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The spectre of August 15, a decade and a half later

by David Goldman

The seed of today's imminent monetary disaster was planted exactly fifteen years ago—on Aug. 15, 1971—when President Nixon removed the link between the dollar and gold. This act, occasioned by a trade deficit that year of a mere $2.6 billion, against this year's $170 billion, opened a Pandora's box for the monetary system, and prepared the takeover of world finance first by unregulated, and finally illegal, flows of capital.

Among President Nixon's closest advisers then were Undersecretary of Treasury Paul Volcker, now chairman of the Federal Reserve Board of Governors, and Budget Director George Shultz, now Secretary of State. Today, they continue to preside over the monetary policy which may ruin the United States forever.

What, precisely, happened during the past 15 years? Aug. 15, 1971 saw a coup against the United States government, by the international banking group which subsequently became the Carter administration. The monetary events of that date represented a devastating setback for the constitutionally-founded American nation-state, which effectively ceded monopoly power to create money to the major commercial banks of Wall Street, Zurich, and the City of London.

Why link dollar to gold

The importance of the dollar's link to gold was universally misunderstood by the economics profession then, and is still misunderstood now. Lyndon H. LaRouche, Jr., the founder of this publication, first gained public prominence as an economist in a series of debates with Professor Abba Lerner of Queens College and others in the weeks following Aug. 15, 1971, in which he demonstrated that the "Nixon shock" would lead inevitably to global depression. In this long-range forecast, now proven correct, LaRouche was virtually alone among American writers.

There are no magical properties to gold as such; rather, the use of gold to settle official balances among nations, reflects agreement among sovereign nations to control such official balances as a matter of national policy. The Constitution's provision that Congress control the currency has become meaningless in a monetary system where as many U.S. dollars are held offshore, in unregulated "Eurodollar accounts," as in the entire American banking system.

Under the pre-1971 gold arrangement, the United States was under obligation to settle its trading imbalances in gold, that is, to pay for its imports with either exports, or the transfer of gold to exporting nations. The United States merely recognized its obligation, as the world's leading industrial nation, to conduct economic policy such that it would generate an exportable surplus. The "discipline of gold" had no other meaning; the United States could, and can, afford, any arbitrary rate of credit expansion, on the condition that the expansion of credit finance investment in improved industrial and farm productivity.

That was Roosevelt's intent immediately before his death in 1944: that the power of U.S. industry which had just won the war, should industrialize the developing sector, replacing "outdated British 18th-century methods." The flaws of the 1944 Bretton Woods agreement and the Marshall Plan steered the United States, instead, toward a rentier relationship to the rest of the world, under which American capital bought undervalued goods and underpriced labor in Western Europe and Japan, rather than investing in new technologies at home.

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Under the flawed Bretton Woods agreement, the U.S. dollar became interchangeable with gold as a means of settling balances between nations, giving the United States an unenviable imperial role as the world's banker. The dollar's role was underpinned, in turn, by the right of foreign governments to convert their excess dollar balances into gold. Starting 1959, after the first European postwar reconstruction, the United States began to suffer a balance of payments deficit, tiny by today's standards, but revolutionary then. By 1967, the British pound, which functioned like the dollar, as a secondary reserve currency among former British colonies, suffered a devastating run; by 1969, a series of runs against the dollar ran out of control.

Throughout this period the United States had the opportunity to reverse course, and take its economic affairs in hand. The late French economist Jacques Rueff, General de Gaulle's economic advisor, made a friendly proposal to the United States: devalue the dollar against gold, to give America breathing room to adopt economic policies which would favor U.S. productivity, and generate an exportable surplus.

President Johnson's Great Society regime did precisely the opposite, burning up the economic capital amassed in previous decades, and eliminating the last real motor of technological progress, his predecessor's aggressive space program. By the time Richard Nixon took office in April 1969, a global monetary crisis was built into the course of economic events.

When Nixon pulled the plug

Faced with a worsening run against the dollar, and foreign governments' demands for gold payment against their dollar holdings, Nixon was persuaded to do the worst possible thing, by the same Volcker-Shultz crew now in command of U.S. monetary policy. Rather than devalue the dollar against gold, and turn the economy around, Nixon let the dollar "float" freely against other currencies. Supposedly, the "free market" would find the best rate for the dollar, Milton Friedman and the Chicago School of liberal economists prescribed, and Friedman's old fellow professor at Chicago, George Shultz, conspired with Volcker et al. to convince the President of this.

The adoption of so-called "free market" policies towards the U.S. currency was one of the biggest swindles in monetary history. The U.S. government merely ceded power over its currency, i.e., the power to create it, to a banking cartel controlled by the major U.S., British, and Swiss international banks. By de-linking the dollar from gold, Nixon demanded that the rest of the world accept unsecured dollar liabilities in payment for the exports they send to the United States; presently, the world absorbs about $150 billion a year of such liabilities. But the expansion of such dollar liabilities could only occur if a powerful banking cartel had free rein to use these dollar liabilities as they pleased. From less than $50 billion in 1971, the volume of Eurodollar, or unregulated offshore deposits, grew quickly to more than $2 trillion today.

President Nixon's problem was that, far from understanding monetary policy, he had not the slightest idea what money is. Currency, or money, derives in earliest history not from precious metals, but from the transferable liabilities of deposit banks. (Metals took on a monetary character only as they were employed to settle clearing imbalances between deposit banks.) By forcing deposit banks to put up reserves against their deposits, governments limit banks' ability to increase liabilities, i.e., to create money.

"Cash money," i.e., currency, differs from "bank money" (checks or credit cards) only in one respect: it is the bank money of a central bank supported by the government's power to tax. When the central bank virtually guarantees the liabilities of ordinary deposit banks, by promising to bail them out in case of trouble, the distinction between cash and "bank money" blurs.

Having embezzled control over the creation of the U.S. currency, the bankers used their monopoly power to hang trillions of dollars of debt onto the world economy, including $1 trillion of developing-sector debt. Their offshore market became the haven for the flight capital which bled dry the economies of the developing sector, increasing the Third World's debt many times above what the countries originally borrowed to finance economic development. The result is the stagnation, and eventual collapse, of international trade.

These parasitical offshore markets, which exhausted their victim economies, are now dependent upon the $500 billion annual flow of narcotics money, most of which is laundered, i.e., turned into seemingly legitimate investments, through the offshore banking system.

On top of the $2 trillion Eurodollar market, American banks have created a couple of trillion dollars of additional liabilities, the so-called "off-balance-sheet liabilities," in the last couple of years. These "off-balance-sheet liabilities," which usually involve some form of direct or indirect loan guarantee, have become the bank regulators' nightmare. The banking system is more overextended than at any time in the 20th century.

By means of "off-balance-sheet liabilities." the banks do not directly create credit, but make it possible for third parties to do so, by guaranteeing the repayment, or the interest-rate or other condition of repayment, of the new liabilities.

A more drastic monetary reorganization than we required in 1971, has become the immediate task of any government which proposes to rule the United States as a sovereign nation. Nothing short of a general reorganization of the banking system, and a massive devaluation of the dollar against a restored gold-basis for official transfers, will prevent a world depression on a scale unimaginable in 1971. The only surprising aspect of the present crisis, is that the full consequences of Nixon's folly have taken 15 years to work themselves out.