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U.S. and Germany to buck the IMF?

by David Goldman, Economics Editor

Central bankers and officials of the International Monetary Fund like to explain to national governments that if they accept the bitter medicine offered them, they can expect at least economic stability in return. That is the content of the International Monetary Fund's "World Economic Outlook" paper published in June, and it summarizes the economic arguments underlying the group-therapy sessions for recalcitrant national governments at the Ottawa summit meeting July 19-21.

To an extent that the West German government appears to understand, the IMF document is a witting hoax on part of the Fund's staff, promising to avert a disaster on the international markets if only national governments accept an appropriate degree of misery. The report's argument is both simple-minded and wrong (see Special Report). It says, in essence, that a reduction by half in the deficits of the industrial nations between 1981 and 1982, due to austerity measures, will enable the industrial nations to borrow less, so that the Third World can borrow more. This is silly, as we will show momentarily. At the Group of 30, the consultative group headed by former IMF Managing Director Johannes Witteveen, the report is thought of as a malodorous concession to "political" pressure on the IMF staff.

On this basis, IMF European Director Alan Whittome and his deputy Brian Rose turned up in Bonn in June, and virtually wrote the German council of economics advisers' report to the government, according to IMF officials. "We told the Germans that if they want lower rates," now "higher than at any time since the birth of Jesus," according to Chancellor Schmidt, "then they must cut their budget," an IMF official said. He added, "The reduction in the budget will make the public sector much tougher in negotiations with the unions in 1982. We need a further decline in real wages."

Noting the miserable situation in the German banking sector, where high interest rates have produced staggering losses on the banks' fixed-income bond portfolios, the IMF believes that this "has taught them a lesson. They will have to stop lending to the long-term government bond market, *given the fact that high interest rates will continue.* This can be handled quite nicely, provided the banks contribute to making the point that they will have to be more reluctant to finance the government deficit. They must join the lobby for budget reductions."

However, Chancellor Schmidt need only look across the English Channel, or for that matter across the Atlantic, to see the results of this approach. Britain's regime of interest rate-led austerity has already produced a 50 percent increase in the estimated public sector borrowing requirement for this year, while in the United States, Morgan Guaranty's economists think their present estimate of $68 billion for the fiscal 1982 deficit, although half again as large as the OMB's, is "too conservative." On some key issues, the Schmidt government is resisting, although the final outcome of the budget fight is far from clear. Schmidt has, for example, refused to chop a DM 500 million aid program for the Ruhr steel industry, without which major bankruptcies might pop up by the end of this year.

Contrary to the IMF's intentions, a number of large commercial banks are backing Schmidt's recalcitrance to

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Chancellor Helmut Schmidt

adopt the Thatcher budgetary approach. They fear that the worst effects on West Germany will appear through a new dollar crisis (see Foreign Exchange). The Schmidt government is continuing to negotiate with the IMF, but has prepared a comprehensive set of exchange controls, i.e., a reverse declaration of monetary war against the IMF, as a contingency plan.

The second feature of the IMF plan applies to the United States, where the IMF's "surveillance report" of early July anticipated Defense Secretary Weinberger's July 28 pronouncement that the defense budget will have to be cut in terms of real expenditure in order to avoid inflationary overruns that might jeopardize the budget-balancing exercise. The United States will begin "recycling" dollars to the developing sector, the IMF believes, once "International Banking Facilities" (offshore-type banks on U.S. soil) open for business at the end of this year. In other words, they expect that the depression-caused collapse of loan demand in the U.S. will free liquidity for lending abroad to cover a major portion of the Third World's $96 billion debt service bill in 1981.

Opposition to the Fed

Despite the experience of the past six months, the United States may not be as easy a nut to crack as the IMF believes. Last week's Senate and House overwhelming votes against the Fed's high interest-rate program opens up maneuvering room in the American economic situation for the first time in months. As New York Fed officials noted, the next day's vote in the House in favor of the President's tax bill reflected overwhelming sentiment *against* the Federal Reserve's monetary austerity.

The main advantage to the economy in the progress toward passage of the tax bill is *not* what the tax bill will do for the the economy, but what it *might* do for the White House. *EIR* demonstrated in a computer econometric study summarized in this publication June 2 that the Kemp-Roth tax approach "will *not* stimulate economic growth as such, but spur an investment shift from 'sunset' to 'sunrise' economic sectors," with a net resultant decline in the total tangible product of the U.S. economy—*assuming that high interest rates continue*. However, the White House had circled the wagons around itself as long as the success of the tax bill remained in doubt, and the bill's passage will at least permit President Reagan to focus on other topics.

Including Japan, whose Prime Minister Suzuki used the Ottawa summit to try to enlist the West Germans in a mutual-defense agreement for their respective currencies against the IMF perspective, the three largest national sectors in the OECD group are not taking the IMF's medicine quietly. Schmidt and Suzuki, at least, understand that the issue is not to avoid a crisis by adjusting their internal and external payments situation per the demands of the IMF, but to maintain the integrity of the decision-making powers of their governments before a real crisis hits. For its side, the IMF does not care so much to avoid a crisis as to weaken national governments to the point that it can call the shots in the course of an international monetary crisis.

The monetary system does not work by adding up the surplus and deficits on both sides of national balance sheets, as the IMF's accountants present it. The problem is that commercial banks who already have twice their shareholders' capital tied up in bad loans to the Third World are now handling most of the $100 billion financing requirement of the Third World this year (see Special Report). To continue this they want to be guaranteed of liquidity that will remain in their political sphere of influence, because it is taken out of national economic sectors by political means. Regardless of the consequences for national economic sectors, the IMF is committed to grabbing hold of as much liquidity as possible. But it is perfectly aware that Europe's capacity to feed money into the offshore dollar pool is exhausted, and that nothing short of a brutal short-term drop in U.S. economic output will provide sufficient liquidity to keep the game going.

But the congressional votes of last week, as much as the recalcitrance of the West German government, show that the instinct of self-preservation has not abated in the industrial nations to the point that governments will ignore the fine print on the IMF's medicine bottle. The world is just short of a rip-roaring international fight over the interest-rate issue—which would be the best economic news in a year.