What is the Franco-German European Monetary System?

by Alice Roth

On March 13, 1979, the European Monetary System (EMS) was officially launched when every European Community government, except Great Britain, agreed to (1) establish a system of stable currency parities within Europe and (2) form the nucleus of a new European central bank by pooling 20 percent of each nation's gold and dollar reserves in a common fund. At the time, most U.S. and British financial press commentators either downplayed this development or predicted the early demise of the EMS within a matter of months, if not weeks. One year later, however, the EMS is not only still alive but well on its way to establishing itself as one of the world's leading financial superpowers and perhaps the core of a new world system.

The EMS holds the gold

The eight member nations of the EMS together control over one-third of the world's monetary gold. Valued at current market prices of $500 an ounce, these gold holdings are worth nearly $202 billion, compared to the $132 billion in gold reserves held by the U.S. Treasury and $56 billion controlled by the International Monetary Fund. The real significance of the EMS gold holdings, however, is not their sheer magnitude but how European governments may potentially *use* them to counteract the effects of the Carter administration's incompetent austerity policies, now threatening to plunge the U.S. and the world into a prolonged depression.

How did the EMS come about and why has the average American citizen heard so little about it? The formal origins of the EMS can be traced back to the Bremen summit of European Community (EC) heads of state held on July 6-7, 1978. At that conference, French President Valéry Giscard d'Estaing and West German Chancellor Helmut Schmidt stunned the British by fighting for and winning EC approval of a bold plan to create "a zone of monetary stability in Europe." A top Bonn official characterized the plan at that time as "the seed crystal for an institution that will replace the World Bank and International Monetary Fund."

The "Grand Design" conception underlying the EMS was actually outlined much earlier with the 1967 publication of Pope Paul VI's "Populorum Progressio." In that document, the Pope called for an international development fund which would mobilize Western advanced technology and productive capacities to industrialize the Third World. This conception was further elaborated in the 1975 "International Development Bank" proposal by noted international economist Lyndon LaRouche, in which LaRouche proposed that the leading Western, Comecon, and Third World nations negotiate a new gold-based international monetary system which would extend credits for Third World development. LaRouche called for the dissolution of the International Monetary Fund and World Bank, which, he charged, were contributing to the disintegration of the world economy by imposing harsh "conditionalities" on Third World economies and favoring labor-intensive "development" projects which only perpetuate backwardness. High-level French government officials today regard LaRouche as one of the chief "intellectual architects" of the EMS.

As a result of Anglo-American armtwisting, implementation of the most important feature of the original EMS program—the formation of a full-fledged European central bank, the European Monetary Fund (EMF), which would have the ability to extend long-term credits to countries outside of the European Community—has been postponed until after the fall 1980 West German elections.

Despite this setback, the EMS has racked up several important accomplishments since its formal founding one year ago. First, it has succeeded in establishing relatively fixed currency exchange rates within Europe, as a necessary first step toward reestablishing fixed parities vis à vis the U.S. dollar. It is widely recognized now among international financial circles that the so-called "floating rate" system which has prevailed since August 1971 has encouraged speculation and disrupted world trade and investment. Under the EMS system, the European central banks jointly intervene to insure that currencies fluctuate by a margin of no more than 2.25 percent against a specified central rate (6 percent in the case of Italy).

Second, by pooling 20 percent of member countries' gold reserves, the Europeans have partially monetized gold—a major defeat for U.S. Treasury and IMF officials who fought to "phase out" the metal's monetary role in favor of SDR funny money. The value of the pooled gold is recalculated every three months by EMS officials based on the average of the London gold fixings over the previous six months.

The EMS gold as well as the pooled dollars has been used as reserve backing for issuances of European Currency Units (ECUs), a kind of currency which does not circulate in private hands but is used to settle imbalances among the European central banks. Since the price of gold has more than doubled in the last year, the EMS has been able to create many more ECUs than originally planned and, if the member countries were to pool all of their reserves, the amount of gold-backed liquidity potentially deployable by the EMS would be truly enormous.

Meanwhile, French President Giscard's trip to the Middle East has opened up the possibility that the late 1980 timetable for implementing "Phase Two" of the EMS may be accelerated. According to French government sources, Giscard may have discussed with Arab nations ways in which the $120 billion OPEC petrodollar surplus might be recycled through the European Monetary System rather than through the traditional London-New York banking channels. In return for placing their funds with the EMF, Giscard could offer the Arab oil-producers special low-interest, gold-backed bonds. The petrofunds could then be used to finance Third World development projects at interest rates substantially lower than those usurious ones presently prevailing in the U.S. Giscard has indicated that he plans to discuss the problems of Third World indebtedness and the petrodollar surplus at this weekend's meeting with Schmidt in Hamburg, West Germany.

The U.S. view

Defending International Monetary Fund policies

by Don Baier

While paying lip service to the EMS as a "technical" measure for European exchange rate stability, the Carter administration has always opposed it as a potentially serious threat to the International Monetary Fund.

Only a month after the Bonn summit, in September 1978, C. Fred Bergsten of the State Department delivered an ultimatum that the EMS "must not mean circumvention of the IMF agreement strengthening of the Special Drawing Right in a reformed currency system, not obstruct in any way the demonetization of gold or the intensification of exchange rate surveillance by the Fund, not circumvent the Fund as chief lender of conditional international liquidity, and not result in any additional controls on currencies."

As often as Schmidt and Giscard have stressed the EMS as a system designed to restore the dollar to its former strength as a reserve currency for international trade, U.S. officials have responded with hymns of praise for SDR paper funny money, and Treasury Secretary G. William Miller publicly stated in Saudi Arabia last year that America was looking forward to the day when the dollar could be replaced by the SDR. Indeed, until the onset of a succession of international crises, when the administration apparently decided that a plunging dollar on the foreign exchange markets was a threat to its "aura of power" diplomacy, the U.S. policy was semi-officially characterized as "talking down the dollar"; and even then strong Franco-German pressure was required to force the administration into undertaking dollar support measures on the foreign exchange markets.

As Bergsten's remarks above indicate, the administration's biggest fear is that "Phase II" of the EMS, in which the European Monetary Fund will provide the loan capital for large-scale investment to industrialize the Third World, will spell doom for the IMF and its policy of forcing developing nations to scrap industry and destroy their labor force's living standards through the imposition of loan "conditionalities."

Therefore, highly placed sources have reported, the Carter administration has told European governments that full implementation of the EMS constitutes a "national security" issue for the U.S.A.

The British view

Out on a limb as faction fight erupts

by Don Baier

Isolated from continental Europe, and with its "special relationship" to the Carter administration a distinctive foreign policy liability, the Thatcher government in Great Britain is once again mooting the possibility of joining the European Monetary System. During the past week, a sharp factional debate on the EMS has surfaced in the British press.

On March 10 the British *Guardian* reported "a strong lobby building up in the Bank of England and the Foreign Office in favour of full participation in the EMS." Endorsing that perspective in its editorial, the *Guardian* scored "xenophobic opposition from the Treasury" and British banking circles, arguing that "it would surely be better for Britain to be fully involved in negotiations which would vitally affect our national interest" than to be left on the outside, looking in, suffering "a deep suspicion of Britain's motives and objectives among our EEC partners."

Weighing in with the opposite viewpoint, the *Times* of London argued March 13 that "the real motive for setting up the EMS is as obscure as ever," and complained that "Herr Schmidt is trying to revive the political element in the EMS, while for some months there has been a vague promise that President Giscard is planning a monetary initiative for this year's world economic summit in Venice." Considering that the British press has heretofore largely confined its anti-EMS propaganda to "economic" objections about "interference with the free market" or, alternately, to dismissing the EMS as a "technical" irrelevancy, the *Times* confession that it has a "political" purpose of global significance constitutes a shriek of dismay.

Britain's factional debate, real enough as far as it goes, does not go very far. Since its inception, the British have done everything possible to wreck the EMS, most especially to forestall American cooperation with it. It is well understood in London that a Europe which functions according to the Franco-German conception as a "superpower for peace" will terminate Britain's cherished role as arbiter of world events, able to divide Europe and play the Soviet and American superpowers against each other in the interests of maintaining oligarchical control over the world economy.

Thus the EMS debate in Britain has been an argument over whether the government should attempt to "bore from within," or continue its opposition from without. Lord Carrington, Thatcher's Foreign Secretary, and former Tory Prime Minister Edward Heath are generally regarded as the standard bearers of the "European" or "realist" grouping, and Industry Minister Keith Joseph, a strict disciple of economist Milton Friedman and Prime Minister Thatcher herself as the leaders of the "rule or ruin" group.

The bad news for the Thatcher government is that Europe, led by France, has given no sign it will make the slightest accomodation to Britain's wishes whichever line the government takes. On March 12 French Economy Minister Monory announced that France would not allow Britain to join the EMS on the same terms it had granted Italy, which permitted the lira to fluctuate in a wider range against other EMS national currencies. British advocates of joining the system had publicly hoped for such a concession.

Moreover on the same day the French officially asserted they would not even agree to discuss Britain's contribution to the European Economic Community's budget when the Common Market countries meet on March 31, unless stiff procedural conditions were met. Mrs. Thatcher has been insisting for months she will extract budget concessions from the EEC amounting to a European subsidy for Britain's bankrupt economy. Indeed Thatcher journeyed to Paris earlier this month to attempt what the press described as a "seduction of the French." And the British press was suddenly filled with suggestions that continental Europe, West Germany's Schmidt in particular, was so anxious to include Britain in the EMS they might grant concessions on the EEC budget if Britain agreed to join.

But on March 17, when British Finance Minister Howe gave an impassioned speech pleading for a cut in poor Britain's contribution to the budget to EEC finance and foreign affairs ministers, he was greeted with a long silence followed by an immediate move to the next agenda item. Britain then announced unilateral plans to cut its contribution by one third.

In response, the head of the Gaullist Party Jacques Chirac stated that former President Pompidou allowed Britain into the EEC as a "test" which she has clearly failed, adding weight to the calls for Britain's expulsion from the EEC.

But short of Britain granting real political concessions to the "ideological" Franco-German policy of peace and economic development—perhaps, as Schmidt has suggested, by agreeing to lower North Sea oil prices for continental Europe—it is hard to imagine a scenario by which Her Majesty's government could mount a successful "Trojan Horse" candidacy to gain entry into the EMS.