

## The Petro-Dollar Era is Ending. What's Next?

Brandon White. September 2021

The recent arms deal between Russia and Saudi Arabia, combined with America's withdrawal from Afghanistan, indicates that we are now in the final stages of the forty-year-old Petro-Dollar Exchange Era. History shows us that this is the average length of a currency cycle, after which trust in the currency regime fails – as it is doing once again. A new form of money is on its way. And it will reflect the way mankind has always found economic stability – in real and productive assets. It truly is a brave new world.

### A brief overview of where we have been

It has been said that '*Currency is printed. Money is minted.*'. I suspect only a minority of people understand this concept. The monetary events of the last fifty years, coupled with the surreptitious efforts by our 'betters', have effectively blinded several generations to the true nature of money. Just like in personal and business relationships, when trust is broken it can never be rebuilt completely. Something new must replace what has been corrupted. Money is a social construct based on trust and only holds value as long as it remains trustworthy. As trust is falling fast, it's clear that the current dollar paradigm will die.

Our current form of money was born in the 1970s during a period of crushing inflation, outrageous debt and an energy crisis that was the result of declining trust in the US fiat dollar system. Statistics show that the petro dollar matured in the 1980s, thrived in the 1990s but started to deteriorate in the late 2000s. That deterioration has escalated to its current critical state. Mainstream media will not touch this issue, denying any discussion or exploration of the subject. You are not supposed to think about nor question this.

In 1971, President Nixon closed the gold window and, for a short period, there was nothing of merit supporting the US dollar. It was merely an empty promise of value. It had become a pure fiat currency, a technical default. Faith in the US dollar plummeted. Reneging on its commitment to exchange US dollars for gold, America scrambled to find a way to back-stop its currency.

During this period, the world began to increasingly distrust the dollar, leading to the economic chaos of the 1970s. Something new was required. It took several years to devise a plan to rebuild trust and that solution is what remains in play to this very day. The US dollar became the 'Petro-Dollar' and it is the primary global trade settlement tool used in the purchase of petroleum – the most important asset mankind needs to maintain modern

### Saudis Sign Military Cooperation Agreement With Russia



This agreement marks the start of a new era, a collaboration on many fronts by two super powers, and a move away from the US dollar as the primary currency for world trade.  
Source: RadioFreeEurope, Radio Liberty, Aug. 22, 2021

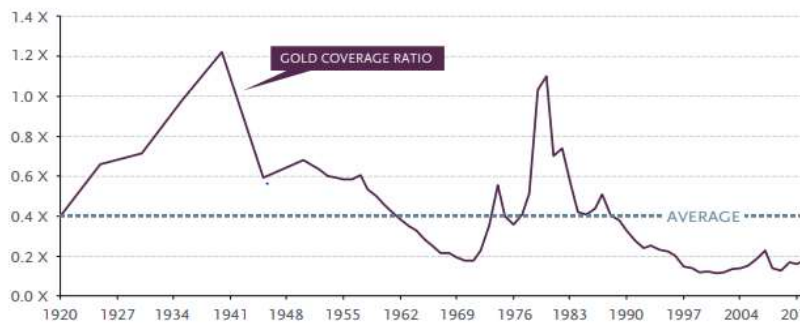
life around the world. Without oil, life as we know it would end. Contemplate that for a moment. Henry Kissinger was largely instrumental in striking a simple deal with the OPEC nations where they would only sell oil in exchange for US dollars. In return, the US pledged its military to protect these countries (especially Saudi Arabia) from their hostile neighbours. It was a simple arrangement that was reflective of the Cold War world that existed in the 1970s.

As long as the world requires US dollars in exchange for oil, this system works. It is far from perfect, but it functions. Oil producers sell their oil for US dollars and then exchange the dollars that they don't hold in reserve for other assets. The primary assets they convert their US dollars for are international bonds (specifically, US Treasuries as this was part of the terms of the deal), global currencies (Euros, Yen, Pounds, RMB), Special Drawing Rights (SDRs), weapons and gold. And, since oil is crucial to so many industries, no matter how much the climate alarmists bleat, oil isn't going to go away anytime soon. A new trusted medium of exchange will soon be required.

Since the discovery and widespread use of oil in the late 19<sup>th</sup> century, the world has seen three types of money used: a gold and silver bullion exchange system, an international gold bullion exchange system and a floating currency fiat system, more commonly known as the Petro-Dollar system. At the turn of the 20<sup>th</sup> century, the world viewed gold and silver as money and all paper currencies in circulation were based on a fractional reserve gold stockpile. The paper money could be exchanged for precious metals upon presentation at a bank. This system has been in place since its institution by the British Central Bank in the 17<sup>th</sup> century.

**A SLIPPERY SLOPE: THE U.S. DOLLAR'S GOLD COVERAGE RATIO**

*The gold coverage ratio refers to the amount of gold backing the monetary base (all U.S. currency plus reserves held at the Fed). The ratio has fallen between the end of World War Two (1945) and now because of dollar-printing by the Federal Reserve. It briefly rose because of the rapid appreciation of gold prices following the end of Bretton Woods. Today, the Federal Reserve only holds gold reserves equivalent to 20% of the value of every dollar outstanding. Does this mean gold at the current price of roughly \$1600 per ounce is underpriced?*



Source: IMF, World Gold Council, Federal Reserve, Bloomberg, Guggenheim Investments. Data as of 6/30/2012.

This gold and silver bullion exchange system worked very well for individuals and kept government deficit spending contained. There was some flexibility in the ratio of how much gold was held in reserve relative to the amount of currency in circulation, (called the gold coverage ratio), which allowed the government the ability to manage imbalances while maintaining trust. It functioned quite well. Central banks continue to play a critical role in managing the value of a nation's currency. However, without the tether to gold, they simply are not equipped to contain deficit spending and government largesse.

In the early part of the 20<sup>th</sup> century, something broke. Some argue that it was the creation of the Federal Reserve and the easy credit of the 1920s that led to the Great Depression. Others believe that the Great Depression was the result of the Federal Reserve not doing enough. It doesn't matter who was to blame, the result was that public trust in the system failed. This led to the rise of the international gold bullion exchange system which ultimately manifested in the signing of the Bretton Woods Agreement in 1944. Countries around the world agreed to use US dollars in international trade and the US agreed to allow the exchange of those dollars for gold. In the late 1960s, the world became increasingly concerned that the US was printing far more dollars than they had gold to back it

up and countries began to request gold for their dollars. By mid-1971, it became very clear that the entire US gold stockpile would be completely drained if this trend continued and then the dollar would become worthless. Trust, once again, was the issue.

**The declining importance of the Petro Dollar**

We are once again in a period of distrust of the US dollar – and the entire Petro-Dollar system is in trouble. Nations that have attempted to create an alternative to this system have been met with economic sanctions, military action– or both. Leaders of these nations have been deposed or eliminated. In truth, the US military is not about global peacekeeping – it exists to maintain the status quo and US hegemony. The withdrawal of troops from Afghanistan is synonymous with the US withdrawal from Vietnam in 1975. The fact that the Petro-Dollar system was created at that same point in history is not to be dismissed. There is a correlation between a nation’s currency and its military operations. It has been this way since long before the collapse of the Roman Empire.

Prior to British Petroleum winning the engineering contracts to build the oil infrastructure in Saudi Arabia, it was the Russians who were most friendly with the Saudis. Had Stalin not executed his two ambassadors to Saudi Arabia, causing the Saudi king to end all relations, we would be living in a very different world. Saudi Arabia and Russia were the two largest oil producers in the world until the US shale production made America the largest producer. It was Russia and Saudi Arabia who, in 2019, cooperated in increasing oil production to combat the threat to their dominance. Their combined efforts collapsed the oil price to the degree that the oil price went negative. There was so much oil being produced that the world was running out of places to store it. This established a very interesting precedent and clearly demonstrates a willingness on their part to defy the US.

The recent signing of an arms deal between Russia and Saudi Arabia further demonstrates a shift in Saudi-US relations. If the Saudis no longer require US military support, then the agreement to only accept US dollars has no further value and will be discarded. The Nord Stream 2 pipeline means oil can be piped directly to northern Germany via the Baltic Sea, circumventing the need for US dollars. Europe has already stated that acquiring US dollars to exchange for oil from other countries is absurd. Europe has become increasingly frustrated by Washington’s belligerence and seeks to further its economic sovereignty.



Russia and Saudi Arabia signed an agreement to simultaneously increase production. This resulted in more oil produced than could be stored. Source: Source: FactSet, J.P. Morgan Asset Management. Data are as of April 21, 2020

To recap, Saudi Arabia is cooperating with Russia in combating the American oil industry. Russia is now in an economic and weapons relationship with the second largest oil producer in the world. And Europe is now directly connected to Russia through a pipeline under a body of water that the US Navy is not welcome in. Russia's pipeline through Ukraine is no longer a liability. The significance of these events cannot be overstated.

Europe will buy oil directly from the Middle East without using US dollars. The US debt levels are unsustainable and with its military withdrawing from Afghanistan, its declining influence is visible for all the world to see. It is not a matter of 'will' Saudi Arabia cancel its 1970s agreement with the US but 'when'. My best guess is it will be once the missiles purchased from Russia are delivered to Saudi Arabia and the Europeans announce that they are buying oil in Euros. This will likely be the catalyst for a new currency regime designed to challenge the US dollar's dominance and, perhaps, even its relevance.



Russian company Gazprom completed construction of the Nord Stream 2 pipeline to Germany on Sept. 10, which could allow Russia to double gas exports to Europe via the Baltic Sea.

### Gold will once again reign supreme

Mark Twain once said "History may not repeat itself, but it sure does rhyme." Global trade settlement has been largely based in US dollar terms since the end of the World War II. The gap between 1971 and today is an anomalous period where asset pricing did not use gold as the benchmark. All assets reference value against some kind of standardized unit. As far back as mankind has recorded history, gold and silver have formed the basis of trusted economic systems. Without these precious metals as surety, trust fails. History should not be ignored.

The current social construct we call money is a perverted medium that few have stopped to really think about. There are three attributes to a socially acceptable form of money:

1. Money must be a unit of account. (A fixed value that does not change over time.)
2. Money must be a store of value. (A durable and rare asset.)
3. Money must be a fungible medium of exchange. (Easily divided with no loss of value and accepted universally.)

The US dollar no longer serves as a trustworthy form of money. Its value is constantly being lowered against all real assets through debasement. Its utility is decreasing at an alarming rate due to unprecedented monetary policy and a desire by nations around the world to find an alternative. Trust and confidence in this system has been broken. The predictions were accurate. The large-scale asset purchases that began in 2008, (i.e., money printing) have led to a Federal Reserve balance sheet that is now the equivalent of 38% of America's GDP.

The economic success of any society is dependent upon a sustainable and trustworthy system that will foster societal and economic cohesion and growth. The current monetary paradigm only continues to hobble along because we have allowed it to get this far. The excesses and exorbitant privilege that the controllers of the current

currency regime have enjoyed will not continue much longer. The consequences of shifting from a society formed on classical economics (based on savings and investment) to one of corporate statism and crony capitalism (based on debt and consumption) will be severe. America will likely take the brunt of the blame.

Central banks have the formula ready to revalue all assets globally when the time is right. It is called a *Special Drawing Right* (SDR) and resides on the balance sheet of every central bank in the world. The equation for this formula is well established and includes a weighting to gold. It will be the international reference for all central bank-issued currencies. Some will go up in value. Others will fall. The massive increase in central bank gold holdings tells us all what the plan is for gold.

It doesn't really matter what the tool or benchmark will be called going forward. What matters is that it satisfies all the required attributes to serve as money, most importantly trust and confidence. You cannot maintain exposure to a currency backed by a failed faith-based system for long. The petro-dollar continues to exist only because a better solution has not yet presented itself. America's refusal to relinquish its 8,133 metric tonnes of remaining gold is due to its need to have a contingency in place for the inevitable failure of this system.

### **So, what's the answer?**

Central banks creating money out of thin air and then charging interest to the governments who borrow it is not the answer nor the path to economic strength. What we call money is now borrowed into existence. When you combine creating money with interest at no manufacturing cost to the bank with negative real interest rates, you drive governments and people to seek real alternatives to protect their savings.

The long term, sustainable answer is gold and silver. Those who own gold and silver, and especially those who produce it, will be well placed to thrive when the world rejects the use of US dollars as the primary form of money. Gold's rightful role as the global economic benchmark is just around the corner. Owning shares in a gold mining company will become a license to mint more money. Owning physical gold is akin to real savings and will safely port value through the pending global currency reset. This event will likely be a policy announcement which could occur in the near future, given current economic uncertainty and dropping confidence in the US dollar. Those in the know will position themselves smartly, incorporating gold and silver into their investment portfolios in the form of real bullion or stock in precious metals mining and exploration companies. These kinds of opportunities only come once in a lifetime.

Are you ready?

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