

A Perspective on China

*Remarks to a Working Dinner Sponsored by the
Progress & Freedom Foundation*



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Aspen, Colorado
August 18, 2008

The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.

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I may have the longest record of experience with China of anybody in this room, including Chinese nationals. My Australian father and South African-born Norwegian mother sailed out of Shanghai on the *S.S. President Wilson* just as that port was being closed by Communist revolutionaries in 1948. In a story too long to tell, my parents had been dispatched to collect a dollar payment owed an American company—the Spazier Chemical and Soap Company. They left Shanghai with more than Spazier’s loot: My mother was with child—me. I was born the following March, the felicitous by-product of an otherwise fretful stay at the Peace Hotel on the Bund.

I have been asked to speak to you tomorrow about “Monetary Policy in a Globalized World.” Tonight, I establish my bona fides for that talk: I was manufactured by an Australian–South African/Norwegian partnership in China, shipped across the Pacific and on to Mexico for final assembly, and then sent across the border to the U.S. to become one of the innumerable factors that make for a dynamic economy that is uniquely American. You can’t be more globalized than that!

My embryonic experience allows me to lay claim to being a China watcher for nearly 60 years. But it was only in 1979, when I served in the Carter administration as coordinator of policy planning and assistant to Treasury Secretary Michael Blumenthal, that I first saw China. I mention this for a reason. My early experience in China, coupled with my involvement 20 years later in negotiating China’s accession to the World Trade Organization for President Clinton, forms the lens through which I now view China.

I am going to focus my brief remarks tonight on some of the perspectives gained from that first trip to China.

President Nixon and Henry Kissinger had famously normalized political relations with China in their meetings with Mao Zedong and Zhou Enlai in 1972. It fell on President Carter to settle the counterclaims between the U.S. and China that stemmed from the Communist takeover in 1949. Mao’s forces failed to seize the cash of Spazier Chemical and Soap, but managed to seize the railroad stock and other assets the U.S. had lent or invested in Nationalist China; we, in turn, retaliated by freezing China’s accounts in U.S. banks. Without settling those counterclaims, we could not normally trade with each other. So after months of rigorous preparation, Secretary Blumenthal and his team, including me as his faithful chef de cabinet, were dispatched from Andrews Air Force Base to Beijing on Feb. 23, 1979, to settle the claims. We met with Deng Xiaoping, then-Chairman Hua Guofeng—a hapless fellow traveler of Mao’s whom we met with only for the purposes of being photographed for the *People’s Daily* but paid little attention to, given that we knew of Deng’s ascendancy—and Blumenthal’s official counterpart, Finance Minister Zhang Jin-fu. We sealed the preliminary deal on March 1, after arduous negotiations with Deng and Zhang, and that day officially raised the flag over the American Embassy in Beijing, establishing the fulsome presence of the U.S. in China.

The memories of this trip flooded back as I viewed the opening ceremonies of the spectacle and pageantry of the Olympics in Beijing.

When we landed in that city on Saturday night, Feb. 24, 1979, we were whisked off to the official guesthouse in Red Flag limousines. The roads into Beijing had no cars—not because the route had been cordoned off for our delegation but because there simply weren't any. What traffic we did see included skinny horses, donkeys, camels, oxen, exhaust-spewing trucks and countless bicycles made in the Forever bicycle factory in Shanghai for the purpose of realizing Zhou's "four modernizations."

By 2006, just 27 years later, Beijing had some 2.4 million motor vehicles, a small fraction of China's total of 37 million.

Think about that. Worldwide, roughly half of oil production goes into making gasoline and diesel fuel. In 2008, China is projected to consume nearly 8 million barrels of oil daily. Let's say that, conservatively, 2.5 million barrels of that goes into propelling the present auto and truck fleet of the country. You can do the numbers and see the amount of oil that will be required just to feed the fleet of Chinese autos as it grows to 100 million.

When the Blumenthal delegation arrived in Beijing in 1979, the main customers for OPEC and other oil producers were the U.S., Japan and Western Europe. You may remember that in today's dollars the price of oil was broaching \$90 at that time, on its way the next year to \$100 plus. Now, oil producers have as customers an added 1.3 billion Chinese, who not only drive cars but operate factories and require heat for their homes, as well as the populations of catch-up players like India and the countries liberated from Soviet tyranny. This puts the supply and demand for oil and diesel and gasoline into perspective. A week ago, the *Wall Street Journal* pointed out that Japan consumes 14 barrels of oil a year per capita, Europe consumes 17 and America consumes 25. If China used the same amount per capita as parsimonious Japan, Chinese consumption would total more than 18 billion barrels a year, an amount that dwarfs our country's 7.5 billion barrels. Add that to new demand for oil stemming from India, the newest members of the European community, an increasingly prosperous Brazil and so on. For those trying to discern the long-term future of oil prices, this is considerable food for thought.

Once we reached the initial agreement to settle our claims on China—at roughly 40 cents on the dollar—we flew to Shanghai on a Chinese military plane for a little R&R before returning to Beijing to tidy up some fine points. The Chinese government had picked out the prettiest military women they could muster to serve us drinks and meals on the flight—nothing becomes a pretty woman like the uniform of the People's Liberation Army. On a whim, my counterpart and seat mate from the State Department, Bob Hormats, who is now vice chairman of Goldman Sachs, took out a Polaroid camera and took a picture of these impromptu flight attendants. You would have thought he had struck a match in some far corner of the world where fire had never been seen. The flight attendants squealed with delight, and the entire crew, including the pilots, came to the back of the plane to examine this previously unseen, newfangled technology. Imagine that. This was roughly a quarter century after Polaroid had become commonplace in the U.S. and four years after the two Steves—Jobs and Wozniak—brought forth the first commercial Apple computer. The Chinese public had never seen a Polaroid camera, let alone heard of a computer.

Polaroid has since gone kaput. China now owns what used to be IBM's PC business. Today, China produces 93.4 million microcomputers, and it has 600 million domestic cell phone subscribers. The country has become the world's largest exporter of information technology goods. The Chinese conduct technological espionage so brilliantly that business and government leaders in Europe and the U.S. are told that any conversation held anywhere in the world within range of a BlackBerry can be listened to by Chinese agents even if you have it turned off, so long as the SIM card and battery are in place.

We no longer regard China as a technological backwater. Think back to that opening Olympic ceremony two Friday nights ago. In 1979, a Polaroid camera stunned the most advanced Chinese military pilots. In 2008, the show put on in the Olympic "Bird's Nest" exhibited an ability to harness technology that rivals the most sophisticated weapons or game designer or software programmer in Silicon Valley.

Which brings me to this ancient land's willingness to adopt and adapt. When Deng Xiaoping entered the room for the initial encounter with Blumenthal, he cackled, "Where are these big American capitalists we Chinese are supposed to be so afraid of?" During our meeting, he made a remark that paralleled his famous "black cat, white cat" theme—"it doesn't matter if the cat is white or black as long as it catches mice." Deng's remarks encapsulated the importance of practical results over political correctness and economic development over ideological purity—both hallmarks of modern China. Deng made it clear to our delegation that China was intent on modernization, that the Chinese cat was focused on catching droves of economic mice as it engaged the rest of the world, starting with the trade that would be liberated from our settlement that week.

This China has done. In 1979, the U.S. imported a mere \$595 million from China under onerous tariffs; the Chinese did not have a single dollar in official reserves. Now, they send more than \$300 billion in goods to the U.S. and hold over \$840 billion in U.S. Treasuries and agencies. Since Deng's ascendancy, China has grown their economy at least 10 percent per annum, has become the world's pivotal factory and is quickly moving to the cutting edge of technology.

The Chinese are survivors. During our trip to Beijing in 1979, we were treated to a soiree in the Great Hall of the People on Feb. 27. The seventh act of the evening was a piano recital—a performance of Liszt's "Hungarian Fantasy No. 6"—by a haggard and emaciated pianist named Liu Shikun. Today, Liu is regarded as China's finest pianist; he has performed worldwide, including with Seiji Ozawa and the Boston Symphony for one of the best-selling classical music albums of all time. He had given his premiere performance at the age of 5. In 1949, at the age of 10, he had won the Chinese National Competition for Teenagers and Children. In 1956, at the age of 17, he was so brilliant in his performances around the world that the Hungarian government presented him with a lock of Liszt's hair. He was a boy wonder, a musical genius who won innumerable international competitions worldwide.

If you read Liu's official Chinese biography, you will note that "he has performed in front of several generations of Chinese statesmen, including Mao Zedong...Deng Xiaoping, Jiang Zemin and Hu Jintao." What it does not tell you is that he was imprisoned during the Cultural Revolution and maintained his skills by carving a keyboard on the wall of his cell and playing it day after day, hearing its music only in his imagination. His performance for us was one of his

first public appearances since his “rehabilitation,” and it was so stirring that even our Chinese hosts, many of whom had blood on their hands, were moved to tears.

I thought of Liu when I saw those eight People’s Liberation Army soldiers goose-step their way forward with the Olympic flag. They, too, are symbolic of modern China, a nation whose thousands of years of history have given us numerous repressive leaders.

China occasions an update of Winston Churchill’s famous epigram about Russia: “It is a riddle wrapped in a mystery inside an enigma.” With China, things are not always what they seem. The Olympics have provided us with at least two examples of that. The fireworks in the video of the opening ceremonies contained computer-generated images to make the display more vivid. A cute-as-a-button 9-year-old girl lip-synched the national anthem being sung by a 7-year-old reportedly deemed not attractive enough by a member of the Politburo.

These enigmatic efforts to control and to bend reality to conform to image were evident during my 1979 visit to China. The front page of the March 1 edition of the *People’s Daily* prominently displayed a photograph of Chairman Hua escorting Secretary Blumenthal, Treasury Undersecretary Anthony Solomon and Assistant Secretary of State Jules Katz, with me in tow, into the Great Hall. A discerning viewer would have detected that the shape of our eyes had been doctored by hand into almond-shaped, Chinese-like features.

The economic advances that put millions of Chinese in cars are real, as is the technological prowess on display in global markets and at the Olympics. The determination of a pianist practicing on a makeshift keyboard is real, as is the discipline of the goose-stepping soldiers of the PLA. But here is the message: As we contemplate modern China’s impact on our economy and culture and national security, we must work to find the China that lies behind a carefully crafted façade. Churchill concluded his alliterative “riddle, mystery and enigma” line by saying that the key to getting our minds around a perplexing Russia was an understanding of her underlying national interests. In contemplating China, we need to look past carefully crafted images and deepen our understanding of her national interest. Failure to do so will be perilous.

Thank you.