nance has taken hold in Italy, Britain, and West Germany, an approach characterized by moves toward a new international monetary system to get at the real problems of industry. Only France, whose government remains in the hands of pro-Wall Street President Giscard d'Estaing, has refused to join in the growing actions against U.S. dollar hegemony in Europe.

The Italians have led the way, with the Libyan purchase of ten per cent of Italy's Fiat auto giant marking the beginning of similar arrangements netween OPEC and British and West German companies including British Petroleum and Volkswagen. In these deals OPEC capital is infused directly into European inudstry to foster industrial development. More importantly, direct government-to-government oil-for-machinery barter deals have begun to proliferate between these European governments and OPEC member's national oil companies, bypassing the U.S. multinational oil companies control of the European oil market — and bypassing payments in U.S. dollars. Exemplary is the arrangement announced last week under which ENI, Italy's national oil company, will trade Italian industrial goods for four to five million metric tons of oil per year. The National Iranian Oil Company will provide this oil to ENI's European sales network outside Italy.

The end on which these interim trade policies converge is significant Italian, British, and West German support for last month's proposal by the Soviet Union that the Comecon's unit of account, the gold-backed transferable ruble, be used as a new global form of credit to finance expanded East-West and Third World-developed sector trade. Scores of prominent West European bankers and their foreign ministers have voiced support for the transfer-ruble proposal. The Banca d'Italia stands out in this category. As a medium-term transitional program to the transfer-ruble scheme, the Italian government has called for the formation of an East-West European Bank which would promote large-scale trade expansion and be capitalized through European and Arab foreign reserve contributions.

These qualitatively new international monetary mechanisms make bright prospects for Europe in the medium-to-long term. This, of course excepts France under the Giscard government, which rejects such financial mechanisms because of their political implications for the independence of Europe from the financial policies of the New York banking community. Without institutional arrangements for the new expansion of trade, no country can possibly deal with current deflationary developments except with the destructive options of still more deflation, or severely inflationary resort to the printing presses.

West Germany Economy Limps Into 1977

West German economic activity took a downward turn in October and November, and the continuation of the production drop is heralded by declines in both foreign and domestic industrial orders. In monetary policy, the central bank continues to emphasize that inflationary measures will sabotage real growth, and has met the speculative expansion of the money supply with strict control of monetary aggregates. The Schmidt government thus far has also declined to introduce more than a token fiscal stimulus on the grounds that overall international economic contraction, the root of the problem, must be directly addressed to promote trade and investment.

The unfavorable prospects for the West German economy must accordingly be qualified in view of the government's attempts to help major trading partners' recoveries, as exemplified by Schmidt's quiet support for the British policy of high-priority industrial growth, and by the new entente between Italy and the Federal Republic expected to be consolidated this month, possibly with trade-assistance credits, around the meeting between the heads of state of the two nations. Bringing North-South relations to a new level of mutual profitability and expansiveness was the keynote of the Chancellor's New Year's addresses, which specifically focused on economic as well as diplomatic relations with Arab oil producers.

Meanwhile, the key indicators for production and trade are negative. After rising somewhat above the "summer lull" level, industry's total output showed a 1 per cent drop in November from the downwardly revised October figure. Domestic manufacturers' view of the future is

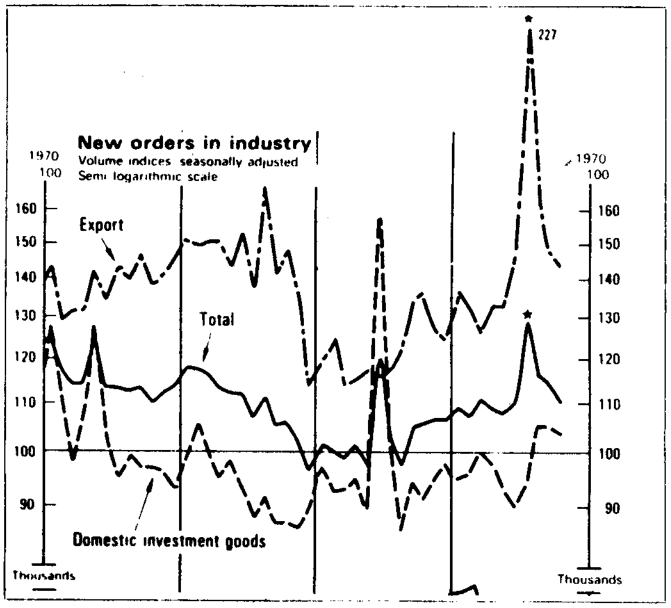
Index Of West German Industrial Net Production 1970=100

Period	All Industries	Basic and Producer Goods Industries	Capital Goods Industries	Consumer Goods Industries
1975 Aug.	104.5	101.6	102.1	101.9
1976 Jan.	102.1	97.8	99.3	100.9
Feb.	111.0	109.2	108.8	111.1
Mar.	108.8	109.6	104.5	108.8
Apr.	117.4	118.8	113.8	117.3
May	116.3	117.9	115.0	113.0
June	118.2	119.5	117.8	111.0
July	99.0	108.6	88.4	91.7
Aug.	97.9	105.9	88.2	92.2
Sept.	113.3	115.3	109.1	113.9
Oct. (p)	120.2	116.4	117.0	126.0
Nov. (p)	119.1	(n.a.)	(n.a.)	(n.a.)

(p) — Provisional

(n.a.) — not available

Source: Deutsche Bundesbank



indicated by a switch from the relatively vigorous stock-building of the first half of 1976 to a running down of both primary-product stocks and commercial goods, and a refusal to place new orders, according to the December monthly report of the West German central bank, the Bundesbank. September-October maintenance of capital goods output was based partly on large one-shot foreign purchases and partly on auto-related domestic demand, both of which have abated, according to the latest incoming-orders. Total West German exports already declined absolutely by 3 per cent from October to November, with ominous slack-offs in deliveries to key trading partners in the European Economic Community. (EEC), in an acceleration of the trend already seen over the third quarter.

Both the Bundesbank report and the December *Economic Outlook* published by the Organization for Economic Cooperation and Development (OECD) underline the dark prospects for exports — on which at least half of West German manufacturing activity depends. The OECD stresses the "weak outlook" for both foreign and domestic demand, citing the lack of prospective boosts from either trade, domestic consumption, or domestic capital investment. The bundesbank — which for two years has promised a solid "upswing" — now points out that even those export sources which have not yet contracted may soon do so, and frowns at the effects of austerity among Western European trading partners. While the OECD's forthrightness about the failed recovery seems to stem from a desire to promote West German reflation as the only solution, the Bundesbank is firmly maintaining its anti-reflationary policy.

Credit and Monetary Developments

The joint decision this week of the government and the Bundesbank not to give the dollar major support through foreign exchange market operations has been accompanied by a refusal to ease the pressure on the dollar by lowering West German interest rates significantly, and by stringent measures to "mop up" excess liquidity which was basically created by continued currency inflows, expressing both the 9 billion mark 1976 current account surplus and speculative purchases of marks. At the beginning of this week, rumors mounted that the Jan. 3-4 slippage in West German interest rates betokened a commitment to easier policy. However, this turns out to be a short-term phenomenon due to the scheduled release of 25 billion marks from pension funds; when government bond sales did not suffice to absorb this additional liquidity, interest rates had to be temporarily dropped. Since October, the general approach of the Bundesbank, as described in the December report, has been to reduce banks' free reserves by selling bonds and relatively illiquid paper, compelling the banks to use their reserves to obtain central bank money and Lombard credits, and, by early December, even forcing the overnight money rate above the Lombard rate. The expansion in the broadest-defined category of money supply, M-3, was clamped from 9.7 billion marks in October to 2.1 billion in November.

A concurrent curb on the money supply resulted from tight credit policies (during the second half of the calendar year.) Corporations, who are not only refraining from investments but are depleting their stocks, show a low level of loan demand; in some sectors like chemicals, companies used their 1976 increment in liquidity to make net repayment of loans since December 1975. While construction loans rose 1.5 billion marks from April to October, total net new credit to the manufacturing sector as a whole was only 4 billion. Yet between August and October, the Bundesbank reports, total private credit-taking rose 20 billion as a whole. (Public borrowing has scarcely increased at all.) At least 5 billion of this is accounted for by lending to foreign individuals and corporations, a category whose increase represents another short-term curb on domestic liquidity. As the upturn in unemployment and short-time attest, there can be no doubt that most West German corporations are not enjoying the comparatively favorable cash situation of the Big Three chemical producers, but credit expansion without corresponding world market pickup is not seen as a remedy.

State of Industry

Even a cluster of giant export orders in July and August failed to lift September-October total production over the April-June index, according to seasonally adjusted statistics, and November output fell 1 per cent. In the basic and producer goods sector, even before the running down of stocks became the norm, production has never returned from its July-August drop, owing to the weakness in steel in particular. Investment goods' autumn flatness subsumed a downturn in machinery output despite the special export super-orders; stagnation in commercial vehicles; and relatively strong electrical engineering, which has been aided by large power-plant business but remains heavily export dependent and, according to the industry's federal association, faces a slippage of its Mideast and East bloc business. The construction industry has been kept from shutting down by moderate government stimulation. The only sector with a post-summer semblance of sturdiness was consumer goods, but the auto thrust which sustained output is now coming to an end.

Incoming industrial orders fell across the board from September to October, and stagnated or fell again in November, when consumer goods orders dropped by 12.5 per cent, getting a jump on the German Motor Industry Association's prediction that 1977 would not resemble 1976. A 1 per cent drop in total orders, a 5 per cent drop in foreign orders, and a 16.8 per cent drop in orders for investment goods (3 and 9 per cent for domestic and foreign respectively) were the most notable developments in October; in November, incoming foreign orders were level, domestic orders fell .5 per cent, and the government now puts October-November decline in total orders from August-September at 2.4 per cent. November investment goods orders rose only 2 per cent after the previous 16.8 drop, and domestic investment goods fell another .5 per cent.

Moreover, the auto contraction immediately hits not only steel but branches like chemical which relied on auto for their own 1976 comeback. Unemployment has already reached 1.09 million at the end of December, through a 10.7 per cent monthly jump which is difficult to explain in purely seasonal terms. The number of employees on short-time grew by over 20 per cent in December to 213,000, partly because of steel layoffs.

Steel Lineup

It is the steel sector that most dramatically shows the crisis point being reached in both industrial policy questions and market trends. Rolled steel output was cut 800,000 tons in November; deliveries exceeded incoming orders, down 23 per cent from the first-ten-month average of 1976, so that orders on hand corresponded to the ultra-recessive level of November 1966. And in the same month, the country's steel export surplus reversed to a 100,000-ton steel import deficit! Fifty-five thousand steelworkers or 17 per cent of the total workforce, were on short time last month, followed by extended vacations. Cost squeezes and low capacity use have intensified financial pressures on the industry.

This industrial catastrophe intersects the battle over cartelization now occurring both domestically and EEC-wide. The Simonet compromise approved last month by the EEC basically entails a compromise with the West Germans which will be in effect for four months; then the voluntary quota arrangements will be reviewed to see whether more drastic measures are needed. The continental cartel subsumes four West German sub-cartels. The largest is Thyssen-Rheinstahl, politically dominated by Kurt Birrenbach, a Trilateral Commission member who leans toward de-industrialization policies. The second largest group is the "northern cartel" dominated by the Kloeckner works; after a recent purchase of the Flick family's Maximilian Huette, Kloeckner is now the second largest producer as a corporate entity. Krupp-Bochum also belongs to this group, as well as the state-owned Salzgitter concern, which has connections with those West German and other European industrialists looking toward expanded East-West and North-South economic relations outside dollar channels. The third largest is the partly Dutch-owned Hoesch-Hoogevens, and the fourth, the "southern group," is based on the German-Luxemburg ARBED firm and Otto Wolff A.G. The cartel members are reported to agree not to produce certain categories of products, hold financial reserves for mutual assistance, share out orders, and shift sales contracts if necessary.

No overt fights have appeared among the groups, but Wolff, Krupp and Kloeckner as well as Salzgitter directors have been involved in export and expansion programs in other industries, including the energy sector, and it is possible that the cartel formation represents an effort to undercut Thyssen's domination of the market and of long-term policy. The federal cartel office has just issued a disapproval of a 15-month-old Thyssen merger with the Hueller-hille GMBH, a machinery producer, on the grounds that combined control over the machinery market would be about 30 per cent. Through Rothschild financing, the Thyssen corporation was allowed to take over as the dominant force in German steel after the 1923 inflation; today it accounts for 15 million out of 60 million in West German steel capacity, and since capacity utilization is certainly no more than 45 million at present, their control of the market is very substantial.

Trade Threatened

The question of whether steel output will be restricted or political ways will be found to expand it is being thrashed out against a background of an overall jeopardy to West German exports which cannot be concealed by impressive 1976 surpluses. After more than a 1 billion mark decline in exports to the rest of the EEC during the third quarter, or 3 per cent, October showed another 1 per cent minus from September.

October exports to Italy and Denmark rose despite those countries' import brakes, but Britain bought 4 per cent less and France, the single largest West German customer, 2 per cent less with far worse to come. The decline for OPEC purchases was 5 per cent and for the Comecon countries a full 10 per cent. These three areas are West Germany's key customers, not to be compensated for by increases on the order of 300 billion marks a piece in U.S. and non-oil Third World deliveries under present circumstances. The 3 per cent decline in total West German exports from October to November was accompanied by a 1 per cent drop in imports, which had been maintained by oil stockpiling, drought-induced food purchases, and the now-defunct stockbuilding by industry.