May 23, 2005 Last week the US Treasury department issued a warning to the Chinese government with regard to its policy of pegging the value of the Chinese yuan to the US dollar. In essence, the Treasury department accuses China of artificially suppressing the value of its currency by tying it to the dollar, thus making Chinese imports very cheap and worsening our trade imbalance. This kind of bluster may serve political interests, but in reality we have nobody to blame but ourselves for the sharp decline in the US dollar. Congress and the Federal Reserve, not China, 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 US 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. If anything, the US government should be embarrassed that another nation has depressed its currency by tying it to the US dollar. An economically sound nation would take pride in its currency, one that maintains a stable value and provides incentive for savers. Yet here we are, mad at China for our own sin of flooding the world with cheap dollars. The root of the problem is the Federal Reserve and our fiat monetary system itself. Since US dollars and other major currencies are not backed by gold, they have no inherent value. Their relative values are subject to political events, and fluctuate constantly in highly volatile currency markets. A fiat system means every dollar you have can be eroded into nothing by the actions of politicians and central bankers. In essence, paper currencies like the US dollar operate as articles of faith-- faith in the policies of the governments and central banks that issue them. When it comes to a government as deeply indebted as our own, that faith is sorely lacking among investors worldwide. Politicians often manage to fool voters and the media, but they rarely fool financial markets over time. The precipitous drop in the US dollar over the past few years is proof that investors around the globe are very concerned about American deficits and debt. When investors lack faith in the U.S. dollar, they really lack faith in the economic policies of the U.S. government. Unlike wealthy currency traders, most Americans are stuck with their U.S. dollars. Average people, particularly those who depend on savings or fixed incomes to fund their retirement years, cannot abide the continued devaluation of our currency. A true strong-dollar policy would not depend on the actions of China or any other nation. It would, however, require a constriction of the money supply and higher interest rates, both of which would cause some short-term pain for the American economy. In the long run, however, such a correction is the only alternative to the continued erosion of our dollars.