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Dollar's drop challenges U.S. power

By [Steven C. Johnson](#) Reuters

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NEW YORK: The United States may have no military equals, but the challenges to its financial power have become impossible to ignore.

A stark reminder came on Friday when the weakening dollar slumped to a record low against its main rival, the euro, after the U.S. economy recorded its fourth consecutive quarter of below-trend growth. The euro hit a record high of \$1.3680.

The strength of the dollar is more than just a matter of bragging rights.

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Experts say the consequences of its long-term decline could have deep significance - for average Americans and for the country's position as an unrivaled global power.

Over time, the forces behind its decline could further marginalize the United States on the world stage, lower its standard of living and tie its hands in responding to crucial security issues or financial crises.

"We can no longer view ourselves as king of the hill," said Leo Melamed, chairman emeritus of the Chicago Mercantile Exchange and founder of the world's first market for financial futures.

"There are a lot of other potential kings now vying to take our place."

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Today, China is growing more rapidly than the United States, and many investors and historians alike see the European Union as its economic equal.

Wall Street seems to be losing its edge, too, even though the Dow Jones industrial average of 30 major U.S. stocks closed at a record high this week. Companies that would once have turned to New York to raise money now increasingly go public on exchanges in London and Hong Kong.

To students of history, the situation looks like a rerun of the decline in Britain 60 years ago, when massive postwar debt and a sharp slide in the pound forced the dissolution of the empire and marked the end of Britain's days as a major world power.

"The United States is a power, but it's hardly the only power, and it's certainly not a superpower anymore," said Jim Rogers, who co-founded the Quantum hedge fund with the billionaire investor George Soros in the 1970s.

The dollar is perhaps the biggest problem. As a net debtor, the United States must attract some \$3 billion every working day to finance a gaping current account deficit that in 2006

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amounted to 6.5 percent of gross domestic product.

Economic rivals like China and Japan, on the other hand, boast massive surpluses.

Since Americans also spend more than they save, the money to cover the U.S. deficit must come from foreign lenders like central banks. China, which holds more than \$1 trillion in foreign currency reserves, is one of the biggest creditors.

As the dollar has steadily weakened over the past year, the value of the dollar-denominated assets held by central banks has also declined.

The trend may motivate foreigners to start holding more euros instead, exacerbating pressure on the dollar and leading to faster U.S. inflation rates and a declining standard of living. That is increasingly possible because euro-denominated debt today accounts for a bigger share of the international bond market than do dollar-based securities.

That also means that oil exporters could find it easier to start pricing crude in euros, Rogers said, adding to the financial burden on the United States, the world's biggest consumer of oil.

While a weaker dollar may bolster U.S. exports and the profits of American companies with overseas operations, weaker foreign demand for U.S. Treasury bonds would push up long-term interest rates, raising mortgage payments for U.S. homeowners and borrowing costs for an indebted government.

"I don't see that it's possible to avoid a weakening of a country's power projection if it doesn't have the fiscal muscle to sustain that power," said Paul Kennedy, history professor at Yale University and author of "The Rise and Fall of the Great Powers."

There is a potential upside to the dollar's fall. For one thing, its decline would help shrink the massive U.S. trade deficit.

Some economists also argue that competition between countries is part of globalization's rising tide that will eventually lift all boats.

"If China does well, it doesn't put the United States out of business but creates opportunities to sell to richer Chinese consumers," said Sebastian Mallaby, senior fellow for International Economics at the Council on Foreign Relations in Washington.

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