Chancellor Schmidt elaborates his approach to economic policy-making

by David Goldman, Economics Editor

EIR *Economics Editor David Goldman filed this report from Hamburg, West Germany.*

West Germany's Chancellor presented his perspective for the world economy in the 1980s before an elite audience, the Hamburg Overseas Club, on April 5. No text was made available to the press, and the following summary from myself represents the only full account available of this definitive policy address. Speaking to his Hamburg home base, Schmidt gave the most frank and comprehensive account of his economic policies to date. More than that, he concluded his grim portrait of "the second worst economic crisis in this century" with a demand for political support by West Germany's business elite. No other government, Schmidt emphasized, could maintain Germany's internal stability such that this country could play the crucial international role of maintaining strategic equilibrium.

In effect, Schmidt sought and obtained a vote of confidence from Hamburg business, his old home base, while emphasizing that, in effect, they needed him more than he still needed them.

In private discussions, leading Hamburg businessmen and investment bankers warned that public accounts of the imminent collapse of the Bonn coalition government should not be taken seriously, and Schmidt would stay in office much longer than most people thought. Among friends and advisers of the Chancellor in Hamburg, the prevailing estimate is that Schmidt could still call and win a national parliamentary election against Christian Democrat Helmut Kohl, the phlegmatic and unattractive opposition leader. At least for the next year, leading investment bankers believe, Schmidt will be able to draw on sufficient political resources to stay in power, which they believe to be a precondition for political stability in West Germany.

Preventing a German trade collapse

Two features of Schmidt's address need to be highlighted. First, his discussion of the "need to replace the funds lost to the Eurodollar market through the shrinkage of the OPEC surplus" answers the most critical question before German economic policy: what will West Germany do to prevent a collapse of its own foreign trade in the context of a general crisis in the dollar markets? With German deliberateness, the commercial banks and investment houses are making preparations to correct the situation in which "West Germany is economically independent of the United States, but is still monetarily and politically dependent," as the chairman of a centuries-old Hamburg banking house that still bears his name told me. In some form, Germany will use its improved payments situation, due in large part to the drop in oil prices, to replace the international credit that the Eurodollar market can no longer make because its own deposit base is dwindling as a result of the same drop in oil prices.

Secondly, Schmidt's remarks concerning the U.S. situation shows that he does not understand the problem behind the present American crisis and therefore is not capable of intervening in the American situation in such a fashion as could change American policy. Rather, he is relying on "the force of circumstances," as one banker close to the Chancellor told me, to compel the Fed to change policy. Schmidt is also relying on the collapse of President Reagan's proposed rise in the defense budget to help bring down interest rates, as the accompanying text makes clear—a stance which indicates he has mis-estimated a fundamental concern of the United States. Also striking is Schmidt's forthright commitment to population-control policies, however moderated by his concern that economic growth must be the basis for the reduction of population growth rate. This viewpoint—which may be traced to Schmidt's close ties to the Evangelical Church in Germany—aligns him to the real problem in Washington, namely, that Volcker, Stockman, Regan, and other policy-makers see economic decline as a means of enforcing population reduction. Although Schmidt does not share this horrifying view of the world, the fact that he is convinced by at least a part of the Club of Rome argument introduces a great flaw in his perception of American problems. The irony of Schmidt's position is that howsoever hard he has striven to remain an Atlanticist and a supporter of NATO—motivated as much by his conviction that American and German interests must be united, as by his dislike for the Soviets expressed in his speech—he is after all much more effective as a German nationalist.

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Below are excerpts from Mr. Goldman's transmission of the Chancellor's speech.

We are in the second greatest economic crisis of this century. It is wrong to attribute the inflation problem merely to OPEC. Inflation began in earnest when the Johnson administration financed the Vietnam War through inflationary policies. This in turn led to the events of August 1971 and the introduction of floating exchange rates, which were an invitation to inflation. Unlike the fixed-rate system, they encouraged central banks to adopt inflationary monetary and currency policies. This accounts also for the eight-fold growth of the Eurodollar market since 1971. Then came the second oil shock in 1979, and instead of inflation, we had general economic contraction. The oil countries themselves, and the Soviet bloc are suffering from this situation. . . .

Let me turn now to developments in the United States. Compared to last year, there has been a 4.5 percent drop in Gross National Product, and there are now 10 million unemployed, which is 9 percent of the workforce. . . .

I should like to say something about what has come to be known as supply-side economics. It combines a growing fiscal deficit and a tight monetary policy. I would characterize it as Keynesian in the Budget Office and Friedman at the Federal Reserve. There is the added problem that high U.S. interest rates draw in large volumes of international funds. Now there is additional demand for funds, putting more pressure on interest rates. There has been a great deal of criticism of the budget deficit from Congress, the trade unions, and large industrial firms. No one is going to say in this situation that the present Federal Reserve policy is wrong. That leaves a degree of uncertainty until September. . . .

As for the U.S.S.R. and Comecon, it is no longer the case that they may hope that the crisis of capitalism will effect the West alone. This is a deceptive viewpoint. Every national economy must adjust to the impact of the energy situation. Now the East bloc as a whole is suffering from the inefficient use of economic inputs, poor capacity for innovation, and is finding it difficult to raise the level of production. Annually the Soviet Union must import 30 to 45 million tons of wheat, and 45 million tons of wheat is $12 billion. Opening the Siberian resources requires enormous capital costs. Now, the necessary support for Poland, and also Romania, implies a reduction of orders to the West.

In the oil-producing countries, whereas in 1979 the spot oil price was $40 per barrel, now it is one-third lower. The official price will also continue to fall. That means both less demand for Western goods, as well as a reduction in the volume of the surplus, which contracted dramatically. That is good for the oil importers, whose payments situation will improve and who will have more domestic buying power, and it is especially good for the non-oil LDCs, especially the NICs [Newly Industrialized Countries]. The problem in the situation is that the financial flows previously associated with the OPEC surplus must be replaced. . . .

For the non-oil LDCs, there is now less maneuvering room for financing. One-third to one-half of their total export earnings must be paid for oil. Now, with the world recession, their exports are reduced. This has spread insecurity in the international markets, given the $80 billion debt-service [requirement]. . . .

Kenya's 4 percent per annum population growth rate brings up a central issue, the world population explosion, the source of the cycle of poverty. In the last 35 years, the world population has doubled. Population is growing 2 percent per annum in the Third World. By the year 2000 there will be 6.3 billion people, of which 5 billion will be in the Third World. This also means an increased concentration in large cities, such as Mexico City, and ensuing social unrest. There is no time to be lost to introduce an effective population policy. The next 28 years will be decisive for the next century. It is possible to stabilize the world population at 8 billion or at 12 to 15 billion, and we must ensure that it is 8 billion. . . .

What policies must we seek in the industrialized West? Neither Keynesianism nor monetarism will avail us. . . .

However, let me outline the basic steps I feel are necessary in the present world situation:

First, each nation must first seek to solve its problems at home, which means a continuation of strict monetary policies and restrictive budget policies.

Second, each nation must pay careful attention to the foreign effects of its national policy. There must be no beggar-thy-neighbor policies. Of all the major world economies, only China is relatively isolated in terms of the effect of its policies on the rest of the world. There must be no monetary protectionism, and no bank domino collapses.

Third, the United States has the best possibility now to contribute to the world recovery. It has 36 percent of the world GNP, but even more important, 80 percent of world reserves are in U.S. dollars, and three-fourths of the Eurodollar market—$1.7 trillion! The most important thing the United States can do is to reduce interest rates in the interest of the entire world.

Fourth, contries with big balance-of-payments surpluses like Japan, must take measures to open their internal markets while others, like France, must use budget and monetary tightening to reduce their deficits.

Fifth, there must be continued moderation in growth of real incomes, but through voluntary action and negotiation. Wage and price controls are only a placebo with no real effect.

Sixth, there can be no advantage taken from devaluation; that is, no competitive devaluation. I recall [Bundesbank chief] Dr. Poehl's warning that devaluation and inflation form a vicious circle.

Seventh, the International Monetary Fund must be strengthened, and it cannot be an instrument of development aid, and its policies cannot be determined by the debtor countries.

Eighth, there must be orderly market conditions on the foreign exchange markets to provide security. By this I do not mean intervening against the trend, or fixing rates.

Ninth, GATT must be strengthened to reduce the danger of protectionism.

Tenth, for the LDCs and the less developed LDCs there must be help toward stabilization of their raw-material export prices through producer-consumer arrangements, not so much on the Common Fund [price-increase] model as through an extension of the [European Community's price-stabilization] Lomé approach. I realize this will not be pouplar in this room.

Eleventh, continued develoment aid for the Third World is absolutely necessary, and there must be continued pressure on the Soviet Union and Comecon to contribute its share.

Twelfth, the global negotiations in the United Nations must be pursued in order to achieve step-by-step realization of these theses. The negotiations must take into account the demographic future of the world. Through dialogue, the LDCs need to learn what the content of a new international economic order must be, while the industrialized nations must learn that great changes are needed in the world economy. I am aware that the last two or three theses may be unpopular.

A problem of democracy, which we must always seek to master, is the tendency to neglect our own long-term interest in the pursuit of short-term interests. We must keep this in mind as we consider what ways around our problems, or ways out of them, are available. The further drop in the oil price will help. It means that Japan will have a considerable balance-of-payments surplus, while West Germany will at least be in balance, and the United States will come closer to balance. This gives us maneuvering room for stronger de-coupling from U.S. interest rates. Sinking long-term interest rates are the key to recovery. They create the basis for investment. In this context I must say that when my colleague [Finance Minister] Herr Matthöfer mentioned an oil import tax, he did not speak for the coalition. Such an action would be futile especially if prices were to rise again, and is not under consideration. At the Versailles Conference [of Western leaders], we will discuss all these issues. A central issue will be a lower U.S. budget deficit, but this will be approached not through confrontation but through an effort to come together in agreement. . . .

EIR
seminar in Europe

Bonn: May 5

'The U.S. Depression: Why the Projections of All Leading Econometric Services Failed'

10:00 a.m. **Comparison of *EIR* and Leading Econometric Projections for U.S. Economy Since October 1979**
David Goldman, Economics Editor, *EIR*

1:30 p.m. **'Mathematical Basis for Successful Economic Forecasting'**
Uwe v. Parpart, Research Director, Fusion Energy Foundation

3:00 p.m. **'Why Only a Two-Tier Credit Policy and Regulated Banking Can Foster Recovery From the Present General Depression'**
Lyndon H. LaRouche, Jr., Founder, *EIR*

7:00 p.m. **Chamber music featuring the Kloeckl Quartet**

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