destabilize Schmidt strictly depends on the extent to which Alexander Haig is able to block effective discussion and agreement between the chancellor and President Reagan on crucial matters, particularly economic policy and détente. It is not for nothing that the *New York Times* and *Washington Post* have been asserting of late that Schmidt's vulnerability rests with his increasing difficulty in realizing his foreign policy aims.

The second prong of the disinformation campaign, which in fact has been conducted through the simple technique of press blackouts, has to do with economic policy. The line of the "left" German Marshall Fund and the "right" Heritage Foundation converges here, too.

Heritage's Geoffrey Gaynor confidently explains that Schmidt's attacks on Volcker's interest-rate policy can have no impact on the United States because they will "never be covered in the American press. . . . Schmidt knows that." Guido Goldman, a member of the German Marshall Fund board of advisers, equally attempts to dismiss the chancellor's views of Volcker as "a cry of anguish and pain, nothing more."

The American press, meanwhile, blocks out the news that this supposed cry of anguish and pain was the central concern of last week's summit between Schmidt and his French ally, President Valéry Giscard d'Estaing.

The Socialist International threads

The links between the Socialist International and the Haig State Department, the German Marshall Fund, the Heritage Foundation, leading press, and similar conduits go beyond the obvious fact of a shared similarity of outlook and policy. The operational interpretation of these networks is massive and can be indicated in summary form.

The German Marshall Fund was founded by Willy Brandt during his tenure as chancellor, and functions as a conduit for Socialist International policy. Its networks into the current State Department are substantial. These State Department inroads function traditionally through Cyrus Vance appointees and Henry Kissinger former appointees who have returned to State through Haig appointments.

Vance, who at one time pressured the West Germans to increase defense expenditures, accept the stationing of medium-range missiles on European territory, and help militarize the Middle East, has more recently done a convenient about-face and is one of the founding members of the Socialist International's Palme Commission, recently established in Vienna to coordinate international disarmament. He now operates out of the Geman Marshall Fund's Arms Control Commission. The GMF cosponsored the Washington Socialist International conference that laid out the disinformation campaign currently in operation.

The motives for Europe's opposition to Paul Volcker

by David Goldman

European leaders have an immediate stake in breaking the Federal Reserve's interest-rate spiral: the present European recession is the direct result of the international market-spinoff effects of 20 percent U.S. interest rates. The French and West German export profile is heavily geared towards infrastructure- and plant-building goods produced for developing-sector markets. But the shrinkage of developing-sector markets in a regime where most of the developing world's $500 billion debt burden bears a 20 percent interest charge makes the European economies unviable. With lower interest rates, Europe's economies would be poised for the most startling recovery in the postwar period.

West German exports rose by 11 percent last year, slightly higher than the 6 percent inflation rate, but far below historical growth levels. In consequence the German trade surplus fell to about $4.8 billion, barely one-third of the 1979 trade surplus of $13 billion. During the summer months the trade balance swung momentarily into deficit, one of the few points in postwar history where the nation's model exporting economy did not register a substantial surplus. The trade deficit was exacerbated on the import side by the 1979 rise in oil prices, which accounted for most of the country's 17 percent rise in import costs last year.

The second-round interest-rate increase in the United States, which the Fed began in late August, caught West Germany in a vicious spiral. The rise in international financing costs dampened potential markets in the developing sector, which require long-term export financing. At the same time, the lowered trade surplus and the outflow of German capital seeking higher short-term returns in dollar interest rates—which have been between 8 and 10 percent higher than deutschemark interest rates—drained liquidity from the domestic banking system. The combination of a lower trade surplus and capital flight pushed West Germany into a 1980 balance of payments deficit of more than $14 billion.

The Fed's impact

Between midsummer and this writing, German interest rates have rates have risen from 6 to 10 percent

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on the Frankfurt capital market, and the German mark's parity has declined by 20 percent against the dollar—raising oil import costs (oil is priced in dollars) while leaving few opportunities for expanded exports. German industrial output, starting in the steel sector and spreading through the consumer-durables industries, including especially construction, declined in overall terms by 6 percent during the past eight months. In parallel, Italian industrial output dropped by 5 percent, and French industrial output by 3 percent. If the present scenario continues, the consensus forecast indicates a continued gradual dropoff in economic activity during 1981. Germany presently has 1.3 million unemployed—a politically unacceptable level—and France over 2 million.

The industrial downturn has prompted efforts on the part of the European Commission's industrial chief, Viscount Etienne Davignon, to "restructure" the European economies along lines similar to those forwarded in the Carter administration's "Agenda '80s" proposal of December. Last fall, Davignon's plan to introduce permanent capacity reductions through the European Community's market-sharing mechanism in the steel industry prompted bitter resistance by West German and some Italian steel manufacturers (see accompanying interview). Now the EC bureaucrats, who report more or less directly to the British and Belgian governments, are proposing to make the temporary distress of European industry permanent. In a speech last week at the European Management Forum conference at Davos, Switzerland Davignon called for an end to all government subsidies to industry except those to aid in the reduction and restructuring of industrial capacity, directing all European investment into data processing, electronics, energy-saving devices, and coal gasification.

The Davignon pressures

At the European Parliament, the British Conservative-led caucus, the "European Democrats," issued a mammoth report last week urging governments to "restrict investment in declining industries [such as] textiles, steel, and consumer durables," while building up the electronics-related sectors of the economy. Europe faces a "triple challenge," the Parliament's "Nicolson Report" argued: the recession, competition from Japan and the newly industrialized countries in traditional European markets, and the "automation revolution" introduced, the report has it, by the computer. Laissez-faire policies are not sufficient to meet this challenge, the report concludes. It foresees military spending as becoming the vehicle for this technetronic shift of European industry, emphasing aerospace, rocketry, telecommunications, data transfer, and computer systems.

Western European industrialists have no illusions concerning the Davignon approach. Among steel managers, it is regarded as a cynical effort to exploit a temporary problem in furtherance of a deindustrialization strategy most of Europe opposes. However, the pressures on heavy industry are having a major impact. Last week the management of the big Hoesch steel concern in West Germany announced that it would not build a new steel facility in Dortmund, a case that had become a national issue.

In effect, Volcker is conducting a repeat of the Bank of England's speculative runup of the British pound in early 1980, when skyrocketing British interest rates disrupted European currencies by attracting flight capital to London. The much larger dollar markets have a correspondingly more damaging impact. During the past week alone the German central bank lost almost DM 1 billion supporting its currency, reducing liquidity in the German banking system by a similar amount. Should American interest rates rise sharply, the short-term consequences for the German and other Western European economies would be severe.

What suppresses German industrial activity is not simply the tight internal credit-market conditions, but the way the Volcker interest-rate policy affects the world market. With Eurodollar interest rates still in the 16 to 17 percent range, long-term financing for trade purposes is unavailable. But the core of West German and French industrial exports depends on long-term infrastructural development in their developing-sector markets. The balance of payments deficit further prevents the West Germans from providing long-term export financing themselves, except where they are able (as are France and Japan) to re-lend petrodollars invested in their economy by the Saudis and other oil producers.

The first step toward economic recovery in Europe, therefore, is a uniform drop in dollar and other major currency interest rates, taking the immediate pressure off both the international and domestic markets. This would open the situation for a basic clean-up of the Eurocurrency markets. In their present condition the $1.3 trillion Eurocurrency markets are unsuitable for any form of long-term lending, turning over about every two weeks. The resources of the European Monetary Fund, which would convert the present gold backing of the European Monetary System from a simple currency support fund into a potential global lending facility, would be crucial in this operation, probably in cooperation with the U.S. Treasury. This cooperation would make possible an exchange of volatile Eurodollars for long-term, low-interest bonds denominated in gold at a specified price, transforming presently unusable liquidity into the means of financing world trade on an unprecedented scale.