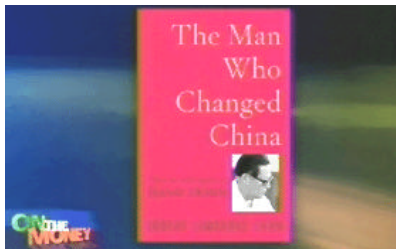


## CNBC “On The Money” – December 28, 2005



### Robert Lawrence Kuhn: Investment Banker, Advisor to China, Author, “The Man Who Changed China”

**DYLAN RATIGAN (host):** We turn to China. It is now one of the top six economies in the world, but it is poised to take over the number four slot, worldwide, after the 2005 numbers come in.



Robert Lawrence Kuhn, Senior Advisor at Citigroup Investment Banking, focuses on China for them. He is also the author of a book by the name of *The Man Who Changed China: the Life and Legacy of Jiang Zemin*. It is the best-selling book of the year in China. And, in a sentence, this Dr. Kuhn is very well-informed on China, and we welcome him to the program.

**ROBERT LAWRENCE KUHN:** Thanks.



**RATIGAN:** I have a market and mathematical conundrum. There has been lots of talk about the sensational Asian market performance. Japan’s fantastic. South Korea, record highs. India continues to go gangbusters. You ask people, “Why South Korea? Why Japan?” Well, they say, it’s because they’re so close to China. It’s the proximity to China. But you look at the Chinese stock market, and it’s not doing anything.

**KUHN:** China is a complexity. It is the most important country for the United States. The bilateral relationship between the U.S. and China is vital for the peace and prosperity of the 21<sup>st</sup> century. Trade is a problem and a major issue – we’ve got to get it right. On the one hand, we have a huge trade imbalance, and on the other hand, as you say, the Chinese stock market has been depressed in the last several years. That’s the conundrum of China, which is why it’s so important to get our relationship right.



China has a huge manufacturing base and they need manufacturing to drive jobs in order to keep their economy growing at a sufficiently high level – eight, nine percent a year – which is necessary because of all the problems China has with unemployment.



The Chinese under-consume and over-save, whereas Americans over-consume and under-save. This creates a huge flow of capital that goes from America to China [the trade imbalance]. When the Chinese get our money for their products, they send it back here as a loan [China buys U.S. Treasury securities with their surpluses]. We use their money, borrowed money, which enables us to have a high rate of consumption, even while we maintain a low rate of savings. But this cannot continue forever, and China has some endemic problems with their system.

**RATIGAN:** What are the problems?



**KUHN:** The transition from a planned economy. For decades, China had one of the worst economies in the world until the period of reform that began in 1978, and it is only since the early to mid 1990s that China’s economy really began to burgeon.

**RATIGAN:** They’re buying too much of “x” and they don’t have enough of “y”? Is that what you mean?

**KUHN:** In the past, China’s economy was managed by bureaucrat “planners” sitting in Beijing and deciding who should make what, say, how many shoes a factory should produce. And even when the factories manufactured what they had been instructed to



make, nobody wanted to buy those products! That's the problem of a planned economy. The transition from a planned economy to a market economy is exceedingly complex, especially in a country with 1.3 billion people. And all the complexities of the system make it difficult for anyone, especially investors, to understand what is really going on. Chinese enterprises are not used to being open and accountable. And if they're not open, they can't do proper accounting and cannot report actual numbers in which investors can have confidence. If they can't do proper accounting, the stock market depresses their prices. It's a natural reaction. This transition will take time.



**RATIGAN:** Another riddle for you. Recently both Governor Schwarzenegger and then President Bush made trips to China, and there was a lot of clamoring in the U.S., such as from people at Harley-Davidson, that our leaders should tell China to buy more American products, such as Harley-Davidson motorcycles for their police force. And they should buy American for their medical needs. It is unclear to me what leverage an American leader -- whether the president, governor or CEO -- has with Chinese officials to persuade them that they should buy American products.



**KUHN:** There are two issues here. First is the quality of the American product itself versus those of other countries. American products may or may not be the best in terms of quality and price. And second is a recognition by China that they must be responsive to America.

**RATIGAN:** Why? Why must they be responsive?



**KUHN:** Chinese leaders understand that China's relationship with America is critical for its current existence because of the demands of their still-fragile economy and for the stability of the world [because of America's geopolitical position and leadership]. So they want to get it right with America.

**RATIGAN:** So what does China get? In other words, the more accommodating and responsive China is to U.S. demands, what do they receive in exchange for that accommodation?



**KUHN:** Stability. China needs their factories to be able to sell products to America to keep their economy growing at the rate it must maintain, considering the social dangers of unemployment of rural citizens who become migrant workers, of those laid-off from archaic state-owned enterprises and of young people entering the workforce. China is addicted to growth. They must have growth. But at the same time, they have multiple interests, so they need to balance them.

America may be most important, but China also needs to deal with Europe and the developing world [the Chinese call for a "multi-polar" world]. They need energy from Africa and the Middle East. They have a complex foreign policy, and America is critical to it. China does not want American politicians or the American public to become so upset with the trade imbalance that we apply mutually destructive tariffs or react in a way that will hurt both our countries and citizens. So, therefore, they have to make some accommodations, such as on trade and buying American products.



**RATIGAN:** I could go on all night with this but they're not going to let me. It's a pleasure to have you with me. Thank you very much for coming out.

**KUHN:** Thanks, Dylan.