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Europe decouples from the United States economy

by David Goldman

This month *EIR* will publish the results of an in-depth computer econometric study of the West German economy, which, we believe, will produce some shocks at senior policy levels in the United States. Although tests on the application of the *EIR*'s LaRouche-Riemann model to a West German data base prepared by *EIR*'s Western European economics editors are still incomplete, the work so far points conclusively to a devastating result: the Western European and American economies decoupled during 1979.

At a moment when the central debate in American foreign policy involves the means by which the sinking Carter administration can continue to hold Europe to American policy objectives, the strategic importance of this result is obvious. As *EIR* has documented in a groundbreaking survey of the American economy's survival prospects, the United States is headed into a recession unlike any previous one, threatening a "phase change" into a nonindustrial economy. In fact, in terms of productive potential, the American economy never recovered from the 1975 recession, in that the quotient of tangible reinvestible surplus in our economy never rose above the zero margin. It has fallen sharply below zero as of the final quarter of 1979 and continued downward, toward a rapidly approaching "point of no return."

By contrast, the West European economies, centered around the West German economy, are in the middle of a boom that has confounded the OECD economists and various others, who expected these economies to move in phase with the American. West German industrial output is currently growing at a 6 percent annual rate, and the industrial output growth is founded on capital formation, rather than consumer spending. The annual rate of West German productivity growth is a solid 3 percent per year; America's manufacturing productivity fell 2.3 percent during the single first quarter of 1979. Some of that fall is undoubtedly recession-induced, but nonetheless more drastic than during any previous recession, reflecting the underlying collapse of American productive potential.

Other European economies are "in phase" with the West German; French industrial output growth is 3 percent p.a., Italian 12 percent p.a. Only Britain (along with Canada) is falling in tandem with the American collapse.

No recession for Germany

The question, of course, is whether this is a temporary, lagging growth phenomenon, or a basic "structural" development. The above data have been available for some time, but *EIR* avoided passing judgement until at least the preliminary results of Riemannian computer analysis were available. We can say with confidence at this point in the investigation that while the American economy never went through a recovery after 1975, the German economy really never went through a recession, except for a one-year spike downwards in the basic parameters.

Consistently, our study will prove, German industry maintained a high rate of capital formation in both the most-efficient methods of energy production, and in energy-intensive, high-productivity manufacturing methods, while the American economy reoriented toward energy-conserving, labor-intensive investments

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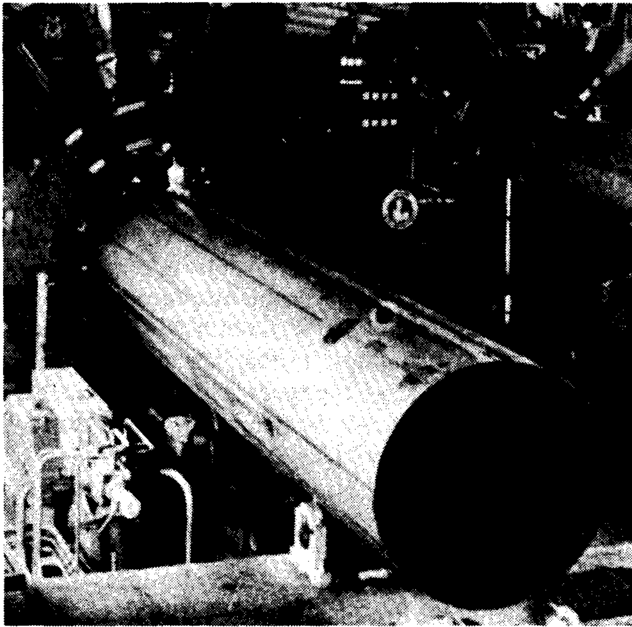

An advanced West German pipe-welding machine at Demag GmbH.

which penalized goods-producing industries in favor of services, and capital-intensive methods in favor of labor-intensive methods within the goods-producing sector.

As *EIR* has previously shown, this sordid picture explains the apparent "success" of the American economy in achieving energy conservation in manufacturing. No such "success" was tolerated by West German industry, which maintained an energy-intensive profile throughout the 1970s. Although the quadrupling of oil prices in 1974 interrupted the long-term growth trend of the German economy, growth restarted from a somewhat lower level, and the process of capital investment was never interrupted in an important way.

In fact, contrary to our expectations, the West German economy appears relatively unaffected—excepting monetary criteria on the internal inflation and foreign payments side—by the oil price increase in tangible terms. That is, German industry managed to increase its productivity sufficiently to make up for the interest-cost of borrowing back from the Arabs the additional funds they paid out for oil.

This divergence is particularly disheartening for the United States when we consider that German exports to the Soviet Union rose by 23.8 percent during the first quarter of 1980. Albeit from a low base-line, this result is spectacular, and indicates that whatever the Germans can't ship westwards due to American recession conditions, they will ship east instead.

On to Venice

French President Giscard and Chancellor Helmut Schmidt are playing the cards they hold in advance of the Venice Summit of leading industrial nations close to the waistcoat. Most press reports concerning Venice reflect to a great extent Washington's wishful thinking on the subject. Giscard has promised a new monetary initiative at Venice, a promise echoed in a statement last week by the dean of West German commercial bankers, Hermann Abs. The Deutsche Bank's emeritus chairman warned that either a chaotic "multi-currency reserve system" or a replacement of the dollar by Special Drawing Rights of the International Monetary Fund were unacceptable proposals; but the introduction of the gold-backed European Currency Unit (ECU), the projected reserve currency of the European Monetary System, was not.

Federal Reserve Chairman Paul Volcker's decision to rescind part of the credit controls package he imposed in installments last October and March has persuaded any European who had doubts that the Fed has no control over the steering wheel. Indeed, the drop in American interest rates, which brought the critical short-term rates (Fed funds and Eurodollar rates) down by almost 10 percent from their April peak to the trough last week, bespeaks Washington's fear of Europe. Earlier this year, American bankers boasted fairly incautiously—in the pages of *Business Week* magazine and in frequent discussions with this publication—that European banks would take the brunt of any major Third World debt defaults. Certainly the Fed's push on short-term interest rates, which might have cost the Third World an additional $20 billion in interest charges this year alone, implied a degree of recklessness with respect to the international debt situation.

The dollar and Europe

Whether or not Europe would suffer the worst financial consequences in the event of major disruptions of the Eurodollar market is not a technical but a political question. Europe still depends on the dollar as the leading medium of trade. Ultimately the dollar is backed by the strength of the American economy. As the American economy dissolves—and particularly if it dissolves in an inflationary direction—Europe will no longer be able to employ the dollar as a reserve instrument. However, as banker Abs points out, the ECU is acceptable.

Considering the direction of American policy, the prospects of orderly negotiations on any new monetary formula President Giscard might propose are negligible. In a perverse way, this suits Giscard's ally, Chancellor Helmut Schmidt, just fine. Schmidt will under no circumstances adopt measures which openly flout American authority, but will defend the same measures if presented as a response to force of circumstance.

We cannot say, as yet, what the Europeans will do at Venice. But it is a fair estimate that they will adopted whatever monetary measures are necessary to the prosperity they have built on their side of the Atlantic.