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Interview: Robert Lawrence Kuhn, Ph.D.

Kathleen Campion (Host):
This is the Bloomberg "Big Picture." Our guest is Robert Kuhn. He serves as advisor to the Chinese government and Senior Advisor to Citigroup Investment Banking. His book, *The Man Who Changed China*, was the best-selling book in China in 2005. We're talking about a number of China-related issues: the trade relationship with the U.S. and reports that the U.S. Treasury is considering labeling China a "currency manipulator."

Dr. Kuhn, you have long argued that the U.S. gets nowhere by trying to force China to do anything or punish China for having done something. This has been the position that [former Chairman] Greenspan has taken as well, that China will eventually see a market-driven currency is in their own interest. Is that how you see it?

Robert Lawrence Kuhn, Ph.D., China Expert:
That's absolutely right; however, constructive pressure, if properly nuanced, can be helpful. Currency exchange rates, intellectual property rights, the need to open markets, are all real issues, but more progress would be made working behind the scenes. Modulated, quiet pressure would help China to do what is truly in its own best interests. As I've said, let's look at the context. China was a planned economy that stagnated for decades. It made fledgling, volatile, politically contentious efforts to reform in the 1980s, some of which turned traumatic and led to Tiananmen Square. It was only in the early 1990s that China's economy really began to take off.

Remember that China had to devalue its currency in the early '90s, but then they resisted pressure during the Asian crisis [1997-1998] to devalue it further, which would have destabilized all Southeast Asia. China acted responsibly during that period. Now China is addicted to growth. They need growth to maintain employment, because there are tens of millions of migrant workers from rural areas, laid-off workers from old state-owned enterprises, and legions of young people entering the work force. There are only three fundamental ways that an economy can grow: consumption by its people; investments by business entities (largely foreign) or by the government (primarily infrastructure); and exports. China's growth has been driven by the latter two. They need more consumption; the Chinese people need to spend more and enjoy the fruits of their labors. The government is trying. China is trying to develop the economy by increasing consumption, which will relieve pressures on exports. There is great pressure to keep China growing because of social necessities: China needs economic growth of 8 or 9 percent per year because of the transformation of the economy, the need for jobs, the closing of moribund state-owned enterprises, and the migration into the cities of farmers who don't have work in rural areas.

China is desperately trying to maintain its social stability. For this they need growth. And they know from where it must come. The government is trying to raise consumption, to encourage spending, but until Chinese citizens purchase more goods and services, the country still is highly dependent on exports. So, American pressure is correct, but it needs to appreciate context and be nuanced.

Campion:
As you point out, one reason the Chinese like to hold on to so much foreign currency is so that they can help to protect their exports. Is another reason that they sit on so much foreign currency an attempt to prevent a repeat of what happened in 1997, when the lack of ample reserves allowed speculators to attack various currencies?

Kuhn:
Good point; well said. Stability has long been the overriding mission of Chinese leadership, and indeed stability is necessary [but not sufficient] for economic growth and social change. President Hu Jintao has an overarching philosophy of creating what he calls "a harmonious society." This can be achieved, Hu

envisions, by means of a “scientific development perspective,” an integration of social and cultural goals, which, along with economic goals, can deal with what is the most problematic and invidious aspect of Chinese society today—imbalance. There are dramatic differences between eastern coastal regions and western inland regions, between urban and rural incomes, imbalances that are getting worse, driven by this need for growth. Optimum growth comes most efficiently from areas that are the most developed, and while such growth increases the vibrancy of the economy overall, it exacerbates the imbalances in society, which leads to social unrest. So considering this complex socio-economic equation, American interests are best served by being sensitive to China’s domestic conundrums even while pushing for currency adjustments, protection of intellectual property, and further opening of markets.

American trade imbalances with China are unsustainable. China knows that. It’s impossible to go on this way forever. We need to work together to find ways to alleviate the problem. The primary salutary mechanism, in my opinion, is helping China to increase domestic consumption; this will be a natural way for China to maintain social stability and allow its export income to diminish. And increasing Chinese consumer consumption will also enable American exports to rise. This should be our focus.

Campion:
This week we heard Pascal Lamy, a leader at the WTO, lash out against what he sees as a rising protectionist sentiment in the U.S. Congress, specifically increasing Congressional opposition to free trade. We know that we have two senators—Senator Schumer (New York) and Lindsay Graham (South Carolina)—who are proposing tariffs on Chinese goods as both punishment for what they see as an unequal playing field and as a way to improve the balance of trade. How are such tariffs going to play in world markets? And with the Chinese?

Kuhn:
It would be like shooting yourself in the foot. If your foot trips, you don’t shoot it; you find out why your foot tripped and try not to do it again. Tariffs would be counterproductive in two ways. First, it is insulting to the Chinese, and therefore would create anti-American feelings, not necessarily among Chinese leaders, but primarily among common people and students. Such antagonisms would not be in our own interests, politically or economically.

Second, what would tariffs accomplish? Granted, they would help certain workers in certain American industries, but they would lower the standards of living for all Americans because so much of what we buy is made in China. [Other countries in Asia and the Americas would fill in for China, mitigating benefits for American workers while still raising prices for American consumers.] It’s a complicated set of simultaneous equations. Politicians speak to their own audiences. It may sound superficially good to orate that we’re going to “punish China” and make life more difficult for them. But what tariffs would really do is make life more difficult for everyone.

America needs China to be a responsible nation, a bulwark of stability in international affairs from East Asia to the Middle East. We have many problem areas around the world. We need China to be on our side in securing the new world order. That’s the way our future is best designed. And threats of tariffs are not the way to bring such harmony of interests about.

Campion:
Let me argue, as you do, that lifting millions of Chinese out of poverty, making them productive consumers, will ultimately benefit the U.S. and everyone else engaged in the world economy. Whether that’s a rosy scenario or not, can you put a time frame on it? Americans, as you know, are impatient.

Kuhn:
This is a long process. Let’s take the Chinese view. Their goal is to have what they call a well-off social level (in Chinese, the word means “modestly well-off”) by the year 2020—they’ve pointed to a country like Portugal as exemplifying this kind of mid-lower development. We’re dealing with an order of magnitude of 15 years, but achieving this transformational goal requires unabated continuation of current levels of growth. You need 8, 8.5 percent growth. Last year China hit 9.9 percent, which was red hot. [2006 is forecast at 9.2 – 9.3 percent.] But the bigger the economy, the more difficult it is to maintain high growth.

Campion:
It’s always enlightening to hear what you’re thinking about. Robert Lawrence Kuhn, advisor to China.