Interview

The Group of 30's Peter Kenen discusses European credit controls and trade limits

Princeton University Professor Peter Kenen, who gave the following interview to *EIR*'s Richard Freeman Feb. 19, is one of the most influential international economists in the United States. Chairman of the Academic Panel of the "Group of 30," the advisory body created by former International Monetary Fund managing director Johannes Witteveen, and an adviser to the International Monetary Fund, Dr. Kenen is a former Treasury Department consultant for the Carter administration. The views expressed in the interview are his own, not necessarily those of organizations with which he is affiliated.

The debate over European exchange controls to which Dr. Kenen refers was triggered by the present high U.S. interest rates. As the London *Financial Times* complained in a recent editorial, the stated perspective of the U.S. Council of Economic Advisers is to meet a federal financing requirement estimated at above $200 billion by some economists for fiscal 1982 by drawing in substantial amounts of capital from abroad, presumably at the expense of European governments and private industry, who have their own substantial financing requirements. The American high-interest policy represents in European eyes a form of financial warfare, or "dollar imperialism," as an international economist at Chase Manhattan bank phrased it.

At the meeting of European Finance Ministers Jan. 16, French Minister Jacques Delors presented a formal motion for comprehensive European controls, which was rejected by the Germans and also by the British—despite calls by former Conservative Prime Minister Edward Heath for a "defensive ring" around Western Europe. Particularly after the acrimonious negotiations Feb. 21 over the devaluation of the Belgian franc, it now seems less likely than ever that the Europeans will, as a body, adopt a general system of controls. At the same time it seems more likely that Europe will feel compelled to undertake control measures on a national basis, or around the emerging "deutschemark bloc." German officials point out that full authority for controls is already established in Paragraph 23 of the *Aussenwirtschaftgesetz* (legislation on international economic activities); but they warn that it would take "at least a year" to establish the legal base for European-wide controls. At the moment this is on the back burner, but officials say a further strong rise in U.S. interest rates might change this.

EIR's Richard Freeman interviewed Prof. Peter Kenen on Feb. 19.

Freeman: Do you think that Europe will move toward exchange controls to defend against the high U.S. interest rates?

Kenen: Well, France already has exchange controls of a sort. It has a two tier credit system in which the banks lend at lower rates for domestic industry. This would be hard to maintain in most countries, but in France it seems to be working, because France is used to working with controls.

Freeman: What about controls for all of Europe?

Kenen: Well, Europe could have capital controls. This would mean essentially splitting banks in two. The domestic side would lend for domestic industry, for trade within the European Community, and for trade with other countries. But lending for international matters would be handled by the other half of the banking system. The international half would be allowed to take deposits but not make international Eurodollar loans. This would include restricting loans to the subsidiaries of American companies in Europe, like Ford Motor Company, etc. Thus, what you have is two banking systems, segregated off from one another, operating strictly separately, though you are really talking about the opposite sides of the same bank. This would mean essentially splitting the City of London in two. The American banks in London would be watched closely.

Freeman: Such a system sounds like it would be difficult to enforce.

Kenen: Yes, that's true. This would mean that any German banker going to his international bank in Luxembourg couldn't take any money with him. Germany or some German bankers might not like the system, but Germans had restrictions on which German firms could borrow abroad during the 1960s and 1970s. This would mean turning the situation around and limiting German bank lending. But this form of capital controls could be done. In Britain, Maggie Thatcher and Geoffrey Howe pride themselves on having lifted exchange controls when they took office, so there may be opposition there.

Freeman: Would such a system be effective?
Kenen: It's an awfully high fence that would have to be put around Europe, and that's very hard. I don't know. But the French have been able to isolate themselves much better than most. Of course they use a dirigist economy. Mitterrand is now enforcing provisions to prevent shipments of gold outside France, and arresting people and applying criminal penalties.

Freeman: If the Europeans do not move toward capital controls, is there something else the Europeans can do?
Kenen: One thing that I think that the Europeans may do is refuse to buy American products. This is what the French are doing. The French have decided to protect French industry against the effects of high interest rates. The French government is buying only or mostly French goods for its French plans. This is not like the buy-American campaigns. In France, when you talk about French government purchasing, for French companies and the French government—and there are more and more companies being nationalized every day—you're talking about 25 percent of all purchases. That's decisive.

Freeman: What does it mean to buy French products and not American products?
Kenen: It means that, for example, Europeans buy only European computers for their postal systems, not American computers. This could be extended not only to goods produced in America, but also goods produced by American companies who do production at factories in Europe. Technically, these are actually European companies, but everyone sees them as American.

Freeman: You mean like Ford Motor and IBM?
Kenen: Yes. You just don't let American companies bid on European government or other contracts.

Freeman: Wouldn't America immediately retaliate? What could the Europeans do, step up their trade with the East bloc?

Kenen: Yes, America would retaliate. I don't think that the trade with the East bloc would offer that much more trade or work out, because of the East bloc's bad credit rating. I don't know what would happen if the Americans retaliate. But this is already starting in France, and this approach represents one of the only ways that the Europeans can give a real response to the U.S. Treasury and people like Beryl Sprinkel. If Europe just says to Sprinkel, "Please lower interest rates, they're hurting us," he won't listen. But this is a threat he'll respond to. This idea is also one of the lead editorials of the latest issue of the London *Economist*.

Freeman: Do you think that the Europeans can take hope that Volcker will lower interest rates?
Kenen: No. I think that Volcker and President Reagan are thinking in the same way. If you want to know the truth, I think that Reagan's attacks on the Fed are demagogic. He has these monetarists in his administration and he is not going to break with the Fed unless he gets rid of those monetarist advisers. And Reagan doesn't plan to split from his monetarist advisers.

Freeman: What do you think Volcker would say if Reagan said to him, "lower interest rates"?
Kenen: Paul would say "get lost."

Freeman: You seem to know Volcker well.
Kenen: Yes, I know Paul pretty well. He has laid his credibility on the line. If I, Peter Kenen, were to become Fed Chairman tomorrow, I might have some latitude.

The French government is keeping U.S. bidders out of government purchasing, which represents a quarter of all purchases, as part of the pressure for lower American interest rates. Paul Volcker has locked himself into his policy, however.

But Volcker doesn't. He's already locked himself into this policy, and he knows that if he veers from this policy, both his liberal and conservative critics will jump on him. I think that Paul is showing that he has the guts to stick his program out. Further, I'll just say about the monetarist critics of Volcker, who keep saying that he has been too tight one month and too easy the next [in handling money supply], it's mostly their damn fault. You can't manage money supply month to month, but only on longer periods. And if there are too many people getting upset by month to month variation, that's because the monetarists have made this a focus of the press.