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Emerging economies shouldn't rely on dollar: economist

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JACKSON HOLE, Wyoming (Reuters) - Emerging economies should find other ways to buffer themselves from global crises than stockpiling U.S. government debt, a prominent economist argued on Saturday.

U.S. Treasuries and the debt of other advanced nations may be liquid, but it is far from safe, Cornell University professor Eswar Prasad said in a paper presented to a group of central bankers gathered here.

Emerging countries seeking protection from global shocks by individually stocking up on U.S. debt would be better off banding together to create a pool of funds that could be drawn on in a crisis, he argued. Doing so would give them a backstop should they need it, without saddling their national investment portfolios with debt that could turn sour.

Sharply rising levels of public borrowing and weak growth prospects in the United States mean that over time the dollar will continue to decline against the currencies of faster-growing emerging markets, eroding the value of emerging nations' foreign investments, he said.

And the risks are not only for the long-term.

The United States' near brush with default earlier this month, as lawmakers refused to raise the country's borrowing ceiling until a deficit-cutting deal was reached, brought the potential pitfalls of holding U.S. debt into sharp relief.

"As demonstrated by recent events in the euro zone, bond investors -- both domestic and foreign -- can quickly turn against a vulnerable country with high debt levels, leaving the country little breathing room on fiscal tightening and precipitating a crisis," Prasad wrote. "The U.S. is large, special and central to global finance, but the tolerance of bond investors may have its limits."

The dollar has long been the world's main reserve currency, and since the financial crisis emerging economies have built their reserves by buying Treasuries and the debt of a few other advanced economies, according to Prasad.

Any change could hurt the ability of the United States to borrow at low rates despite soaring debt levels.

That would turn the tables in a world where traditionally it was developed nations that pressured developing ones to bring their finances under control, he said.

"It is high time for advanced economies to take the tonic of macroeconomic and structural reforms that they have for so long dispensed to the emerging markets," he said.

(Reporting by Ann Saphir; Editing by Padraic Cassidy)

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