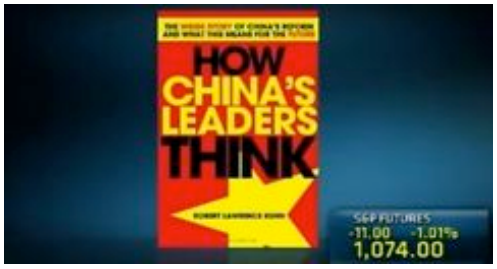
CNBC "Squawk Box" – August 12, 2010



Robert Lawrence Kuhn: China Under Pressure

Carl Quintanilla (Host): One question surrounding the markets is, "Is the world relying too much on China to sustain global economic growth?" Joining us this morning is Robert Kuhn. He's the author of "*How China's Leaders Think*" and chairman of the Kuhn Foundation. He joins us on set, along with Larry Meyer. Robert, good to have you.

Kuhn: Good morning.

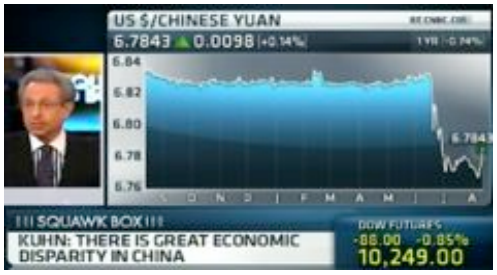
Quintanilla: This is not the first book you've written about China.

Kuhn: No, but it's a critical time and you put the question properly. "Is the world relying too much on China?" And I think the answer is, very simply, "Yes."

Quintanilla: Is that what *they* think?

Kuhn: Absolutely. China's leaders do think that. They have huge problems at home. Their responsibility is to build the economic value of the lives of their people, deal with imbalances. Pollution is a major problem; they just had to close 2,000 factories. Look at the growth that they've had. Last quarter was 10.3 percent. Sure it was down from 11.9 in the first quarter, but 10.3 on a five trillion dollar economy is terrific. That's terrific for the world. But to keep going at very high levels of growth risks inflation, and to the extent driven by exports, it risks other problems in China, which we complain about.

What I'm worried about today, though, with all the [U.S.] jobless claims, is a whiplash effect. Because in China we see exports increasing, imports decreasing, as their economy slows, right? In the U.S., what do we see? Exactly the opposite. We see our imports increasing. People are buying cheaper goods and our



exports are decreasing. So in China, because of a slowing economy ,there is pressure to *de*preciate the Yuan. They have to protect their own people and their own economy. And in the U.S. we have exactly the opposite pressure because our trade balances are getting larger. So now we will have more pressure to force them to appreciate the Yuan. So we have this whiplash effect in both countries, and worse yet, both countries in an election cycle. We're in a mid-term election, heading into a two-year presidential election, and in China they are heading for a leadership change in two years. And so, in those conditions, both countries naturally tack more towards a more conservative, patriotic, nationalistic stance. So we have to be careful.

Quintanilla: Where do they stand on the line between maintaining stability in their own country and making sure that we don't fall off the cliff? Because they need us too.

Kuhn: Certainly they need us too, but how can they affect us in such a dramatic way? Their role has to be—and China's leaders have said this continuously—totally focused on maintaining their own stability. They would do that normally, but when you get into this leadership change cycle, they have to do it even more so.

Quintanilla: Is it as tough doing business there as some corporate leaders have complained about in recent weeks?

Kuhn: You know, I hear this question a lot, and it's a matter where I think the perception creates the reality. Let's divide this into two parts. The leaders would say, "No, there is no difference. China is open for business. We're willing to do just like what we always have." The reality is not quite that, because China's economy has become substantially different from a decade ago. Ten years ago, China had about 150 billion dollars in reserves. Now they have close to two-and-a-half

trillion, right? Over time, they want Chinese corporations to be among the among the leading companies in the world, so there will be subtle pressures. Yet, China still need technology. They still need management. They are looking for those kinds of things. But China's approach to foreign invesetment is not the same as it was a decade ago.

Quintanilla: So is the Rio Tinto case illustrative of anything broader?

Kuhn: That's a hard question, but I think the answer is No. It's a reasonably isolated case, but it speaks not so much to the difficulty of doing business in China as to the sensitivity that they have towards so-called "state secrets," – which to us are not that secret – and to protecting the resource environment of China.

Becky Quick (Host): What about China's comfort level with holding a major portion of U.S. treasuries?

Kuhn: I think they are conflicted, because if they move away too much, or give the wrong signal, it will not only affect the value of their holdings in U.S. securities, but will also affect the U.S. economy, which has a direct effect on the Chinese economy because of the export market. So they are very sensitive about it. I think they do want to diversify, but they don't want to spook markets.

Quintanilla: Can we afford to have them continue to tap on the breaks, Larry?

Larry Meyer: Well, the perception of their role in the global economy, as Robert said, may be greater than it is. But they have been the anchor of global growth. It's not just China. It has a multiplier effect because as China goes, so Asia goes, and Asia is very important to the U.S. So I think it will be very damaging to market psychology if it turns out that China is slowing. Not from 11 percent to 10 percent, but from 10 percent to seven percent.

Kuhn: I agree with that. I think China has to keep eight at minimum, but nine desirably. That's what China is trying to do. That's what its leaders want to do. They want to maintain stability, and they're saying, "We can't run too quickly. We have to maintain our stability. We have to maintain growth. That's our best contribution for our own people and our best contribution to the world."

One leader told me a very funny thing. He said, "In the 1950's, some people in China tried to export revolution and foreigners got nervous. But we weren't that powerful, so you shouldn't have worried, and today we're not that powerful to help the world."

Quintanilla: Robert, interesting stuff, thanks for coming by. Robert Kuhn.