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China less of a U.S. creditor as it becomes more of an election issue

View Photo Gallery — Who owns U.S. debt: Here are the top 10 countries that hold the largest share of the nation’s debt, according to August figures from the Treasury Department.

By Zachary A. Goldfarb, Published: October 16

The U.S. government has become less reliant on the Chinese to fund its gaping budget hole over the past two years, even as the political rhetoric over borrowing from China has heated up.

An enduring meme of the 2012 political campaign — and the battle over the ballooning federal debt in Washington — is that the government increasingly needs China to lend it money to meet its obligations.

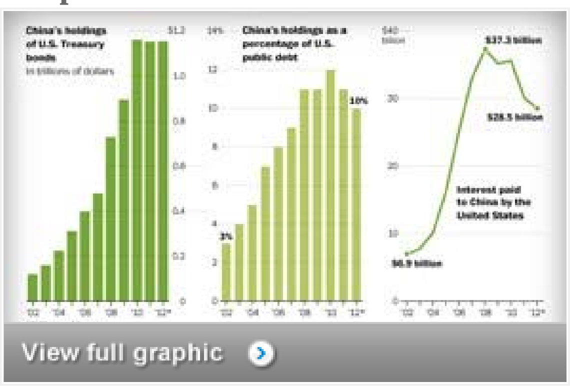
But new data released Tuesday showed that taxpayers owe China 10 percent less than they did a year ago, even though the federal government has continued to borrow huge amounts of money overall. China also owns a smaller percentage of the U.S. debt than in the past, with the slack picked up by other countries such as Japan, as well as American investors.

China remains a major lender. It owns $1.15 trillion of U.S. government debt, more than any other country does, and dramatically increased its holdings over the second half of the past decade.

That growing dependence has alarmed many policymakers, including President Obama, who said early in his term that “we can’t keep on just borrowing from China.” The warnings lately have come mainly from Republicans — especially presidential nominee Mitt Romney, who in speeches and ads has made them a hallmark of his campaign.

“I’m not going to keep on spending money on things to borrow money from China to pay for it,” Romney said this month at the first presidential debate.

Graphic



China's holdings of U.S. debt since 2002.

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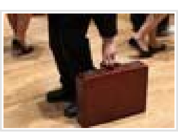

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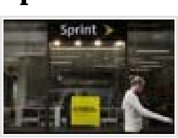

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Yet by a variety of financial measures, China is figuring less prominently than in the past. China holds 10 percent of the U.S. public debt today, compared to 12 percent two years ago.

What's more, the amount of interest the government pays to China each year has declined significantly as a result of declining interest rates.

U.S. taxpayers paid about $30 billion to China last year in interest, compared to the average of $37.5 billion in the previous five years, according to a calculation by The Washington Post based on data from the Treasury and Commerce Departments. The figure is likely to fall even more this year.

Eswar Prasad, an international economics professor at Cornell University, said it's natural that people would worry about U.S. obligations to China, but that the real problem is the debt, not who owns it.

"It's fear about China's rising dominance, and it's one way to focus additional attention on the U.S. debt levels," Prasad said. "The real issue here is the runaway U.S. borrowing, not really China."

China's smaller share of U.S. government securities is being offset as other countries increase their holdings. Japan has bought $215 billion in U.S. government debt in the past year, bringing its total holdings to $1.12 trillion. Japan was long the largest foreign owner of U.S. debt until China eclipsed it in 2008.

The reason for the shift is related to how China and Japan are managing their currencies. When foreign governments buy U.S. dollar-denominated securities such as Treasury bonds, it has the effect of making the currencies of these countries cheaper relative to the dollar. That tends to boost exports and economic growth of these countries.

For years, China expanded its holdings of U.S. government securities, and this reduced the value of its currency, the renminbi, helping Chinese manufacturers get a leg up. China has been under pressure for several years from officials in the U.S. and elsewhere to let the renminbi appreciate in value. Lately, China has been buying fewer U.S. assets and the value of its currency has gone up.

Japan, meanwhile, is worried that its currency, the yen, could become more expensive as global investors increasingly move their money into Japan, which is considered a safe haven at a time of financial turbulence in European and other markets. So Japan has been working to keep the value of the yen down.

American investors have also filled in the hole left by China’s reduced borrowing. Mutual funds and money market funds have increased their holdings of U.S. Treasury debt by $227 billion over the past year and a half.

China also has lent more than $200 billion to the U.S. government-backed mortgage-finance giants Fannie Mae and Freddie Mac. Recent trends suggest that China’s holdings have held steady or declined.