Written by **Bob Adelmann** on December 18, 2012

More of America’s National Debt Being Bought by Foreign Governments

On Monday, December 17, the US Treasury Department announced that China and Japan have increased their purchases of United States government securities despite concerns over the continuing negotiations over the “fiscal cliff.” Foreign holdings rose to $5.5 trillion in October, or about one-third of the country’s $16 trillion national debt. The increased interest in owning U.S. government debt by foreign governments is welcome as the government’s deficits continue growing at about $150 billion every month.

Although China is often referred to as the primary financier of America’s continuing profligacy, that country’s total holdings, some $1.16 trillion, represents just a little over 7 percent of the U.S. national debt. Japan comes in at second place, owning $1.13 trillion, with Brazil holding $255 billion. In contrast, two-thirds of the country’s national debt is owed by individual American investors and by the Social Security and civil service and military pension plans. The balance of $1.6 trillion is owned by the Federal Reserve.

How much longer can such profligacy with its resulting trillion-dollar annual deficits continue? Back in 1995, Harry Figgie wrote *Bankruptcy 1995* and predicted the end would occur within five years:

> The good news and the bad is that neither we nor any other nation can continue the sin of deficit spending indefinitely. The laws of economics eventually exact their punishment, and we are dangerously close to getting ours.
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> Just as interest compounds in a savings account, it compounds on our debt. The $4 trillion debt we owed in 1992 becomes $6.56 trillion in 1995 and $13 trillion by the year 2000 just from the accumulation of deficits and interest alone.
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> Only a fool would contend that this insanity doesn’t have to end.

The year 2000 was nearly 13 years ago, yet that “day of reckoning” hasn’t arrived. Part of the reason is those “laws of economics” that resulted when interest rates were forced down by the Federal Reserve following the bursting of the dot.com bubble and have remained historically low ever since. That brought the cost of borrowing to record lows. For instance, the percentage of taxes that were devoted to interest payments on the national debt in 1991 was nearly 20 percent, but by 2003, it had declined to just over 8 percent. When compared to the country’s gross domestic product, interest was eating up just 1.4 percent of it. As Bill Sardi noted, “America was saved by cheap money.”

But with interest rates at near zero, how much longer will investors, foreign and domestic, continue to put up with such low returns in the face of an ever-increasing risk of default? Following the debt ceiling crisis during the summer of 2011, the rating agency Standard and Poor’s downgraded its rating on U.S. government debt for the first time in history. And unless something positive comes out of the fiscal cliff negotiations, Fitch Ratings is likely to follow.

The Tax Policy Center, using rosy economic assumptions, projected that deficits would continue at least out to the year 2017, and would average $700 billion a year. As Sardi noted, "There is no substantiation for this scenario." And so something's got to give.

Indeed, if the average monthly deficits of $150 billion were simply extended in a straight line into the future, deficits over the next five years would add $9 trillion to the national debt, bringing the total to over $24 trillion by 2017.

There are several reasons why that "day of reckoning" may in fact be years away. For one thing, where else would China and Japan invest their surpluses? Name one country that boasts, at least on paper, a better credit rating than the United States. With Germany and Japan in recession, and the eurozone countries struggling to stay afloat, options for "safe" places to invest are limited.

Second, because at present the U.S. dollar is the world's reserve currency, there continues to be a demand for dollars no matter what they might be worth. Since Saudi Arabia must deal in dollars when selling the West their oil, there is a floor under that demand. And the recent drop in the price of oil shows, for the moment at least, that Saudi Arabia is happy with the arrangement.

And then there's the Federal Reserve offering itself as the lender of last resort, announcing last week that it will continue to buy at least half of the government's deficit for the foreseeable future.

The "day of reckoning" may occur in baby steps as the value of the American dollar continues its slow decay in purchasing power.

Despite the cries of worthies like Figgie and Sardi that the end is near, it may not be. The cross-currents of forces demanding further deficit spending and those demanding fiscal sanity will likely put off that "day of reckoning" for some time, perhaps years into the future. That may indeed by enough time for those demands for sanity to be heard by enough in Washington to begin the sensible rebuilding of the country's fiscal integrity, in which case the "day of reckoning" would happily never arrive.

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