“We’re concerned about the security of our assets”

China premier warns of potential dollar collapse

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In a public statement raising questions about the solvency of the US government, Chinese Premier Wen Jiabao said Friday that China, the largest holder of US treasury debt, was "concerned about the security of our assets."

Wen's remarks came at a news conference following the annual session of China's parliament, where he commented on the economic policies of the new US administration. "President Obama and his new government have adopted a series of measures to deal with the financial crisis," Wen said. "We have expectations as to the effects of these measures. We have lent a huge amount of money to the US. 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."

Chinese officials fear that the huge borrowing in world credit markets required to finance the US government's budget deficits—a projected $5 trillion over the next four years according to an estimate released by the Obama administration last month—will lead to a decline in the value of the dollar.

Since Beijing now holds about $1 trillion in dollar-denominated assets, including nearly $700 billion in US Treasury debt, a decline in the value of the US currency would hit China hard.

Wen added that while concerned about the safety of its dollar holdings, Beijing would "at the same time also take international financial stability into consideration, because the two are inter-related." This underscores the conservative role of the Chinese regime, which places the defense of world capitalism at the center of its policy.

US officials reacted with repeated reassurances about the value of the dollar and the safety of the dollar-denominated assets held by Chinese and other overseas investors.

White House economic adviser Lawrence Summers defended the record of US Treasury borrowing, saying Friday that dollar holders would suffer much more if full-scale deflation sets in and US gross domestic product collapses.

A Treasury spokeswoman declared, "The US Treasury market remains the deepest and most liquid market in the world." White House Press Secretary Robert Gibbs added, "There's no safer investment in the world than in the United States."

President Obama followed up Saturday, during a joint media appearance with visiting Brazilian President Luiz Inacio Lula da Silva at the White House, declaring that, "Not just the Chinese government, but every investor can have absolute confidence in the soundness of investments in the United States."

Obama depicted the influx of dollars into the United States as an endorsement of the future prospects of American capitalism. "There is a reason why even in the midst of this economic crisis you have seen actual increases in investment flows here in the US," he said. "I think it is a recognition that the stability not only of our economic system but also our political system is extraordinary."

The driving force of this influx of capital is fear rather than confidence, however. Investors are pulling out of weaker regions like eastern Europe and southeast Asia, as well as Africa and Latin America. They are also shifting from the purchase of stocks and bonds issued by American banks and corporations, now regarded with great distrust, in favor of government-issued debt instruments.

The US fiscal deficit has mushroomed. During the first five months of fiscal 2009 (October 2008 through February 2009), the federal budget deficit tripled compared to the same period the previous fiscal year, growing from $265 billion to $764.5 billion, the largest ever. The five-month deficit is already nearly 70 percent larger than the full-year deficit of $459 billion for fiscal 2008.

Writing in the *Financial Times* on March 12, Paul Kennedy, Yale University professor and author of *The Rise and Fall of the Great Powers*, argued that the Obama stimulus program would have a destabilizing effect on world financial markets: "no one is asking who will purchase the $1,750bn of US Treasuries to be offered to the market this year - will it be the east Asian quartet, China, Japan, Taiwan and South Korea (all with their own catastrophic collapses in production), the uneasy Arab states (yes, but to perhaps one-tenth of what is needed), or the near-bankrupt European and South American states? Good luck! If that colossal amount of paper is bought this year, who will have ready funds to purchase the Treasury flotations of 2010, then 2011, as the US plunges into levels of indebtedness that could make Philip II of Spain's record seem austere by comparison?"

According to an estimate by Merrill Lynch, US Treasury notes have produced Chinese investors a 2.7 percent loss this year in terms of the Chinese currency, the yuan. Beijing is in a bind, however, since any effort to unload a significant part of its massive dollar holdings could flood the market and trigger a financial panic, with devastating effects on the value of all dollar-denominated securities, including its own investments.

Objective processes are undermining the longstanding symbiotic relationship between Beijing and Washington, however. The US slump has produced a massive drop in purchases of Chinese goods. Chinese exports plunged 25.7 percent in February, slashing the country's trade surplus from $39.1 billion to $4.8 billion. Continuation of this trend means China will earn correspondingly fewer dollars to invest in US government bonds.

The mounting conflicts between the two major powers find expression not only on the financial plane, but in diplomatic and security issues. Wen's statement of concern over the dollar was issued only days after the highly publicized clash between US and Chinese naval vessels off the coast of Hainan Island. Chinese vessels sought to force the USNS Impeccable out of an area, about 75 miles offshore, where it was conducting surveillance of traffic in and out of China's biggest submarine base.

President Obama dispatched a guided-missile destroyer to the South China Sea on Thursday, armed with torpedoes and missiles, to escort the Impeccable as it continues its surveillance mission. Obama later met with Chinese Foreign Minister Yang Jiechi at the White House.

The next day came Wen's declaration about the dollar, and then a day later a Chinese consortium signed a $3.2 billion natural gas deal with Iran. Beijing effectively thumbed its nose at the US policy—escalated by Bush and continued by Obama—of seeking to undermine the Iranian regime economically. The three-year deal involves extensive Chinese engineering assistance to the development of the South Pars gas field under the Persian Gulf seabed, in return for gas deliveries to Chinese customers.