
The August 1971 Prelude

Two tracks in postwar policy

What follows are excerpts on post-World War II economic history and the circumstances of the Aug. 15, 1971 decision, taken from The Ugly Truth About Milton Friedman by Lyndon H. LaRouche, Jr. and David P. Goldman (New Benjamin Franklin House, 1980).

The Marshall Plan, as Secretary of State George Marshall first envisioned it, was to carry out Roosevelt's threat to dismantle the British Empire and replace it with a regime of American-sponsored world development. It became the 180-degree reverse in implementation. The State Department Policy Planning Staff turned effective control of the plan over to Britain, and diverted the largest single share of Marshall Plan aid, \$3.4 billion of the \$14 billion total, to London. Instead of piercing the boil that the pound sterling left on the international monetary scene after the war, the Marshall Plan, as well as the International Monetary Fund, bailed out the sterling monetary area, building into the monetary system a detonator for the exchange crises that exploded in the late 1960s.

The Marshall Plan undermined the dollar's long-run stability by intentionally *restricting* American exports to war-stricken Europe. Europe was compelled to rebuild, in some cases literally, out of its own rubble. The Marshall Plan's official target was to reduce European imports from the United States to \$2.7 billion for 1952-1953, against \$3 billion in 1938—at the trough of the Depression—and \$6.7 billion in 1947. Under the direction of British treasury official Sir Eric Roll, Harlan Cleveland (now chairman of the Aspen Institute), and George Kennan's State Department planners, the Marshall Plan succeeded in reducing America's exports to trifling levels compared to those of other industrial countries. Britain offered America the status not of a world industrial power but of a rentier. . . .

Simultaneously, the International Monetary Fund, the central monetary institution formed at Bretton Woods, imposed a "fiscal austerity" regimen on developing nations, preventing them from absorbing large-scale American industrial exports, which would have implied trade deficits forbidden under the IMF's Rules of Agreement.

America became a continental, not a world, industrial power, hemmed in by the postwar monetary blueprint authored by John Maynard Keynes, Britain's negotiator at Bretton Woods. From a position of unchallenged strength at the war's end, the American dollar became a deficit currency by 1958 and a bankrupt currency in 1971. The era of dollar weakness began as soon as Europe, by virtue of enormous and prolonged sacrifice, recovered from the war, despite the flawed Marshall Plan.

The dollar's obituary was already the subject of memoranda among Marshall Plan economists in 1950, when Robert Triffin, the bright young man of the "Austrian School" of von Hayek and von Mises, became Special Adviser on Policy, Trade and Finance to the Economic Cooperation Administration, the government agency that administered the Marshall Plan. Under him worked Milton Friedman, newly notorious for his extreme monetarist views. Triffin, a Jesuit-trained Belgian, came to the U.S. government via Harvard University. He became the leading postwar proponent of Keynes's original scheme to eliminate the dollar as an international currency altogether, in favor of a "one-world" currency like the present Special Drawing Right controlled by the International Monetary Fund. Friedman, his consultant, took the apparently opposite, but actually compatible position that chaos should be allowed to take its course.

Under what were considered normal conditions until 1971, central banks maintained the respective prices of their currencies against each other and against an international standard, gold. World trade necessitates such stability. If the values of currencies shifted continuously, exporters, importers, and international investors would have no way of knowing what the future price of the currencies they are to be paid in would be, except through enormously expensive hedging operations. But Friedman insisted that chaos should be the acceptable norm of economic affairs, and nations should accept that notion by abandoning fixed rates. . . .

Friedman cannot be accused of lack of foresight here. America formally agreed to end the world role of the dollar in 1965, after Treasury Secretary Henry Fowler told Lyndon Johnson that if he wanted to finance the Vietnam War, he would have to junk the dollar for the IMF's Special Drawing Rights, historian William Wiseley reported. Wiseley noted maliciously that Britain's Field Marshal Lord Carver persuaded the United States to get into Vietnam in the first place. Vietnam did not create the 1960s dollar crisis any more than the Algerian conflict created the French franc crisis of 1958, but it did provide the final blow.

Friedman added to this prescription in late 1968—when he began to advise Richard Nixon, the President-elect—that the United States should eliminate gold from the monetary system, and "set the dollar free by stopping pegging the dollar." He told an American Economics

Association conference gleefully, "Each of these steps is within the unilateral control of the U.S. No other country can by its action prevent us from taking them." The most Europe could do in response to shotgun monetary diplomacy, Friedman suggested, was "to try to set up a kind of gold bloc whose currencies would be linked at fixed rates to one another but fluctuate as a group vis-à-vis the dollar." In August 1971, to the disbelieving outrage of the Europeans, Nixon took Friedman's advice, at the urging of then Undersecretary of the Treasury Volcker.

[Gaullist economist] Jacques Rueff was determined that this would not happen.

Instead of abusing the dollar's international acceptability as a reserve currency by running continuous payments deficits, he argued in a June 1961 essay in the Paris daily *Le Monde* that the United States should pay its foreign obligations in gold. Rueff did not suggest that the United States should give up its gold stocks (as it did, in fact, give up half of them before 1971). He instead proposed an increase in the gold price relative to all currencies, which would enable America to meet its foreign obligations in gold. The contents of the *Le Monde* article, which Rueff had earlier sent to President de Gaulle in memorandum form, set off an international controversy that lasted throughout the 1960s. Until LaRouche's 1974 "Golden Snake" proposal, which projected what later became Phase One of the European Monetary System, Rueff was the authoritative spokesman for the politics of the Grand Design in the monetary sphere. Relative to LaRouche's more comprehensive formulation of the required new international monetary system, Rueff's plan was simple, but no less effective. The United States was an underexporting nation, Rueff wrote, and required a discipline by which to correct the tendency toward rentier status of the postwar period. . . .

The collapse of the French franc in September 1968 undermined de Gaulle's ability to guide international monetary affairs, and it was the unpleasant job of a new finance minister, Valéry Giscard d'Estaing, to go to the IMF and make a temporary peace with the British. De Gaulle's ouster and the accession of Willy Brandt's Social Democrats to power in West Germany put the world on direct course toward the August 1971 debacle. . . .

How much the United States lost when its great wartime ally and postwar friend Charles de Gaulle departed office is not understood by most Americans. President Nixon is one of the few who had an inkling; he saw the postwar political leadership of the West "in the shadows of those two giants, Eisenhower and de Gaulle." Despite Nixon's great personal regard for de Gaulle, his comprehension of what the French president and his adviser Rueff represented was subminimal.

How little Nixon understood is evident in his decision to make Milton Friedman the guiding economic policy

voice of the first two years of his administration, until Friedman's money program had put the United States into deep recession by 1970. But Nixon carried out the full Friedman program on August 15, 1971, with the addition of the wage-price controls demanded by "populist monetarist" Henry Reuss. . . .

Nixon, in any event, had learned his economics at the White House at Arthur Burns's knee. Burns now moved back to the White House from Columbia as counselor to the President. The next year, Burns replaced the aging William McChesney Martin as chairman of the Federal Reserve's Board of Governors.

During the first half of 1969, the Federal Reserve held the rate of money supply growth to 4.4 percent per year, right in the middle of Friedman's recommended range of 3 to 5 percent. Prices rose by an annual rate of 5.8 percent, faster than they had during what Nixon considered a period of monetary laxity under Lyndon Johnson, when they had risen by 4.6 percent per year.

The record on economic crisis predictions

Arthur Burns, 1969: "We have made considerable progress toward full employment and economic stability in our generation, and we have accomplished this while preserving the essentials of political and economic freedom. Financial crises, which frequently disrupted economic life in earlier times, no longer exacerbate our troubles"

George Shultz, director of the Office of Management and Budget, May 10, 1971: "When [Nixon] came into office. . . others said the inflationary thrust could never be contained without a virtual takeover of economic activity or a major depression. It was—and without either."

Paul Samuelson, 1970 Nobel Prize winner in economics; from the seventh edition of his textbook *Economics*: "The modern fiscal system has great inherent automatic stabilizing properties. All through the day and night, whether or not the President is to be found in the White House, the fiscal system is helping to keep our economy stable. If a recession should get under way while Congress was out of session, powerful automatic forces would go instantly into action to

This did not upset Friedman, who believed that monetary policy operated with a six-month lag. He wrote, however, in August 1969, "If the rate of price rise has not begun to abate by the fourth quarter of this year, it will be time to ask us for an explanation."

But the rate of price inflation did not abate. It continued at 5.8 percent per year through the second half of 1969, and showed no signs of improvement.

Friedman prescribed more of the same medicine, and the Federal Reserve, under Nixon's imprimatur, obeyed. Monetary growth stopped dead in the half-year from June 1969 to December 1969, and the economy collapsed. Starting in the summer, industrial production fell, and unemployment rose from 3.5 percent in 1969 to 5 percent in May 1970. Despite the deterioration of economic conditions, inflation did not fall. During the first half of 1970, inflation was *higher* than it had been the previous year. As Leonard Silk summed it up:

"The economy was slipping into recession, with no

counteract it without the need for any committee meetings or for exercise of any human intelligence."

EIR founder Lyndon H. LaRouche, Jr., following the Aug. 15, 1971 devaluation article titled "Why It Happened Now," in which he explained the method by which he was able to foresee the 1971 events a decade earlier: "The developments leading up to President Nixon's August 15 have more or less totally living economist but this

"During the period, 1958-59 . . . LaRouche developed and presented the following ideas: 1) That the 1957-58 recession represented a turning point in post-war capitalist development, a point of exhaustion 'endogenous' U.S. potential the domestic *productive* labor force. On this basis he predicted a period of minority without immediate new radicalization among trade unionists.

in sight, since continued satrapies in Western Europe and Japan provided a prop to the U.S. dollar on a world scale. 3) That the basis for continued healthy capitalist expansion in Western Europe would begin the middle of the 1960s, after which the international monetary system must begin to unravel. . . . Since that time, the theses been denounced by nearly every leading figure in sight. It was charged that LaRouche overlooked the 'built-in stabilizers,' 'ism' and the 'postindustrial society.'

tangible evidence that inflation was abating. Interest rates had climbed to levels not seen in a hundred years, with devastating effects on housing. The federal budget was dropping into deficit, aggravating pressures on money markets. The stock market went into the worst decline it had experienced since the Great Depression."

Friedman nearly brought the American economy through a repetition of the 1929 crash, by identical methods. In May the Penn Central Railroad went bankrupt, leaving hundreds of millions of dollars in short-term commercial paper outstanding. The entire structure of American short-term credit, which depended on tens of billions of dollars in short-term promissory notes secured only by the faith of the borrower, was in danger. Bankers sat in their offices deciding whether or not to panic, and Arthur Burns made a series of frantic phone calls to New York and Chicago promising that the Fed would provide as much money as needed as soon as they needed it. From dead zero, the rate of money supply growth jumped to 13 percent.

Penn Central did not lead to a general panic in the American credit markets. However, the sudden lurch from monetary strangulation to a postwar extreme in monetary laxity sent the American dollar skidding down toward the great debacle of August 1971. The first big dollar crisis of the Nixon administration broke out almost as soon as Burns opened the floodgates in May 1970.

Richard Nixon was stupid, but not that stupid. On the next moonless night he buried Milton Friedman's reputation in the White House back lawn. Immediately after followed Nixon's great recantation, "We are all Keynesians now," manites"!

That didn't get either the White House or the United States out of the hole that a year of Friedman's medicine had put it in. By August 15, 1971, Nixon caved in to the demands of Rep. Henry Reuss and Treasury Undersecretary Paul Volcker, de-linked the dollar from gold, and placed wage-price controls on the American economy that would, within two years, lead to double-digit inflation.

Friedman's mugging-mate, William F. Buckley, Jr., had what turned out to be the most appropriate comment on Milton Friedman as oracle to the White House. In an August 16, 1971 editorial in *National Review* entitled "Goodbye Milton Friedman," Buckley wrote:

"Mr. Friedman can absolutely be counted upon to say that his theories were not given an adequate exercise. There is no doubting that he is correct. *But it is possible that his theories suffer from the overriding disqualification that they simply cannot get a sufficient exercise in democratic situations*—because it takes longer for them to produce results than the public is prepared to wait. . . ."