Chinese are Seriously Worried about their U.S. Holdings—a Sign of What's to Come

[This is a letter I sent to friends on March 13, 2009, together with an article about Chinese worries from the *New York Times*. –S.H.]

Hi everybody,

When a truly major social development occurs, like the current financial/economic crisis, there soon develops an enormous mass of news, commentary, and so forth, about it, which continues day after day, month after month. Much of this mass of material is of little value, even if it includes some secondary or minor facts about the situation. In order to really understand the developing situation from the huge mass of verbiage it is necessary, first of all, to have an organizing theory—which for us Marxists is basically Marx's theory of overproduction crises, though of course even within the Marxist milieu there are actually a large number of diverse interpretations of that theory. Hopefully, this crisis will eventually allow us to properly sum up Marxist crisis theory and clear up much of that confusion and conflict. We will soon be learning which of the various Marxist theories is actually most correct! Some notions have already been disproved, such as that of the RCP that the slowly developing economic crisis which began in the 1970s somehow got "resolved" (or "partly resolved") around 1990.

But in addition to having an overall scientific organizing theory which allows us to comprehend the situation we also need to focus on particular news reports and analysis based on whether they merely rehash or reinforce what we already know, and about what has transpired so far, versus about what will eventually unfold. To understand a process you have to also look to the future development of that process. And the validity of your theory is shown by the predictions you are able to make.

At the present time there appears to be different things happening on the short-term scale, the medium-term scale, and the long-term scale. Very short term, we have another in what is likely to still be a series of "dead cat bounces" in the stock market, which has risen a bit over the past few days, and some minor and temporary "good news" about Citibank and General Motors. Medium term we have the unfolding of the basically Keynesian "stimulus program", which by tremendously raising Federal debt will serve to at least somewhat moderate the economic collapse for a while later this year and perhaps slightly into the next year. [The effect actually lasted through the first half of 2010. –S.H. (6/29/10)]

But what about the longer term prospects for the development of this crisis? There are hints even now as to how that will also likely play out. The growing sentiment in bourgeois circles (especially among Republicans, but also among many Democrats) that Keynesianism may not be the answer (and that therefore additional bouts of "stimulus" will be tougher to get through Congress), is one example. This reinforces my prediction that we will be headed towards an inadequate series of Keynesian deficits (some big, some not quite so big) that over time will give our descent into the New Depression a look somewhat like that of Japan over the past couple decades (but more serious and intense).

An even better example of a glimpse into the future is provided by the article below from today's *New York Times* about how the Chinese rulers are nervous as hell about the safety of their trillion dollar investment in U.S. treasury bonds.

China has been buying these "Treasuries" in a big way for a couple decades now, and this is a major reason why the U.S. economy has been able to stumble along as well as it has been. The U.S. consumes more than it produces, and it can only continue doing so if those who produce more than they consume send back much of their profits here to keep building up the U.S. debt. But now we have a major crisis (still in its early stages) which requires a qualitatively greater expansion of debt in the U.S. (which means primarily Federal debt at this point) in order to keep the economy from sinking into outright depression. And now we see that those who have been propping up the U.S. debt growth are already starting to panic.

The article points out that the Chinese are probably unable to suddenly pull out all of their investments in U.S. Treasury bonds, because it would lead to a major collapse of the nominal value of all those bonds. So probably what they (and the Japanese and other major holders of U.S. debt) will do is simply stop buying nearly as much *new* U.S. debt. For one thing, they have their own economies to prop up with major deficit financing, and that means they need much more of the money at home. But this is happening, as I say, just at the time when the U.S. needs to qualitatively *increase* its debt with its own Keynesian deficit expansion.

What this means is that the dollar will have to fall relative to other currencies, and (putting it in different terms) there will start to be much more U.S. inflation. This will lead to further panic by the Chinese and Japanese about their trillions of dollars invested in the U.S. and they eventually *might* decide to pull large chunks of that investment out of the U.S. even if it *does* mean the further collapse in the value of their remaining investments here. (That would be the true financial doomsday!) But even if they do not pull out one single dollar of their existing investments, the mere great slowdown in their purchase of new U.S. Federal debt will have the same effect, only more slowly.

It is true that the development of this world economic crisis over the past few months has actually served to strengthen the dollar relative to other currencies, as investors from around the world seek to escape their own sinking economies. This "flight to safety" in the form of U.S. Treasury bonds and the like will, however, only last as long as other economies sink *faster* than the U.S., and until the really massive new U.S. deficits start to lead to inflation in this country. Here again, the short-term events of the past few months are *not* a valid predictor of the long term.

The crisis is still developing, and the worst is yet to come. By far!

Scott

The New York Times

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China's Leader Says He Is 'Worried' Over U.S. Treasuries

By Michael Wines

BEIJING — The Chinese premier Wen Jiabao expressed concern on Friday about the safety of China's $1 trillion investment in American government debt, the world's largest such holding, and urged the Obama administration to provide assurances that its investment would keep its value in the face of a global financial crisis.

Speaking at a news conference at the end of the Chinese parliament's annual session, Mr. Wen said he was "worried" about China's holdings of Treasury bonds and other debt, and that China was watching United States economic developments closely.

"President Obama and his new government have adopted a series of measures to deal with the financial crisis. We have expectations as to the effects of these measures," Mr. Wen said. "We have lent a huge amount of money to the U.S. Of course we are concerned about the safety of our assets. To be honest, I am definitely a little worried."

He called on the United States to "maintain its good credit, to honor its promises and to guarantee the safety of China's assets."

Mr. Wen raised the concerns at a session in which he touted China's comparatively healthy economy and said that his government would take whatever steps were needed to end the country's economic slump. He also predicted that the world economy would improve in 2010.

The confident performance underscored the growing financial and geopolitical importance of China, one of the few countries to retain massive spending power despite slowing growth.

China has the world's largest reserves of foreign exchange, estimated at $2 trillion, the product of years of double-digit growth.

Economists say half of that money has been invested in United States Treasury notes and other government-backed debt. Some has also been deployed in major investment projects intended to prop up flagging growth at home.

The Chinese government faces a difficult dilemma. If the United States government borrows less and engages in less fiscal stimulus, this could help prevent interest rates from rising in the United States and would preserve the value of China's existing bond holdings.

But less government spending in the United States could also mean a slower recovery for the American economy and reduced American demand for Chinese goods. The United States imported 17.4 percent less from China in the first two months of this year compared to the same period last year, contributing to a record drop in Chinese exports that is braking the entire Chinese economy.

The bulk of China's investment in the United States consists of bonds issued by the Treasury and government-sponsored enterprises and purchased by the State Administration of Foreign Exchange, which is part of the People's Bank of China.

But some of China's most controversial investments on the other side of the Pacific Ocean, judging by comments in Internet chat rooms, have been the purchases of shares in American financial institutions in 2007 by the China Investment Corporation, the country's sovereign wealth fund, which was bankrolled nearly two years ago with $200 billion from its foreign reserves.

The China Investment Corporation's most-publicized deal came in June 2007, when it spent $3 billion on shares of the Blackstone Group, a big private-equity fund, paying $29.605 a share. The stock closed on Thursday at $6.10, for a loss of 80 percent, or $2.4 billion of the initial investment.

During her visit to China last month, Secretary of State Hillary Rodham Clinton publicly assured Beijing that its American holdings remained a reliable investment. On Friday, Mr. Wen neither detailed his concerns about their safety nor said what sorts of new assurances he expected the United States to deliver.

But economists have cited several possible threats, led by the prospect that the dollar's value will depreciate over time, lowering the value of China's holdings.

"In the short run, the dollar is appreciating" because global investors see the American currency as a safe haven at a time of crisis, Bai Chong-En, who heads the economics department at Tsinghua University in Beijing, said in a telephone interview. "But we don't know what's going to happen in the long run. If the American stimulus package is financed mainly by borrowing, then that may affect the future value of Treasury securities."

Some specialists also say that high inflation could erode the dollar's value. Finally, some believe that China's investment in American debt is now so vast that, should it need foreign exchange in some emergency, it would be unable to sell its Treasury securities without flooding the market and driving down their price.

"The only possibility, really, is that China will have to hold these bonds until maturity," said Shen Minggao, the chief economist at Caijing, a Beijing-based business magazine. "If you start to sell those bonds, the market may collapse."

At Friday's news conference, Mr. Wen said he believed that China's economic problems were less severe than in many Western nations because, he said, China's banks remain relatively healthy. While the United States and Europe are battling both a recession and financial-system collapse, he said, "we haven't had to use money to fill a financial hole."

But he also conceded that it would be difficult to meet the government's 2009 goal of an 8 percent growth in G.D.P., a rate that government experts have repeatedly said was needed to create sufficient new jobs and reduce the chance of social unrest.

China has lost millions of jobs in recent months, including at least 20 million factory and construction jobs once held by migrant laborers.

He also defended the government own four trillion yuan, or $585 billion, stimulus program, saying it had been "misunderstood" by some who questioned whether the package was completely new or partly composed of older projects for which money had already been allotted.

He said that the national government's 1.18 trillion yuan, or $173 billion, contribution to the plan was a new investment in "public welfare, technological innovation, environmental protection and infrastructure projects. The remainder of the package is to be financed by local governments, banks and private investors.

That two-year investment should be sufficient to help China's recovery, he said, but "we have prepared enough ammunition and we can launch new economic stimulus policies at any time."

Mr. Wen's two-hour news conference — by tradition, his only meeting with the media each year — was dominated by questions about the economy. But he also sidestepped a question about North Korea's apparent plans to launch a new missile capable of delivering a warhead to parts of the United States, saying only that "the most important thing is to resolve the key issues affecting the six-party talks" over rolling back North Korea's nuclear-weapons program.

Mr. Wen also rejected suggestions that the massive Chinese military presence in Tibet and ethnic Tibetan parts of China — parts of which are under a virtual lockdown this month, the 50th anniversary of a failed uprising against the Beijing government — indicated that China's policies toward Tibet were flawed.

“The general situation in Tibet is stable and peaceful,” he said. “the peacefulness of Tibet and its ongoing progress have proven that the policies we have adopted are correct.”