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A return to gold: world deflation or expanded credit?

by David Goldman, Economics Editor

The U.S. Federal Reserve's determination to take the world monetary system to the point of crisis, in an exercise of economic brinksmanship, has forced the option of returning to a gold-based monetary system into the international forefront. However disappointing have been the results so far of the President's study commission on gold, the attention given it reflects an undeniable underlying reality: that "gold is no longer a dirty word," as Dutch central banker Jelle Zijlstra told an elite banking audience at the International Monetary Fund meeting in Washington.

Not if, but when and how, are the right questions to ask. The U.S. dollar unsupported by gold cannot function as the leading international reserve asset during the 1980s as it did, poorly, during the 1970s.

The 10 years since gold backing for the dollar ended on Aug. 15, 1971 have culminated in a classic bubble of credit expansion on the Eurodollar market, mainly to capitalize the pricipal and interest due on the previous Eurodollar expansion. For the first time, the leading body of the International Monetary Fund, the Interim Committee, pronounced the deficits of the oil-importing developing countries—estimated for this year at $96 billion—to be "unsustainable."

The 1970s dollar monetary system, based on manipulations of uncontrolled international markets operating without reserve requirements on bank deposits or any other form of central bank supervision, has gone to ground on these "unsustainable deficits." Whatever form the repair takes—and matters could proceed either for good or ill—the world's central banks will have to mobilize the one means of payment they have whose validity cannot be challenged, namely gold.

Gold's remonetization began, in fact, with the pooling of 20 percent of Europe's gold in early 1979 through the European Monetary System (EMS). The pooled gold was matched to credits that Europe's central banks could draw against each other for intervention on the foreign exchange markets, to

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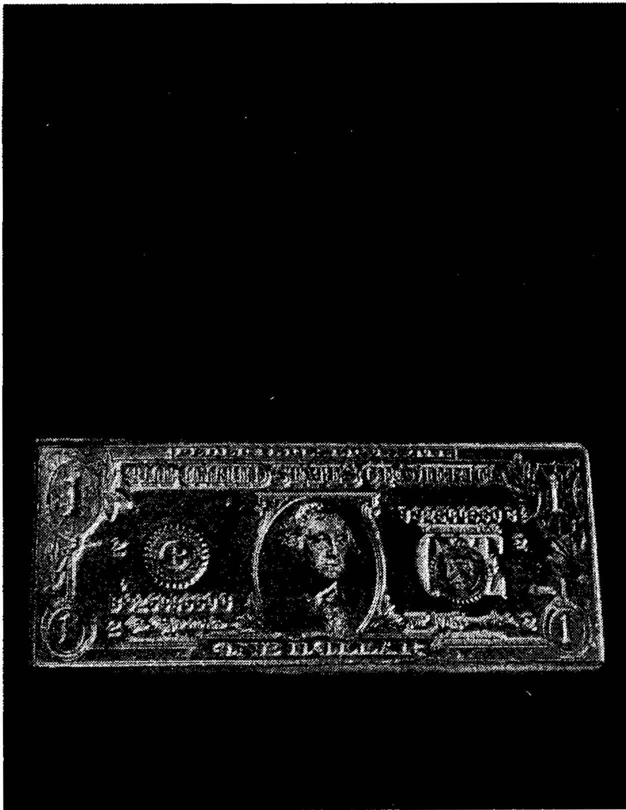

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maintain the eight member currencies of the system within a fixed-parity band of fluctuation. The EMS buffered Europe's economies from the potentially devastating effects of sudden swings in currencies' values, intolerable among countries whose economies are intimately linked with one another. The delimited achievements of the EMS would not have been possible without partial remonetization of gold.

However, it says little to point out that when the Eurodollar market gives way, gold will become the basic international means of payment among central banks. What monetary and *economic* program that implies is another, and fundamentally more important question.

The actual issue under debate is whether gold's reintroduction into the world's official monetary life occurs through a brutal *deflation*, or whether gold-based credit is oriented towards an *expansion* of international trade and productive investment.

We include in this section a proposal prepared at the request of *EIR* Contributing Editor Lyndon LaRouche, Jr., now circulated through the National Democratic Policy Committee, whose advisory committee LaRouche chairs. Under the LaRouche plan, nations would obligate themselves to settle their current-account payments balances with each other through transfer of gold, in order to discipline their domestic credit issuance in favor of productive credits.

LaRouche proposes to combine gold-reserve status for the dollar with a domestic issue of U.S. notes to replace existing Federal Reserve notes. The latter would enter the economy through Treasury participation in commercial bank loans to expand manufacturing and other goods-producing activity. The argument is simple: the United States can issue any volume of credit it wishes so long as the *effect on the real economy* of this credit is to expand output of tangible wealth. Gold settlement with trading partners disciplines Americans to produce sufficient goods for export to ensure this takes place.

We also present in some detail the competing proposals for gold remonetization, including those associated with "supply-side" economists Lewis Lehrman, Jude Wanniski, and Arthur Laffer, as well as the proposals of the Bank for International Settlements and the U.S. Federal Reserve System. To our knowledge. *EIR*'s publication of the latter two plans is exclusive at this time.

Monetarism revisited

In one fashion or another, both the "supply-side" and the central bank plans amount to a supposedly improved form of *implementation* of the same monetarist policies that got the world into its present crisis status. Outgoing Bank for International Settlements President Jelle Zijlstra agrees with the "supply-siders" that the Fed's present methods of monetary management are haphazard and incompetent; like them, he ultimately seeks for ways to prevent credit issuance more effectively than the Federal Reserve policies. Although some of the "supply-siders," such as Jude Wanniski, argue that their plans will not produce deflation and economic downturn, careful analysis of the programs in circulation makes it difficult to foresee any other possible result.

The European Monetary System, drawn in part from a plan for a European "Golden Snake" LaRouche published in 1974, and the LaRouche program presented inside, agree with the others on the inevitability of gold remonetization; yet the underlying economics involved are fundamentally different. The present bankruptcy of the dollar has one simple cause, namely that the Eurodollar market—now counted at about $1.3 *trillion* in offshore dollars—has grown *seven times faster than international trade* during the past 10 years. The Federal Reserve's mismanagement has severed the growth of credit from the growth of productive investment and trade.

Fed Chairman Paul Volcker's tight-credit regime has accelerated the "wedge" between credit expansion and real economic growth, because high interest rates shift funds into short-term, quick-turnover forms of speculation, away from long-payoff productive investment. The cure must take the form of the restriction of credit expansion to nonproductive, speculative sectors, and availability of credit to the goods-producing sectors of the economy. What ultimately will make the dollar "as good as gold" once again is American productivity.