German Economist Backs FDR, Calls For New Bretton Woods

An Interview With Prof. Dr. Heiner Flassbeck

The economist Prof. Dr. Heiner Flassbeck was Germany's deputy finance minister in 1998-99, during the early phase of the first Schröder government, and is now chief economist of the United Nations Conference on Trade and Development (UNCTAD), based in Geneva. Flassbeck has become known for his strong attacks on the European Union's deflationary Maastricht Treaty, now strangling Europe's economies, and his public calls for a "New Bretton Woods," a "multilateral international monetary system with fixed exchange rates." He also proposes huge infrastructural investment programs in order to boost the world's real economy. That is not at all surprising, since Flassbeck studied in the tradition of the famous German economist Wilhelm Lautenbach, who, in 1931, had proposed the German version of President Franklin D. Roosevelt's "New Deal," a government-steered investment program to overcome the Depression of the 1930s by creating real wealth and jobs. On Oct. 21, Flassbeck was interviewed in his Geneva office by Michael Liebig and Hartmut Cramer. The interview has been translated from German.

EIR: Mr. Flassbeck, where do you see the main components of the systemic cluster-risk in the present worldwide financial and economic system?

Flassbeck: The main current risks I see are in the immense American current-account deficit on the one hand, and the refusal of the Europeans, on the other hand, to contribute to the growth of the world economy. Therefore, a very severe crisis of the international financial system is preprogrammed. Without exaggeration: The Europeans in the last 20 years—actually already since the beginning of the '70s, when they were "released" from the Bretton Woods System—have systematically refused to play any role in the growth of the world economy. But without expansion, the world economy cannot function reasonably.

EIR: How do you evaluate the Maastricht Treaty, which prevents, and even strangles economic growth? What is, in your view, the background to "Maastricht," and its so-called "Stability Pact"?

Flassbeck: Basically, Maastricht is the logical continuation of the policy of the Bundesbank [Germany's central bank] in the 20 years before this treaty was signed. After 1973, when the Bretton Woods System was ended, the Bundesbank completely lost sight of the world economy and practiced a primitive "monetary nationalism," as von Hayek called it back in the '30s. And this basic national monetaristic direction was then tranferred to Maastricht. This is naturally deadly. In principle, the European Monetary Union and the euro represent a big opportunity, because we now no longer have any speculative financial flows inside Europe, and the inner-European currency casino was closed down. But on the other hand, the present monetary constitution of Europe is absolutely not adequate for solving the problems of the European economy. Quite the contrary; it contributed to causing them. With Maastricht, the national monetaristic dogma was imposed upon the whole of Europe.

EIR: In the meantime, the failure of the Stability Pact has become evident, as can be seen in black and white, in the falling investment figures and rising unemployment figures. What possibilities do you see, to eliminate this corset of the Maastricht Stability Pact?

Flassbeck: Presumably this will only happen with the full outbreak of the present crisis. Also in the '20s and beginning of the '30s it was, unfortunately, only after the climax of the world economic crisis, that a shift in thinking was possible. By way of Maastricht, we in Europe were forced to pursue a *deflationary* policy. I fear that this will be continued—up to the point that, to quote the economist Wilhelm Lautenbach, even the entrepreneurs or the neo-classical ideologues have to grasp the fact that it cannot go on this way. Only then will people see the need to shift to an expansive economic policy.

Maastricht has destroyed the decisive option offered to us by the market economy: to overcome economic crises and other structural disparities by way of an expansive credit policy. In the U.S., this was done. This outlet was closed by Maastricht. Therefore, we Europeans are now condemned to go the wrong neo-classical, or neo-liberal way, called: "Tighten your belt!" But this wrong path leads deeper into the crisis, because with that approach you cannot solve the problem, but instead, you strangle the economy ever more.

Naturally, you can compensate for a deflationary economic policy, as is being done now, with increased competitiveness, at least for a certain time. But this then results in extreme current-account balances: high surpluses in Europe, and the record-high American deficit, which in the end can only be compensated for by a strong devaluation of the dollar. Only then, will the European delusion, that problems can be solved by means of deflation, evaporate.

EIR: Could you be more precise concerning American financial policy? You say it is credit-expansive, but obviously, in a quite undifferentiated way. It is not investments into the physical economy that are being stimulated, but rather the financial system as such, and consumer spending. Can you explain, what, in your view, is going wrong in the U.S. economy?

Flassbeck: The American policy of credit expansion was not always merely consumptive and unstructured. During the '90s, investments increased enormously, even if many of these investments were made in the field of electronics and computer equipment. But for sure, not all of these were wrong investments.

I see the problem in the fact that, since the "stock bubble" burst three years ago, we have not had any significant dynamic of investment in the U.S. any more. At the same time, we have a high consumption dynamic, which is not justified by anything, and therefore can't be sustained. Incomes didn't increase, and consumption was promoted primarily by the monetary policy of the Fed and other measures by the government. This policy should be now replaced by one where the market generates increasing investments and incomes, as well as through an orderly savings rate, since the savings rate in the U.S. is dangerously low. Any additional shock, no matter whether caused by high oil prices or rising interest rates, could now lead to a situation whereby America's consumers normalize their savings quota "overnight," so to speak—and that would be a catastrophe for the American, and therefore, the world, economy.

EIR: Recently, you have repeatedly warned that the present international monetary system harbors the danger of a grave crisis, for example a big devaluation of the U.S. dollar. Could you, in this light, explain again your estimate of the present state of the world financial system, and your strong public call for a New Bretton Woods system?

Flassbeck: Paradoxically, we see right now the emergence of a highly curious "Bretton Woods System." By that I mean the emergence of a huge dollar bloc, in which Asia, and also large parts of Latin America, are pegging their currencies unilaterally to the U.S. dollar. This is being done in a unilateral way, without a multilateral system, and therefore, it is not the New Bretton Woods system which I am calling for.

The reasons for the emergence of this dollar bloc are easy to understand, as we have documented in the just published UNCTAD annual report: For many developing and threshold countries, the unilateral pegging to the dollar is the only means to create stable currency relations and thereby create reasonable conditions of investment. But this means, at the same time, that the entire burden of the present imbalance, and clearing it up, falls on those parts of the world whose currencies are still floating versus the dollar—and that is mainly Europe.

In a very short period of time, Europe, therefore, has to face the choice of either living with a massive up-valuation of the euro—and thereby massively endangering its export markets—or, paradoxically, intervening against an up-valuation of the euro. This is what the Asians did, and of course Europe can do this too, in order to prevent an up-valuation of the euro. But in that case, this curious "Bretton Woods" would emerge—but one without multilateral rules. In fact, we then would have a worldwide dollar bloc. But this would only end up in America's practicing stronger protectionist measures, because otherwise it could not bring down its current account deficit, and could not even prevent a further increase of this deficit.

EIR: That then forces the argument, that Europe should actively pursue the creation of a durable New Bretton Woods. In the U.S., this is being done by the economist and politician Lyndon LaRouche. In Italy, the Parliament over the last two years, several times—and in a non-partisan way—has urged the government to actively pursue the creation of a New Bretton Woods. You, Mr. Flassbeck, have clearly and publicly called for a New Bretton Woods—a multilateral, international monetary system with fixed exchange rates. How is it that the debate for a New Bretton Woods has not yet reached "critical mass"?

Flassbeck: I believe that Europe, since the "liquidation" [an East German ironical metaphor for destruction] of the Bretton Woods system at the beginning of the '70s, simply has not understood its international role, and the enormous opportunities which a stable international monetary system offers to promote economic growth. Whoever was in power in the European countries did not recognize the significance of a functioning international monetary system for the growth of the entire world economy, and that of their own countries. I also don't have the impression, that presently the "established" politicians, who like to quarrel about almost everything, understand in any way, what is at stake here—not only economically, but also politically.

In addition, the European central banks, above all the Bundesbank and now the European Central Bank [ECB], are completely refusing to cooperate internationally. They suffer under the delusion that they can conduct an "autonomous" monetary policy. But this is not possible in a globalized world. Nobody can presently pursue an "autonomous" monetary policy, not even the U.S. Federal Reserve, which, in my experience, did a better job at that than the ECB.

EIR: Could one therefore say, that the European central banks, and the ECB, by way of Maastricht, are forcing the countries of Europe to conduct a policy of deflation domestically, and externally, are blocking a rational reorganization of the world financial and monetary system?

Flassbeck: Yes, you could say that. By being absent in the field of economic policy, and with their pressure in the direction of a restrictive financial policy—especially concerning the real economy—the central banks are pursuing a deflationary course of action. Consequently, the national governments see no other chance than to undercut each other, concerning the level of their costs and taxes. And that must lead to an impasse. I have to stress here, that the governments "see" it this way, which does not mean that they don't have the chance to act differently. With Maastricht, all possibilities for a credit-expansion policy on a European and national level are, in effect, "forbidden." This absurd mixture, taken together with the refusal to assume international responsibility, will push Europe, as I believe and have written about several times, into an extremely severe situation: Europe will be confronted with the devaluation of the U.S. dollar and the upvaluation of the euro.

EIR: Do you think that, at the point that in Europe, the economic, social, and political effects of the crisis, which we monitor daily, become fully manifest, there will be a chance that people will finally realize that things cannot go on this way?

Flassbeck: In Germany, too, people will stop discussing secondary and tertiary political questions, and will finally also take into account the entire world and the realities of the world economy. But presumably, this will happen only—it's sad, but true—when the crisis has gone so far, that people *have* to recognize: It cannot go on this way!

EIR: Do you see the possibility that other actors, like the United States, but also Asia—China, Japan, East Asia, India—Russia, or Brazil could take initiatives in the direction of a New Bretton Woods?

Flassbeck: I think that practically all those countries are rather open to a New Bretton Woods. In principle, they are ready to go in this direction. There are already regional initiatives everywhere; in Asia, there is an intensive debate going on about monetary policy, because it is clear that cooperation is necessary. In Latin America, too, the discussion of a new monetary system is beginning, because it is being recognized there that the unilateral pegging to the U.S. dollar cannot work in the long run, and that multilateral regulation is required. And then we have the big euro bloc.

In fact, there are only three or four currencies left. Obviously there are also other bills of paper money being printed, but they don't have any real significance for the world economy any more. Besides the Swiss franc and the British pound, none of the "small currencies" has any real significance. Almost all "small currencies" are pegged to the few "big currencies." That's the trend in a globalized world economy.

EIR: But you certainly don't mean this in terms of the proposals of Robert Mundell and his circles, who propagate a strange "world currency." Isn't the present trend, after all, going more in the direction of the former European Monetary System [EMS], but this time on a worldwide scale?

Flassbeck: Yes, that is exactly what we need. I regard the EMS definitely as a model for a new world monetary order. In the next 100 years, presumably we will not have a "world currency," but nevertheless, right now, we do need multilateral cooperation in currency questions. We need the mutual obligation of all states—not only the unilateral obligation of weak states toward the strong ones, but also the willingness of the strong states to help the weak ones.

This became very clear in Latin America, and also during

If a huge expansion of exports does not lead to growth, then you know how serious the situation really is. Then you definitely need much more than a mere program of credit expansion; then you need a complete shift in the thinking of the political class and its accompanying media.

the so-called "Asian crisis." Let's take the example of the uncontrolled devaluation of the Brazilian currency, the real. The exchange rate of the real was just being floated, instead of going for an orderly devaluation, which at a certain point, had to be stopped, in order not to ruin Argentina. But the Brazilian real was being floated freely, until it had dropped much too low, much lower than would have been justified by the data of the real economy. Therefore, a huge crisis in Argentina was unleashed—with worldwide repercussions. This, in my estimatation, is almost a classical example of how *not* to do it. The orderly devaluation of a currency, which sometimes may be the only way to solve a severe crisis, is totally different from the free floating of a currency after having given up the unilateral peg to the dollar.

EIR: Back to the New Bretton Woods, a model of which, in your opinion, could be the original EMS from 1979.

Flassbeck: Absolutely. But I think the "old" Bretton Woods was much better, since it defined more clearly, under what exact circumstances a currency should be devalued or upvalued; this stupidly was not done with the EMS. The EMS rather relied on the "financial markets," and it was argued that, in respect to exchange rates, something has to be done only when a currency comes "under pressure." That this is not correct, was shown in the case of France, which in 1992, despite considerable pressure from the financial markets, did not devalue its currency, in fact.

In a New Bretton Woods, one has to define very clearly, as was done in the old Bretton Woods from 1944, when, and where, external economic imbalances exist. Naturally, these imbalances have to be recognized officially, and to do so, we today have much finer instruments at our disposal. But, if there are indications of the fact that, after a strong real devaluation, a country has lost its competitiveness, that country must return to an exchange rate which corresponds to the state of its real economy. For that, there are simple and reasonable rules, which have to be used multilaterally, though. But if this multilateralism does not exist, we will get unilateralism, which is what we are seeing right now.

As I already mentioned, the developing and newly industrializing countries, in fact all countries that are weak, are trying to obtain current-account surpluses. It is only this, which gives them the strength to peg their exchange rates unilaterally to another "strong" currency. Since they understandably do not want to be engaged in free floating, they have to try, from a position of strength, to fix the exchange rate of their currencies. This is precisely what China is doing at the present time; other countries are doing it too. In one sense, this is a rather intelligent solution, since this way you prevent yourself from becoming a slave of the international financial markets. Besides, this way you create very favorable conditions for exports, as well as very favorable conditions for investments domestically. But this cannot be done in the whole world, since the world as a whole, obviously, cannot create current-account surpluses.

EIR: Let's come back to the situation in Europe, and especially to Germany. You talked about a shocking repetition of the behavior of the '20s and early '30s, in respect to what has happened during the last years in Europe in general, and Germany in particular.

Flassbeck: With the dominant policy of "belt-tightening," we, in principle, are doing the same thing that, during the '20s and the early '30s, was considered to be the only means to overcome the economic crisis. Just by saving more and cutting expenditures anew, the governments believed then they would be better able to compete internationally, and in this way get out of the crisis by pulling themselves up by the bootstraps. That didn't function, and *can't* function. This approach can only and always lead to deflation. And it provokes a counterreaction of other countries or economic blocs—as will happen today with 100% certainty. If it does not come in the form of a competitive devaluation, as in the early '30s, then it will come in the form of a massive up-valuation of one's own currency—we will see this with the euro.

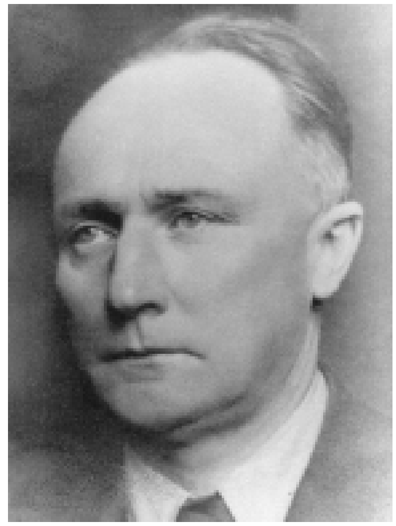
A big, relatively closed region like Europe, has to have its own strength for growth. The domestic market has to flourish; there have to be investments in the real economy; people have to have money to buy; and there must be private consumption—only then does an entire economy grow. Just yesterday, the six German economic institutes presented their common report, in which they state that Germany's economy this year produced an export surplus of 30 billion euro. Of course, this is a big "boost" for the economy, but even this has not sufficed to pull Germany out of the crisis.

This shows, as I see it, how deep we are already in the deflationary crisis. Despite this "boost," income expectations of the overwhelming majority of Germans have not increased. People don't believe that in the foreseeable future their incomes will rise again—and as long as they don't believe in that, there will be no way out of the crisis.

EIR: In 1931, in the very midst of the world depression, the economist Wilhelm Lautenbach in Germany proposed a program for boosting the economy, with very big infrastructure projects as its top priority. Today, similar ideas, concerning present national and transnational infrastructure projects exist in form of the "Delors Plan," the "Tremonti Plan," and the "Eurasian Land-Bridge," none of which, however, has gotten off the ground. What chances do you see for a way out of the crisis, if such public investment programs, which clearly create real wealth, productive jobs, and are not merely comsumer-oriented, were to be realized?
Flassbeck: Eventually, the realization of such projects will be the only measure which will work. There simply is no other way—today, as also then, at the time of the worldwide economic crisis. At the point the deflation has manifested itself, one has to become active in the economy in a credit-expansive way—according to the rule: The stronger the policy of deflation was before, the more expansive the policy has to be now—in order to turn the deflationary powers around. Right now, we see in Japan how difficult this is: Only China's huge economic growth—a gigantic program for promoting the exports of the Japanese economy—prevented Japan from falling into a very big crisis—but it has not rescued Japan yet. In overcoming deflation, therefore, one has to think and act in huge dimensions. As I said, the 30 billion euro export-surplus in Germany this year was not sufficient to transfer the spark of the exports to increased domestic demand.

In such a deep crisis as the present one, more is required than an infrastructure program financed by the state, although there is no way around that. At the same time, there has to be a normalization of income-expectations—i.e., the return to a reasonable wage policy. We have to turn away from the deflationary wage dumping that we see now in Germany, be it in the form of longer working hours—which is nothing but wage cutting—or many other forms, for instance, the cuts in the social system. All of this is promoting deflation. The more strongly such a deflationary policy is pushed, the more hopeless it appears to be to get out of the crisis.

EIR: You are obviously calling for an expansive economic policy like Lautenbach's, or like Franklin D. Roosevelt's New Deal, for Germany and Europe now. How do you see, in this context, recent proposals to use Germany's Stability Law of 1967 as a lever, since this law not only contains a whole series of potential actions, but also of *obligations* to act?
Flassbeck: When the present export boom is gone—and it will evaporate—the conditions under which the Stability Law for state-sponsored measures to initiate economic growth can be used, will emerge in a much stronger way than now. Because after the export boom is over, we will again fall down to zero growth, and unemployment will increase even more. Therefore it will be mandatory then to use the Stability Law. But we have to recognize that Germany's 1967 Stability Law today is in contradiction to the Stability Pact and the Maastricht Treaty.


Wilhelm Lautenbach in 1931 proposed a German version of FDR's New Deal, which could have prevented Hitler's rise to power. Lautenbach, says Dr. Flassbeck, "understood the entire economic system much better than 99.9% of all the economists in Germany who came after him."

EIR: Then it is merely a question of mobilizing the political will to change this?
Flassbeck: Yes, certainly. In the end, one can always do what is necessary, if one has the political will to do so. But today, the hurdles are set much higher with a Europe which, in my eyes, has a wrong monetary constitution, since it blocks an active autonomous economic policy of a country. Therefore, it is much more difficult for a single European country today, even if, like Germany, it is one of Europe's biggest, to "break out."

EIR: The alternative therefore, would be either: Stability Law, or Stability Pact?
Flassbeck: Yes, you could see it that way. The Stability Law was ignored for a long time. Honestly speaking, the European Stability Pact is also being ignored right now. Eventually, politics has to be pragmatic, and neglect these "juridical hurdles"—and that is what will happen.

EIR: In order to stimulate the discussion about an active anti-deflationary policy of promoting growth and development, the already mentioned economist Wilhelm Lautenbach is of key significance. You are one of the few experts on Lautenbach in Germany. How was Lautenbach unique?
Fassbeck: In my eyes Wilhelm Lautenbach—one doesn't know if before Keynes, after Keynes, or together with Keynes—saw with an unbelieveable clarity (and sometimes

with an even greater clarity than Keynes himself), the connections within an economy as a whole. This applies especially to the *save/invest* paradox. In principle, Lautenbach understood the entire economic system much better than 99.9% of all the economists in Germany who came after him. It is fatal and tragic, that the discrediting of Lautenbach already started in the '50s; at that time, it was said that there was no longer a time of crisis, and therefore, Lautenbach was no longer needed. He was called the "German Keynes," and together with Keynes, Lautenbach was also ruined.

But Lautenbach's thinking can absolutely not be reduced to the complex of an economic crisis. In reality, he developed an economic theory which is valid for all economic conditions, not only for times of crises. His theory is simply able to explain the dynamic development of an economy, investment, much better than the neo-classical, neo-liberal theory.

EIR: In addition, Lautenbach's memorandum of September 1931, *The Possibilities for Boosting Economic Activity by Means of Investment and Expansion of Credit,* is not only unique in respect to analyzing a crisis correctly, but also to overcoming it effectively. What about stimulating a real debate about this question today, a debate which was strangled for a long time, but which is being forced upon society in this time of crisis?

Flassbeck: We will get this debate, I am totally sure. It cannot be blocked. But in Germany right now, because of the existing conditions imposed by the media and scientific community, one cannot conduct this debate without being immediately branded as an esoteric outsider.

How many relatively well-known economists representing my position still exist in Germany today? You can count them on the fingers of one hand. In this climate, such an economic-political debate cannot emerge, let alone be conducted in a competent way. But I am sure that this will change, because otherwise, there is no way out of the crisis. Very clearly, this was shown by the developments of this year in Germany. If you get such a huge expansive promotion of exports to foreign countries, and even that is not enough to put the country back onto a path of growth, then you know how serious the situation really is. In such a situation you definitely need much more than a mere program of credit expansion; then you need a complete shift in the thinking of the political class and its accompanying media.

EIR: How do you explain this paralysis, dogmatism, and complete one-sidedness of the economic-theoretical debate in Germany?

Flassbeck: This has a lot to do with the fact that Lautenbach was systematically ignored in Germany. Remains of Keynesian thinking, which still existed at the end of the '70s, were eradicated by the uncritical takeover of monetarism. This, in turn, is connected to the fact that Germany's university system does not at all favor "maverick thinking," "outsider-thinking," or "other-thinking," but exactly the opposite. The principle of cooptation in German universities has the effect of always reproducing just the same schools of thought. Thinking goes only in one direction, instead of promoting an open, broad debate. Additionally, the associations in Germany, especially those of the entrepreneurs, are permanently pumping a lot of money into society, in order to steer the discussion in a certain direction. They seem not to notice the fact that in this way they are only damaging themselves in the end.

EIR: Are you thinking in this connection of well-financed organizations like the "Initiative for a New Social Economy," or the "Convent of Citizens"?

Flassbeck: These are only two of the many initiatives, which are all pushing in the same direction. They want to suppress any alternative thinking in Germany, and cover it with a *mainstream,* which only reflects something that one could call "pre-Keynesian thinking," or "thinking of the '20s." What is really astonishing about this is, that the entrepreneurial associations, which are promoting this thinking with a lot of money, are ultimately doing harm to themselves. Because it is their membership, above all the middle-sized entrepreneurs, who, in the end, suffer the consequences of this thinking. Just as the workers are suffering from the effects of the present deflationary policy.