The Lehrman-Laffer neo-monetarist plan

Perhaps the most ballyhooed gold proposal now in active circulation, said to be taken quite seriously by President Reagan and some of his advisers, is that of Lewis E. Lehrman, chairman of the Lehrman Institute in New York. Lehrman, in his 44-page February 1980 "Monetary Policy, The Federal Reserve System, and Gold," demands a systematic reform of U.S. domestic central banking, monetary, and international monetary policy based entirely on the 19th-century British model.

The Lehrman plan would, internationally, remove the U.S. dollar and all other national currencies as reserves from the system, forcing central banks to trade strictly on gold account. This would constrict world trade.

Dr. Lehrman is a spokesman for Europe's Warburg banking family, which belongs to and finances the Siena Group, and has long worked with the Bank for International Settlements to promote the reduction of population and economic activity. He is a life-long protégé of conservative Republican lawyer Maxwell Raab, currently U.S. ambassador to Italy, who has been the family lawyer for the Warburgs in the United States at the firm of Strook, Strook & Lavan for the past 20 years.

It was Raab, former chairman of the New York Republican Party and chief Reagan fundraiser in New York, who promoted Lehrman as the nation's leading exponent of a new gold standard during the 1980 presidential campaign, for which Dr. Lehrman's proposal was expressly written. Lehrman became the official adviser on gold to Rep. Jack Kemp (R-NY).

In their sales pitch to President Reagan, Lehrman and his supply-side propagandists sturdily denounce the austerity policies of Britain's Thatcher government, and present themselves as the "all-American" alternative. Lehrman claims that his program is a break with the Thatcher program and its architect, Milton Friedman, a program which he correctly says constricts credit and causes economic depression.

"[My] new financial policy would rely on the creation of real economic growth and more jobs—not on unemployment and reduced demand—in order to produce more goods, not less," he writes. In both its international and domestic aspects, the plan would do the opposite.

Lehrman calls for the United States to "convoke an International Monetary Conference, under the leadership of the U.S., with the goal of establishing a true gold standard, one which would rule out the special privilege of *official* reserve currencies and thus remedy the most profound defect of the Bretton Woods exchange-rate regime [emphasis in original]." Under the Bretton Woods system, the U.S. dollar was a reserve held as such by central banks, "as good as gold," and it added new gold-backed liquidity to the international financial system. Under Lehrman's plan, the credit base would be profoundly constricted.

Lehrman's gold standard, as he himself emphasizes, can only be understood within the context of his call for sweeping reform of the U.S. banking system. First, before any gold remonetization takes place, the Federal Reserve chairman must take all credit creation more tightly under control by terminating open-market operations, the current means by which the Federal Reserve System provides cash to banks dealing in the Treasury debt market. No mechanism for ensuring adequate credit flows replaces this (unsound) open-market arrangement. Instead, only "the market" can properly allocate credit, he argues, and it must be left to "the market," i.e., Wall Street and the Eurocurrency bankers, to decide how much credit shall be created. Under this system, the only recourse would be to what Lehrman calls a "remobilized discount rate," the use of the Federal Reserve discount window at punitive interest rates on the model of the old Bank of England "bank rate."

The Federal Reserve has accurately derided this plan as a widely deflationary tight-credit policy which would send interest rates in the market as well as at the discount window soaring, as banks and corporations scrambled for scarce discount funds; Lehrman admits as much.

Lehrman is actually proposing, he explained to journalists early this year, a fully 19th-century style U.S. free gold market, under which both U.S. and foreign citizens have the right to come to the U.S. Treasury and demand gold in return for this dollars. This means that if Wall Street bankers decide that they want higher interest rates, they will have the right to line up at the Treasury window and buy U.S. gold reserves. The only way the central bank will have to stop a run on U.S. gold stocks would be to jack up the discount rate, cutting all credit to the economy, until the banks began to need liquidity badly enough to raise their interest rates as well. That would attract funds into dollars out of gold, but strangle the economy in the process.

The Laffer version

Arthur Laffer, a leading "supply-sider," wrote his February 1980 document, "Reinstatement of the Dollar: The Blueprint," as a campaign document for Ronald Reagan. It amounts to a popular translation of Lewis Lehrman's proposal. The most distinctive aspect of

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Laffer's plan is that it is somewhat more specific than Lehrman's: Laffer proposes that before any gold price can be set, the Federal Reserve act to halt *all* credit to the economy by the central bank.

Laffer's plan is explicitly based on then Treasury Undersecretary Paul A. Volcker's 1972 "U.S. Proposal to the International Monetary Fund," in which Volcker proposed a return by the U.S. to the gold standard in such fashion as to contract credit in the U.S.: "Any radical change in our monetary order . . . would require not only Volcker's acquiescence, but more likely his enthusiastic support. It is quite conceivable that Volcker could actually lead the search for a new order," Laffer quotes from Volcker's 1972 plan throughout.

Laffer claims to seek a system, he told *EIR* in an interview, in which the dollar, contrary to Dr. Lehrman's proposal, would be re-affirmed as the world reserve currency. Laffer claims that merely by setting a gold backing, other countries will be forced to use the dollar as their basic reserve.

Laffer proposes that "The Federal Reserve will stand ready to sell gold to all demanders at a price 0.7 percent higher than the official price in exchange for units of its liabilities." It is unclear whether this includes private as well as official liabilities. In any case, the opening for foreigners to dump Treasury securities for gold, remains, as in Lehrman's plan.

Like Lehrman, Laffer calls for a "transition period": "The U.S. would announce its full intention of returning to a convertible dollar at some prespecified time, say three months," at which time the *market* would set the price. During this period, "money supply" through open market operations and all other Fed loans through the discount window would be halted. "The U.S. could announce that during this three month interval, neither the Federal Reserve nor the U.S. Treasury would 'take a vacation' so as not to disrupt the natural forces in the private markets." As Laffer notes, this would reduce new credit to the economy to zero at a time when the U.S. economy needs a 35 percent annual rate of credit growth merely to stay afloat.

Laffer proposes that the "free market" then set the U.S. gold price at whatever level it reaches after the credit crunch has taken effect. It is possible that the shutoff of Federal Reserve credit could plunge the economy into such a slump that U.S. prices would fall sharply enough to lead the dollar to rise vis-à-vis gold. If that happened, the United States would have to peg the dollar to gold at a low price ($300 or less), then keep reducing credit to maintain the peg. If the dollar collapsed on world markets due to the recession, the dollar would be devalued drastically with respect to gold. In either event, the new gold price would reflect and maintain industrial collapse, rather than paving the way for recovery.

Wanniski: 'A Specie Resumption Act'

Jude Wanniski, the former Wall Street Journal *editor turned supply-side economist, has embarked on a wide campaign boosting a return to the gold standard throughout the national press. A close ally of Arthur Laffer, he has been the publicist for Rep. Jack Kemp on supply side issues and is now supporting Kemp's campaign for gold remonetization. Mr. Wanniski's most recent piece on the gold standard "Now Money," was published by his new economic consulting firm Polyconomics in August 1981.*

Mr. Wanniski, a collaborator of Lewis Lehrman, has endorsed the Lehrman plan and his writings on gold conform to it, although they are much less detailed. We print here a Sept. 28 interview with him by *EIR*'s Kathy Burdman which exposes one of the most important flaws in the Lehrman free-market ideology.

Burdman: You say you object to the statement that your gold proposal would lead to the sort of credit contractions advocated by Milton Friedman. Given the large volumes of inflationary credit now in the U.S. markets, how would you keep the dollar on the gold standard without cutting credit?
Wanniski: We want to expand credit to the economy. When the dollar is linked to gold, people will automatically decide to lend long. Everyone who has money to lend will begin to lend it to the economy. Credit will grow.

Burdman: But there are 1 trillion Eurodollars out there, over $300 billion in speculative real estate earnings a year, there are speculators in the Treasury debt, and all of them may decide to dump now, and demand gold for their dollars. Your whole argument rests on "confidence." If the confidence doesn't materialize, what's to keep the dollar from collapsing?
Wanniski: We will have to limit our credit creation according to the lines of people lining up asking for gold. But there won't be any lines.

Burdman: You said a year ago that the supply side program of budget and tax cuts, and tight money, would create a stock and Treasury bond market boom, and a