I. How to Change History

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The LaRouche Gold Proposal: Averting Economic Depression

Editor's Preface: *Today, when the world stands on the verge of a plunge into financial crisis, Lyndon LaRouche's [Four Laws]() and his proposed [New Bretton Woods System]() point to the only direction for economic recovery. Because a background in LaRouche's economic thinking is required to comprehensively understand and implement such measures, we reprint below a proposal of his from 1981, to help start that thinking process among our readers.*

Stuart Lewis

Lyndon LaRouche in a San Francisco press conference in 1984.

The National Democratic Policy Committee under the direction of Advisory Board Chairman Lyndon LaRouche, issued the following urgent resolution on gold policy on Sept. 22, 1981.

Even at this late hour, the re-introduction of gold into the world monetary system can prevent a major financial crisis and economic depression. The Federal Reserve's incompetent, destructive monetary policy has already pushed the U.S. economy into the second stage of a depression that began immediately after Chairman Volcker's "Saturday Night Massacre" of Oct. 4, 1979. Between now and year-end, unless appropriate countermeasures are adopted, the U.S. financial system will endure a liquidity crisis on a scale worse than that of 1929-33.

This is a war for the survival of the United States, not—as the Fed has argued—payment for the past sins of largesse committed by previous Administrations. America's banking system is already under the dictatorial control of the "offshore" money markets, which the Fed has transformed into the only source of liquidity available to American borrowers. Remonetization of gold is the step required to win the war on behalf of American productivity and living standards.

Step one is to remove the gold issue from monetarist incantation over "market perceptions," "inflationary expectations," and "monetary control." Those disciplines which the American financial system requires may be reduced practicably to a single overriding constraint: we must restrict the expansion of credit to those uses which will improve productivity, output, and exports. That is, we must do the opposite of the Federal Reserve's sup-

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posedly "restrictive" program, which has added $25 billion per year to federal debt-service costs and deficit-financing needs, and a debt-service burden to the private sector that forced a 35 percent annual rate of credit expansion during the first eight months of this year.

The proper use of gold is to build such a constraint into our financial system, through our financial relations with other nations. The specific measures required to bring about this arrangement are straightforward and clearly understandable to a majority of the American population, once we agree that monetary controls exist to address the real problem, the state of the economy's productive base.

Below, we outline the requirements of a return to gold-based monetary stability, and explain why the competing monetarist versions of the gold standard have no hope of success.

1) Remonetize American Treasury gold reserves at $500 per ounce or the market price, whichever is higher.

In current capital-goods and labor costs, $500 per ounce is the marginal price of gold, i.e., the price at which new gold mines may be brought into production on sufficient scale to assure an adequate supply of new monetary gold.

2) Establish the value of the U.S. dollar as a fixed weight of gold, e.g., one-five hundredth Troy ounce of gold, and agree to exchange gold in payment for current account deficits or surpluses with nations who follow a similar monetary policy.

By agreeing to exchange gold with nations to balance our current account payments (merchandise trade plus shipping, insurance, tourism, and similar services), we are making a commitment to pay our own way in international trade.

However, we will do this only with nations that adopt the same program. In practice, there is little question that most of the nations that now belong to the European Monetary System, a gold-reserve and fixed-currency agreement among the eight leading European countries, as well as Japan, would join such an agreement enthusiastically.

By making the dollar as good as gold on international markets, this action would immediately bring down interest rates, by eliminating hundreds of billions of dollars in currency speculation and hedging in foreign markets, which consumes the biggest portion of credit generated worldwide.

3) Issue a new series of U.S. Notes against our gold reserve, through participations in productive-investment credits in the banking system.

To make good our promise to pay gold to cover our international accounts with our trading partners, we must simultaneously ensure that the credit we issue at home expands productivity and output. At present the Federal Reserve "prints money" by adding funds to the New York money market, i.e., to the large international banks. Under this system the American banking system opened up $49 billion in credit lines for inflationary, speculative corporate takeovers, but lent on net virtually nothing to basic industry.

The Federal Reserve's method of creating credit is inflationary. We propose, instead, to return to the monetary policy of the Lincoln administration—U .S. Notes issued for productive purposes, and backed by America's ability to back the dollar with gold.

Instead of an independent agency with unlimited discretionary powers to create money, the Federal Reserve should be reduced to a mere agent of the U.S. Treasury, by amendment to the Federal Reserve Act. All discussion at the Federal Reserve or otherwise about "monetary targets" and "desired rates of money growth" at the Federal Reserve or elsewhere is pure bunk. We can create as much credit as we want, provided that Americans can absorb it into new investments in industry, agriculture, mining, construction, and transportation, i.e., activities that add to the nation's tangible wealth.

The Treasury will lend out U.S. Notes at 6 percent interest for investment or working-capital purposes in manufacturing, agriculture, mining, construction, and transportation, according to this procedure: any private banker may apply to the local Federal Reserve banks, acting as the Treasury's agents, for a U.S. Notes *participation* in a credit for these designated areas. Only when a private corporation will initiate such investment, and a private bank will take at least half the credit risk, will the Treasury issue U.S. Notes.

There is no great complexity or threat of bureaucracy in this program. Presently, local bankers have to turn to the mirror-world of the money centers, e.g., overnight repurchase agreements, federal funds, correspondent loans, and so forth to raise funds, and turn their operations upside-down with every new patch of regulation or "deregulation" introduced by the Fed or Congress. We will reduce bankers' sources of funds to

two: deposits generated by business activity in their localities, or direct infusions of low-interest loans of U.S. Notes where required.

Although monetarists will throw up their hands at a distinction between "productive" and "nonproductive" credit, despite the insistence upon such a distinction in all economics up through and including Adam Smith and David Ricardo, every local banker will understand precisely what is involved. Any intelligent banker knows that certain types of business put "real tax-base" into a community, e.g., manufacturing, agriculture, and mining. He knows that a community which invests exclusively in fast food restaurants, high-rise office towers, and the other staples of the late 1970s U.S. economy will go broke.

Gold backing for this credit issue constitutes a basic discipline on our actions. America's slippage into trade deficit during the 1970s is a consistent and accurate measure of our declining productivity, brought on largely by the malfeasance of the Federal Reserve. Correction of these policies and restoration of our productivity growth will also revive our export potential; otherwise our gold will flow out to foreign nations.

4) Prevent inflationary credit from undermining the U.S. Notes program.

The principal source of inflationary credit in the U.S. economy is not the "printing-press" money of the Federal Reserve but the accumulated "book-money" of the Eurodollar market. With no reserve requirement, the foreign branches of the Wall Street banks, along with the British and Canadian international banks, create unlimited book-credits among each other. This $1.5 trillion mass of fictitious paper is the world's principal source of inflation. Inflows of Eurodollar book-credit account for virtually all the speculative credit lines for corporate takeovers in the U.S.

Monetary inflation can be eliminated overnight by two simple, long-overdue measures:

1) The Federal Reserve shall cease to be a net issuer of credit, and act only as the Treasury's transfer agent for U.S. Notes. U.S. Notes will gradually replace the unconstitutional issue of Federal Reserve notes as circulating currency of the United States of America.

2) The Treasury shall institute a policy of *transparency of sources of credit* to prevent the influx of inflationary, Eurodollar book-credits. One rule will suffice: as a matter of simple banking safety, no substandard paper will be permitted to circulate in the American banking system. A Eurodollar loan to an American company is a right to draw on a Eurodollar account unbacked by any reserves, contrary to American banking law. No such fictitious money may be lent into the United States, period.

Such action will immediately break the stranglehold over world credit now exercised by the Anglo-Canadian banking cartel, the main beneficiary of the Federal Reserve's unconstitutional policy of money issue.

5) Except for participations in productive credits, the Treasury will create U.S. Notes on only one other condition, to buy gold from U.S. citizens presented to the Treasury.

The Treasury will buy such gold at the price fixed at the outset of such a program.

6) The United States and other nations participating in this gold-reserve system will trade gold among each other at a fixed price, regardless of the behavior of the free market price. No U.S. monetary policy shall be subject to the whims of gold speculators.

Since the basis for determining the fixed price of gold is the required production-price of new gold supplies, this price fixing will endure-provided that credit issue contributes to anti-inflationary gains in productivity. Any attempt by speculators to push the price above the level at which central banks exchange gold among each other might, temporarily, produce a "two-tier" gold price of the type seen between 1968 and 1971. However, we have no doubt who would come out the victor in this sort of economic war.

The flaw in the various monetarist proposals for gold restoration (e.g., Laffer, Lehrman, Wanniski, Ron Paul) is elementary. The United States must conduct a form of economic warfare against an international financial cartel whose principal objective is to have the carcass of the U.S. economy to pick over. Their ally is the Federal Reserve, and their chief operator is Federal Reserve Chairman Paul Volcker. Without the two fundamental safeguards described above, i.e., *transparency of sources of credit*, and *priority for productive credits*, the United States monetary authorities will have little say in the management of the monetary system relative to the London and Cayman Islands offshore centers. Either, as the Federal Reserve proposes, the monetary authorities will bring about a deflationary collapse of the credit system by tightening credit to pre-

vent gold outflow, or the U.S. will simply lose its gold stock to speculators.

By making the dollar "as good as gold" through the above plan, the United States can return to international economic pre-eminence.

Questions About the LaRouche Proposal

Below are replies, provided by Richard Freeman for the October 13, 1981 EIR*, to the then most frequently asked question about the LaRouche gold proposal.*

Q: Which specific agency, authority, or special committee shall make the decisions as to which are the productive and which are speculative investments? In other words, who decides where the gold-based notes go?

A: The specific agency is the Federal Reserve Board of Governors, based in Washington, D.C. But the Federal Reserve will be changed, by an amendment of the Fed Act—passed by Congress—into the status of a mere agency within the U.S. Treasury. Therefore, the Treasury Department will make the final decision.

Q: What volume of gold-based notes is foreseen?

A: The LaRouche proposal proposes to freeze the level of U.S. Federal Reserve notes in circulation—currently $125 billion—at its present level. It will then increase the money supply solely through the mechanism of Federal Reserve issuance of gold-based currency notes for loans for productive purposes. The Fed will cease creating new currency through any other procedure, including monetizing the Treasury debt.

Q: What happens to credit issuance before your new system has taken effect?

A: Nothing. Unlike the proposal of Art Laffer, the LaRouche proposal does not plan to have a waiting period of a year or more, to determine the "free-market" price of gold. The idea of a "free-market" price of gold for a government gold system is ridiculous. Governments, by treaty agreement, will set the price of gold, and therefore, the system can go into effect immediately. One day there will be one system of credit issuance, the next day the LaRouche system.

Q: Explain in detail the international exchange of accounts. How would bilateral trade work?

A: The United States will settle its accounts with its bilateral trading partners in gold. This means whichever of the two countries, the U.S. or its trading partner, runs a current-account deficit at the end of the year (that is, a deficit on trade, insurance, freight, tourism and other invisibles) will remit the amount of that deficit in gold to the country it is in deficit to. By the end of the year, all current-account imbalances will be squared away.

Q: Is LaRouche proposing the creation of a new international financial institution based on the use of gold?

A: Yes. LaRouche has long been of the view that the world financial system is troubled by the uncontrolled Eurodollar market, now totaling over $1 trillion, and by the overhang of $500 billion of non-oil-producing third world indebtedness, the bulk of which is nonperforming. Therefore he has proposed an international gold-based fixed exchange monetary system, in which currencies are set in parity bands relative to one another; and the creation of a new international credit-issuing banking institution based on the use of gold.

The basic principle of the new bank is that it would reorganize world debt, and issue gold-denominated new currency notes as the terms of the new loans. The interest rate on the loans would be 2 to 4 percent.

First, the bank will acquire its currency at the time that the charter creating the new banking institution is adopted. Deposits will consist of gold-reserve currency notes of sovereign nations deposited at the bank, for which the sovereign nations, such as the United States, will receive stock subscription in the new bank. Against this pool of notes, the new bank has the collateral to issue its own gold-denominated currency notes.

New loans by the new bank will be made to any nation or economic entity that has signed the treaty creating the new bank. The loans are made by the new bank essentially as *discounts on loan agreements between participating members of the new bank*.

An importing nation, say Brazil, would contract a loan with Germany, for example, or with a German exporting agency and that agency's bank. Once the loan is determined to be for productive purposes, Brazil would submit that loan to the new bank, asking that bank to discount either part or all of the loan. This means that the new bank, after examining the loan itself, would make available to the German exporting agency's bank

either all or some of the value of the loan in gold-denominated currency notes at 2 to 4 percent interest rate. This money is then lent by the Germany exporting agency's bank to Brazil.

Q: Which nations would participate immediately in this new gold-based monetary system, and why? What about the Third World?

A: The leading eight European nations of the gold-based European Monetary System, most importantly Germany, as well as Japan, which bought 68 tons of gold this July alone, would be more than glad to join the United States immediately in a world gold-based system. These nations and the United States combined have large enough gold reserves to make the system work and preserve its integrity.

The Third World nations would be encouraged to join. If they were low on gold reserves, they would pledge future productive capacity for goods production as security for their loans. A redistribution through open-market sales of gold reserves could be easily conducted to provide Third World nations with ample gold to conduct their current-account settlements.

Q: How does the LaRouche proposal help to dry out the enormous liquidity being wasted by corporate mergers, money-market funds, and the Eurodollar market?

A: The Eurodollar market is like an international "crap game" in that it sloshes around the world, controlled by no national government and swelling the money supply of key nations, especially America's. The Eurodollar market creates a mass of fictitious paper values; it is the major cause for double-digit U.S. inflation. Corporate mergers, which totaled $34 billion in the first six months of 1981, are nonproductive, but as you suggest suck up a tremendous amount of liquidity.

The LaRouche proposal begins with the distinction of productive versus nonproductive and inflationary forms of economic activity. The Fed will reward loans to productive industry, by agreeing, under the LaRouche proposal, to take participation in any private commercial-bank loan that the private bank makes to manufacturing, mining, construction, transportation, or agricultural entities. The Fed will participate by agreeing to discount up to 50 percent of any private bank loan it deems worthy. The private bank must risk its assets for the other 50 percent of that loan. The Fed will issue to the private bank up to 50 percent of the value of any productive loan in gold-based U.S. currency notes at interest rates of 2 to 4 percent.

On the other hand the Fed will refuse to make credit available for nonproductive, speculative, wasteful or overhead loans except at the prevailing free-market rate, which is now 19.5 percent. Under these conditions, banks will choose to make productive loans. The spread on the difference between what a bank can earn when it pays 2 to 4 percent for its money and when it pays 19 percent, is enormous, even if the productive investments have lower profit margins.

A bank knows that if it relends the money it got from the Fed at 4 percent for 6 percent interest, it will get its earnings back, because the investment will produce a real-wealth profit. Individual investors, having to pay correspondingly higher interest rates if they borrow from a bank for non-productive purposes, will also choose to invest in productive investments.

And the Euromarkets will dry up as soon as the new treaty agreement is signed. Under this agreement, no bank will be permitted to lend dollars, unless the loan conforms to the terms of the treaty, and that includes meeting reserve requirements. Most Eurodollar banking thrives on its reserve-free status.

The speculative outlets that are the chief lending objects for the Eurodollar market will be dried up. Very soon, all international lending will take place in gold-denominated currency notes—these will be the only type that governments and private institutions and individuals will want to hold. All non-gold-secured dollars that are not earmarked for productive loans will not be discounted internationally by the new lending bank, and will not be trusted by private investors.

Q: Why doesn't the issuance of new LaRouche gold-based currency notes add to the money supply?

A: It will add to the money supply; however, this will be a noninflationary increment. Each new increment in credit, C, will be lent to industry or agriculture to increase its absolute surplus or overall profit. Insofar as overall profit grows faster than C, then goods production is exceeding money supply, and that is noninflationary. Moreover, since the new productive loans generate will go primarily to industries employing high technology, the cost of production will decline, and that is in fact *counterinflationary.*