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ECONOMIC ANALYSIS

The Dollar Is Down, but Should Anyone Care?

By EDMUND L. ANDREWS

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WASHINGTON, Nov. 15 - It sounds eerily like the worst economic nightmare for President Bush's second term.

Bogged down in a costly war that shows no sign of ending, the United States faces a gaping budget deficit and ballooning foreign indebtedness. The dollar plunges against other major currencies, while turmoil in the Middle East sends oil prices soaring. The rest of the decade is plagued by rising inflation, increased joblessness and sky-high interest rates.

But the president under fire was Richard M. Nixon - not George W. Bush. The war was in Vietnam, not Iraq. And the dollar crash was in 1973 rather than 2005.

Could it happen again? With the dollar down more than 40 percent against the euro since 2002, and hitting new lows since Mr. Bush's re-election, economists are debating whether America's foreign indebtedness could lead to a collapse in the dollar and a global financial crisis.

The United States is spending nearly $600 billion more a year than it produces, almost 6 percent of its annual gross domestic product. Much of that spending has been financed by Asian governments, which bought more than $1 trillion in Treasury securities and other dollar assets in the last two years to help keep the dollar strong against Asian currencies.

Many analysts expect the financing gap to widen and the dollar to decline further. But there are at least three schools of thought on whether a dollar collapse is likely and, if it happens, what it would mean.

One group, which includes the Federal Reserve chairman, Alan Greenspan, contends that global financial markets are awash in so much money that the United States can borrow much more than seemed possible 20 years ago.

The dollar may well decline in value, according to this view, but the decline would be gradual and would help reduce American trade

Yuriko Nakao/Reuters

One school of thought holds that foreign governments like Japan will continue to finance American borrowing and keep the dollar strong because they are determined to sustain exports and create jobs.

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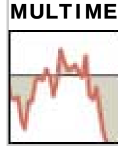

Chart: Growing Gap

imbalances by making exports cheaper and imports more expensive.

The Bush administration goes one step further, arguing that America's huge foreign debt simply reflects the eagerness of others to invest here.

"Productivity has been remarkably high in the last few years," John Taylor, deputy secretary of the Treasury, said at a recent conference. "Foreigners want to invest in the United States. That's what that gap illustrates."

A second school of thought holds that foreign governments like China and Japan will continue to finance American borrowing and keep the dollar strong because they are determined to sustain their exports and create jobs.

But a third school, which includes officials at the International Monetary Fund, worries about a collapse in the dollar that would send shock waves through the global economy.

That group argues that the dollar needs to depreciate another 20 percent against the other major currencies but warns about a run on the dollar that could reduce its value by 40 percent.

A collapse of that size would severely affect Europe and Asia, which have relied heavily on exports to the United States for their growth.

A steep drop in the dollar could lead to higher interest rates for the federal government and American private borrowers, as foreign investors demanded higher returns to compensate for higher risk. And it could expose hidden weaknesses among financial institutions and hedge funds caught unprepared.

"There is a school of thought that the U.S. can keep borrowing forever," said Kenneth S. Rogoff, professor of economics at Harvard University and a former chief economist at the I.M.F. "But if you add up all the excess saving being thrown out by the surplus countries, from China to Germany, the United States is soaking up three-quarters of it right now."

For Mr. Rogoff and several other economists, the question is not whether the dollar declines - but how fast and how far the fall turns out to be.

The United States current account deficit, which encompasses annual trade as well as the balance of financial flows, has gone from zero in 1990 to nearly $600 billion this year. The United States' accumulated debt to foreign investors is $2.6 trillion, or 23 percent of the annual output of the economy.

But where foreign investors in the 1990's poured trillions of dollars into American stocks and corporate acquisitions, investment from abroad now comes mostly from foreign central banks and goes heavily to buying Treasury securities that finance the federal deficit.

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