this way: "Expenditure-restraining monetary policies are unavoidable if we want to put an end to inflation and so are its costly effects in terms of lost employment and real income. . . . [Government must] defuse inflationary expectations by sending more signals about interest rates and credit shortages."

During fiscal 1981, Manufacturers Hanover Trust pointed out in their Nov. 23 *Financial Digest*, the sum of federal borrowings already equalled net private savings, and this year's deficit threatens to be half again as high as last year's; broadly speaking, the deficits of leading industrial-nation governments due to the consequences of two years' of Paul Volcker's "expenditure-restraining monetary policy" are greater than the world sum of advanced-sector savings, and can only be financed through the intervention of savings pools like the OPEC investment funds. This means the advanced-sector governments are not much better off than those of the Third World.

Professor Mundell on his gold proposal

Professor Robert Mundell, formerly at the International Monetary Fund and University of Chicago, is the acknowledged creator of the "supply-side economics" promoted by his graduate student Arthur Laffer and former Wall Street Journal *editor Jude Wanniski.*

In this Dec. 3 discussion with EIR*'s David Goldman, Professor Mundell shows how his gold plan would prevent excess money manipulation in the Euromarkets from draining U.S. gold reserves, but acknowledges that speculative capital inflows from the Eurodollar market might turn into a squeeze on American banking resources.*

In addition, he warns of a possible credit crack and argues for a gold price high enough to generate international liquidity sufficient to prevent this.

Goldman: Professor Mundell, in 1971 you warned that "we have moved into a system where what is ordinary money in the United States—bank money, low-powered money so to speak—becomes essentially high-powered money in Europe, so that ordinary deposits in Chase Manhattan or First National City Bank in the United States form not only part of the money supply in that country, but also the base of a potentially explosive money supply in Europe." Could your gold proposal work under these circumstances? Wouldn't explosive money growth in Eurodollars drain away American gold?

Mundell: It's possible for it to operate, yes. The problem is that all U.S. liabilities aren't liabilities of the Fed.

The Federal Reserve cannot be liable for Eurodollars, only for base money in the United States. To get gold from the United States you wouldn't be able to take a check from a foreign bank and present it at the Treasury.

Goldman: Let's say that U.S. Steel borrows $1 billion abroad to buy Marathon Oil, and Marathon stockholders get that $1 billion in the form of checking accounts at U.S. banks. Could they use these dollars to buy gold from the Treasury?

Mundell: No, they would have to pay for gold in base money, in cash.

That way the dollars coming into the Treasury would cut the reserve base of the U.S. monetary system, and would eventually create a squeeze on the Eurobanks. If the Fed doesn't replace those dollars, total reserves will be lower in New York, and this will have an effect throughout the financial markets.

Any reduction in the monetary base will create a multiple contraction in the volume of quasi-dollars in the Euromarket. The Fed would only give gold in return for real dollars, forcing a withdrawal of cash from the banking system.

Eurodollars are not real dollars, but bank debts. To buy gold people would have to take vault cash out of the banking system [which forms part of banks' reserves—D.G.], and that tightens the system.

Goldman: With the introduction of International Banking Facilities, Federal Reserve officials are pointing to the factor of country risk—that IBFs are safer for depositors than bank foreign subsidiaries that might be abandoned in case of a series of defaults on the international market, after which dollar liabilities would be frozen. How does your proposal address this problem?

Mundell: This is a danger. That is why gold must be remonetized at a comfortable price.

It would be a great mistake to set the gold price at a low level. There would be serious risks in putting the price of gold too low in a completely convertible gold standard system. For example, a level of $200 to $300 would be too low, but a level of $400 to $500 would be comfortable.