Wanniski: EMS an answer to inflation

To our knowledge, apart from coverage by this news service, only one report setting forth the real purpose and potential fits of the new European Monetary System — and Carter Administration response — has appeared in the U.S. news media. That report was a guest editorial by Jude Wanniski, until recently an editorial page editor of the Wall Street Journal *and author of the book* The Way the World Works. *Excerpts from Mr. Wanniski's article, which appeared in the Oct. 1* Detroit News *under the title, "Return to gold: An answer to inflation," follow.*

...Inflation will get worse before it gets better, but we are seeing now in Europe and Japan the beginnings of a solution to the worldwide problem of inflation. The solution, which involves the cautious reentry of gold as backing of paper currencies, may soon be forced on the United States to the benefit of the U.S. economy. An opening of the gold window in the 1980s, with a clear understanding of why Mr. Nixon's decision (the demonetization of gold on Aug. 15, 1971 — ed.) was wrong, will bring an end to the inflation and a return to the kind of interest rates the United States experienced during most of its history — 1.5 percent short-term, 3 percent long-term.

For all of U.S. history, until Aug. 15, 1971, the gold window at the U.S. Treasury was open to either individual citizens or foreign governments or both....

The practice worked remarkably well. In 1800 the wholesale price index was 100 and 130 years later, in 1930, it was 100....

The system broke loose completely in 1971 when the Federal Reserve, spurred by the Nixon economic advisers and Chicago monetarists, pumped up the money supply on the theory that loose money would bring prosperity. Instead, the world was choked with surplus dollars and by early August the foreign central banks were telling Treasury they wanted gold. President Nixon said no and slammed the gold window.... By 1976 the wholesale price index leaped to 410. By the end of this year, the index will be approaching 500.

When the monetarists and Keynesians counseled Richard Nixon into snapping the dollar's last ties to a monetary standard, they posed different theoretical arguments. But at bottom the notion was the same: Given a free hand to create money, the Federal Reserve would be able to bring economic prosperity. The dollar would fall against other currencies. It would become more "competitive" as a cheaper currency. And the U.S. economy would become better off....

In the five years that followed, though, the results were exactly opposite. Countries that the dollar devalued against sharply — Germany, Japan, and Switzerland — enjoyed sharp increases in per capita incomes and rising general prosperity. The United States remained stagnant. And those currencies that fell faster than the dollar belonged to countries — Britain and Italy — that reeled backwards.

Politicians in the United States may be slow to figure out the implications. But in Europe and Japan the message has gotten across that the U.S. economy is hurt worst by a falling dollar and they should not be dragged along with it. In Bremen, West Germany, on July 6, the European Economic Community gave a clear message to the world marketplace that Europe will no longer be wagged by the U.S. dollar.

On Jan. 1, 1979, a European Monetary System will be established with membership open to the entire world. This EMS will issue gold-backed bonds, which means that instead of waiting for a return to dollar convertibility in the United States, Europeans will take the lead themselves in developing a world trading currency that holds its value.

The Carter Administration, which has done everything it can to push Europe and Japan in this direction, is nonetheless alarmed at this development. Treasury Secretary Blumenthal a year ago began talking down the dollar. His aides complained to Japan to stop supporting the dollar. And Fed Chairman G. William Miller now tries to drive down interest rates by creating new dollars.

But the threat from Europe is this: If the EEC is determined to create a world trading currency that promises to maintain its value over time by hewing to a gold standard, world traders will flock to it, and in the process abandon the dollar — which means it falls even faster with greater inflationary consequences. This is what is now happening on the financial markets, which do not have to wait until January 1 to make adjustments in the holding of currencies.

The unfolding events may be "bad" for the Carter inflationists, who have lost leadership on monetary policy to the Europeans in the same way they have lost leadership on fiscal/tax policy to the U.S. Congress. But all this bodes well for the U.S. economy, if we can assume the end result will be a return to dollar convertibility, a reopening of the gold window....

... Interest rates would drop like a stone, to 1.5 percent short-term and 3 percent or so long-term.

Can a probability be put on this? The question is not really if, but when?

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