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*Laffer economics*

# Why Ronald Reagan's gold plan is all wrong

by David Goldman

Republican presidential front-runner Ronald Reagan has done the United States a service by raising discussion of the need to return to a gold-backed monetary system, a point made emphatically at the outset of the primaries by Democrat Lyndon LaRouche. However, the policy drafts Reagan has received to date are incompetent or worse, entirely missing the point of what makes a return to gold necessary.

These drafts include a paper by California professor Arthur B. Laffer entitled "Reinstatement of the Dollar: A Blueprint," and a piece inserted into the March 6, 1980 Congressional Record by a Reagan supporter, Rep. Jack Kemp, entitled, "Restoring the U.S. Dollar Through Reform of Our Monetary Policy and Federal Reserve System." The latter piece was written by Louis Lehrman and originally published by Morgan Stanley, the blue-chip investment bank.

Laffer, widely known for his argument that a lowering of tax rates would by itself produce an economic boom generating more tax revenues than the federal government lost through the cut, is the recognized Reagan advisor on the subject. He would do well to read the late French economist Jacques Rueff's proposals on the subject of gold-backed monetary systems. Rueff proposed a return to gold as a means of eliminating the now trillion-dollar Eurodollar market, the pool of short-term claims on the United States that is responsible for most of the world's inflation. Rueff intended to use gold to rejuvenate capital investment in industry and launch a major drive for Third World investment.

The point is not gold *per se*, Rueff made clear in a 1958 policy paper at the outset of de Gaulle's Fifth Republic, but the international policy with which it correlates, in that case the Gaullist plan for high-technology investment and high standards of living, including a project of developing the Sahara region. The problem is to convince potential investors that when the loans come due, the currency will still have the same value, Rueff specified—and that is where pegging the currency to gold becomes necessary.

## Laffer's "free market" approach

What Laffer proposes, on the most simple-minded of "free market" criteria, could have either of two effects. On its own merits, it would produce a deflationary collapse of the American economy. Or, given the willingness of the European governments to take matters in hand, it would make America a financial protectorate of the European Monetary System. The latter alternative would be much preferable to what the Carter administration is doing now, but hardly what this country should be reduced to.

Laffer proposes to let "the market" decide what the gold price will be by suspending all Treasury and Federal Reserve interventions in the market for three months, and then fixing the gold price wherever it lands. Then, if the United States Treasury has to pay out more gold than it takes in as dollar-holders demand gold, the fun begins. If gold holdings fall below a certain point, the Federal Reserve will, by law, reduce the amount of credit available to banks, known as the monetary base.

This supposedly will tighten credit at home and encourage people to accept dollars (rather than gold) because there will be fewer dollars. The more gold the Treasury loses, the more the Federal Reserve decreases the money supply—until the Federal Reserve cuts the monetary base by one percent per month.

This is a specific form of lunacy associated with the overtly profascist doctrines of Milton Friedman, who proposes to set statutory limits on money supply growth by law—a formula for a zero growth economy. Laffer proposes to use the straight Milton Friedman formula in the event that holders of dollars want to turn in their dollars for gold. And, under the Laffer plan, not only central banks, but every speculator in the woodwork could present dollars and get gold.

## Set-up for deflationary collapse

Since Laffer does not even suggest what should be done with the trillion-dollar Euromarket bubble, his plan is a set-up for the biggest deflationary collapse the U.S. economy has had since the gold outflow crisis of 1893. The Eurodollars are cigar-coupon money, as Lyndon LaRouche characterized them, backed by nothing. The $115-billion requirement for Third World debt refinancing during 1980 ensures continued spectacular growth of the market merely to service the existing Third World obligations to the Eurodollar market requires that the



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growth of this mass of worthless claims will continue. Chase Manhattan Bank projects a $1.2 trillion Eurodollar market by the end of 1980. Merely fixing the gold price at a market rate one morning three months from now will not solve this problem. Under the Laffer plan, Federal Reserve liabilities may be presented per gold, but the Eurodollar expansion has turned Fed liabilities into confetti money. Even if it did, it would merely confirm the inflationary mess on the Eurodollar market, leaving the dollar and the Treasury gold holdings open to further runs in the near future. There is no reason why anyone should hold Eurodollars instead of gold.

The alternative is that the Europeans will intervene to handle the Eurodollar problem before America goes off the deep end. The European central banks—as they have planned—can issue gold-backed bonds, soak up existing Eurodollars into a central pool inside the European Monetary System, and "dry out" the inflationary markets. In conjunction with this, the European central banks could fix a market price for gold and, by agreement with the Soviet Union, a major gold-producer, keep the price there. Then, EMS loans would be issued to developing countries for development, expanding world trade and investment. The dumb U.S. would sit there with its "gold standard," while American monetary policy was run, in effect, out of Bonn and Paris.

Laffer's paper ends with dreams of glory, such as, "Throughout history, it has been the world's premiere economic and military power that has put its strength behind the maintenance of a stable world currency. The United States abandoned this element of global leadership when it unhinged the dollar from gold. ... An element of cohesion would be returned to the Western Alliance, which, along with the present monetary system, threatens fracture and disintegration." In fact, the dollar might return to a stable world role—but only as the result of a benevolent bankruptcy conducted by our European creditors.

## Solving the Eurodollar problem

In contrast, Jacques Rueff, and later General de Gaulle, proposed to set a higher gold price, sufficient to enable the United States to take over these foreign balances accumulating in the Eurodollar market. Their objective was to stop the United States from flooding the world—as it is still doing—with worthless dollars, and use the dollar to finance world trade and development instead. Now, since the U.S. is so retrograde on these matters, Europe may use gold to accomplish the same end, through the European Monetary System. France and Germany have defined what must be done. A LaRouche presidency could do it. On the current track record, Governor Reagan could not.


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