Written by Charles Scaliger on March 13, 2009

Will China Dump U.S. Debt?

The Chinese government, to which the United States is in debt approximately $1 trillion, is preparing to use its leverage to exact concessions from the U.S. government. “We are concerned about the safety of our assets,” Chinese Premier Wen Jiabao said at a news conference March 13. “I would like to call on the United States to honor its words, stay a credible nation and ensure the safety of Chinese assets.”

The Chinese Premier has ample cause for concern, given that one-half of China’s foreign currency reserves are held in U.S. government debt. Should the U.S. government default on its obligations, the result would be catastrophic for both countries.

But the United States should be more worried still. China — still a military rival — is now the United States’ largest creditor, and the only major country with enough money to purchase the huge amounts of additional debt the Obama administration is manufacturing to pay for trillions of dollars of bailouts and economic stimulus. This has come about in part because of the reversion of Hong Kong, which held large amounts of U.S. government debt, to Chinese control in the mid-1990s. But it is also a result of huge foreign investment in China and the comparative thrift of the Chinese government and citizenry. As a result, China has large budget surpluses where the U.S. teeters on the brink of national bankruptcy thanks to looming trillion-dollar annual deficits.

As the recent naval confrontation in the South China Sea served to underscore, the United States and China are neither friends nor allies, but rival superpowers. While the United States still has a substantial military advantage over China, the Chinese, with their suddenly prominent space program, their development of ICBMs, advanced submarines, anti-ship missiles, and now, apparently, aircraft carriers, may not be laggards for much longer.

As for the rival economies, China, being debt-free and holding the strings to huge American obligations, has a decisive advantage. So dependent have we become on Chinese largesse that Secretary of State Hillary Clinton, in a recent visit to Beijing, essentially begged the Chinese to continue purchasing Treasury bonds. But according to Frank Gong, China economist for JP Morgan, “Inside China there has been a lot of debate about whether they should continue to buy Treasuries.” Some investment experts like Peter Schiff are already warning that, sooner or later, the Chinese will no longer be willing to buy American dollars, leading to a crisis that will overshadow everything we have so far experienced as the U.S. dollar’s value plummets.

What we are witnessing is nothing less than the raising up of China to be the world’s newest superpower, with the financial and economic clout to match its growing military prowess. Should the People’s Republic of China decide to ratchet down its purchasing of U.S. debt, the United States may end up prostrate before the Chinese dragon without a shot being fired.