Editorial

Everyone Pays, in Dollars

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Since the Federal Reserve cut short-term interest rates by half a percentage point two weeks ago, the already softening dollar has steadily lost value against other major currencies. The morning of the rate cut, one euro bought $1.38. At day's end yesterday, one euro bought $1.42 — a level at which analysts believe it begins to compete with the dollar to be the world's top currency of choice.

Americans tend to think of currency exchange rates only when they travel abroad. In today's global economy, the implications of a weak dollar go much further than that, threatening potentially higher costs in the United States for everything from home heating to consumer goods to mortgages.

The recent rate cut was an effort to cushion investor losses from recent turmoil in the financial markets and, in the process, to prevent those losses from harming the rest of the economy. Federal officials become twitchy when such efforts are labeled a "bailout," asserting among other objections that the term should apply only when taxpayers directly bear the burden of an intervention. But the weakening dollar illustrates that government interventions need not be taxpayer financed to pose risks for all Americans.

Lower interest rates weaken the dollar because they reduce the returns on dollar-based investments. A weaker dollar, in turn, risks higher prices for imported goods. The rise in the price of oil to above $80 a barrel is due in part to a declining dollar as foreign oil producers charge more dollars per barrel to maintain their purchasing power in Europe and elsewhere.

A weaker dollar also risks pushing up interest rates because sooner or later global investors demand higher yields to offset the weak currency. Of late, long-term rates have only edged up, but they would be defying gravity to stay down if the dollar continued its decline. Higher long-term rates would further crimp the already ailing housing market, because the interest rates for new mortgages are tied to long-term rates.

A falling dollar makes American-made products cheaper abroad, so the downsides of a weakening dollar could be offset somewhat by a rally in American exports. It's doubtful, however, that bolstered exports could significantly overcome the economic drag of higher inflation and steeper borrowing costs.

Dollar weakness is home-grown. It is rooted in the borrow-and-spend behavior of the United States government and American consumers and in a corollary lack of domestic savings that necessitates foreign borrowing. That indebtedness was unsustainable, even when the economy was growing robustly. Now it's coupled with a weakening economy and lower interest rates, making foreign lenders increasingly reluctant to hold and accumulate dollars and hastening a downward slide.

The public and policy makers must realize that the economic vulnerabilities of a weaker dollar are self- inflicted — and that the responsibility for fixing them lies squarely with Washington.