Monetary Policy

Interest rates and national security

by David Goldman

Although only finance ministers and central bankers will convene to represent the big five Western industrial nations in London Sunday, April 12, the theme of the Western European assault on British and American monetary policies was stated in February by a West German defense official, Lothar Ruehl: "High U.S. interest rates have become a national security problem."

This view, which is shared by most of the German banking and industrial community at large, is motivated by more than just the NATO defense budget. The expansion of NATO's defenses and the additional contributions the American White House wants to solicit from the European allies will be in jeopardy if the West's leading economies remain depressed. But the dangers to the Western monetary system contingent on continued high interest rates also prevent Europe from initiating peace-preserving actions, including refinancing the Polish debt.

The most significant thing about the American response to Europe is the key role of the national security issue. After European leaders met at Maastricht, Holland on March 23 and issued a common demand for global lowering of interest rates, the U.S. agreed to attend a conference to discuss "interest-rate disarmament," as first proposed by the West German Chancellery at the beginning of February. The issue was not handled through Treasury, but referred from the White House to the National Security Council, as a matter of urgent priority for the NATO alliance itself.

The agenda for the April 12 meeting, at which the U.S. will be represented by Treasury Secretary Regan and Federal Reserve Chairman Volcker, is threefold. The Europeans will first ask for interest-rate reduction, and the U.S. delegation will presumably argue that this is impossible in the present inflationary climate.

The second agenda item will focus on the upcoming meeting of the International Monetary Fund's steering group. Although the IMF has just obtained a special credit of $4.9 billion from Saudi Arabia, and has on line smaller contributions from other oil-producing states and a commitment for somewhat less than $2 billion from the Europeans, its resources are still dwarfed by the expected $100 billion 1981 balance-of-payments deficit of the non-oil-producing developing countries. The London meeting will put the U.S. Treasury on the line by "examining" possible means of American financing for the IMF, none of which will be adopted.

The irony in this discussion is that the IMF has always been an instrument for enforcing on Third World and industrial governments the same monetarist policy that the U.S. is now inflicting on itself. But the Treasury's monetarism makes big U.S. contributions to the IMF politically unacceptable. "Back-door" methods of U.S. financing for the IMF will come up, including Federal Reserve "swap lines," with little chance of adoption.

To the extent that the IMF cannot function, the Europeans have full freedom of action to take charge of Third World economies in trouble—*provided they can find the financial resources on their own.* When the European Monetary System (the fixed-parity alliance of eight European currencies backed by a common gold pool) first appeared two years ago, European leaders planned a second phase, a European Monetary Fund, which could replace the IMF. The April 12 discussions, showing the impotence of the International Monetary Fund, indirectly advances the Phase Two project. Europe's prospects of raising the money to make the EMF work are, as reported elsewhere in this section, also advanced by the new bond issue and other arrangements.

The final and most important agenda item will be a series of detailed reports by attending finance ministers on their domestic economic programs. Treasury Secretary Regan will, from preliminary reports, argue that the Europeans should wait six months and give the administration time to make its program work, through tax and budget cuts. The Treasury itself does not expect this to happen according to the rosy predictions of the "Claremont Model," of the Council of Economic Advisers (see interview with CEA Chairman Weidenbaum, *EIR,* April 7). Regan is gambling that a "mild recession" will bring down rates without bringing down everything else. As *EIR* reported April 14, most of the big institutions expect a severe recession with high inflation and high interest rates, a prescription for real disaster.

The Europeans are not blind to this, and will ask Regan "some pretty tough questions," according to one European newspaper account. They will demand to know whether the Federal Reserve or the Treasury is in charge, pointing to recent statements by Fed Chairman Paul Volcker and New York Federal Bank President Anthony Solomon warning that the main burden of the inflation fight still falls on the policies of the Fed.

In effect, the Europeans will attempt to use the April 12 meeting to drive a wedge into the cracks that have already appeared between the White House and the Federal Reserve. The meeting cannot produce an agreement in and of itself, but it can nail the Federal Reserve's policy to the wall as far as the ultimate decision-maker in the administration is concerned.