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EIR Economics

Europe launches the euro, as economic crisis deepens

by William Engdahl

On Jan. 4, the most radical monetary scheme since the end of World War II came into force, as limited trading among central banks and financial markets began on the new European currency, the euro. Far from being the dazzling success and zone of stability which European Commission President Jacques Santer and heads of most European Union (EU) governments have proclaimed it, the euro could likely become the factor which tips the present global financial and economic crisis into the unprecedented systemic disintegration warned of by Lyndon LaRouche since his June 1994 Ninth Forecast.

The euro entered its first phase after a turbulent incubation period lasting almost eight years. Those eight years were filled with unparalleled currency shocks among the member countries of the European Union, financial market storms, record-high public debt levels, and unemployment rising to the highest levels in Europe since the 1930s.

In the present first phase of the euro, all government debt issued in what is now being called "Euroland" will be sold in the market in euro, no longer in national currencies like the deutschemark or French franc. Stock prices in the national exchanges of the euro zone are also now quoted in euro. Otherwise, all economic cash activity of ordinary citizens is still done in their national currencies. Customers are allowed to pay by credit card or check in euro.

This limited euro role is supposed to last until January 2002, when euro notes and coins will replace all existing national currencies for all transactions in the 11 countries making up Euroland.

Within hours of the start of euro trading by major international banks on Jan. 4, the preset value of the new currency rose by an impressive 3% from $1.175 to almost $1.19, before easing back to $1.165 on Jan. 7. "The single currency will be a credible currency accepted by international markets," proclaimed Santer on Jan. 4, echoed by German Chancellor Gerhard Schröder, a former euro critic turned backer, who added, "It will make Europe move forward."

What next?

The question is, forward to what? According to informed currency traders, "The rate of the euro right now is being artificially manipulated to appear stable. Central banks have quietly set up swap lines to offset high volatility in the new currency. No one wants a major global currency crisis at this fragile state between the dollar and the untested euro."

Closer examination of the widely proclaimed euro "success" shows that scarcely any trading is taking place yet. "We are still in a test market, where there are no real orders yet," noted a Geneva banker. On Jan. 4, the day when all hailed the success of the euro launch, a total of 90,000 contracts were written for deutschemark-denominated bond futures for the coming 90-day period, but only a meager 258 contracts were written in euro for the same German government bond futures, a hint at the reality of the situation.

By Jan. 7, it emerged that major technical mistakes in settlement of trades in euro had been made by two of Euroland's largest banks—Commerzbank of Germany and ABN-Amro Bank of Holland. As the news hit financial markets, stock markets across Euroland plunged, along with the euro itself. "There are big fears that far more serious technical problems could emerge when the deadline for stock settlement comes Jan. 11," noted London Bond Broking's chief economist, S.J. Lewis.

But these are all relatively minor, technical problems compared with far deeper problems inherent in the very concept of the euro itself.

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A Frankenstein's monster

The European Monetary and Social Union, or EMU, came about as a result of a political power play in the wake of German reunification. At a summit of EU leaders in Maastricht, Holland on Dec. 11, 1991, little more than a year after German unity, French President François Mitterrand, backed by Italian Prime Minister Giulio Andreotti, blackmailed Germany's Chancellor Helmut Kohl into agreeing to surrender sovereignty over Europe's strongest currency, the deutschemark, and to bind the large new Germany into a single European currency and monetary order. With French Socialist Jacques Delors then in control of the EU Commission, Mitterrand was confident that he held a winning hand to wrest economic and monetary leadership of Europe from newly united Germany.

The Maastricht Treaty on monetary union was finally signed by all 15 states on Feb. 7, 1992. It mandated that by January 1999, the EU member states that met four "convergence criteria"—low inflation, ceilings on public debt and public deficits, and currency stability—would form a new supranational currency, now called euro. Governments would agree to surrender sovereignty over national monetary policy to a new European Central Bank (ECB). The Maastricht Treaty explicitly declares that the ECB may make policy based only on rigid monetarist criteria. The treaty explicitly mandates that the new central bank governors be "completely independent" from any and all political interference—i.e., exercise of national interest. Their sole criterion for regulating the money supply and interest rates of the 11 countries in Euroland is to be control of inflation. As Asians can grimly attest, economic depression is a very effective control on inflation.

One of the first acts of Germany's Social Democratic Finance Minister Oskar LaFontaine last October was to declare war on precisely this independence of the new central bank, demanding aggressive ECB interest rate cuts to stimulate EU employment. Bundesbank President Hans Tietmeyer rejected LaFontaine's call as political interference in the business of the new central bank.

When Euroland base interest rates were finally lowered to 3% on Dec. 3 in all 11 countries, the ECB President, Dutch central banker Wim Duisenberg, stressed that that would be the last rate cut "for the foreseeable future." Any further rate cuts now would be seen by anxious financial market speculators as a sign of ECB capitulation to political pressure, likely triggering a panic selloff of euro as well as Euroland bonds and stocks.

But, with euro interest rates effectively frozen, the prospects for economic growth which looked so rosy only six months earlier in Europe, have suddenly blackened. On Jan. 6, the German machine-builders trade association, VDMA, released November data showing that new export orders for German engineering products, the heart of Germany's physical economy, plunged a hair-raising 24%, year-on-year. And for the period September-November, foreign orders fell 25%, while total domestic and foreign orders dropped 13%.

The influential Berlin economics institute DIW has just released its forecast for German economic growth for 1999. After growing 2.7% in 1998, it will slow to only 1.4% this year, the institute reports. In Italy, domestic growth in the past several months has also slowed dramatically, led by a plunge in car sales since October. The picture in the rest of Euroland looks equally gloomy, as the spreading economic impact of the crises in Asia and Russia takes its toll on trade.

This means that the boldest monetary experiment in recent history, the euro, is being managed by a technocratic supranational institution, the ECB, answerable to no elected government anywhere. Moreover, it is moving to establish its credibility as a major world currency precisely when the economies of Euroland are cascading into severe recession or worse. "Euroland is headed for deep recession, I calculate, by latest, spring," Lewis emphasized. "The effect could be to add at least 6 million more to European unemployment. But the ECB is all but prevented from further cutting rates for fear it would collapse confidence of world financial markets in the new euro. This virtually ensures deep recession in coming months."

But under the curious Maastricht terms, while the ECB has arrogated sovereignty over Euroland monetary policy centrally, national governments still control fiscal policy, including the ability to run budget deficits. Theoretically, Maastricht terms limit any country's deficit to no more than 3% of GDP before financial penalties are supposed to be imposed to control fiscal excess. But the threats of LaFontaine and French Finance Minister Dominique Strauss-Kahn and other government ministers in Euroland to make job creation a top priority, mean that a near-term collision between national political forces and the monetarist ECB is easy to foresee.

More alarming is the fact that the 11 European nations, whose 290 million citizens comprise the world's second largest economic zone after the United States, are utterly preoccupied with the internal problems of euro "credibility," at the very moment when the entire global financial structure is plunging into its worst crisis in this century. That, until now, has meant that the orientation of Euroland is quite other than in a serious reorganization of the bloated global debt structures.

Recent French and other EU government calls for a monetarist "new Bretton Woods," opposite to the proposal of Lyndon LaRouche, are intended to help create a strong euro, while leaving intact the $130 trillion in unpayable derivatives and other financial contracts that are choking real economic growth globally. It was with such issues in mind that former Danish National Bank head Erik Hoffmeyer recently stated that the very idea of a single European currency, in absence of a comparably powerful political body to govern it, was a "political, in fact geopolitical" creation, a reference to the original Mitterrand demands on Germany in 1991. It is most probable at this point that the late Mitterrand will be most remembered for having created a Frankenstein's monster, which helped sink the world into chaos in 1999.