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Viewpoint

Chinese Can't Dump Our Debt Too Soon

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The Chinese can save both themselves and U.S. taxpayers by selling a large portion of their U.S. Treasury holdings this year. In fact, this economic missile may be the only way to save taxpayers in 2010.

Foreigners hold about $3.6 trillion in U.S. Treasuries, and foreign central banks hold two-thirds of that. The good news is that the Chinese and Japanese, combined, hold at least $1.5 trillion, or 12% of Treasury debt outstanding.

The Chinese and Japanese are our friends for two reasons: (1) Their net purchases help keep bond yields low, and (2) Chinese warnings about not buying more Treasuries or in fact selling Treasuries can send shock waves through capital markets.

Congress and the Obama administration don't seem overly concerned with huge federal deficits. But the administration does understand the crisis that would be created in capital markets were the Chinese to become net Treasury sellers, even for a short period of time.

The Chinese can act as a constraint on the reckless federal spending of Congress and the administration. In fact, the Chinese may be the only realistic constraint in 2010. The administration seems to have ignored the voting results from Virginia, New Jersey and Massachusetts.

Some analysts say the Chinese won't be net sellers of Treasuries. What is to prevent the Chinese from shorting the U.S. equity market before they announce they are going to be net sellers of Treasuries?

The Chinese can lecture the administration about excessive federal outlays, but nothing would be more effective than dumping Treasuries, even for a short time. Such action would panic investors, and as a result the administration may well agree to constrain spending to placate the Chinese.

No one wants havoc in the capital markets, but the Chinese can do U.S. taxpayers a major favor by dumping Treasuries just as soon as the Chinese can buy their put options on U.S. equities.

U.S. equities will quickly recover their lost ground and much more if the administration would agree to constrain federal outlays. Excessive federal spending and regulatory involvement in the economy are holding back equity gains.

The sooner the Chinese dump Treasuries, the better. It is a message that all members of Congress, as well as the Obama administration, need to hear. The Chinese needed to take such action during the Bush years, but that is water under the bridge.

The Chinese can see how the Japanese ruined their economy by growing public debt outstanding to over 225% of GDP in 2010 from 68% in 1991, according to IMF data. The U.S. outstanding gross central government debt to GDP ratio was also 68% in 1991. In 2008 it was 70%. At the end of this year it will be about 94%.

The current Congress and administration seem intent on repeating the mistakes of Japan that in the end will also ruin the U.S. economy.

The Chinese need the U.S. economy to thrive and buy the large volume of Chinese exports, thereby sustaining growth in the Chinese economy. A strong U.S. economy is in the interest of the Chinese, who would face major social and political issues should the U.S. economy falter and Chinese unemployment rates increase significantly.

No one wants the U.S. to be the next Greece, and the sooner the Congress and administration are forced to start making cuts in government spending the better. State and local governments need to take the same action.

Large deficits and increases in outstanding public debt in mature economies like the U.S. and Japan only act to slow economic growth as the resulting tax burdens cripple incentives for innovation and expansion.

The Chinese may be our salvation in 2010.

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