance when things have gone this far.

After the failure of the Martens mission, concern spread throughout Europe that nothing could be done to stop the slide into economic disaster. President Mitterrand stated: "We must defend our economies together and guard against exaggerated interest rate increases totally undermining our efforts to achieve stability." The reality behind this brave statement, however, was spelled out by a finance ministry spokesman: "All they will do will be a diagnosis of the situation, but no initiative will come out. That would only be decided in consultation with the other EC partners, which means later. At most, what could be asked would be that the U.S. intervene regularly on the foreign exchange markets, not to achieve a solution, but to restore a bit of stability to the markets, and improve a daily situation which is intolerable. . . ."

A lead article in the French daily *Le Monde* by noted commentator Paul Fabra gives a sense of the underlying European diagnosis: "This new rise of U.S. interest rates [has] severe consequences. . . . It comes at the worst possible moment for Europe. . . . A strong dollar can only contribute to aggravating the recession in the U.S.A.,
ingly deflationary. . . . Preconditions [could be] prepared for the outbreak of a large-scale crisis, very difficult for the authorities to control."

Helmut Schmidt, who has not let one day go by for the last few months without hammering away at the theme that the danger of depression is the prime danger for world peace, is now trying to rally Mitterrand to this fundamental standpoint.

Schmidt-led Europe

So long as a powerful political goal was propelling the European Monetary System (EMS) toward an institutional form, the so-called phase two based on creating a European Monetary Fund to generate cheap long-term, gold-based credit, the EMS withstood stormy monetary circumstances. That political impetus was the common will of EMS founders Schmidt and Valéry Giscard d'Estaing. With the latter's political demise, the EMS is little more than a shell with technical functions in foreign-exchange market-regulation.

The recent crisis of the Belgian franc represents a watershed for the EMS—or rather, the first crack announcing its ultimate demise. Contrary to earlier occurrences, in which intra-EMS parity adjustments went remarkably smoothly, the Belgian devaluation was only achieved at the price of bruising political confrontation. Many European observers view this as a landmark: "It's not the thing itself, but *la manière* which matters, and it's been a political disaster," a leading Swiss financier told this author.

The most likely scenario now is that, with the coming disruptions on the exchange markets due to wide fluctuations of U.S. interest rates, strains inside the EMS will become intolerable, and it will collapse. Countries already halfway out, like Italy, will distance themselves further, while others, like France, will suspend participation. The result will be a return to the old European "currency snake," with a hard-core of middle-European countries clustered around a strong Germany, and involved in a loose parity-management relation with other EC and European countries.

While this dispels Triffinesque plans by various central bankers concerning a supranational central-bank control over the monetary and credit policies of individual EC nations, it nonetheless means an increased vulnerability of European nations to currency disruptions. West Germany has been compelled to cast off the French and Belgians, in economic shambles since Mitterrand's election last May, and prepare a defensive ring around what bankers call a "deutschemark bloc," including Austria and the Scandinavians. It therefore means the end of the precarious, yet real, relative stability achieved under the Schmidt-Giscard regime of the last three years.

[The Economics Editor adds: *EIR* wrote in our Oct. 20, 1981 issue that the useful function of the EMS had come to an end, and that the West Germans must therefore cease to waste resources on the futile defense of the French franc, and coordinate currency matters more closely with the Japanese—a possibility which emerged during the Ottawa Summit. At least half the German mark's depreciation during 1981 was due to Bundesbank bailouts for the French, particularly after the May elections, with massive consequent harm to the West German economy; the chance of preserving at least some economic stability in central Europe requires the jettisoning of the Mitterrand regime.]

Changing U.S. policy

Traditionally pro-American financier circles in Europe look in horror upon the "incoherence" of U.S. policy. "There is a danger a fresh rise in U.S. interest rates, which means a worsening of the U.S. recession, and its spread worldwide. Arithmetically, it is impossible that they reach their monetary targets, unless idiotic rates of well over 25 percent are imposed. How much longer can the U.S. economy stand the dose of deindustrialization imposed by Volcker, I wonder," one of Europe's best-informed monetary experts stated. "I don't see why the Russians should not use this tremendous advantage offered them for free. They'll move."

The fear of God, that is, Moscow, is striking a similarly deep chord in hearts usually not so intelligent. David Watt of the Royal Institute for International Affairs recently called in the London *Times* for a heeding of Helmut Schmidt's warnings, and proposed that only a reorganization of the international monetary system starting with cheap credits to the Third World can stop the disaster.

One of Geneva's top bankers told this writer that "on the international stage, the only man who understands things is Helmut Schmidt." That is a highly unusual admission from these quarters. But pending more rallying of international forces around Schmidt's policies, the short-term view in Europe focuses on a modicum of technical decoupling of European currencies from the dollar—i.e., from high interest rates. The consensus is that European currencies should be allowed to slide gently downward, letting the dollar fly upward as much as Volcker and the markets wish.

Contrary to the situation that prevailed one year ago, depressed petroleum and commodity prices allow European currencies to depreciate in relation to the dollar without immediately importing inflation through soaring import bills. Additionally, lower dollar parities mean enhanced price-competitiveness on international markets, which explains why over recent days, in spite of rising U.S. interest rates, many European central banks let their own rates drift gently downward.

In the special case of Schmidt's Germany, where economic conditions are relatively better than either in the United States or most other OECD nations, the problem lies with the artificial effect of higher U.S. rates, which attract international capital to U.S. banks, and conversely, depress Germany's current account. It is to slow down this outflow that the Bundesbank just reintroduced its "gentleman's agreement" with the big commercial banks, under which the latter are to moderate the size and amount of bond issues, in order to better control capital outflows.

This reveals that the maneuvering around interest rates and exchange rates, although capable of bringing about some temporary immprovement, is very limited and constrained by the dangeous games of Paul A. Volcker. Volcker is blindly supported by the White House. Therefore, Schmidt's solution of forcing a shift by the White House is the only approach that can bring about a fundamental change. That is the reality to which much of Europe is at present awakening.