The Buck Stops Where?

When Paul Volcker declared several weeks ago that the world was in a “dollar crisis,” his successors at the Federal Reserve made their private disapproval very clear. This week current Fed Chairman Ben Bernanke waved the white flag over Mr. Volcker’s point by declaring his own public concern “that the dollar remains a strong and stable currency.” Apologies accepted, provisionally.

The tragedy is that this is big news. The Fed has monopoly power over dollar creation, and concern for its value ought to go without saying. Yet so great has been the Fed’s dollar abduction in recent years, and especially since last summer, that Mr. Bernanke’s words have come as a great relief. The dollar strengthened in welcome response, and the price of gold has fallen in each of the last three days. Oil fell, too, for two days before rising yesterday.

The question now is whether the Fed will follow up its new words with action. “We are attentive to the implications of changes in the value of the dollar for inflation and inflation expectations,” Mr. Bernanke said on Tuesday, a sign that the Fed may be waking up to the inflation threat. But the Fed chief also signaled that he isn’t about to tighten monetary policy any time soon because current “policy seems well positioned to promote moderate growth and price stability over time.”

Price stability where? Not in the U.S., where every economic report shows rising price pressure. Wednesday the feds reported that labor compensation rose at a healthy 4.9% for the first quarter, but only 0.6% after inflation. The Fed-inspired commodity boom has sent food and energy prices soaring, while wage gains invariably lag. If Republicans want to know why voters are so upset about an economy with a jobless rate of 5%—below the 5.2% rate when Bill Clinton won re-election in 1996—this erosion of real incomes is the reason.

The Bernanke Fed has also been oblivious to the fact that it runs a global dollar bloc. Central banks in dozens of countries peg or otherwise link their own currencies to the world’s reserve currency, which is the dollar. They do so for the sake of exchange-rate stability, which helps with trade and investment flows. They essentially subcontract their monetary policy to the U.S. central bank.

The Fed’s dollar indifference has sent an inflation shock through those dollar-linked economies. This week alone, we’ve read about price riots in Vietnam; inflation hitting 10.1% in Kuwait; Abu Dhabi contemplating price or wage controls; South Korean and Indonesian central bankers considering rate hikes; and the Chinese letting the yuan rise ever higher to curb inflationary pressures imported from the U.S.

Many of these countries are now de-linking from the greenback. Meanwhile, the dollar plunge has translated into a net transfer of trillions in wealth from the U.S. to the rest of the world. The result has been the largest decline in America’s global economic influence since the 1970s.

It will take more than a single speech from Mr. Bernanke to undo all this. A statement of support for the strong dollar from both the Treasury and President George W. Bush would certainly help. The last time Mr. Bush dared to speak his mind this way, in March, Treasury quickly hushed him up. Now would be a good time for the President to say he agrees with what Mr. Bernanke said this week.

The business press has been chattering about Treasury “intervention” in the foreign exchange markets, but this would mostly be symbolic action to scare currency traders. Such interventions are invariably “sterilized,” meaning that central banks are careful not to increase or decrease the net supply of dollars. Changing the value of the dollar means reducing the supply of, or increasing the demand for, dollars. At the current moment, the world isn’t likely to demand more dollars until it concludes that the Fed is serious about stopping the greenback’s further decline.

In this context, last week’s announcement of the August departure of Fed Governor Frederic Mishkin is good news. Mr. Mishkin is one of the intellectual architects of the Fed’s dollar debacle. His departure means the Fed will soon have three of seven seats unfilled, with one more Governor unconfirmed. The Senate seems inclined to confirm any more Bush nominees, and that may be just as well. The next President deserves an opportunity to remake the Fed with sound-money appointees. This Administration has named too many academics who know a lot about monetary theory but too little about currency markets and price signals in the real world.

The best news would be if this week marks a turning point at the Fed and at the Treasury. The leaders of those institutions have justified the Fed’s sprint down the interest-rate curve as a way to boost exports, rescue the financial system and prevent a recession. They were wrong.

What has spared Wall Street more pain is the Fed’s decision to open the discount window wider and to more borrowers. The easy-money experiment has merely hit consumers and the already struggling economy with a commodity price wallops, while inspiring a global flight from dollar assets. It’s time to start acting to repair the damage.

Bernanke discovers he and the world have a dollar problem.