The Proposed Iranian Oil Bourse

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Abstract: The American Empire depends on the U.S. dollar. The proposed Iranian Oil Bourse will accelerate the fall of the U.S. dollar and hence the fall of the American Empire.

I. Economics of Empires

A nation-state taxes its own citizens, while an empire taxes other nation-states. The history of empires, from Greek and Roman, to Ottoman and British, teaches that the economic foundation of every single empire is the taxation of other nations or of their subjects. The imperial ability to tax has always rested on a better and stronger economy, and as a consequence, a better and stronger military that peacefully or militarily enforced the tax. One part of those taxes went to improve the living standards of the empire and the other part went to reinforce the military dominance necessary to enforce those taxes.

Historically, taxing the subject state has been in various forms, usually gold and silver, where those were considered money, but also slaves, soldiers, crops, cattle, or other agricultural and natural resources, whatever economic goods the empire demanded and the subject-state could deliver. Historically, the taxation has always been direct: the subject state handed over the money (gold/silver) or the economic goods directly to the empire.

For the first time in history, in the twentieth century, America was able to tax the world indirectly—not by enforcing the direct payment of taxes like all of its predecessor empires did, but by distributing its own currency, the U.S. Dollar, to other nations in exchange for goods with the intended consequence of devaluing over time those dollars and paying back later each dollar with less economic goods. The difference between the value of the dollar during the initial purchase and the devalued dollar during the repayment was the U.S. imperial tax. Here is how this happened.

Early in the 20th century, the U.S. economy began to dominate the world economy. At the time the U.S. dollar was tied to gold, so that the dollar neither increased, nor decreased its value, but was always convertible into the same amount of gold. The Great Depression with its the preceding inflation from 1921 to 1929 substantially increased the amount of paper money in circulation without the correspondent increase in gold. This rendered the effective backing of the U.S. dollar by gold impossible. As a consequence, President Franklin Delano Roosevelt decoupled the dollar from gold in 1932. Up to this point, the U.S. may have well dominated the world economy, but from an economic point of view, it was not technically an empire. The fixed value of the dollar for gold did not allow the Americans to extract economic benefits from other countries by supplying them with gold-backed dollars.

Economically, the American Empire was born with the establishment of the Bretton Woods system in 1945. The dollar was made only partially convertible to gold—convertibility to gold was available to foreign governments only, but not to private institutions. At this time the US dollar was established as the international reserve currency. This was possible, because during WWII, the United States had supplied its allies with food and military provisions, accepting gold as payment, thus accumulating significant portion of the world's gold.

An economic Empire would not have been possible if the dollar remained fully backed by gold, i.e., if the dollar supply was kept limited and within the availability of gold, so as to exchange back dollars for gold at the pre-agreed exchange ratio. However, the dollar supply was actually increased far beyond its gold backing and handed over to foreigners in exchange for economic goods. There was no prospect of buying back those dollars at the same value—the amount of gold was not sufficient to redeem those dollars, while the quantity of dollars continually increased, so that those dollars constantly depreciated. The constant depreciation of the increasing dollar holdings of foreigners via persistent U.S. trade deficits was tantamount to a tax—an inflation tax.

When in 1971 foreigners demanded payment for their dollars in gold, The U.S. Government defaulted on its payments on August 15. The popular spin of this default was that "the link between the dollar and gold was severed". The proper interpretation is that the U.S. Government went bankrupt, just like any commercial bank is declared bankrupt.

However, by doing so, the U.S. declared itself an Empire. It had extracted an enormous amount of economic goods from the rest of the world, with no intention or ability to return those goods. The world was effectively taxed and it could not do anything about it: it could not force the U.S. in bankruptcy proceedings and take possession of its gold and other assets for payment, nor could it take forcefully what it was owed by declaring war and winning it. Essentially, the U.S. imposed on the world an inflation tax and collected an imperial seigniorage!

From that point on, to sustain the American Empire and to continue to tax the rest of the world via inflation, the United States had to force the world to continue to accept ever depreciating dollars in exchange for economic goods and to have the world hold more and more of those dollars, while those dollars depreciated. It had to give the world an economic reason to hold dollars, and that reason was oil.

In 1971, as it became clear that the U.S. Government would not be able to buy back its dollars for gold, it prepared an alternative arrangement to hold the world hostage to its fiat dollar: during 1972-1973 it struck an iron-clad arrangement with Saudi Arabia—to support the rule of the House of Saud in exchange for accepting only dollars as a payment for Saudi oil. By imposing the dollar on the OPEC's leader, the dollar was effectively imposed on all OPEC members. Because the world had to buy oil from the Arab oil countries, it had the reason to hold dollars as payment for oil. Because the world needed ever increasing quantities of oil at an ever increasing oil prices, the world's demand for dollars could only increase. Even though dollars were no longer exchangeable for gold, they were now exchangeable for oil.

The economic essence of this arrangement was that the dollar was now backed by oil. As long as that was the case, the world had to accumulate increasing amounts of dollars, because those dollars were needed to buy oil. As long as the dollar was the only payment for oil, its dominance in the world was assured, and the American Empire could continue to tax the rest of the world. If, for any reason, the dollar lost its oil backing, the American Empire would cease to exist, because it would no longer be able to tax the world by making them accumulate ever more dollars. Thus, Imperial survival dictated that oil be sold only for dollars. It also implied that oil reserves were spread around various sovereign states that none was strong enough, economically or militarily, to demand payment for oil in something other than dollars. If someone demanded a different payment, he had to be convinced, either by political or by military means, to change his mind.

The man that actually did demand Euro for his oil was Saddam Hussein in late 2000. At first, his demand was met with ridicule, later with neglect, but as it became clearer that he meant his demand and even converted his $10 billion reserve fund at the U.N. into Euro, political pressure was exerted to change his mind. Other countries, like Iran, also wanted payment in other currencies, most notably Euro and Yen. The danger to the dollar was clear and present, so a punitive action was in order. Bush's war in Iraq was not about existing weapons of mass destruction, about defending human rights, about spreading democracy, or even about seizing oil fields. It was about defending the dollar, ergo the American Empire; it was about setting an example that anyone who demanded payment in currencies other than U.S. Dollars would be likewise punished.

Many have criticized Bush for staging the war in Iraq in order to seize Iraqi oil fields. However, those critics can't explain why Bush would need to seize those fields—he could simply print dollars for nothing and use them to get all the oil in the world that he needs. He must have had some other reason to invade Iraq.

History teaches that an empire goes to war for one of two reasons: (1) to defend itself or (2) benefit from war. Economically speaking, in order for an empire to initiate and conduct a war, its benefits must outweigh its military and social costs. Benefits from Iraqi oil fields are hardly worth the long-term, multi-year military cost. Bush went into Iraq to defend the American Empire. Indeed, this is the case: two months after the United States invaded Iraq, the Oil for Food Program was ended, the country's accounts were switched back to dollars, and oil began to be sold once again only for U.S. dollars. No longer could the world buy oil from Iraq with Euro. Global dollar supremacy was once again restored. Bush descended from a fighter jet and declared himself the victor: the mission was indeed accomplished—Bush successfully defended the U.S. dollar, and thus the American Empire.

II. Iranian Oil Bourse

The Iranian government has recently proposed to open in March 2006 an Iranian Oil Bourse that will be based on an euro-based oil-trading mechanism that naturally implies payment for oil in Euro. In economic terms, this represents a much greater threat to the hegemony of the dollar than Saddam's, because it will allow anyone willing either to buy or to sell oil for Euro to transact on the exchange, thus circumventing the U.S. dollar altogether. If so, then it is likely that much of the world will eagerly adopt this euro-denominated oil system:

* The Europeans will not have to buy and hold dollars in order to secure their payment for oil, but would instead use with their own currency.
* The Chinese and the Japanese will be especially eager to adopt the new exchange. It will allow them to drastically lower their enormous dollar reserves and diversify them with Euros. One portion of their dollars they will still want to hold onto; another portion of their dollar holdings they may decide to dump outright; a third portion of their hoards they will decide to use up for future payments without replenishing their dollar holdings, but building up instead their euro reserves.
* The Russians have economic interest in adopting the Euro – the bulk of their trade is with European countries, with oil-exporting countries, with China, and with Japan. Adoption of the Euro will immediately take care of the first two blocs, and will over time facilitate trade with China and Japan. Also, Russians seemingly detest holding depreciating dollars, for they have recently found a new religion with gold: their central bank is diversifying out of dollars and accumulating gold. Russians have also revived their nationalism; if embracing the Euro will stab the Americans, they will gladly do it and smugly watch the Americans bleed.
* The Arab oil-exporting countries will eagerly adopt the Euro as a means of diversification against rising mountains of depreciating dollars. Just like the Russians, their trade is mostly with European countries, and therefore will prefer the European currency both for its stability and for avoiding currency risk.

Only the British will find themselves between a rock and a hard place. They have had a strategic partnership with the U.S. forever, but have also had their natural pull from Europe. So far, they have had many reasons to stick with the winner. However, when they see their century-old partner falling, will they firmly stand behind him or will they deliver the coup de grace? Still, we should not forget that currently the two leading oil exchanges are the New York's NYMEX and the London's International Petroleum Exchange (IPE), even though both of them are effectively owned by Americans. It seems more likely that the British will have to go down with the sinking ship, for otherwise they will be shooting themselves in the foot by hurting their own London IPE interests. It is here noteworthy that for all the rhetoric about the reasons for the surviving British Pound, the British most likely did not adopt the Euro namely because the Americans must have pressured them not to: otherwise the London IPE would have had to switch to Euros, thus mortally wounding the dollar and their strategic partner.

At any rate, no matter what the British decide, should the Iranian Oil Bourse gain momentum and accelerate, the interests that matter—those of Europeans, Chinese, Japanese, Russians, and Arabs—will eagerly adopt the Euro, thus sealing the fate of the dollar. Americans cannot allow this to happen, and if necessary, will use a vast array of strategies to halt or hobble the exchange's operations:

· Sabotaging the Exchange—this could be a computer virus, network, communications, or server attack, various server security breaches, or a 9-11-type attack on main and backup facilities.

· Coup d'état—this is by far the best long-term strategy available to the Americans.

· Negotiating Acceptable Terms & Limitations—this is another excellent solution to the Americans. Of course, a government coup is clearly the preferred strategy, for it will ensure that the exchange does not operate at all and does not threaten American interests. However, if an attempted sabotage or coup d'etat fail, then negotiation is clearly the second-best available option.

· Joint U.N. War Resolution—this will be, no doubt, hard to secure given the interests of all other members of the Security Council. Recent rhetoric about Iranians developing nuclear weapons undoubtedly serves to prepare this course of action.

· Unilateral Nuclear Strike—this is a terrible strategic choice for all the reasons associated with the next strategy, the Unilateral Total War. The American will likely use Israel to do their dirty nuclear job.

· Unilateral Total War—this is obviously the worst strategic choice. First, the U.S. military resources have been already depleted with two wars. Secondly, the

Americans will alienate other powerful nations. Third, major reserve countries may decide to quietly retaliate by dumping their own mountains of dollars, thus preventing the U.S. from further financing its militant ambitions. Finally, Iran has strategic alliances with other powerful nations that may trigger their involvement in war; Iran reputedly has such alliance with China, India, and Russia, known as the Shanghai Cooperative Group, a.k.a. Shanghai Coop.

Whatever the strategic choice, from a purely economic point of view, should the Iranian Oil Bourse gain momentum, it will be eagerly embraced by major economic powers and will precipitate the demise of the dollar.

III. The Demise of the Dollar

The collapsing dollar will dramatically accelerate U.S. inflation and will pressure short-term and long-term interest rates much higher. At this point, the Fed will find itself between two equally disastrous options—deflation or hyperinflation. The first option, deflation, known in the international finance literature as the “classical medicine”, requires stopping the monetary expansion and raising interest rates, thus inducing a major economic depression, a collapse in real estate prices, and an implosion in bond, stock, and derivative markets, most likely precipitating a total financial collapse. The alternative option is to take the easy way out by inflating, whereby the Fed pegs the long-bond yield, raises the Helicopters and drowns the financial system in liquidity, bailing out numerous LTCMs and hyperinflating the economy.

The Austrian theory of money, credit, and the business cycle teaches us that ultimately there is no in-between the mythological Scylla and Charybdis scenario—between deflation and hyperinflation. Sooner or later, as pressure on the dollar rises and inflation rears its ugly head, the monetary system must swing one way or the other, forcing the Fed to make its choice. There is no doubt that the newly-appointed Commander-in-Chief of the Federal Reserve, Ben Bernanke, an renowned scholar of the Great Depression and an adept helicopter pilot, will choose the latter course of action—hyperinflation. Bernanke has learnt well the lessons of the Great Depression and the destructiveness of deflations. He has also learnt well from the Maestro the panacea of every financial problem—to inflate his way out, come hell or high water. He has even devised ingenious unconventional ways around the deflationary liquidity trap and teaches the Japanese how to apply them. To avoid deflation, he has publicly stated that he will accelerate the printing presses and “drop money from helicopters”. If necessary, he will monetize everything in sight. He will ultimately destroy the American currency in Hyperinflation.

Hyperinflations, however, do not happen in an instant. It usually takes years before the final collapse. The Weimar hyperinflation began around 1920 and ended in 1923 with the total destruction of the currency. Similar was the fate of some post-communist countries: it took Russia and Bulgaria 7-8 years to hyperinflate their currencies before they ultimately destroyed them.

However, because the dollar is the reserve currency of the world, hyperinflating the dollar will be fundamentally different in two ways from all hyperinflations in history. On the one hand, there are tens of trillions of dollar-denominated debt and hundreds of trillions of dollar-denominated derivatives. Given that the ratio of currency to debts and derivatives is tiny, the coming hyperinflation must be necessarily of epic proportions. On the other hand, central banks around the world will fight tooth and nail to support the dollar, so that world financial system does not collapse and that their reserves do not evaporate into the nothingness. Many central banks will choose willy-nilly to support the dollar by inflating their own currencies. Thus, these two powerful forces will drive the dollar in opposite directions. Its inevitable demise may be swift and sudden, or it may be protracted and painful.

Whatever the speed of hyperinflation, ordinary Americans will have few available options to protect themselves—during crises, peoples' first instinct is to resort to more "stable" fiat currencies of neighboring countries, like the Canadian Dollar and the Mexican Peso, but their availability will prove limited and complicated as people will most likely have to cope with governmentally-imposed capital controls. Next, people instinctively convert hyperinflating currencies to hard assets like land and real estate, but sellers refuse to accept the hyperinflating currency and quickly disappear from the market. Having run out of meaningful options to protect themselves, ordinary people will have little choice, but to convert their dollars to hard currencies like gold and silver, thus driving their prices much higher. On the other hand, central banks have no other options but gold. First, in times of crises, central banks fear the risk inherent in all fiat currencies. Moreover, not even the largest fiat currencies will accommodate their need to convert their reserves. Also, it is not practical for central banks to hold real estate and land. Thus, central banks will have no alternative, but to scramble to convert their reserves to the only hard currency known to man—gold. Historically, in times of crises, gold has always been the ultimate safe haven. When people and central banks flee en masse to gold, its value has always skyrocketed. This time, it will be no different.