Paulson committed to dollar as reserve currency

Mon Jun 2, 2008 6:46am EDT

By David Lawder

ABU DHABI (Reuters) - U.S. Treasury Secretary Henry Paulson on Monday defended the dollar's status as the world's reserve currency and said its recent decline was only a small factor behind a surge in oil prices.

"The U.S. dollar has been the world's reserve currency since World War Two and there is a good reason for that. The United States has the largest, most open economy in the world, and our capital markets are the deepest and most liquid," Paulson told a business group in the United Arab Emirates.

Paulson's comments mark a slight strengthening of his recent language on the dollar and could resonate with Gulf oil producing states that are struggling with soaring inflation and may be re-evaluating their dollar currency pegs.

The U.S. Treasury Secretary is on the final day of a four-day tour to Saudi Arabia, Qatar and the United Arab Emirates to discuss currency and economic issues with regional leaders and reassure them that the United States remains receptive to their investments.

In his remarks, he pledged to deal with problems in the U.S. economy that have hurt the dollar's value in recent months.

"I am committed to promoting policies that enhance the underlying competitiveness of the U.S. economy and ensure that the dollar remains the world's reserve currency," he told the U.S.-UAE Business Council.

He said these include advocating open investment and trade and working to stave off a U.S. recession and return capital markets to health. He said the dollar's value would ultimately be reflected in strong long term fundamentals, which "compare favorably to any advanced economy in the world," he said.

On Sunday, Paulson said officials in Saudi Arabia and Qatar had told him that they believe dropping their dollar pegs would not solve high inflation, which also is due to high food and cement prices.

Paulson's goodwill tour, however, may have little influence over currency policy among the five Gulf oil producers that peg their currencies to the dollar. Kuwait dropped its dollar peg last year.

"Those guys will take their own decisions," said a foreign exchange trader in Dubai who declined to be named. "They rule their own world and go by their own rules... and to be honest with you, I don't think this is going to influence or speed up any decisions they make."

SMALL FACTOR

Paulson said speculation and dollar weakness were not to blame for soaring oil prices and the only way to relieve oil market pressure was to better balance supply and demand.

He called for more international investment in both oil production and alternative fuels, while "market distorting" fuel-price subsidies in many countries should be abandoned.

"High oil prices are the result of supply and demand factors that are likely to persist for some time," he said.

"Supplies have been affected by low capacity expansion and declining yields, while demand has surged largely due to growth in emerging markets," he said. "Speculation and the depreciation of the dollar are likely only small factors behind oil price increases."

Paulson's comments on the causes of record prices that touched $135 per barrel last week are at odds with many economists and officials in oil-producing countries who say dollar weakness and speculative activity has sparked increased flows of capital into oil from other asset classes.

The Organization of Petroleum Exporting Countries says world oil markets are well supplied and investments are sufficient to meet demand.

OIL PRICE PAIN

Paulson also said opening up the Gulf economies to foreign investment and trade will make them more prosperous and stable.

"Remaining closed to investment will have the opposite effect, by inhibiting growth and magnifying domestic economic vulnerabilities," Paulson said.

He commended Abu Dhabi for new investments in upstream production and domestic refining capacity through partnerships with foreign companies.

"More liberalization along these lines would benefit all oil producing countries," he said.

He sought to reassure investors in Abu Dhabi that America welcomes their investments and is not prejudiced against investments from the Middle East, despite the controversy over a proposed Dubai purchase of U.S. port operations two years ago.

"As we seek to open new markets abroad, America will keep our markets open at home to investment from private firms and from sovereign wealth funds. We reject measures that would isolate us from the world economy."