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Gambling Against the Dollar

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A couple of years ago, [Robert E. Rubin](#) — éminence grise at [Citigroup](#) and the Democratic Party's economic wise man — decided that the United States dollar was headed for a fall.

This view put Mr. Rubin in good company. Nearly everyone who spends time thinking about the American economy believes that the value of the dollar has to fall at some point.

The United States has been borrowing enormous sums of money from other countries, largely so that American consumers can turn around and buy the computers, clothing and other goods those countries make. Like all borrowing booms, this one will eventually subside. When it does — and foreign investors stop buying so many dollars to lend back to us — the dollar will drop.

With this chain of events in mind, a former colleague of Mr. Rubin's at [Goldman Sachs](#) had been whispering in his ear that anybody who didn't have 20 or 30 percent of his holdings tied to other currencies was "out of his mind."

Yet as Mr. Rubin told me last week, his finances at the time were "totally dollar-based." (As are yours, in all likelihood.)

So he decided to bet against the dollar by buying options on other currencies. It turned out to be a very bad bet.

This is a column about why Mr. Rubin's logic made perfect sense — why it still does, in fact — yet why most people who have made similar bets in recent years have taken a bath. [Warren E. Buffett](#) cost [Berkshire Hathaway](#) almost \$1 billion last year shorting the dollar. On the opposite end of the investing spectrum, I put a small amount of my retirement savings last year into a T. Rowe Price mutual fund that is linked more directly to foreign currencies than most foreign-stock funds are. It has delivered a return of negative 7 percent.

The fate of the dollar, to be blunt, often seems like one of the most boring economic subjects around. It doesn't offer obvious "Freakonomics"-type lessons about the foibles of everyday life. Instead, it has inspired a stack of policy papers filled with terms like current-account deficit and trade-weighted exchange rate.

But it really is worth trying to understand what's going on. In the end, the value of the dollar will go a long way toward determining how well Americans live: which food we can afford to eat, which cars we can buy, which foreign policy we can pursue. As Mr. Rubin says: "It is vitally important. It has the potential to affect all of us."

The simplest way to explain the problem is to say that the United States has been living beyond its means.

Both the federal government and American families have been spending more money than they take in, leaving both in debt. To close the gap between our resources and our spending habits, we have borrowed from abroad. It's the only option.

The net amount of money leaving the United States — that is, the amount of money we need to borrow back to support our lifestyle — has soared to \$800 billion a year. “It’s just stunning,” said Kenneth S. Rogoff, former chief economist of the [International Monetary Fund](#). “It’s unprecedented.”

The big question now is how will the situation reverse itself. It could happen gradually, with other countries slowly reducing their purchase of dollars. This wouldn't be horrible, as Americans discovered when the dollar dropped in the 1980s. But most of us would be worse off for the simple reason that foreign loans would no longer be letting us live beyond our means.

The other possibility is that an unexpected event — a spike in oil prices, say — could cause foreign investors to cut their dollar purchases sharply, bringing all sorts of economic havoc. Edwin M. Truman, an economist who spent a quarter-century at the Federal Reserve, compares the situation to a merry-go-round that is moving too fast for its underlying mechanics. It gradually loses speed, leaving its riders disappointed but unscathed, or it stops suddenly and throws some of them off their horses.

[Paul A. Volcker](#), the Fed chairman who whipped inflation in the '80s, has become sufficiently worried to call the circumstances as “dangerous and intractable” as any he can remember. Yet, he laments, no one in Washington is taking steps to minimize the risks.

Whatever the outcome, a decline in the dollar will probably be part of it. That's why Mr. Rubin made his bet. But the dollar didn't cooperate. While no longer at the highs it reached in 2002, it has stayed strong. Mr. Rubin ended up losing more than \$1 million (which, certainly, he can afford) before getting out of the currency market.

Throughout his career — as an arbitrage trader at Goldman, as the Treasury secretary who led the 1995 bailout of Mexico — he has argued that decisions should not be judged solely on the outcome. Somebody could do a perfectly good job of weighing the relevant risks, make a call that maximizes the chances of success and still not succeed, because the world is a messy, unpredictable place.

This point has usually been somewhat academic, however, because his results have generally been good. At Goldman, he rose to become co-chairman thanks partly to his trading record. In the Clinton administration, he won more than his share of policy arguments and helped guide the economy to its best performance of the last 30 years.

But when he talks about the dollar, you can see how hard it is, even for somebody with his self-assurance, to remain confident in the face of a failed prediction. “I think I was right, probabilistically,” he said recently, sitting in his Citigroup office overlooking Park Avenue. “But I don't know. I really don't. I don't think anyone does. It's also possible that none of this could happen. It's possible that for reasons none of us can see that this will work itself out in a very copacetic way.”

Mr. Rubin and the other dollar bears look a little like the skeptics of the real estate boom back in 2005. For years, those skeptics warned that things had gotten out of hand and that reality would soon reassert itself. And for years, they were wrong. The longer they were wrong, the more out of touch they sound.

How is that housing boom going, anyway?

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