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Monetary union dooms German stability

by William Engdahl

The strict budget austerity criteria for the planned European Monetary Union (EMU) are forcing the greatest political and economic ruptures in German society since World War II. In early July, the German Parliament was scheduled to debate the Kohl government's new budget, in which the shortfall of revenue and excess of spending exceed estimates by a wide mark. As well, Chancellor Helmut Kohl himself is under the greatest pressure of his 15-year political reign as chancellor. The budget austerity of the past three years mandated by the EMU, has created postwar unemployment records, with 11% of Germans officially out of work. Unofficially, the number is far higher.

The EMU, the controversial scheme to forge one supranational currency, the euro, from the national currencies of the 15 European Union (EU) member countries, is in its critical countdown phase. According to the 1992 Treaty of Maastricht on European Monetary Union, 1997 is the qualifying year to determine which nations will be in the exclusive euro club. The most critical requirement of the treaty is a mandated limit on a government's annual budget deficit of no more than 3% of Gross Domestic Product for 1997, in order to join the EMU by January 1999.

A new Socialist government in France, under Prime Minister Lionel Jospin, is putting added pressure on the German government. On July 3, French Finance Minister Dominique Strauss-Kahn announced that France regarded the issue of unemployment as more urgent than a strict 3% deficit target. Without France, the EMU project would collapse for lack of sufficient economic backing. But, if France is allowed into the EMU with a higher deficit—some speculate it could hit as high as 3.6-3.8%—under the byzantine rules of EU politics, that would open the door for Italy to join. Italy, with a public debt exceeding 123% of its GDP, is one of the world's most indebted countries. That combination would define what is the nightmare scenario for Bonn, and for the German Bundesbank, the strict German central bank.

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Power politics

A "weak" euro along French lines, with governments still allowed to run large deficits in order to stimulate employment in recession periods, or the German demand for a "strong, stable" euro, is no mere prestige point. "This is an issue of power politics," notes K.A. Olsen, a Danish banker who is following the EMU very closely. "A hard or stable euro will be to Germany's advantage. It will put the big German banks in a commanding position to expand across Europe without currency risk. Keep in mind that banks like Deutsche Bank or Dresdner Bank have extraordinary political influence in Germany, owing to their control of the major industrial groups."

This view of why Bonn is so insistent on a strong euro with strict 3% deficit rules, was echoed by a senior economist of Dresdner Bank, who told *EIR,* "Frankly, I don't understand why the French go ahead with the euro. Don't they realize, German banks are so strongly capitalized and French banks so weak after their real estate bad debt problems, that after 1999, the French banking system will simply disappear? It will be bought up by German banks."

The other motive for demanding a strong euro, again pushed by leading European bankers, is to create a world reserve currency to rival the dollar. Jacques Santer, the EU Commission president, told an international banking conference in Frankfurt on July 1, "With introduction of the euro, we will clearly have a surplus of dollar reserves." The question will be, what is done with that surplus.

Today, EU central banks use dollars for settling intra-EU trade balances. The euro will eliminate that need. As well, non-EU central banks, from Asia to Russia and eastern Europe, which today hold some $612 billion in dollar-denominated U.S. Treasury bills and bonds as reserves, could decide

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to turn a share of their dollar reserves into euro after 1999. If that happens, "get ready for a shock," Washington economist C. Fred Bergsten warned in a recent interview with *European Voice,* a Brussels paper covering EU affairs.

Bergsten predicts that as much as $1 trillion could shift out of dollars into euros in the near term, producing an "earthquake." If that takes place, it could force the Federal Reserve to raise U.S. interest rates to at least the 15-20% levels of 1979-80, in order to defend the dollar and prevent a collapse of the U.S. government bond market. The impact on the fragile U.S. economy would be gruesome. "Americans are going to be shocked by the impact," Bergsten said.

Bonn fiscal emergency

That all seems far distant, given the present political crises in Bonn over meeting the EMU targets. On July 3, Kohl's chief of staff, Friedrich Bohl, announced that the government likely will be forced to declare an official "budget emergency." Under Article 115 of the German Constitution, annual government borrowing cannot exceed annual spending on investment. If it does, the government must declare a "grave disruption of the economic balance" as the reason. This emergency declaration, an admission of intellectual bankruptcy if not official state bankruptcy, has only been invoked a handful of times in the postwar period. Estimates of the current deficit which must be financed by new borrowing, is 70 billion deutschemarks (about $40 billion), far beyond the DM 53.5 billion projected last January. Investment spending is DM 59 billion, leaving a gap of some DM 11 billion to be filled.

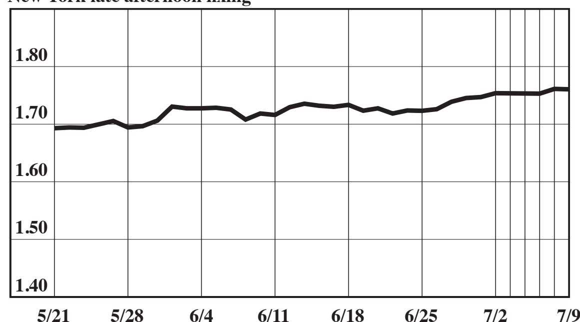
Ironically, the main source of the gap is soaring government spending on unemployment, itself a consequence of the savage budget austerity of the past three years to meet the EMU targets. This year alone, Bonn will spend DM 180 billion on unemployment benefits for the 4.222 million jobless, a record not seen since the depression peak in 1932-33. The government must pay DM 41,000 for every jobless worker, though the worker sees only DM 12,095 of that. The rest is bureaucratic and social security overhead. On July 7, German trade union federation (DGB) Vice Chairman Ursula Engelen-Kefer threatened that German unions will reject the EMU, if "the nice formulations of the recent EU summit at Amsterdam are not followed by concrete measures against unemployment now."

The other side of soaring unemployment is falling state tax revenues. The scissors cut of the two has created the present crisis. But to date, Chancellor Kohl has shown no sign of flinching from the EMU goal. Kohl met recently with Bavarian Christian Social Union state Gov. Edmund Stoiber, a hard-euro advocate, and assured him Germany would hit the 3.0% deficit target. In a debate in parliament, Kohl also repeated that "the Euro will come on time and the criteria will be met." Little wonder that rumors of Kohl's possible political collapse are growing.

Currency Rates

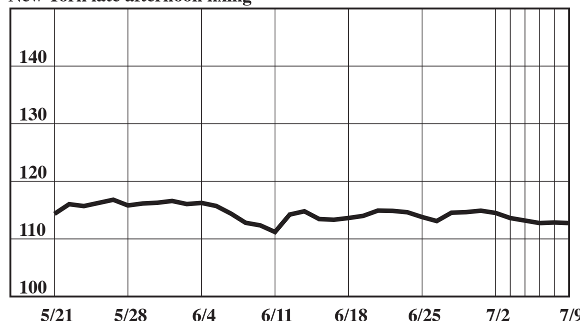
The dollar in deutschemarks

New York late afternoon fixing



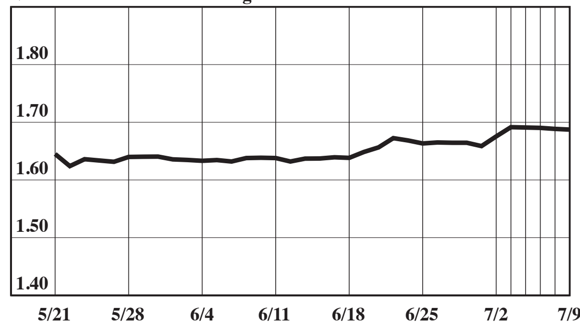
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing