
In his first interview since the world financial crisis, Gao Xiqing, the man who oversees \$200 billion of China's \$2 trillion in dollar holdings, explains why he's betting against the dollar, praises American pragmatism, and wonders about enormous Wall Street paychecks. And he has a friendly piece of advice:

by James Fallows

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“Be Nice to the Countries That Lend You Money”

AMERICANS KNOW THAT China has financed much of their nation's public and private debt. During the presidential campaign, Barack Obama and John McCain generally agreed on the peril of borrowing so heavily from this one foreign source. For instance, in their final debate, McCain warned about the “\$10 trillion debt we're giving to our kids, a half a trillion dollars we owe China,” and Obama said, “Nothing is more important than us no longer borrowing \$700 billion or more from China and sending it to Saudi Arabia.” Their numbers on the debt differed, and both were way low. One year ago, when I wrote about China's U.S. dollar holdings, the article was called “The \$1.4 trillion Question.” When Barack Obama takes office, the figure will be well over \$2 trillion.

During the late stages of this year's campaign, I had several chances to talk with the man who oversees many of China's American holdings. He is Gao Xiqing, president of the China Investment Corporation, which manages “only” about \$200 billion of the country's foreign assets but makes most of the high-visibility investments, like buying stakes in Blackstone and Morgan Stanley, as opposed to just holding Treasury notes.

Gao, whom I mentioned in my article, would fit no American's preexisting idea of a Communist Chinese official. He speaks accented but fully colloquial and very high-speed English. He has a law degree from Duke, which he earned in the 1980s after working as a lawyer and professor in China, and he was an associate in Richard Nixon's former Wall Street law firm. His office, in one of the more tasteful new glass-walled high-rises in Beijing, itself seems less Chinese than internationally “fusion”-minded in its aesthetic and furnishings. Bonsai trees in large pots, elegant Japanese-looking arrangements of individual smooth stones on display shelves, Chinese and Western financial textbooks

behind the desk, with a photo of Martin Luther King Jr. perched among the books. Two very large, very thin desktop monitors read out financial data from around the world. As we spoke, Western classical music played softly from a good sound system.

Gao dressed and acted like a Silicon Valley moneyman rather than one from Wall Street—open-necked tattersall shirt, muted plaid jacket, dark slacks, scuffed walking shoes. Rimless glasses. His father was a Red Army officer who was on the Long March with Mao. As a teenager during the Cultural Revolution, Gao worked on a railroad-building gang and in an ammunition factory. He is 55, fit-looking, with crew-cut hair and a jokey demeanor rather than an air of sternness.

His comments below are from our one on-the-record discussion, two weeks before the U.S. elections. As I transcribed his words, I realized that many will look more astringent on the page than they sounded when coming from him. In person, he seemed to be relying on shared experience in the United States—that is, his and mine—to entitle him to criticize the country the way its own people might. The conversation was entirely in English. Because Gao's answers tended to be long, I am not presenting them in straight Q&A form but instead grouping his comments about his main recurring themes.

Does America wonder who its new Chinese banking overlords might be? This is what one of the very most influential of them had to say about the world financial crisis, what is wrong with Wall Street, whether one still-poor country with tremendous internal needs could continue subsidizing a still-rich one, and how he thought America could adjust to its “realistic” place in the world. My point for the moment is to convey what it is like to hear from such a man, rather than to expand upon, challenge, or agree with his stated views.

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About the financial crisis of 2008, which eliminated hundreds of billions of dollars' worth of savings that the Chinese government had extracted from its people, through deliberately suppressed consumption levels:

We are not quite at the bottom yet. Because we don't really know what's going to happen next. Everyone is saying, “Oh, look, the dollar is getting stronger!” [As it was when we spoke.] I say, that's really temporary. It's simply because a lot of people need to cash in, they need U.S. dollars in order to pay back their creditors. But after a short while, the dollar may be going down again. I'd like to bet on that!

The overall financial situation in the U.S. is changing, and that's what we don't know about. It's going to be changed fundamentally in many ways.

Think about the way we've been living the past 30 years. Thirty years ago, the leverage of the investment banks was like 4-to-1, 5-to-1. Today, it's 30-to-1. This is not just a change of numbers. This is a change of fundamental thinking.

People, especially Americans, started believing that they can live on other people's money. And more and more so. First other people's money in your own country. And then the savings rate comes down, and you start living on other people's money from outside. At first it was the Japanese. Now the Chinese and the Middle Easterners.

We—the Chinese, the Middle Easterners, the Japanese—we can see this too. Okay, we'd love to support you guys—if it's sustainable. But if it's not, why should we be doing this? After we are gone, you cannot just go to the moon to get more money. So, forget it. Let's change the way of living. [By which he meant: less debt, lower rewards for financial wizardry, more attention to the "real economy," etc.]

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About stock market derivatives and their role as source of evil:

If you look at every one of these [derivative] products, they make sense. But in aggregate, they are bullshit. They are crap. They serve to cheat people.

I was predicting this many years ago. In 1999 or 2000, I gave a talk to the State Council [China's main ruling body], with Premier Zhu Rongji. They wanted me to explain about capital markets and how they worked. These were all ministers and mostly not from a financial background. So I wondered, *How do I explain derivatives?*, and I used the model of mirrors.

First of all, you have this book to sell. [He picks up a leather-bound book.] This is worth something, because of all the labor and so on you put in it. But then someone says, "I don't have to sell the book itself! I have a mirror, and I can sell the mirror image of the book!" Okay. That's a stock certificate. And then someone else says, "I have another mirror—I can sell a mirror image of that mirror." Derivatives. That's fine too, for a while. Then you have 10,000 mirrors, and the image is almost perfect. People start to believe that these mirrors are almost the real thing. But at some point, the image is interrupted. And all the rest will go.

When I told the State Council about the mirrors, they all started laughing. "How can you sell a mirror image! Won't there be distortion?" But this is what happened with the American economy, and it will be a long and painful process to come down.

I think we should do an overhaul and say, “Let’s get rid of 90 percent of the derivatives.” Of course, that’s going to be very unpopular, because many people will lose jobs.

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About Wall Street jobs, wealth, and the cultural distortion of America:

I have to say it: you have to do something about pay in the financial system. People in this field have way too much money. And this is not right.

When I graduated from Duke [in 1986], as a first-year lawyer, I got \$60,000. I thought it was astronomical! I was making somewhere a bit more than \$80,000 when I came back to China in 1988. And that first month’s salary I got in China, on a little slip of paper, was 59 yuan. A few dollars! With a few yuan deducted for my rent and my water bill. I laughed when I saw it: 59 yuan!

The thing is, we are working as hard as, if not harder than, those people. And we’re not stupid. Today those people fresh out of law school would get \$130,000, or \$150,000. It doesn’t sound right.

Individually, everyone needs to be compensated. But collectively, this directs the resources of the country. It distorts the talents of the country. The best and brightest minds go to lawyering, go to M.B.A.s. And that affects our country, too! Many of the brightest youngsters come to me and say, “Okay, I want to go to the U.S. and get into business school, or law school.” I say, “Why? Why not science and engineering?” They say, “Look at some of my primary-school classmates. Their IQ is half of mine, but they’re in finance and now they’re making all this money.” So you have all these clever people going into financial engineering, where they come up with all these complicated products to sell to people.

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About the \$700 billion U.S. financial-rescue plan enacted in October:

Finally, after months and months of struggling with your own ideology, with your own pride, your self-righteousness ... finally [the U.S. applied] one of the great gifts of Americans, which is that you’re pragmatic. Now our people are joking that we look at the U.S. and see “socialism with American characteristics.” [The Chinese term for its mainly capitalist market-opening of the last 30 years is “socialism with Chinese characteristics.”]

It *is* joking, and many people are saying: “No, Americans still believe in free capitalism and they think this is just a hiccup.” This is like our great leader

Deng Xiaoping, who said that it doesn't matter if the cat is white or black, as long as it catches the mouse. It doesn't matter what we call this. It's pragmatic.

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With so much of China's money at stake, did U.S. officials consult the Chinese about the rescue plan?

Not directly. We were talking to people there, and they were hoping that we would be supportive by not pulling out our money. We know that by pulling out money, we're not serving anyone's good. Including ourselves. [This is the famous modern "balance of financial terror." If Chinese officials started pulling assets out of the U.S. and touched off a run on the dollar, their vast remaining dollar holdings would plummet in value.] So we're trying to help, at least by not aggravating the problem.

But I think at the end of the day, the American government needs to talk with people and say: "Why don't we get together and think about this? If China has \$2 trillion, Japan has almost \$2 trillion, and Russia has some, and all the others, then—let's throw away the ideological differences and think about what's good for everyone." We can get all the relevant people together and think up what people are calling a second Bretton Woods system, like the first Bretton Woods convention did.

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On what might make the Chinese government start taking its dollars out of America (I began the question by saying that China would hurt itself by pulling out dollar assets—at which he interjected, "in the short term"—and then asked about the long-term view):

Today when we look at all the markets, the U.S. still is probably the most viable, the most predictable. I was trained as a lawyer, and predictability is always very important for me.

We have a PR department, which collects all the comments about us, from Chinese newspapers and the Web. Every night, I try to pick a time when I'm in a relatively good mood to read it, because most of the comments are very critical of us. Recently we increased our holdings in Blackstone a little bit. Now we're increasing a little bit our holdings in Morgan Stanley, so as not to be diluted by the Japanese. People here *hate* it. They come out and say, "Why the hell are you trying to save those people? You are the representative of the poor people eating porridge, and you're saving people eating shark fins!" It's always that sort of thing.

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And how should Americans feel about the growing Chinese presence in their economy? Isn't it natural for them to worry that China will keep increasing its stake in American debt and assets—or that China won't, essentially cutting America off?

I can understand why Americans might feel that way. But, talking with my lawyer head once again, it's not relevant to discuss how Americans "should" think. We should discuss how Americans *might* think.

This concern is not really about China itself. It could be any country. It could be Japan, or Germany. This generation of Americans is so used to your supremacy. Your being treated nicely by everyone. It hurts to think, *Okay, now we have to be on equal footing to other people.* "On equal footing" would necessarily mean that sometimes you have to stoop to appear to be humble to other people.

And you can't think as a soldier. You put yourself at the enemy end of everyone. I grew up during the Cultural Revolution, when people really treated other people like enemies. I grew up in an environment where our friends, our relatives, people I called Uncle or Auntie, could turn around and put a nasty face to me as a small child. One time, Vladimir Lenin told Gorky, after reading Gorky's autobiography, "Oh my god! You could have become a very nasty person!" Those are exactly the words one of my dear professors told me after hearing what I went through.

But over the years, I believe I learned to be humble. To treat other people nicely. I learned that, from a social point of view, no matter how lowly statured a person you are talking to, as a person, they are the same human being as you are. You have to respect them. You have to apologize if you inadvertently hurt them. And often you have to go out of your way to be nice to them, because they will not like you simply because of the difference in social structure.

Americans are not sensitive in that regard. I mean, as a whole. The simple truth today is that your economy is built on the global economy. And it's built on the support, the gratuitous support, of a lot of countries. So why don't you come over and ... I won't say *kowtow* [with a laugh], but at least, *be nice* to the countries that lend you money.

Talk to the Chinese! Talk to the Middle Easterners! And pull your troops back! Take the troops back, demobilize many of the troops, so that you can save some money rather than spending \$2 billion every day on them. And then tell your people that you need to save, and come out with a long-term, sustainable financial policy.

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Although Gao has frequently mentioned Chairman Mao's maxim—"Go with the Republicans. They're predictable!"—he obviously was hoping for a "change" agenda under the Democrats:

The current conditions can't go on. It is time for the new government, under Obama or even McCain, to really tell people: "Look, this is wartime, this is about the survival of our nation. It's not about our supremacy in the world. Let's not even talk about that any more. Let's get down to the very basics of our livelihood."

I have great admiration of American people. Creative, hard-working, trusting, and freedom-loving. But you have to have someone to tell you the truth. And then, start realizing it. And if you do it, just like what you did in the Second World War, then you'll be great again!

If that happens, then of course—American power would still be there for at least as long as I am living. But many people are betting on the other side.