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Bonn surprises the 'Third Way' planners

by David Goldman, Economics Editor

European finance ministers decided during a Jan. 15-16 meeting to lower interest rates a notch, which resulted in a simultaneous West German-Dutch-British drop in rates Jan. 21. This development attracted small notice in the United States, but was held to be of signal importance among European financial institutions. It represented on the one side an attempt to "de-couple" European rates from still-rising American interest costs, but, even more importantly, it was also the public face of a new phase of West German economic diplomacy.

West German Chancellor Schmidt, whose efforts last year to persuade the United States to lower interest rates were clouded by the suggestion that the United States bring its budget deficit under control, has proposed a much simpler solution to President Reagan, sources close to the Chancellery report. Reducing the budget deficit *before* interest rates come down is something the President cannot do; Schmidt has now suggested something he can do, namely, to fire Federal Reserve Chairman Paul Volcker.

Schmidt's purpose

Schmidt's private proposal to the American President is not, as one senior Federal Reserve official complained, "a demand by one sovereign nation that another sovereign nation get rid of its central bank head," but an attempt to help Reagan salvage his own administration. Well-placed West German sources now report that the Reagan-Volcker issue is uppermost in the minds of West German politicians; indeed, the West German press has puffed up every scrap of public comment from the President that might indicate presidential anger at Mr. Volcker.

However, Schmidt is acting not merely out of altruism toward a friend—both West German and American officials agree that the Reagan-Schmidt relationship is much warmer than official Bonn-Washington relations would suggest—but also displaying a new-found financial strength. As I reported in this space last issue, the West Germans are aware of a massive shift in balance of payments positions in their favor (and that of the Japanese) during 1982, associated with the elimination of the OPEC oil surplus. The same factors which, after the doubling of oil prices in mid-1979, ruined the German payments position and brought the deutschemark down from a high of almost DM 1.70 to an August low of DM 2.57, are working in reverse, i.e. a slight lowering of oil prices and therefore of demand for dollars with which to buy oil.

According to senior Bundesbank sources, the basis of the West German interest-rate move was expectation of a handy strengthening of the mark during 1982—and possibly even a dollar rout. Although U.S. Federal Reserve officials expressed caution in recent discussions, concerning the weakness of the dollar, they conceded that a major credit contraction following continued tight-money conditions could provoke a collapse of the dollar in the 30 to 40 percent range predicted by economists like Kurt Riechebächer, formerly of Dresdner Bank, or T. Nakamae of Daiwa Securities'

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London office.

The biggest West German fear is that the Fed will—as it appears to have already—decide to push for monetary tightness no matter what the consequences for either interest rates or the U.S. economy, and, albeit temporarily, provoke huge amounts of flight capital into the dollar, before the disruption of the home dollar market sends even more flight capital running back out again. Under these circumstances, said a source close to the West German Chancellery, "West Germany would have to work out a comprehensive economic and monetary policy agreement with the other European countries."

That is a euphemism for exchange controls, which, in fact, were already proposed by French Finance Minister Jacques Delors during the Jan. 15 European Community meeting. The Mitterrand government has, since taking office, turned the West Germans' harsh but constructive criticism of the Reagan administration into the worst sort of America-bashing. Delors and his British colleague, Chancellor of the Exchequer Sir Geoffrey Howe, are toying with the prospect of a dollar crash, for reasons that have been under discussion at the Swiss-based Bank for International Settlements for years, and a prime topic of British interest since the London *Economist* ran its December 1977 cover story, "Buying America Cheap." Just-retired Bank for International Settlements President Jelle Zijlstra laid out a policy of putting American monetary policy into a sort of Swiss receivership in a now-notorious speech to the IMF in October.

Apart from the incentives a section of the European financial oligarchy finds in a pricing-down of American assets comparable to the early 1930s, there is above all a political motive at work in London: sundering Reagan from his potentially most important foreign ally and counselor, Chancellor Schmidt.

For example, there has been a sudden change of heart about European policy at least among the editorial writers of the British press in late January; after storming along Secretary Haig's warpath against West Germany, which has refused to take his recent posturings about Polish sanctions seriously, the London *Daily Telegraph* and London *Times* both argued Jan. 26 that the entire Soviet natural-gas pipeline issue should be buried. Meanwhile there is increased speculation that Britain will shortly join the European Monetary System, the eight-nation system of stable exchange rates centered around the West German mark, which it boycotted since the EMS's founding in January 1979. The London *Financial Times* meanwhile reported Jan. 26 that the Bank of England has already shifted monetary policy to stabilize the pound sterling's exchange rate against the EMS, rather than following a target for domestic monetary aggregates as such, an apparent preparation for an attempt to enter the EMS.

These little flickerings from London would not be significant except for the gravity of the monetary situation. They indicate that the British (as well as the French) would be prepared to toss the dollar overboard if the worst consequences overtake the dollar—as *EIR* believes is likely, barring the sort of "geopolitical catastrophe" that some analysts predict will save the dollar at the eleventh hour. Clearly the Bank of England hopes to have leverage inside the sort of "third way" arrangement, i.e. between the United States and the Soviets, that sections of the Europen bureaucracy and individuals like International Monetary Fund architect Prof. Robert Triffin, now at the University of Louvain in Belgium, have advocated for some years.

However, from what can be discerned at present, Anglo-French actions are chasing after the Germans, not inspiring Bonn. Schmidt has pulled off a coup of sorts inside West Germany, superseding the longstanding conflict between the Bundesbank and the government, which deplored the Bundesbank's tight-money policy, "by turning [Bundesbank President] Karl-Otto Poehl around 180 degrees," in the phrase of one Swiss source, who complains that the "central bankers' club at the Bank for International Settlements has broken up as a result." What is involved, in the chagrined evaluation of the Swiss, is not so much the European "Third Way" break from the dollar, but rather a German-Japanese alliance in monetary affairs.

Drastic options

Both Schmidt and his Japanese colleague, Prime Minister Suzuki, will attempt to avoid measures that could be interpreted as hostile in Washington—e.g., exchange controls—as long as the United States credit system shows the potential for recuperation. No one should have any doubt that they will take drastic action, starting with exchange controls, revaluation of gold, and exchange of gold among central banks, if their worst fears come to pass.

This implies that the next two months will be among the most tense in world monetary history. President Reagan will take no immediate action against the Federal Reserve Chairman. Perhaps after two months more of rising unemployment, some Federal Reserve sources speculate, Volcker could fall, a view which is also widely held in Western Europe. But that is simply to say that the economy would be out of control and the possibility of a financial crash in the United States real to all participants. It is questionable whether President Reagan might put things back together at such a late date. West Germany's policy towards Washington, or at least Schmidt's policy towards Reagan, is twofold: offer a helping hand, and build flood-barriers in case the proffered hand were rejected.