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From: Huma Abedin

Sent: 11/16/2009 11:28:05 PM +00:00

To: H <HDR22@clintonemail.com>

Subject: Re: H: New memo on China. Sid

Ok

----- Original Message -----
From: H
To: Huma Abedin
Sent: Mon Nov 16 18:27:17 2009
Subject: Fw: H: New memo on China. Sid

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----- Original Message -----
From: sbwhoeop B6
To: H
Sent: Mon Nov 16 09:33:36 2009
Subject: H: New memo on China. Sid

CONFIDENTIAL

November 16, 2009

For: Hillary
From: Sid
Re: What was outside the box is the new box on China

Consensus on China arrived today on the op-ed page of the NYT. Both the center-left in the form of Paul Krugman and the center-right in the form of Niall Ferguson converged on US-China policy, focused like a laser on the Chinese currency policy. Ferguson cut to the quick in a line: "Call it the 10:10 deal: the Chinese get 10 percent growth; America gets 10 percent unemployment. The deal is even worse for the rest of the world — and that includes some of America's biggest export markets and most loyal allies." I would suggest that this is not a zero-sum game. China is not inherently a stable nation but is riven by profound ethnic/language/regional divisions as well as yawning economic and social inequalities growing greater by the day with a vast majority of billions not sharing the benefits of its brand of turbo-charged, despotic authoritarian Communist/capitalism. It is not the wave of any future, China's own perhaps least of all. Medvedev, in his statement last week, made it plain that this sort of system is not Russia's aspiration. He leaves China isolated as an example, shredding its "soft power" appeal. Following China's current path will not lead to its unbroken ascendancy, but exacerbate its centrifugal trends. Only by reforming its currency policy, as a first step, can it begin to spread its own wealth internally because it will have to develop an internal market with consumer demand. The US should make the argument that currency reform is in China's interest. If China doesn't want to play, condign trade methods carefully targeted can be applied and human rights campaigns ramped up. The raw truth is that China has no real alternatives despite its arrogant sneering about the US debt. China is our captive. If it doesn't hold the debt its currency wobbles. China is still relatively weak with a small array of options. I've included, below the Krugman and Ferguson pieces, an article I commissioned this July from my friend and former New Yorker colleague Isabel Hilton, a China expert, fluent in Mandarin, who publishes a website, chinadialogue.net, on the subject of "Will China Implode?" Her view, contrary to Western promoters of conventional wisdom, is that this is a likely possibility, and I think it is advantageous to consider in designing policy.

New York Times
November 16, 2009
Op-Ed Columnist
World Out of Balance
By PAUL KRUGMAN
<http://topics.nytimes.com/top/opinion/editorialsandoped/oped/columnists/paulkrugman/index.html?inline=nyt-per>
International travel by world leaders is mainly about making symbolic gestures. Nobody expects President Obama to come back from China with major new agreements, on economic policy or anything else.

But let's hope that when the cameras aren't rolling Mr. Obama and his hosts engage in some frank talk about currency policy. For the problem of international trade imbalances is about to get substantially worse. And there's a potentially ugly confrontation looming unless China mends its ways.

Some background: Most of the world's major currencies "float" against one another. That is, their relative values move up or down depending on market forces. That doesn't necessarily mean that governments pursue pure hands-off policies: countries sometimes limit capital outflows when there's a run on their currency (as Iceland did last year) or take steps to discourage hot-money inflows when they fear that speculators love their economies not wisely but too well (which is what Brazil is doing right now). But these days most nations try to keep the value of their currency in line with long-term economic fundamentals.

China is the great exception. Despite huge trade surpluses and the desire of many investors to buy into this fast-growing economy — forces that should have strengthened the renminbi, China's currency — Chinese authorities have kept that currency persistently weak. They've done this mainly by trading renminbi for dollars, which they have accumulated in vast quantities.

And in recent months China has carried out what amounts to a beggar-thy-neighbor devaluation, keeping the yuan-dollar exchange rate fixed even as the dollar has fallen sharply against other major currencies. This has given Chinese exporters a growing competitive advantage over their rivals, especially producers in other developing countries.

What makes China's currency policy especially problematic is the depressed state of the world economy. Cheap money and fiscal stimulus seem to have averted a second Great Depression. But policy makers haven't been able to generate enough spending, public or private, to make progress against mass unemployment. And China's weak-currency policy exacerbates the problem, in effect siphoning much-needed demand away from the rest of the world into the pockets of artificially competitive Chinese exporters.

But why do I say that this problem is about to get much worse? Because for the past year the true scale of the China problem has been masked by temporary factors. Looking forward, we can expect to see both China's trade surplus and America's trade deficit surge.

That, at any rate, is the argument made in a new paper by Richard Baldwin and Daria Taglioni of the Graduate Institute, Geneva. As they note, trade imbalances, both China's surplus and America's deficit, have recently been much smaller than they were a few years ago. But, they argue, "these global imbalance improvements are mostly illusory — the transitory side effect of the greatest trade collapse the world has ever seen."

Indeed, the 2008-9 plunge in world trade was one for the record books. What it mainly reflected was the fact that modern trade is dominated by sales of durable manufactured goods — and in the face of severe financial crisis and its attendant uncertainty, both consumers and corporations postponed purchases of anything that wasn't needed immediately. How did this reduce the U.S. trade deficit? Imports of goods like automobiles collapsed; so did some U.S. exports; but because we came into the crisis importing much more than we exported, the net effect was a smaller trade gap.

But with the financial crisis abating, this process is going into reverse. Last week's U.S. trade report showed a sharp increase in the trade deficit between August and September. And there will be many more reports along those lines.

So picture this: month after month of headlines juxtaposing soaring U.S. trade deficits and Chinese trade surpluses with the suffering of unemployed American workers. If I were the Chinese government, I'd be really worried about that prospect.

Unfortunately, the Chinese don't seem to get it: rather than face up to the need to change their currency policy, they've taken to lecturing the United States, telling us to raise interest rates and curb fiscal deficits — that is, to make our unemployment problem even worse.

And I'm not sure the Obama administration gets it, either. The administration's statements on Chinese currency policy seem pro forma, lacking any sense of urgency.

That needs to change. I don't begrudge Mr. Obama the banquets and the photo ops; they're part of his job. But behind the scenes he better be warning the Chinese that they're playing a dangerous game.

New York Times
November 16, 2009
Op-Ed Contributors
The Great Wallop
By NIALL FERGUSON and MORITZ SCHULARICK

A FEW years ago we came up with the term "Chimerica" to describe the combination of the Chinese and American economies, which together had become the key driver of the global economy. With a combined 13 percent of the world's land surface and around a quarter of its population, Chimerica nevertheless accounted for a third of global economic output and two-fifths of worldwide growth from 1998 to 2007.

We called it Chimerica for a reason: we believed this relationship was a chimera — a monstrous hybrid like the part-lion, part-goat, part-snake of legend. Now we may be witnessing the death throes of the monster. The question President Obama must consider as he flies to Asia this week is whether to slay it or to try to keep it alive.

In its heyday, Chimerica consisted largely of the combination of Chinese development, led by exports, and American overconsumption. Thanks to the Chimerican symbiosis, China was able to quadruple its gross domestic product from 2000 to 2008, raise exports by a factor of five, import Western technology and create tens of millions of manufacturing jobs for the rural poor.

For America, Chimerica meant being able to consume more and save less even while maintaining low interest rates and a stable rate of investment. Overconsumption meant that from 2000 to 2008 the United States consistently outspent its national income. Goods imported from China accounted for about a third of that overconsumption.

For a time, Chimerica seemed not a monster but a marriage made in heaven. Global trade boomed and nearly all asset prices surged. Yet, like many another marriage between a saver and a spender, Chimerica was not destined to last. The financial crisis since 2007 has put the marriage on the rocks. Correcting the economic imbalance between the United States and China — the dissolution of Chimerica — is now indispensable if equilibrium is to be restored to the world economy.

China's economic ascent was a result of a strategy of export-led growth that followed the examples of West Germany and Japan after World War II. However, there was a key difference: China made a sustained effort to control the value of its currency, the renminbi, which resulted in a huge accumulation of reserve dollars.

As Chinese exports soared, the authorities in Beijing consistently bought dollars to avoid appreciation of their currency, pegging it at around 8.28 renminbi to the dollar from the mid-1980s to the mid-'90s. They then allowed a modest 17 percent appreciation in the three years after July 2005, only to restore the dollar peg at 6.83 when the global financial crisis intensified last year.

Intervening in the currency market served two goals for China: by keeping the renminbi from rising against the dollar, it promoted the competitiveness of Chinese exports; second, it allowed China to build up foreign currency reserves (primarily in dollars) as a cushion against the risks associated with growing financial integration, painfully illustrated by the experience of other countries in the Asian crisis of the late 1990s. The result was that by 2000 China had currency reserves of $165 billion; they now stand at $2.3 trillion, of which at least 70 percent are dollar-denominated.

This intervention caused a growing distortion in the global cost of capital, significantly reducing long-term interest rates and helping to inflate the real estate bubble in the United States, with ultimately disastrous consequences. In essence, Chimerica constituted a credit line from the People's Republic to the United States that allowed Americans to save nothing and bet the house on ... well, the house.

Nothing like this happened in the 1950s and 1960s. At the height of postwar growth in the 1960s, West Germany and Japan increased their dollar reserves roughly in line with the American gross domestic product, keeping the ratio stable at about 1 percent before letting it move slightly higher in the early 1970s. By contrast, China's reserves soared from the equivalent of 1 percent of America's gross domestic product in 2000 to 5 percent in 2005 and 10 percent in 2008. By the end of this year, that figure is expected to rise to 12 percent.

The Chimerican era is drawing to a close. Given the bursting of the debt and housing bubbles, Americans will have to kick their addiction to cheap money and easy credit. The Chinese authorities understand that heavily indebted American consumers cannot be relied on to return as buyers of Chinese goods on the scale of the period up to 2007. And they dislike their exposure to the American currency in the form of dollar-denominated reserve assets of close to $2 trillion. The Chinese authorities are "long" the dollar like no foreign power in history, and that makes them very nervous.

Yet there is a strong temptation for both halves of Chimerica to keep this lopsided partnership going. Despite much talk of the need to reduce global imbalances, the biggest imbalance of all persists. This year, America's trade deficit with China will be around $200 billion, the same as last year. And China has again intervened in the currency markets, buying $300 billion to keep its currency and hence its exports cheap.

United States policy makers, meanwhile, seem equally willing to prolong America's addiction to cheap money as long as economic recovery seems so fragile, regardless of the effect on the dollar's exchange rate with other currencies. (When American officials insist that they favor a "strong dollar," it's usually a sure sign that they want the opposite.) And why would Americans want to discourage the Chinese from buying yet more dollar-denominated securities? With trillion-dollar deficits as far as the eye can see, the Treasury needs all the foreign buyers it can get.

The reality, however, is that an end to Chimerica is in the American interest for at least three reasons. First, adjusting the exchange rates between the currencies would help reorient the American economy — primarily by making American exports more competitive in China, the world's fastest-growing economy.

Second, an end to Chimerica would lessen the potentially dangerous reliance of American economic policy on measures to stimulate domestic purchasing. American fiscal policy is clearly on an unsustainable path, and the Federal Reserve's negligible interest rates and the printing of dollars are artificially inflating equity prices.

Finally, renminbi revaluation would reduce the risk of potentially serious international friction over trade. The problem is that as the dollar weakens against other world currencies — notably the euro and the Japanese yen — so does the renminbi, magnifying China's already large advantage in global export markets. The burden of post-crisis adjustment falls disproportionately outside Chimerica. Unless China's currency is revalued, we can expect an uncoordinated wave of defensive moves by countries on the wrong side of Chimerica's double depreciation. Already we are seeing the danger signs. Last month Brazil imposed a tax on "hot money" — large, volatile flows of foreign investment that may exit an economy as quickly as they appeared — to try to slow the appreciation of its currency, the real. A number of Asian economies last week intervened to weaken their own currencies relative to the dollar. Similar currency games were a feature of the worst economic decade of the 20th century, the 1930s.

Historically, as production costs and income levels in countries have risen, their currencies have adjusted against the dollar accordingly. From 1960 to 1978, for example, the deutsche mark appreciated cumulatively by almost 60 percent against the dollar, while the Japanese yen appreciated by almost 50 percent. The lesson is that exporters can live with substantial exchange rate revaluations so long as they are achieving major gains in productivity, as China still is.

To be sure, China's central bank has suggested that it might be willing to switch from the dollar peg to some form of exchange-rate management, taking account of "international capital flows and movements in major currencies." But, like the recent Chinese comments about replacing the dollar as the premier international reserve currency, this may be no more than rhetoric.

During his visit to China this week, President Obama must resist the temptation to respond to these overtures with rhetoric of his own. This is not the time for big speeches, but for subtle diplomacy. Right now, Chimerica clearly serves China better than America. Call it the 10:10 deal: the Chinese get 10 percent growth; America gets 10 percent unemployment. The deal is even worse for the rest of the world — and that includes some of America's biggest export markets and most loyal allies. The question is: What can the United States offer to make the Chinese abandon the dollar peg that has served them so well?

The authorities in Beijing must be made to see that any book losses on its reserve assets resulting from changes in the exchange rate will be a modest price to pay for the advantages they reaped from the Chimerica model: the transformation from third-world poverty to superpower status in less than 15 years. In any case, these losses would be more than compensated for by the increase in the dollar value of China's huge stock of renminbi assets.

It is also in China's interest to kick its currency-intervention habit. A heavily undervalued renminbi is the key financial distortion in the world economy today. If it persists for much longer, China risks losing the very foundation of its economic success: an open global trading regime.

And this is exactly what President Obama can offer in return for a substantial currency revaluation of, say, 20 percent to 30 percent over the next 12 months: a clear commitment to globalization and free trade, and an end to the nascent Chinese-American tariff war.

For as long as the People's Republic has existed, the United States has been the principal upholder of a world economic order based on the free movement of goods and, more recently, capital. It has also picked up the tab for policing the oil-rich but unstable Middle East. No country has benefited more from these arrangements than China, and it should now pay for them through a stronger Chinese currency. Chimerica was always a chimera — an economic monster. Revaluing the renminbi will give this monster the peaceful death it deserves.

Niall Ferguson, a history professor at Harvard, is the author of "The Ascent of Money." Moritz Schularick is a professor of economic history at the Free University in Berlin.

The Daily Beast

WILL CHINA IMPLODE?

By Isabel Hilton

July 28, 2009

There is a story that the Chinese government likes to tell: that China is the world's oldest continuous, unchanging civilization (the dates vary, according to the exuberance of the moment, from 2,000 to a mythical 5,000 years). This unique history, the story continues, will determine China's future. In this narrative of Chinese exceptionalism, the leadership remains immune to demands for democracy or any resemblance to other developed countries. The government hopes that this story will prove persuasive enough for the Communist Party to keep the Mandate of Heaven and avoid challenges to its exclusive right to rule for the foreseeable future.

It's a curious story for a Communist Party and very different to the earlier myths of origin. Where once it promoted class struggle and revolution, today's party invokes history and tradition in support of its right to rule. In its latest identification with the imperial orders of the past, the regime is even restoring Confucianism as the core state narrative.

It's a long way from the Communist Party's own origins in the revolt in the early 20th century against the suffocating orthodoxies of Confucianism, blamed by the modernizers of the day for China's slide into stagnation. As recently as the 1970s, Confucius was still thought sufficiently poisonous as an inheritance to merit a virulent campaign of criticism, along with such imported bad hats as the Italian filmmaker Michelangelo Antonioni, the late Ludwig Van Beethoven and the children's book Jonathan Livingston Seagull. They made an odd quartet, but no odder than the current spectacle of a Communist Party that extols the virtues of Mencius and claims to be building a "harmonious" society.

Remarkably, despite its obvious flaws, this narrative appeals to those Western commentators who believe that China's rise is, in the Marxist phrase, a historical inevitability, and who accept Beijing's latest version of history at face value.

Take this recent example, from the British author Martin Jacques' book When China Rules the World:

"China has existed roughly within its present borders for 2,000 years and only over the last century has it come to regard itself as a nation state."

China does not, in fact, officially define itself as a nation state but as a multiethnic state in which all nationalities theoretically enjoy equal status. A more accurate description would be that it is a recently expanded land-based empire struggling to justify itself. Far from living within the same borders for 2,000 years, China today occupies a land area roughly twice the size of Ming Dynasty China, its expansion driven by the Manchu conquest in the 18th century. It has an aggressive policy of colonization, exploitation of natural resources, and assimilation. Like all such empires before it, it suffers from the strains of keeping the lid on those it has colonized, who do not identify with an imperial project from which they derive little benefit.

When China Rules the World was published some 10 months after last year's uprising in Tibet and six weeks before this year's riots in Xinjiang. By the time it had been on the bookshelves eight weeks, the Chinese government had been obliged to put nearly half of its territory (including Xinjiang and the Tibetan Autonomous Region) under tight paramilitary control.

The People's Armed Police, the shock troops of Beijing's attempt to impose civil order (officially described as "harmony") are pursuing familiar tactics in Xinjiang: mass arrests within a troublesome demographic—ethnic minority males—undisclosed places and conditions of detention; trials that meet no standards of justice and long prison sentences, often preceded by rough treatment.

It is doubtful, though, whether these measures will be any more effective than they have been in the past. Beijing's diagnosis of the sickness in its body politic is as flawed as its treatment: If repression fails, apply more repression, a policy response that has steadily ratcheted up the resentment in China's far west.

The question is, how far will these troubles affect the majority Han population and what impact will the blowback from the troubles have on China's future? In a related move, the government recently raided the offices of the Open Constitution Initiative in Beijing, confiscating computers and interrogating staff. The OCI was an important legal office, distinguished by its members' belief in the right to a fair, independent, and transparent legal process, and their willingness to defend people whom the government wished to silence or send to jail. Their clients included the parents of infants affected by last year's adulterated milk scandal, Tibetan prisoners, Falun Gong practitioners, and other persecuted or disadvantaged groups. An additional 50 lawyers who handled human-rights cases have also been disbarred.

The OCI also produced one of the only rational responses to last year's uprising in Tibet: Having examined the evidence, they concluded that the uprising had not been orchestrated by the exiled Dalai Lama, but provoked by decades of bungled government policy. Now they have been hit with a massive fine for alleged tax irregularities and their office closed. Neither in Tibet nor in Xinjiang, it seems, do the authorities wish to acknowledge their mistakes.

But mistakes not acknowledged tend to be repeated, and policies that have provoked angry responses in the past are unlikely to promote harmony in the future. The test of China's future trajectory, of its ability to go from large power to great power, is only partly about economics. Thus far, China's economic growth has been based on unsustainable low-end manufacturing for the export market and the legitimacy bestowed by rising living standards. To manage the next phase of development successfully, China needs to move up the value chain, improve its governance, cut down on the huge waste in the economy, distribute the rewards of the effort more fairly, and inject some justice into its politics and legal affairs. But to do that, the Communist Party has to take on the vested interests on which it depends for its power.

We all have an interest in China's success, as President Obama underlined at the opening this week of a two-day high-level dialogue with visiting Chinese officials. With just a nod to the recent troubles in Xinjiang, Obama ticked off a list of common concerns from climate change to economic recovery. In all of them, Chinese cooperation is essential.

In a globalized world, China's troubles are everybody's troubles and the U.S. has little interest in seeing them grow. But China's solutions, to date, are unlikely to help. The revolt of the minorities is only a symptom of a wider political malaise. Even taken together, their numbers, compared to the overwhelming majority of Han Chinese, are small. But the indignation and resentment that burst into view in Xinjiang in Tibet are also visible, for a wide variety of reasons, in the Han population. As Xu Zhiyong, one of the founders of the OCI put it in a withering public statement of protest at the centre's closure:

"It's not us causing trouble, and the tens of thousands of mass incidents every year aren't caused by us .... On the contrary, we strive to bring into line the contradictions caused by corrupt officials, we advocate absolute nonviolence and we hope we can ameliorate some of the endless hate and conflicts in our society... do not let this country once more be dragged by those in power to a place where we are dead but not buried.

Why have we been targeted with this retribution? Because we have an awe-inspiring righteousness, because we advocate for better politics, because our dreams are too beautiful, because we as a people have never given up hope, because no matter what befalls, our hearts are always full of the sunlight of hope.

.. I am a poor man, so poor that all I have left are my beliefs. Great leaders, can I give you a little bit of my belief? You should be needing these beliefs and you should, like me, have the ability to show compassion, compassion to see the restless souls disturbed by evil spirits."

Confucius himself would have applauded.

Isabel Hilton has reported extensively from Latin America, East and South Asia, Africa and Europe. She has made many documentaries for the BBC, has presented Radio 4's flagship current affairs program, The World Tonight and BBC Radio 3's main cultural program, Night Waves. She is a columnist for The Guardian. She was editor in chief of openDemocracy.net <http://www.opendemocracy.net/> and founded www.chinadialogue.net <http://www.chinadialogue.net/> , which she

founded in 2006. She is the author of The Search for the Panchen Lama
<http://www.amazon.com/exec/obid os/ASIN/0393321673/ thedaibea-20/> .

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