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Subject:

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We can do some powerful deals when partnering with China to co-invest abroad, but we need to start the process soon.

People are starting to talk about this now...

Writing in the Financial Times of London, Yu Qiao, a professor of economics in the School of Public Policy and Management at Tsinghua University in Beijing, proposed a plan for the U.S. government to guarantee foreign investments in the United States. While Secretary Clinton may not have pledged American homes to China under eminent domain rights, the Obama administration may well be willing grant a financial guarantee as an inducement for China to convert U.S. debt into Chinese direct equity investment to establish Chinese ownership in U.S. successful corporations and potentially profitable infrastructure projects.

Is the Obama administration is willing to put the U.S. for sale to China in order to induce China to keep financing U.S. government deficit spending?

The U.S. Treasury is preparing to borrow \$2.5 trillion in 2009 and another \$4 trillion in 2010, an amount that would increase by 65 percent in two years the \$10 trillion in national debt accumulated since George Washington was president. As noted in the same chapter, the U.S. government faces over \$65 trillion in unfunded Social Security and Medicare benefits scheduled to be paid out largely to baby boomer retirees in the coming decades. Yu Qiao observed that foreign nations now hold \$1.6 trillion of U.S. government debt, with Asians including China and Japan holding half of the outstanding public-owned U.S. Treasury bonds. He also noted China directly or indirectly holds more than \$1.2 billion of U.S. treasury bonds.

If the U.S. dollar collapsed under the weight of proposed Obama administration trillion dollar budget deficits into the foreseeable future, holders of U.S. debt would face substantial losses that the Financial Times estimated "would devastate Asians' hard-earned wealth and terminate economic globalization."

"The basic idea is to turn Asian savings, China's in particular, into real business interests rather than let them be used to support U.S. over-consumption," Yu Qiao wrote, reflecting themes commonly suggested by Chinese government officials. "While fixed-income securities are vulnerable to any fall in the value of the dollar, equity claims on sound corporations and infrastructure projects are at less risk from a currency default."

The problem is that China does not want to trade Chinese investment in U.S. Treasury debt securities, with their inherent risk of dollar devaluation, for equally risky investments in U.S. corporations and infrastructure projects, where a struggling U.S. economy could risk the depreciation of those assets.

"But Asians do not want to bear the risk of this investment because of market turbulence and a lack of knowledge of cultural, legal and regulatory issues in U.S. businesses," he stressed. "However if a guarantee scheme were created, Asian savers could be willing to invest directly in capital-hungry U.S. industries."

Yu Qiao's plan included four components:

1. Asian countries would negotiate with the U.S. government to create a "crisis relief facility," or CRF. The CRF "would be used alongside U.S. federal efforts to stabilize the banking system and to invest in capital-intensive infrastructure projects such as high-speed railroad from Boston to Washington, D.C.

2. Asian nations and especially China would pool a portion of their holdings of Treasury bonds under the CFR umbrella to convert sovereign debt into equity. Any CFR funds that were designated for investment in U.S. corporations would still be owned and managed by U.S. equity holders, with the Asians holding minority equity shares "that would, like preferred stock, be convertible."

3. The U.S. government would act as a guarantor, "providing a sovereign guarantee scheme to assure the investment principal of the CRF against possible default of targeted companies or projects.

4. The Federal Reserve would set up a special account to supply the liquidity the CRF would require to swap sovereign debt into industrial investment in the United States.

"The CRF would lessen Asians' concern about implicit default of sovereign debts caused by a collapsing dollar," Yu Qiao concluded. "It would cost little and help the U.S. by channeling funds to business investment."

This plan to convert Chinese debt to equity investments in the United States could easily add another \$1 trillion to outstanding Obama administration guarantees issued in the current economic crisis.

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