The debt crisis spreads to Western Europe

by David Goldman

As Mr. Carlo De Benedetti of the Olivetti Corporation argues elsewhere in this issue, not merely France but also Italy is in line for the "Mexico treatment" now being accorded the Mitterrand government in Paris. With the descent of one of the big industrial nations to the status of financial victim, the world financial system resembles the chaos of the Roman arena, with the Bank for International Settlements in the role of the Emperor Nero, directing the slaughter.

A phase-change in the world monetary system is now taking place, as this publication projected for the March-April 1983 period in analysis published last summer and fall. The rise in American interest rates by about 1 percent over the past month marks the end of a desperate holding operation conducted by the Federal Reserve and the Bank of England, which re-liquefied the world monetary system at the cost of the fastest rate of reserve creation on the recent record (see Domestic Credit). This occurred against the bankground of a 2 percent decline in international reserves during 1982 reported in late March by the International Monetary Fund—the first such decline since 1959, and a crude but useful measure of the extent of the world liquidity crisis.

The Federal Reserve's bluff was called early in the month by the Dutch-German-Swiss central bankers' group which the London Financial Times March 22 dubbed "the disciplinarians," linking it to the monetarist faction in the United States which now demands Federal Reserve stringency. Treasury Secretary Donald Regan's warning March 21 that the rise in interest rates is the result of excessive money supply growth indicates the present dominance of the "disciplinarian" group.

The rise in interest rates intersects the end of the "recovery" euphoria, and the potential for a drastic decline in U.S. output levels documented in this issue (see article, page 11).

Since the Feb. 10-11 Interim Committee meeting of the International Monetary Fund, which failed to call for easier monetary conditions and nearly failed to reach any agreement at all to increase member contributions to the IMF, a political shift has occurred. The Wagnerian outlook expressed by Bank for International Settlements President Fritz Leutwiler in an interview *EIR* was first to release by in our March 1 issue, has now spread to Bonn with the new Kohl government. The Swiss and allied monetarists in the United States have seized upon the Federal Reserve's frantic effort to postpone the crisis via the printing press to argue, convincingly in some circles, that Volcker's quack remedy is the cause of the disease—that explosive monetary growth is the cause of higher interest rates.

That is bunk: interest rates are rising despite the Fed's extraordinary actions because the U.S. Federal government is attempting to borrow about $100 billion this year in excess of normal income or credit-creation sources, and because the developing sector is attempting to roll over about $90 billion in short-term credit during the present quarterly closing date. Not only are Argentina, Venezuela, Peru, and Uruguay, which declared moratoria on short-term principal payments early in March, in trouble; Brazil is falling into arrears, and has no prospect for finding the resources to cover them.

However, seen in the ideological distorting mirror of the U.S. Treasury, Leutwiler's cynical argument appears credible: money supply growth must be contained. At the same

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time, the Swiss-German-Dutch bloc enthusiastically opposes additional resources for the International Monetary Fund (beyond the 47.5 percent quota increase agreed to on Feb. 11), siding with the Beryl Sprinkel monetarists at Treasury.

Crisis at Williamsburg

These ingredients may brew up "the last big blowup between the United States and Europe before there is real monetary trouble," according to the author of one of the widely circulated plans to refinance the banking system. Belated preparations in the U.S. administration to offer some combination of debt relief and officially supported rescheduling along the lines proposed variously by Felix Rohatyn, Peter Kenen, or the National Security Council's Norman Bailey are in progress, although it seems unlikely that an adequate plan might be formulated in time. This is an active fear among senior administration officials.

At present, the White House has ruled out any compromise of American sovereignty, i.e., additional powers for the International Monetary Fund or Bank for International Settlements; a major factor is the continuing emphasis of these institutions' bureaucracy upon reductions in the American defense budget, which President Reagan will never agree to. Nonetheless, a faction of the administration centered around Secretary of State George Shultz and Commerce Secretary Lionel Olmer argues that the administration will have no choice but to agree to supranational controls over economic policy as the crisis worsens.

This perspective is circulating outside the administration in the form of an Atlantic Council policy paper entitled "The International Monetary System: Exchange Rates and International Indebtedness," which proposes "coordination of fiscal and monetary policies," (a euphemism for International Monetary Fund surveillance with teeth); an increase of resources of the IMF; and coordination of intervention in the foreign exchange markets, with target rates for currencies. All this amounts to turning management of the world economy over to the IMF, the public mask of the "Neronic" Bank for International Settlements.

Writing in the March 21 *New York Times*, commentator Flora Lewis portrayed the trade and currency crisis as the opening of a major strategic break between Europe and the United States. In an op-ed entitled "Money and Allies" she wrote, "Europeans agree that . . . it is Washington's 'benign neglect' from Carter to Reagan that has caused the European currency crisis. . . . Without some U.S. cooperation, [the EMS] isn't strong enough to work effectively. The rejection of European pleas for the U.S. to join in some international monetary rules to replace Bretton Woods was a key reason for the fiasco of the Versailles summit." Williamsburg, she said, will collapse into haggling unless the United States listens to European requests "for the United States to accept responsibility of the dollar's role in the world. . . . U.S. industry will also be affected. . . .

"It should be a warning to the United States that allied cohesion is not only a matter of confronting the Russians, . . . but coordination on money and trade, as well as defense."

The Olmer argument

Inside the administration, Undersecretary of Commerce Lionel Olmer is arguing that the United States must reverse its policy of non-intervention in currency markets, and plunge into a supranational deal to manage currency rates. According to an Olmer aide, the argument is that "if the dollar does go up any further, there are going to be people in the administration who are going to push the idea that the United States must get involved in managing the currency system. Olmer would have argued this openly in his testimony recently, but we had to adhere to the administration's public position. Not having the dollar connected to the other currencies is bad for U.S. trade. A strong dollar is bad for U.S. exports. George Shultz is also getting more outspoken about this issue. He's saying we need coordination of exchange rates. Special Trade Representative Bill Brock, too. All the trade people are concerned about it. Olmer thinks something must be done."

This group in the administration is telling Reagan that floating rates are wrecking free trade, and threatening him with world protectionism just like in 1929. "The problem is that we can no longer have both free floating rates, and free trade," he said. "Rates are no longer determined by trade flows, but by huge flows of speculative capital. If we just let the market move the rates, they just move speculatively, and the rates are wrong with respect to real trade in goods. Then, countries react with protectionist measures to protect their trade. Speculative capital flows are swamping the boat of world trade. Can we sacrifice our trade?"

Bank of England analysts, who originated the currency-coordination plans, now despair that any such measures will be able to broach the crisis that the world is entering.

"We would like to be able to do something, but it seems to be going in the other direction," said one economist close to Bank of England management. "All the studies done post-Versailles on currency intervention show that intervention is not effective. What is being said now is that the Europeans have had their own experience of fixed rates and it's fallen apart from under them. That's not an encouraging background. I can't see what they can do, unfortunately. There will be a lot of noise about it, perhaps even talk about bands [of fluctuation] and so forth, but they cannot come up with anything workable. There just isn't any way to do it."

Nothing short of an agreement to back an ambitious "Great Projects" approach to the developing sector, such as Japan may propose at Williamsburg, will revive world trade (see article, page 10), and this cannot be financed short of a commitment of gold reserves to cover major nations' current-account deficits. Otherwise the United States must either turn its sovereignty over to a supranational body such as the IMF, or accept the diminished status of a continental power, a "Fortress America," in a worsening world depression in either case.