

European Monetary System

The Group of Five devalues the franc

by George Gregory, Bonn Bureau Chief

European Community finance ministers, meeting on the heels of the Versailles summit meeting, took rapid action and carried out a sweeping realignment of currency parities in the European Monetary System.

The overall devaluation of the French franc by 10 percent to the deutschemark was the major move, flanked by a 7 percent devaluation of the Italian lira. For the deutschemark/franc parity, the effective rates broke down to a 5.8 percent deutschemark appreciation to all other EMS currencies, and a franc devaluation of 6.9 percent.

A 'disinflation' policy?

There is far more implied by the European action that meets the eye, and certainly far more than a mere internal European "monetary stability" operation. At least, this is how the designs are seen from here. The EC Commission, through a spokesman, pointed out to *EIR* that "the overall implication, included in the intent of the resolutions of Versailles, is a reinforcement of the policy of disinflation, as the BIS [Bank for International Settlements] calls it, in an exacerbated form."

Part of the "disinflation" applies to France. Runaway inflation of up to 14 percent, and balance of trade deficits to West Germany alone in the first quarter amounting to 80 percent of total deficits last year, were factors threatening to rip up the EMS arrangement. Now, as the Commission spokesman stated, the "EMS is a deutschemark zone, and we are now in position to negotiate with and manage in the Group of Five [industrialized nations] context with the other two major zones," the dollar and yen.

The message is supposed to be that "we have done our part, and now the United States has to keep its end of the bargain" sealed at Versailles. And what was that bargain?

"If the dollar starts to drop, we have a situation in

Europe where the funds flowing out of the dollar will not merely flow into deutschemarks, which would have caused problems. Now we can manage that situation." The dollar is expected to drop, timing indeterminate, if the Federal Reserve lowers interest rates and there is a budget compromise; or if the Fed stays tight and interest rates high, and the bankruptcies start rolling. In either case, "we can manage it."

Does the Commission believe that the U.S. budget can be brought under control? "Hardly, but we can manage it." Do they believe that the U.S. economy will come out of depression under such management? "Hardly, but we can manage it."

German central-bank outlook

The German Bundesbank is quite pleased that it has been able to move France to an "anti-inflation policy," but as one analyst put it, "the franc devaluation means the Europe is not going to do anything at all." The Bundesbank has issued a semi-confidential memorandum addressed to the EC Commission rejecting any firmer establishment of the European Currency Unit (ECU), and rejecting any attempt to establish the "European Monetary Fund," or any EMS coordination of dollar policy—all that is in the hands of the deutschemark authorities, which makes the Bundesbank happy, and the Commission, as an adjunct of the Group of Five, is also not unhappy about it.

No one is too confident, of course, that the French economy is going to sit up and behave under four months of wage and price controls, budget cuts of 20 billion francs, and public social expenditure cuts of another 30 billion. But, having lost currency reserves in such volumes, down from 40 billion to 16 billion francs in one year of Mitterrand's presidency, in France no one wants to talk about the IMF or Group of Five; they merely feel a little better tucked away into the deutschemark zone.

Mitterrand had proclaimed at the Versailles summit that "France is not a country that submits, rather one that proposes." France has proposed to submit, because politically the functioning of the Versailles Group of Five arrangement is aimed to get effective "multilateral surveillance" over the U.S. at some appropriate time in the near future. "The Group of Five are the real candidates for management of monetary affairs to avoid a disaster, with the IMF attached, and the central banks playing a coordinated role of lender of last resort," says a top planner in Bonn. "To say that the ultimate purpose is to put the U.S. into IMF receivership would be a bit strong, but the Group of Five will definitely represent a certain external interference in U.S. affairs." Does anyone think this is going to stop a U.S. depression, or is it a managed world deflation, like the 1930s? "More the latter," is the answer.