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EIR Economics

Will Europe be forced to break with the U.S.?

by Richard Freeman

The Finance Ministers of the 10-nation European Community met in Brussels Feb. 15, to discuss the monetary problems triggered by the high interest rates of the U.S. Federal Reserve. The EC decided to send Belgian Prime Minister Wilfried Martens and Belgian Finance Minister Willy le Clerq to meet U.S. President Reagan in Washington, D.C. on Feb. 17 to urge Reagan, on behalf of the entire EC, to lower U.S. interest rates. German Finance Minister Hans Matthöfer stated that the purpose of the European deployment to Washington was "to prevent the U.S. and European economies from drifting further apart."

While for West German Chancellor Helmut Schmidt, preventing an economic and political break between the United States and Europe is one of the first principles of statecraft in this dangerous period, it was clear at the EC meeting that this is not a shared principle. In fact, led by French Prime Minister Mitterrand and Finance Minister Jacques Delors, there are now members of the European Community who would like to see Europe "decouple from the United States," and consider the European Monetary System as a central vehicle for accomplishing this purpose. The view of this camp is, "If the United States plans to slit its own throat, we will form a third entity, separate from the United States and the Soviet Union, and choose the course of a third way." This would mean decoupling the European currencies from the dollar, and letting the dollar drift, especially if it is hit by a currency crisis, as is widely expected.

The deployment of Belgium's Martens to Washington was impelled by the growing recognition that with interest rates in the U.S. rising again, the European economies were being doubly devastated by the impossibility of long-term investment in industry, and the general drain of liquidity out of Europe into high-yield returns offered in dollar-denominated paper.

Challenge to the United States

The day Martens and le Clerq arrived in Washington, Schmidt granted an interview to the *New York Times* saying that "Europe is in greater danger than the Americans have understood so far" because of U.S. high interest rates.

"Right now the richest economy in the world is at the same time the greatest importer of capital. This is an unhealthy state. Some of the capital we don't even need—it's being put into New York because of the high interest rates. The high interest rates not only harm the United States, they harm the rest of the world even more."

Schmidt delivered a warning of a kind he has been giving in his own country for some months: he drew the consequences of the depression that could bring democracy to an end as it did in the 1930s. "The fabric of the economy and the society is endangered by the deepest recession since the middle 1930s. What I fear is economic and social, and therefore political, unrest," he said.

Italian Finance Minister Beniamino Andreatta had told the ministers in Brussels that "the continued U.S. tight-money policy is simply throttling us. The sense of internal U.S. uncertainty and heightened tensions have only created further difficulties in international trade."

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Andreatta said that the sharp dollar appreciation because of high interest rates is disrupting world trade and must be stopped. "Both parts of the Atlantic," he said, "must attempt to bring exchange rates to sane and stable levels. If not, we will, despite high prime rates, have both recession and inflation at the same time."

The Italian lira has become of great concern in Rome. Despite heavy Bank of Italy intervention over the last six weeks, the dollar has risen from 1,193 lira to the dollar on Jan. 4 to 1,271—the highest parity since World War II. Other European currencies are being battered, and the Japanese yen has fallen to 240 yen to the dollar.

In January, Chancellor Schmidt called a meeting in Versailles of the Finance Ministers of the big Five Nations: Germany, the United States, Japan, France, and Great Britain. Four of the nations agreed to plan for lowering interest rates. Treasury Secretary Donald Regan made the United States the odd man out by refusing to even nominally endorse this agreement. The German central bank took the occasion to lower the lombard rate (which is a notch above the discount rate) by 0.5 percent to 10 percent. Other European nations cut their central-bank lending rates somewhat as well.

The Feb. 17 *Neue Zürcher Zeitung* commented that "the German central bank appears calm. . . more concerned with interest-rate disarmament than with the devaluation of the deutschemark." Thus, Germany plans to stick to its policy of lowered interest rates, regardless of short-term capital outflows.

The Anglo-Belgian strategy

However, two camps emerged in Brussels. One was led by France's Delors and, not too far in the background, by the Bank for International Settlements (BIS), the "central bank for central banks" which since 1930 has acted as a headquarters for the subterranean European oligarchs who want to crush the United States and split it from Europe financially and politically. The other camp was led by Chancellor Schmidt, who recognizes that if the U.S. economy goes down, Europe will too.

Delors led the talks in Brussels about "expanding the capacity of the European Monetary System [EMS]" and increasing the functioning of the European Currency Unit (ECU) for intra-European functioning. As originally established in March 1978, by West German Chancellor Helmut Schmidt and French President Giscard d'Estaing, the EMS set up a plan for exchange-rate stabilization that linked the European currencies together and constituted a support operation for the dollar against the wishes of the U.S. Carter administration, which avowedly sought to wreck the dollar and the world reserve currency.

But Giscard is gone. Instead, British and Swiss financiers whose ideologue is Belgian royal household economist Robert Triffin plan to make the EMS a vehicle of "European integration" along "post-industrial" lines. Under this policy, the EMS "breaks free from the dollar."

A similar notion was advanced last September by the BIS, which made "exchange-rate stability" a paramount issue, with the unstated intention of turning Europe into a separate currency and trade zone, during a general world monetary disintegration.

A source close to the International Monetary Fund (IMF), which has similar designs, reported Feb. 17 that one means of severing Europe from the United States is for Europe to apply exchange controls, an idea that was also advanced by former British Prime Minister Edward Heath in the lead editorial of the Feb. 14 London *Sunday Times* as a "ringed fence" keeping the U.S. dollar and the U.S. budget deficit out of Europe.

According to this IMF source, "One suggestion is a two-tier system like France has now. European banks would lend to domestic industry, or to other European countries, or to countries with whom they have trade, but they would be restricted from lending to anyone else on the international markets.

"Thus each country, say England, would effectively have two banking systems, one for domestic and related industry and another for international business. Each banking industry would be segregated from the other. The international industry could take deposits, but not make loans to outsiders. This would prevent the United States from going to Europe and trying to finance its budget deficit from the savings of Europe."

This source added that another track the Europeans might take is to have the respective European nations refuse to purchase American goods for national projects, such as refusing to buy American computers for use in European postal systems. This, the source noted, is already starting in France, and would show Washington that Europe is serious about lower interest rates.

The other prong of this strategy is to use the breakdown in world capital markets to put the Third World, and all of world trade, through a controlled credit cut-off.

Peter Montagnon, Euromarkets correspondent for the London *Financial Times*, developed that perspective Feb. 17: "To put it bluntly,
coming when commercial and central bankers alike feel that deficit countries will no longer be able automatically to turn to the international credit markets as their first port of call."

With the disappearance of the Arab OPEC surplus, and the expectation that in fact OPEC may be a substantial net borrower in 1982, the petrodollar recycling mechanism is gone. If the international banks shut off their lending, OPEC will not fill the gap.