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BIS circles look to the end of the dollar era

by David Goldman

In conjunction with plans for a European Defense Community which might effectively replace the European branch of NATO, European officials are now elaborating an expansion of the European Monetary System to the point of forming a European currency bloc sundered from the dollar. In the view of the European Monetary Commission, long dominated by the views of Tommasso Padua-Schioppa, Prof. Robert Triffin, and other Europeans who believed that the postwar emergence of the dollar standard was an unpleasant interlude in monetary history, a "complete break" with the dollar will occur during the next 12 months—although some European observers doubt the timetable could move so quickly.

In fact, the total instability of world market conditions makes some form of break likely, following less a preconceived scheme of the sort offered so often by the Bank of Italy, than the model of the 1930s breakdown of the world into competing protectionist blocs. The chief economist of the Bank for International Settlements, Alexandre Lamfalussy, warned of "a deterioration of the world in protectionism and other inward-looking measures" if the United States maintained its present disastrous monetary course. But Lamfalussy, who addressed the 20th anniversary meeting of the Atlantic Institute in Brussels Oct. 23, only reiterated the threat of an economic crisis comparable to "the inter-war period" that was made earlier in the June published annual report of the Bank for International Settlements, and the similar utterance of his superior, outgoing Bank for International Settlements President Jelle Zijlstra, the former Governor of the Bank of Holland.

The specific issue under debate is important, but hardly defining, with respect to the problems involved. The U.S. dollar, as Lamfalussy noted, has risen 25 percent and then fallen considerably over the past year, making world market conditions impossibly unstable for the European economies, who have seen the price of their oil and other raw materials imports skyrocket to the point of becoming a principal cause of the present European recession. Lamfalussy, as sources at the Basel-based Bank for International Settlements emphasized, is after the head of Treasury Undersecretary Beryl Sprinkel, the Milton Friedman clone who announced last May that the United States would take no action whatever to moderate the extreme fluctuations of the dollar on foreign markets, returning in effect to the "benign neglect" policy of the Carter administration.

Immediately prior to West German Chancellor Schmidt's May visit to Washington, European finance ministers agreed upon a plan to link the dollar's value to the European Currency Unit, thus to the fixed-rate zone that Schmidt and Giscard had authored at the Bremen conference of European leaders in July 1978. Specifically, Schmidt intended the dollar/Europe link as an aid to the White House in bringing down interest rates; a move to obviate the $200 billion or so in credit demand associated with hedging and speculation against dollar fluctuations would obviously remove considerable pressure from short-term interest rates. It was in response to this indirect flanking maneuver against the Federal Reserve's monetary policy that Sprinkel, the ideologue par excellence of Chicago School monetarism, announced that the United States would do the precise opposite of what Schmidt had in mind.

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The issue has never merely been currency fluctuations, but rather the monetary policy responsible for them as well. Since May, however, the departure from office of Schmidt's collaborator, French President Giscard, the situation has fundamentally altered. A European link to the dollar on terms amenable to the White House and European leaders is not in the cards.

The outlook

Between now and the first quarter of 1982, the following elements will conspire to bring the longstanding fight to the point of confrontation:

1) After rising to DM 2.56 in early August, the dollar has fallen back to about DM 2.30, and is expected to fall again to DM 1.70 to DM 1.90. Both former Carter administration officials like C. Fred Bergsten, now at the Carnegie Endowment for International Peace, and his ideological enemies at the Regan Treasury, including Beryl Sprinkel, argue that the dollar must fall substantially in order to improve American trade competitiveness.

2) The United States economy is plunging into severe recession while inflation continues to rise (to almost 15 percent p.a. in September), and interest rates refuse to fall substantially, both indications that the debt bubble generated by the Federal Reserve has taken on a life of its own. The implication is widespread bankruptcies throughout the sphere of dollar credit.

3) The unsustainability of the $100 billion current-account deficit of the developing nations, as characterized by the Interim Committee of the International Monetary Fund in its Sept. 27 communiqué. Despite the IMF's unprecedented warning that the cycle of oil- and debt-service-related deficits must come to an end, no such thing is happening; on the contrary, IMF economists point out that commercial banks are lying ferociously about the volume of short-term loans they are still putting out to roll over Third World debt.

West German banks, meanwhile, have already begun to disengage as far as they might from dollar-based lending, and have fallen back—as Deutsche Bank Chairman Wilfrid Guth intimated in an Oct. 13 speech in Luxembourg—upon increased trade financing in their own currency, an unprecedented development during the postwar period.

What the European Monetary Commission's "Third Force" advocates have brought to bear on this is the following: The immediate objective, already endorsed by Deutsche Bank's Guth and other Germans, is to bring the British pound into the European Monetary System (EMS). The British would then support the near-term erection of a European Monetary Fund, as a credit-institution for European purposes—something very different from the original Giscard-Schmidt conception of the European Monetary Fund as a vehicle for long-term trade financing between Europe and its developing-sector trading partners. However, the Germans are understandably cautious about permitting the British to join the EMS, having spent close to DM 15 billion in support for the weak French franc in the course of the past year as a matter of fulfilling their obligations as members of a fixed-rate currency zone. Should they have to back up the chronically weak pound as well, the German currency, whose weakness during the first eight months of 1981 traced principally to oversupply of marks on the market following currency-support operations, would suffer.

Therefore the European Monetary Commission has won the West German central bank's approval for an extraordinary tradeoff. If more German marks must enter the market through expanded German intervention operations to support an expanded EMS, more central banks, particularly those in current-account surplus, must be convinced to hold marks in the form of reserves, reducing the otherwise problematical oversupply of marks. The Commission, consequently, has opened negotiations with the Arabs to price oil shipments to Europe (and possibly other countries) in the form of German marks, European Currency Units (a compound of currencies in which the mark's weight is predominant), or some similar combination.

Nothing is to be expected from such a proposal at the moment; however, under conditions of a rapidly deteriorating dollar, the prospect of significant Arab central-bank diversification out of dollars would be real for the first time since the 1973 oil-price increase. At the University of Louvain, the unofficial think tank for the European Monetary Commission, the view is that a decline of American political influence in the Persian Gulf would accelerate the process on the monetary front. The President's striking political victory on the AWACS sale may throw a monkey-wrench into the scenario, given that the Saudis are less concerned about the possible deterioration of their portfolio than they are about the threatened overthrow of their regime.

The 'Third Force' effort

However, the AWACS victory does not eliminate the basic problem. One top European official, speaking off the record, maintained, "There is talk about some countries leaving the IMF, resigning from the Fund. It is being discussed by very influential people. I am very worried about the U.S. at the moment. Its foreign policy and military planning may create a disruption on the financial front, in particular the issue of missiles emplaced in Europe, and President Reagan's remarks last week [on limited nuclear war]. There is declining acceptance of the American umbrella, and growing unwillingness to accept financial rules which are becoming increasingly distasteful."

As of the IMF meeting at the beginning of October and the October 19 meeting in Scotland of the Nuclear Planning Group, the United States left Europe with a set of entirely unacceptable policy alternatives, including what Weinberger is willing to call plainly a policy of limited nuclear war in Europe, and a currency and interest-rate policy which makes economic life impossible in Europe at the same time. Both policies are the result of the influence upon Washington of the Thatcher government of Great Britain, particularly through its semi-official intelligence arm, the Washington-based Heritage Foundation.

Yet at the same time, Britain's Foreign Minister Lord Carrington and Chancellor of the Exchequer Sir Geoffrey Howe are negotiating with their French counterparts to break away from the obnoxious policies which the British themselves encouraged for so long, in the direction of independent European defense and monetary institutions.

What ultimately will come of this? The United States went through the worst economic decline of any nation during the 1930s, with national output falling peak-to-trough by more than 40 percent. In the currency blocs that emerged from the 1931 flotation of sterling and the 1933 floating of the dollar against gold, the old European family fortunes clustered around a Swiss-French-Italian bloc pegged to gold. The direct continuity of the European gold bloc of the 1930s, whose assets appreciated against U.S. equities (through currency and stock market declines) by roughly 1,000 percent, is foreign ownership of about one-third of U.S. equity.

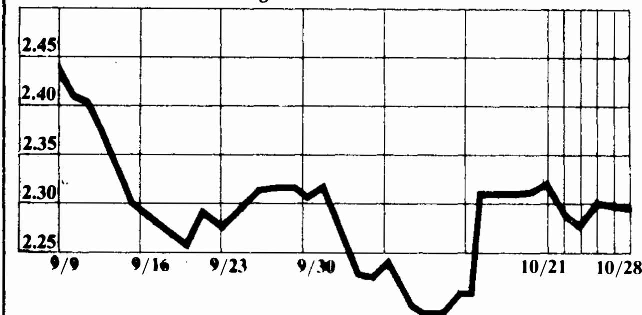
The direct, unbroken connection between the coup of the old continental European fortunes, and present financial institutions is the Bank for International Settlements, created in 1930 as a combined public-private vehicle for managing international reparations payments and debt service associated with their financing.

The gutting of the Paris headquarters of the Banque de Paris et de Pays-Bas (Paribas), in favor of a shift of operations to Switzerland and Belgium, is exemplary. While Mitterrand runs a rampage against French industrialists and bankers, the most important sections of the client business of this most important of the French banques d'affaires has flown to Switzerland and Belgium, and the constituent shareholders of Paribas (e.g. Warburgs) have simply put their money into a new, and inviolable, Swiss- and Belgian-based shell. These interests look toward the demise of even the IMF, whose distasteful feature, for them, was that it was dominated legally by the American government. The world shall return to the type of currency blocs prevailing during the inter-war years, precisely as the June report of the BIS warned; and their advantage in controlling a gold- and petrocurrency-based bloc against a declining United States and failing dollar would be immense.

Currency Rates

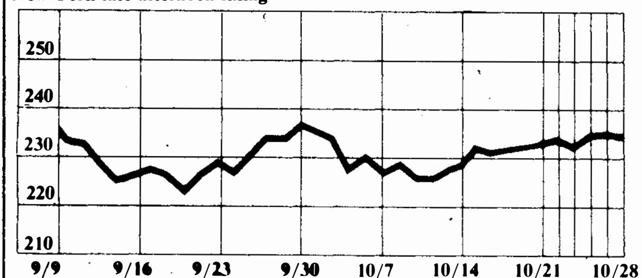
The dollar in deutschemarks

New York late afternoon fixing



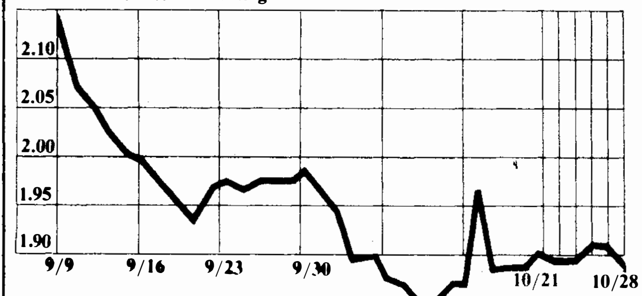
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing