

The World's Reserve Currency

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The financial press reported last week that the euro, the new currency created only five years ago and used by most European nations, has supplanted the U.S. dollar as the most widely used form of cash internationally. There are now more Euros in circulation worldwide than dollars.

This alone is not necessarily troubling, as the dollar remains the world's most important reserve currency. About 65% of foreign central bank exchange reserves are still held in dollars, versus only about 25% in euros. And the European Central Bank faces the same inflationary pressures that our own Federal Reserve Bank Governors face, including a growing entitlement burden that threatens economic ruin as both societies age. European politicians want to spend money just as badly as American politicians, and undoubtedly will clamor to inflate- and thus devalue- the euro to fund their creaky social welfare systems.

Still, the rise of the Euro internationally is another sign that the U.S. dollar is not what it used to be. There is increasing pressure on nations to buy and sell oil in euros, and anecdotal evidence suggests that drug dealers and money launderers now prefer euros to dollars. Historically, the underground cash economy has always sought the most stable and valuable paper currency to conduct business.

More importantly, our greatest benefactors for the last twenty years- Asian central banks- have lost their appetite for holding U.S. dollars. China, Japan, and Asia in general have been happy to hold U.S. debt instruments in recent decades, but they will not prop up our spending habits forever. Foreign central banks understand that American leaders do not have the discipline to maintain a stable currency. When the rest of the world finally abandons the dollar as the global reserve currency, both Congress and American consumers will find borrowing money a more expensive proposition.

Remember, America can maintain a large trade deficit only if foreign banks continue to hold large numbers of dollars as their reserve currency. Our entire consumption economy is based on the willingness of foreigners to hold U.S. debt. We face a reordering of the entire world economy if the federal government cannot print, borrow, and spend money at a rate that satisfies its endless appetite for deficit spending.

At some point Americans must realize that Congress, and the Federal Reserve system that permits the creation of new money by fiat, are the real culprits in the erosion of your personal savings and buying power. Congress relentlessly spends more than the Treasury collects in taxes each year, which means the U.S. government must either borrow or print money to operate- both of which cause the value of the dollar to drop. When we borrow a

billion dollars every day simply to run the government, and when the Federal Reserve increases the money supply by trillions of dollars in just 15 years, we hardly can expect our dollars to increase in value.

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