



Bumpy Transition to New Leadership in China

Nicholas R. Lardy assesses Vice President Biden's trip to China in August and the lingering sources of disagreement over currency and other issues.

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Steve Weisman: Nicholas Lardy, senior fellow at the Peterson Institute for International Economics, is here with me, Steve Weisman, to talk about recent developments in US-China relations. There could not have been a more powerful set of images evoking the complicated relationship than those in the papers today. Vice President Biden expressed warm comments to Xi Jinping, the presumed successor for the presidency of China, but there was also this brawl involving the Georgetown basketball team. Where are we on US-China economic relations coming out of the Vice President's trip?

Nicholas Lardy: I think the trip of the Vice President moved things forward. I think it gave him an opportunity to reassure the Chinese and indeed even the Chinese public about the basic stability of the United States and the soundness of our Treasury debt. The Chinese authorities seemed to welcome that reassurance and there were warm words about the two countries working together to sustain the global recovery and the shared interest and responsibility that we have as the two largest economies in the world.

Steve Weisman: In the wake of the downgrade of US debt, the Vice President was saying, "Your investments are OK and we want more of them." How are the Chinese going to respond?

Nicholas Lardy: I think they don't, quite frankly, have a lot of choice. They have to respond positively. It's in their interest that the United States continue to do well and that its debt is sound. They are the biggest foreign holder of US treasury bonds. Some people think they can diversify, but the reality is, they hold so much there's really no place else to go. There's not another debt market that's big enough to absorb what they have if they wanted to get out of Treasuries.

In a sense you could say we're joined at the hip. We're still dependent on them to lend us the money. They're still dependent on us as the big export market – not quite as big as they'd like, maybe, given our slow recovery, but the degree of interdependence on the economic front is very, very high.

Steve Weisman: There doesn't seem to be as much China criticism in Congress these days.

Nicholas Lardy: I think some members of Congress who have been critical of China in the past continue to be critical today. [Former House] Speaker [Nancy] Pelosi [D-CA] talked about a vote on a currency bill that has been reintroduced. Senator [Charles] Schumer [D-NY] from time to time brings the issue up again. I don't think the issue is completely gone away. I think with an election looming before us. The issue could come more to the fore than it has been in the very recent past.

Steve Weisman: There was an uptick in the Chinese currency appreciation before the Vice President's visit. What's the trend?

Nicholas Lardy: There has been an uptick over the last week or so, beginning just before the Vice President's trip. It's very difficult to know whether this is an inflection point and they're now going to allow their currency to appreciate a little bit more rapidly than it has in the past. Some people think that's a possibility, but there are certainly no guarantees at this point.

The reality is that they've appreciated a little bit vis-a-vis the dollar. But the dollar has been declining since 2002. If you look at the value of the Chinese currency against all of their trading partners, it's still depreciating. It's depreciated over the last two years, so the appreciation [of the renminbi] against the dollar is making the rate of depreciation less than it otherwise would be. But for those of us who believe that China will have to allow real currency appreciation to rebalance its economy, I think it's not a very encouraging trend.

Steve Weisman: What was the point of Vice President Biden's visit?

Nicholas Lardy: I think it had several objectives. Probably the primary one was to have a lot of time to discuss issues with Xi Jinping, who has not participated in any of the [twice-a-year] Strategic and Economic Dialogues and who is the presumed next leader of China – the President, the head of the party, and the number one guy. He will officially take office in just a little bit over a year.

So this is an opportunity to interact with him. The Vice President spent a great deal of time with him. Xi Jinping travelled with him down to Sichuan Province in China's southwest, which is quite a distance from the Chinese capital. They spent more time together there. Xi Jinping is slated to have a return visit to the United States sometime over the next several months, or perhaps early in 2012.

So it was a "getting to know you" trip and an opportunity to gauge what the transition would mean in terms of US-China relations. And I think it was also a good opportunity for the Chinese to hear more directly from the United States, and more authoritatively, exactly what was going on in the debate about the debt ceiling being raised, and what's going to come out of this super community that is supposed to come up with a new and improved plan for reducing our budget deficit.

There is nobody better than the Vice President to do that. He was deeply involved in all those discussions from the very beginning. He has decades of experience in the Senate, so he can explain to the Chinese with great authority how the legislative process works in our system.

If you wanted to send someone to give them an encouraging message, to improve their understanding of what's been going on, I don't think there's anybody better than Vice President Biden.

Steve Weisman: Wouldn't you have liked to have heard what exactly he said?

Nicholas Lardy: As I said, the Chinese are looking for reassurance. I don't think it was a hard sell for him.

Steve Weisman: Tell me a little about Xi Jinping. Where does he come from in the Chinese political system?

Nicholas Lardy: He comes from what is generally seen as kind of an elitist background – a princeling, if you will. His father was a very high level political figure in China. He has served in two of the richest coastal provinces of China: Fujian province across from Taiwan and also Zhejiang

province, which is famous for its highly developed private sector, its entrepreneurial drive, that has generated very high economic growth.

So he's been at the heart of the action on China's economic reform and the growing role of the private sector. He understands or at least has been in an environment where private sector economic activity has been the main driver economic growth over the last decade or so.

Steve Weisman: Would you presume therefore that he has a good feel for the sources of economic tension -- currency, balancing inflation and growth in China?

Nicholas Lardy: Absolutely. Of course, since he has been vice president, he has been dealing with these issues. He is on the standing committee of the politburo, which is the most important decision-making body in China. He has been very much involved in decisions on economic as well as political issues in recent years.

On the other hand we have to say quickly, we don't really know very much what he personally thinks about most issues. His talking points don't differ substantially from [President] Hu Jintao or [Premier] Wen Jiabao of the current leadership. We'll have to wait and see once he assumes office whether or not he's going to try and lead China in a slightly different direction or whether there's going to be a great deal of continuity.

Steve Weisman: There were some critical comments in China about the basketball team that played Georgetown, which appears to be close to the People's Liberation Army. There has also been a lot of discontent with the Chinese government. How worried is the leadership about discontent these days?

Nicholas Lardy: I think they are highly sensitive to it. This is one of the reasons they place such a high importance on reducing inflation, which they think tends to cause popular resentment of the government. People tend to hold the government accountable for what happens in a lot of the economic domain to a much greater extent than we would in the United States or other kinds of economies. They're worried about corruption at the local level, which is a great source of popular unrest.

So I think...they've stepped up their censorship of the internet and tried to squeeze out individuals who had taken anti-government stances on various issues. So I think as you move closer and closer to the leadership transition they will become more and more sensitive. We're likely to see more crack-downs over the next 15 months as we move closer to that transition.

When they get to the transition, they don't want anything untoward happening, anything that would appear to signal discontent or unhappiness. In China there is still this very important belief in the mandate of heaven which is a concept that dates back to Imperial times.

Steve Weisman: Even ancient times.

Nicholas Lardy: Yes, so I think they would try and keep a lid on things.

Steve Weisman: It's always hard to predict. Will the mandate of heaven be unshaken?

Nicholas Lardy: If I were to bet, I'd bet yes.

Steve Weisman: Thanks Nick.

Nicholas Lardy: Thank you.

