

CHARLIE ROSE, HOST: Welcome to the broadcast. Tonight, James Chanos, the man who predicted the Enron downfall, is now predicting a housing bubble in China.

(BEGIN VIDEO CLIP)

JAMES CHANOS, KYNIKOS ASSOCIATES: We're going to be able to tell whether we're right or wrong on China literally by watching it. The thing about property bubbles is when the cranes stop going higher, when the buildings stop being built, and when they stop putting foundations in the holes in the ground, you know that the bubble is over. It happened in Miami, it happened in Dubai. It will happen here.

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CHARLIE ROSE: We continue this evening with Stephen Green, group chairman of HSBC. His book is called "Good Value -- Reflections on Money, Morality, and an Uncertain World."

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STEPHEN GREEN, AUTHOR: You cannot by law or by rules guarantee the appropriate behavior in the markets. You need to focus on the kinds of values that are brought to bear, the ethics that people do their business with.

And, indeed, there's another reason why I think that's true, and that is at the end of the day people who, let's face it, spend 90 percent of their creative energy and potential in their work lives, and in this case of what we're talking about in the financial markets, need to have a sense that they are making a contribution, that there is a contribution to the common good that lies behind all of this.

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CHARLIE ROSE: Chanos and Green, next.

(COMMERCIAL BREAK)

CHARLIE ROSE: James Chanos is here. He is the founder and president of the hedge fund Kynikos, there means "Cynic" in Greek. That firm manages roughly \$6 billion. It specializes in investments against assets that it considers overvalued. On Wall Street, this is known as short-selling.

Ten years ago, he made the first substantial bet that Enron was on the brink of financial ruin. His latest prediction is that the Chinese real estate market is headed towards a similar fate. In January, the "New York Times" took note with this headline "Shorting China -- the man who predicted Enron's fall sees a bigger collapse ahead."

So I'm pleased to have Jim Chanos at this table for the first time. Welcome.

JAMES CHANOS: Thanks, Charlie.

CHARLIE ROSE: It's going to be that bad for China?

JAMES CHANOS: I think it's going to be that bad for the property market in China. Let's be clear. What we're talking about is a world-class if not the world-class property bubble. And by property bubble I mean primarily high-rise buildings, offices and condos going on in China. It really is somewhat remarkable as to just how focused the investment in China is right now in property.

CHARLIE ROSE: What makes it a bubble? And why aren't more people believing that it's a bubble?

JAMES CHANOS: We consider -- what we define as a bubble is any kind of debt-fueled asset inflation where people are borrowing money to buy the asset, where the cash flow generation from the asset itself, a rental property, office building, does not cover the debt service and the debt incurred to buy the asset.

So you depend on a greater fool, if you will. I think Hyman Minsky called it the "Ponzi finance," meaning you need the greater fool to come in and buy it at a higher price because as an income-producing property, it's not going to do it. And that's certainly case in China right now.

CHARLIE ROSE: But why so many people resistant to your idea that it's a bubble that the Chinese can't take care of?

JAMES CHANOS: Well, that's the issue. The issue is not in the facts, in the amount of real estate being built and being contemplated. They are what they are. You can see it, it's tangible.

CHARLIE ROSE: Values and I don't know whether this is rental or appreciation -- in 2009 it went up 50 percent.

JAMES CHANOS: It's appreciation.

In fact, a lot of these apartments are empty. That's the amazing thing. When you buy an apartment in China, typically a high end project, you get an empty shell. You don't even get internal walls, floors.

And what's even more interesting, as we did our research, was the realization that investors who buy more than one property -- as often we saw in Miami and other markets in the U.S. -- they keep them empty. They don't rent them because it's much easier to sell an unoccupied apartment for the next speculator to flip it.

So we're seeing some remarkable behavior that if we put our time machine back in 2005 in Miami or '06 and '07 in Dubai, people will say "Well, why didn't they see this coming? This was obviously so silly." Well, it's happening in China right now.

CHARLIE ROSE: Not only that. You say it's a thousand times worse than Dubai.

JAMES CHANOS: We said that tongue firmly planted in cheek, but then

again I've seen some news reports -- this week, for example, there's a developer according to a news report out of China that's going to put in a new Times Square in suburban Beijing, replete with 32 Broadway theaters.

And you're beginning to hear about these bizarre developments in China -- indoor ski resorts, similar to what we saw in Dubai. We were remarking on the country being much bigger than Dubai, of course. But keep at it another couple of years and it will be Dubai times a thousand.

CHARLIE ROSE: And what can the Chinese government do if they buy into the idea their real estate prices are approaching a bubble?

JAMES CHANOS: Well, they've already begun to take some steps. We're seeing what we call jawboning, some attempts to talk the market down. That's not having much of an affect according to the prices we've seen in February and March.

They've also begun to take some steps as requiring higher down payments for second homes. And so we're seeing some things on the margin.

But the fact of the matter is the game has to keep going. They're on this treadmill to hell, as I call it, because so much of their GDP growth is construction -- 50 percent to 60 percent of this country's GDP is construction. We've not seen that in terms of a major country I think for a long time if not at all.

And so for them to get off of stopping construction, you'll see GDP growth go negative very quickly. That's not going to happen, because in China it's all about making the number. People are rewarded at almost every level of government of making their economic growth numbers. The easiest way to do that is put up another building.

So they're really hooked on this sort of heroine of real estate development to keep the numbers going. It's not infrastructure. It's not airports, high-speed rail. There's some of that. And it's not exports. Exports have been stagnant now for a while. And it's not the consumer in China, either, despite what people believe. It is construction, real estate construction.

CHARLIE ROSE: Tom Friedman has waded in on this.

(LAUGHTER)

JAMES CHANOS: I know.

CHARLIE ROSE: He said "Never short a country with \$2 trillion in foreign currency reserves."

JAMES CHANOS: Yes. The last two economies that had similar foreign currency reserves relative to the size of their economy was Japan in 1989 and the U.S. in 1929. I'll let that be the end of that discussion. It just -- it has no bearing on whether there's a domestic credit bubble or not.

In fact, countries embarked on domestic credit bubbles often tend to

basically accumulate foreign currency reserves.

CHARLIE ROSE: But so many people -- this is my sense of disbelief -- look at the numbers that you talk about. So many people have so much invested in the future of China.

JAMES CHANOS: Literally invested.

CHARLIE ROSE: Exactly. I mean, I read today about a major private equity firm, billions of dollars, and continuing to invest --

JAMES CHANOS: Yes.

CHARLIE ROSE: -- believing that China is the future, that China will be the biggest economy in the world by 2035.

JAMES CHANOS: Yes. Well, it very well --

CHARLIE ROSE: And they wouldn't do that if they didn't believe China could handle this housing problem.

JAMES CHANOS: Well, again, the perception seems to be that China will grow into this real estate problem. But there's a problem with that argument, and that is the real estate that's being built is not being built for the masses. This is not affordable housing for the middle-class. This is high-end condos in major urban areas and high-end office buildings.

Just to give you an idea, right now construction costs in China are starting to hit \$100 to \$150 in some of the cities. That doesn't sound a lot by western standard -- per square foot, by the way. The typical Chinese condo is 100 square feet, about 1,100 square feet.

So that means a condominium that is basically presented to you with no floors, no walls, no appliances, costs the average Chinese two-income couple \$100 to \$150 U.S. Now, that Chinese two-income couple in their 30s probably makes combined \$7,000 or \$8,000 a year.

Now, you do the math. Incomes are about \$3,500 per capita in China, urban areas slightly higher. Even if they were making \$10,000 to \$15,000 a year, you couldn't carry a \$150,000 condo. This is very similar to someone making \$40,000 in the U.S. at the height of our bubble and buying an \$800,000 house. And we know how that ended.

CHARLIE ROSE: I want to speak that. The similarities between the American housing bubble -- which was the beginning of the subprime crisis, which was the beginning of the global economic meltdown.

JAMES CHANOS: Yes.

CHARLIE ROSE: What are the similarities?

JAMES CHANOS: In many cases in this real estate area the excesses are hidden in terms of debts, the credit creation. In the U.S., it was fairly visible. People with very low incomes or non-verifiable incomes were taking on large mortgages. And the mortgages were securitized as we now

know and spread out throughout the world to do their damage.

In China, much of the hidden leverage -- and there's been a lot of groundbreaking work on this in the last few months actually -- is at the state and local government area, where state and local governments make almost all their money from land developments. They don't have property taxes.

And a lot of them simply recycle borrowed bank borrowings to do more land speculation to raise more government revenues.

So although consumers typically only put up 20 percent to 30 percent and borrow 70 percent to 80 percent, unlike in the U.S. where it was often 100 percent, there is a lot of -- the difference is there's a lot of implied leverage at the intermediate government area.

And that's where a lot of this debt is going to go bad and where we think ultimately China will have to nationalize a lot of the bad loans.

By the way, there's a history of this. This happened in the mid-'90s. There was a banking crisis in China. Property prices collapsed. The government nationalized the bad debts, put them in separate vehicles, and it was the outside speculators got burned, your private equity guys.

CHARLIE ROSE: Yes, indeed.

What's the psychology of this today? Because -- and is it comparable to Enron? When you began to make noises about there's something wrong with Enron, is it the same thing in terms of what you hear and what people say?

JAMES CHANOS: Well, I think that --

CHARLIE ROSE: That's a company versus a country.

JAMES CHANOS: But it's similar because Enron was symbolic. That's as far as I go, that Enron was symbolic of a new type of company, a virtual company that was not really an energy company. It was in energy trading. And so a lot of people hooked their reputations and their money on this new vision.

China is much more tangible. I mean, we're going to be able to tell whether we're right or wrong on China literally by watching it. The thing about property bubbles is when the cranes stop going higher, when the buildings stop being built, and when they stop putting foundations in the holes in the ground, you know that the bubble is over. It happened in Miami, it happened in Dubai, it will happen here.

CHARLIE ROSE: OK, then give me the timeline that you see.

JAMES CHANOS: Ah, that's the trouble, the timeline.

(LAUGHTER)

If I do that, I'd be a rich guy. The timeline -- I think that it's getting to the point now -- We're starting to see some of the signs of

silly excess. The new Broadway development, the malls -- giant malls empty, whole cities empty. My guess is this is probably at some point it begins to run its course in late 2010, 2011.

CHARLIE ROSE: And then what happens?

JAMES CHANOS: I don't know. That's a good question. It depends how the -- the government clearly -- everyone's looking to the government. And I think the most cogent argument against our case is not that there isn't a property bubble or bull market going on, it's that the government will handle it.

CHARLIE ROSE: Exactly.

JAMES CHANOS: And that will be the interesting question to see how it does handle it and how it handles foreign investment money that will be clamoring to get out, how it will handle people clamoring to be bailed out just like we were, whether the government will penalize western speculators more than Chinese speculators.

Will it penalize speculators at all? We don't know. Will it simply inflate the currency to bail out everybody else? It has a closed system, so it could be handled in a lot of ways.

CHARLIE ROSE: But on the other hand, it has a group of leaders who have recognized it had problems before. They understand the need to build up domestic demand --

JAMES CHANOS: Yes.

CHARLIE ROSE: -- to fuel their economy.

JAMES CHANOS: Right.

CHARLIE ROSE: They understand that well. It's one of the reasons they have the attitude they do about their currency.

JAMES CHANOS: Right.

CHARLIE ROSE: They understand and need to stimulate their economy. They put \$500 plus billion in a stimulus program. They understand the need to --

JAMES CHANOS: A lot of which went into real estate, by the way.

CHARLIE ROSE: Well, yes. They understand the need to find alternative sources of energy.

JAMES CHANOS: Yes.

CHARLIE ROSE: They understand and deal with their future in remarkably smart ways. Why won't they be smart about this?

JAMES CHANOS: Well, because the previous times they've had troubles it's been much smaller relative not only to their own economy but to the

impact on the global economy, number one.

Number two, the problem I have philosophically with that argument is that when you talk to western investors, who were absolutely abhorrent about government in the U.S. getting more involved in our health care sector -- the free market does it better, accurate pricing reflects supply and demand, why should government meddle? -- have no problem with nine guys in a room, the central committee of the politburo, the Chinese Communist Party, determining economic policy, and determining when they make mistakes how to get out of those mistakes.

And the fact of the matter is this one is going to be bigger than those nine guys.

CHARLIE ROSE: That's your argument, this is bigger than anything they've seen before, and therefore it's in question as to whether they have the ability and the commitment to stop it?

JAMES CHANOS: And the skill.

CHARLIE ROSE: And the skill, ability and skill.

All right, Ken Rogoff, who's been on this show, who is a pretty smart economist, said "In my work on the history of financial crises with Carmen Reinhart," his partner in this, "we find that debt-fueled real estate price explosions are a frequent precursor to financial crisis."

What do you expect the ramifications to be when this Chinese bubble bursts? What happens if nothing is done?

JAMES CHANOS: Well, it will run its own course no matter what because you, of course, now have people trying to develop any piece of property they can get their hands on to sell it to real estate speculators. So supply will equal demand at some point. It always does.

And then there's this precarious tipping point where suddenly you can't sell a project. And then it's just as if everyone from the port side of the cruise ship goes to the starboard side of the cruise ship all at once. You get a tipping point, you get this sort of light bulb moment "I've got to get out while I can," and the buyers dry up. It's as old as markets itself.

CHARLIE ROSE: OK, but this is not Dubai World. This is the People's Republic of China. What are the global implications?

JAMES CHANOS: Well, that's an interesting question.

We're all looking at -- one of the most obvious, obvious trades of the world right now is that the RMB, the Yuan is undervalued. Mr. Geithner I think is in Beijing tonight talking about whether or not China is a currency manipulator. Everyone is assuming China needs to peg its currency higher to avoid the export deflation going on.

Well, Chinese exports aren't the problem here. And what if it turns out that by having to nationalize lots and lots of real estate, bad debts,

the RMB is devalued? That's something --

CHARLIE ROSE: The other way.

JAMES CHANOS: Exactly. That's something nobody's expecting because - particularly all the hot money that's going into China. Keep in mind a lot of money going into China is Chinese nationals outside the country in London, Singapore, Vancouver, San Francisco, who are trying to get in on the bubble, too.

CHARLIE ROSE: But it's just -- there's a lot of global capital that flows to where it think there's opportunity.

JAMES CHANOS: Yes.

CHARLIE ROSE: And the opportunity in the last, what, five years has been China and India.

JAMES CHANOS: Right.

CHARLIE ROSE: Emerging nations.

JAMES CHANOS: Right.

CHARLIE ROSE: Especially Asia.

JAMES CHANOS: Yes.

CHARLIE ROSE: So if there is a collapse, tell me what the collapse looks like and is does the impact, say, for the United States?

JAMES CHANOS: Well, one proviso I'll give you is that the history of western investors making a lot of money in China is not a great one.

CHARLIE ROSE: Yes.

JAMES CHANOS: There's been a couple wonderful books, including one called "Mr. China" about two investment bankers who set up shop right after Tiananmen Square. They spoke Mandarin, they were connected. They hired the kids of the high party officials.

And they couldn't have gotten it more right from a big-picture point of view. And they wrote this book a number of years later on how they were lucky to get out with their skin. They were completely bankrupted by China.

CHARLIE ROSE: Suppose you're right. What does it mean for the rest of us?

JAMES CHANOS: I don't know. These things shake out in different ways. Does it bring on a -- if they devalue the RMB, does it bring on a trade war? I don't know. Certainly we're all assuming the currency will be revalued upward. What if it doesn't? Does China sacrifice its middle-class, burgeoning middle-class who are becoming real estate speculators? Does it fry them in the --

CHARLIE ROSE: Politically it can't afford to do that.

JAMES CHANOS: I don't think so either. So what does it do? Does it sacrifice the western investors? Can it politically afford to do that? They're going to be facing difficult choices.

CHARLIE ROSE: And what might they do with all those dollars it holds.

JAMES CHANOS: Well, they're going to need those dollars to in effect sterilize the banking system. And that was what we needed our currency reserves, by the way, in 1929, our pounds and gold reserves and what Japan needed in 1989.

CHARLIE ROSE: So if the bubble bursts they'll need the dollars.

JAMES CHANOS: Absolutely.

CHARLIE ROSE: So that's good they have all those dollars.

JAMES CHANOS: I think it's the one asset they have.

CHARLIE ROSE: Transparency. Is that a big issue?

JAMES CHANOS: It is. We by and large --

CHARLIE ROSE: The absence of transparency.

JAMES CHANOS: Yes, absence of transparency.

We're using Chinese figures for our reports and our conclusions. But I take them with somewhat of a large grain of salt. I think they're much more optimistic than need be.

And I think that, for example, China does not produce any statistics in its government series of depreciation of fixed assets. For an economy where construction is 50 percent to 60 percent of your economy, if you don't give analysts or economists any data on how you're depreciating those airports and bridges and -- you know, things could be a little misleading, particularly in an economy where they seem to replace this stuff every four or five years. So that's a problem.

And then I'm more concerned even philosophically about the whole idea -- as we say, it's all about the number. So in the west our economic growth is a result of decisions that you make and I make and that the market reflects via pricing, and at the end of the day we calculate all activity, and that's our economic growth.

In China it starts with, "We are going to grow nine percent next year. Now, how do we get there?" It's the start of the equation and the activity is the residual. And that's ultimately philosophically the problem.

CHARLIE ROSE: The problem is they need to grow nine percent a year and so therefore they're not going to take steps that might engender that nine percent to fix something they're not sure is broken?

JAMES CHANOS: Exactly, because we don't want to lose face and because it's all-important to my advancement in the Communist Party and my local party to make that number.

CHARLIE ROSE: So when you saw Enron and figured out Enron was in trouble --

JAMES CHANOS: Enron was about making the number, by the way.

CHARLIE ROSE: Yes, and you say they were in trouble. And there was publicity and reporters wrote about what you were thinking. It put you on the map, first of all, when it turned out right. What did you do? You went out and shorted the stock?

JAMES CHANOS: We did some work based on a piece that a great "Bloomberg" writer John Wyle wrote in the Texas "Wall Street Journal." He put a piece out that was lost in the shuffle about firms like Enron that had just gotten the SEC to agree to their new mark-to-model accounting that allowed them to take in up front all the profits they expected on a derivative sale immediately.

We had seen this before in the insurance business when I started my career, and annuity companies used to do that until they all blew up. So we started looking at Enron in the fall of 2000 on the basis of that article, and immediately as we started looking at the SEC filings things caught our eye, the disclosures about these offshore entities doing business with Enron --

CHARLIE ROSE: It all became a giant confirmation for you.

JAMES CHANOS: As we did more and more work, everything fell right into place of something very, very wrong -- heavy insider stock sales, heavy executive departures, odd disclosures, and a lot of gobbledygook in the financial statements.

And so everything we did began to confirm fairly easily the perception that this was a company that was aggressive. Even we didn't think it was a fraud until basically Jeff Skilling resigned, and that's when I knew there was something -- it wasn't just a gray area, it was in the black.

CHARLIE ROSE: What if you'd been wrong? What would have been the consequences for you?

JAMES CHANOS: We would have lost money. I mean, it would have -- we're wrong on things all the time.

CHARLIE ROSE: Would it have threatened the firm?

JAMES CHANOS: No, no.

CHARLIE ROSE: Just a small investment --

JAMES CHANOS: No one position is ever more than five percent of our capital.

CHARLIE ROSE: OK, so what if you're wrong on China? You just take a loss?

JAMES CHANOS: Yes, sure.

CHARLIE ROSE: That's it.

JAMES CHANOS: Of course.

CHARLIE ROSE: But if you're right on China it has implications for everybody?

JAMES CHANOS: Well, I think it has implications for more than just my investors, yes.

CHARLIE ROSE: So if you're right you have to back up your idea with your money.

JAMES CHANOS: Yes.

CHARLIE ROSE: So what will you do? Where will you short? Construction companies? Other people that are building things in China?

JAMES CHANOS: By and large those are Chinese companies. But there are some Chinese land development countries that trade in Hong Kong. Increasingly there are ways to play Chinese companies outside of the China market in either Hong Kong or New York.

But probably more importantly from an investment point of view those this has implications for the people selling stuff to China, commodity, people -- anything that are selling things to people who put up high-rise buildings, cement, glass, copper. That's where you're going to see probably a step function down in demand -- steel, because right now it's all going into China.

CHARLIE ROSE: Those are the companies you will short and are shortening now I assume?

JAMES CHANOS: Yes, sure.

CHARLIE ROSE: Short selling generally. What do you think the reputation of short sellers is?

(LAUGHTER)

JAMES CHANOS: Well, after Enron I thought it was getting better. But with the financial crisis of '08 when, thanks to some of my friends in the banking industry, we started sprouting two horns and a tail again.

CHARLIE ROSE: It's more than that. Your friends in the banking community who run some of the biggest banks we know thought that you were part of the problem.

JAMES CHANOS: Yes.

CHARLIE ROSE: And they asked Paulson and others to stop them.

JAMES CHANOS: Absolutely.

CHARLIE ROSE: Otherwise they are aggregating -- they are causing the problem.

JAMES CHANOS: Yes, and without a shred of evidence. And yet every banker went down to Washington in April of '08 and went on till Lehman collapsed.

And we joked, the two things they asked Congress and the SEC was not to accept their apologies for screwing up or to get some capital forbearance for a while so they could be get house in order. The two things they asked for was liberalize the accounting again on mark-to-market and stop short-selling. So that ought to tell you something.

Now, what I have pointed out to people in the government, and I'm hoping somebody asks somebody under oath, is that our view was that the largest short sellers in purchasers of credit default swaps in the banking industry in '08 were the other banks, and for a good fiduciary sound reason. They were counterparties with each other. They were all interrelated.

And the only two ways to hedge your exposure on anything that you can't sell -- I have a promise from Charlie Rose, Inc., to make good on some payments down the road -- is to short Charlie Rose Inc.'s shares or to buy credit default swaps in Charlie Rose Inc.'s Debt.

And banks acting in a fiduciary sound manner are trying to hedge off the exposure to Lehman or Bear Stearns can in and of itself have a destabilizing effect broadly speaking on the market. And Bill Akman and others have pointed this out as well.

And I would love to see the trading records of the proprietary trading desks of the big banks during 2008. I would like to see if they were shorting each other and buying credit default swap protection in each other.

CHARLIE ROSE: Are you suggesting to people like Barney Frank that that might be an appropriate subject for investigation by the financial services committee?

JAMES CHANOS: Absolutely, or the financial inquiry commission. We need to find out, because so much of this narrative was hedge funds and short sellers being vilified and being pointed to as the cause or additive to the problem. And, in fact, people like me were covering our financial shorts in 2008. We had put them on in 2005 and 2006.

CHARLIE ROSE: Do you think the financial services committee the financial inquiry committee will do this?

JAMES CHANOS: I hope so, because I think it's important to understand who were the villains, who were the guys wearing the white hats, who were

wearing the black hats, who was calling out warnings correctly, who was asleep at the switch. We need to find this out.

CHARLIE ROSE: What have we learned from the recent disclosures from the Lehman investigation?

JAMES CHANOS: Well it wasn't short sellers.

(LAUGHTER)

I mean, look, when Lehman went under --

CHARLIE ROSE: That's part of your mantra now. But when you look at what happened to Lehman it wasn't short sellers. It was executive action.

JAMES CHANOS: It was Lehman. It was Lehman. When Lehman went under their debt -- the credit default swaps on their debt settled out at nine cents on the dollar in October, one month after they went bankrupt.

We publicly pointed out the time that that was on the basis of \$150 billion of Lehman's debt. So the debt was impaired by 90 percent, roughly, or \$135 billion. Couple that with the \$20 billion of equity that was wiped out, we confidently said in October of '08 that the hole at Lehman brothers was \$150 billion give or take.

The hole at Enron, Charlie, when the bust settled was about \$65 billion. Lehman was twice Enron. We haven't even gotten to AIG yet.

So the magnitude of the holes in these balance sheets -- and Secretary Paulson eluded to it in his account when he said the banks look at Lehman's books in the last fateful weekend, they realized that the stuff was overvalued by 100 percent still.

So as I pointed out, you can be --

CHARLIE ROSE: That's why they couldn't get anybody to buy it.

JAMES CHANOS: Exactly. You can be off by a billion here and a billion there, maybe. But when you're off by a \$150 billion on a \$600 billion balance sheet, there's fraud involved. There's fraud.

And someone knowingly signed those financial statements, which is a violation under Sarbanes-Oxley, and signed financial statements they knew not to be fair and accurate.

CHARLIE ROSE: So you think there ought to be more criminal indictments?

JAMES CHANOS: I think there ought to be a lot of criminal indictments in what we saw, because you have to understand that the -- what John Kenneth Galbraith called the nub of the crime -- was simply taking aggressive marks on illiquid derivatives and hard-to-value securities, calling it profit, and paying yourself 50 cents on the dollar a bonus. You were stealing from your shareholders.

CHARLIE ROSE: You went to Yale. You didn't intend to go into business.

JAMES CHANOS: I was pre-med for about three weeks.

CHARLIE ROSE: And then what happened?

JAMES CHANOS: I didn't want to walk up Science Hill.

(LAUGHTER)

CHARLIE ROSE: So you started looking towards business.

JAMES CHANOS: Yes.

CHARLIE ROSE: What brings you to short-selling?

JAMES CHANOS: It was completely an accident. One of the very first companies when I left investment banking and went to work for a retail brokerage firm in Chicago in '82, one of the first companies I was asked to look at was a high flying insurance company gobbling up all kinds of other S&H green stamp and MGIC insurance. It was called Baldwin United, the old Baldwin piano company, and it transformed itself into a financial services juggernaut.

And it just was completely all smoke and mirrors. And so as we did some work and began to pull on strings and the strings pulled back, and we documented all our work with documents from state insurance departments and a variety of other things, they were selling annuities to Wall Street firms and booking all the profits, a la Enron, up front.

And I put out a couple of sell and sell short reports on Baldwin. The stock promptly doubled, which was my first real introduction to the short side. We were ridiculed and threatened with lawsuits. All the sort of stuff short sellers live with, as I learned very quickly.

And then the company was -- insurance companies were seized on Christmas Eve 1982 and the company was rendered insolvent almost overnight.

CHARLIE ROSE: So what we should be looking to over the next six months is what in China?

JAMES CHANOS: I think evidence that the government efforts to jawbone this thing actually turn into much more strict policy where you see actual restriction on loans or they cut back -- let's face it. The governments control the largest banks there and if they want to stop this funding they can.

I think right now because there's so much world attention being focused on China in this property bubble that they're trying to take steps to reassure investors that they're on it, they're on the case.

But we're still seeing big property rise numbers month to month in March and February, the big cities, and it seems to me that all systems are still go for speculation. So I'm not quite sure yet that the actions are

matching the words. And that's something to look for.

CHARLIE ROSE: But you don't think they will take the necessary measures not because they don't recognize the problem, but because they have these other issues, which is expected annual rate of growth?

JAMES CHANOS: They can't afford to. As I said, they're on a treadmill to hell. They can't afford to get off this heroine of property development. It is the only thing keeping the economic growth numbers going.

CHARLIE ROSE: And that's the question, isn't it?

JAMES CHANOS: How do you go cold turkey? I don't know.

CHARLIE ROSE: Thank you.

JAMES CHANOS: My pleasure.

CHARLIE ROSE: James Chanos.

Back in a moment. Stay with us.

CHARLIE ROSE: Stephen Green is here. He is group chairman of HSBC where he was CEO from 2003 to 2006. He's also an ordained priest in the Church of England.

With his new book, he draws on both of those roles to explore the intersection of business and ethics. The book is called "Good Value: Reflections on Money, Morality, and an Uncertain World." I'm pleased to have him here at this table for the first time. Welcome.

STEPHEN GREEN: Charlie, thank you.

CHARLIE ROSE: Good to have you here.

STEPHEN GREEN: Good to be here.

CHARLIE ROSE: The obvious thing everybody wants to know is how did a priest end up as CEO as one of the largest financial institutions in the world?

STEPHEN GREEN: Well, I have to say I didn't start as a priest. That is to say when I left college and started my career -- actually, I started in the British civil service, then I went to McKenzie, and now I ended up in the bank, and it was in my mid-career in the bank when I felt this urge to explore what is quite common in England. We call them non-stipend stipend ministers, a mind-numbingly boring for people who stay in secular careers but get themselves trained, accredited, and ordained and there function as a fifth wheel, if you will, in church on Sundays.

CHARLIE ROSE: What's the most important thing you came away with from that ecclesiastical training and experience?

STEPHEN GREEN: Well, I think in many senses what it does is heighten

your awareness of the issues about spiritual well-being, about purpose in life, about the need to have an integrated view of what it takes to be a whole person.

And in particular I think that's relevant to business life because so many of us run the risk -- actually, all of us run the risk -- of what you might call compartmentalizing our lives into a work life where you run your life according to certain kinds of rules, a home life, a social life where you run different kinds of rules.

That's not at the end of the day spiritually healthy, to say the least.

CHARLIE ROSE: Are you a better banker because you had this experience?

STEPHEN GREEN: Well, I wouldn't know about that and nobody is perfect. But I certainly believe that it has helped me think through the issues that you confront on a daily basis.

CHARLIE ROSE: Give me an example.

STEPHEN GREEN: Well, I think it's inevitable as you confront the various challenges of being a banker in the world today or any other kind of business life you run into all sorts of difficult decisions. Very rarely is life a matter of black and white. Usually it's shades of gray.

And finding your way through that, recognizing human imperfection in yourself and the people you deal with, and also understanding the potential in yourself and the people you deal with such that you confined the best result for the common good, I think that's a constant challenge for us all. It's awfully easy to ignore it.

CHARLIE ROSE: You also make the case for bankers, that banking is an essential part of our community.

STEPHEN GREEN: Yes, I certainly do. I do not believe you can run modern societies and economies without having prosperous, thriving, vibrant banks as part of the system.

I mean, for all of the issues that have been thrown up by the financial crisis in the last two to three years, there is no question of an alternative the way that does without the financial markets. We need the markets. There are lots of things to be said about their imperfections for sure, but one thing you cannot say we can somehow turn our backs on them all together.

CHARLIE ROSE: Tell me what financial reforms need to be made today.

STEPHEN GREEN: I think -- I mean, some very technical ones, and we can spend an average talking through those.

CHARLIE ROSE: Risk ratios --

STEPHEN GREEN: You have to ensure the system the properly

capitalized. You have to ensure the system is properly liquid, that it's not overly leveraged, the people understand the kinds of products they're selling to the customer and why it's reasonable to sell them to the customer.

In other words, there that's a lot to do with suitability and fairness and rightness. And it's those questions that have been brought to the fore in a way that were probably too ignored looking back to the go-go years.

CHARLIE ROSE: As you know, there's much discussion here of something called the "Volcker rules" in which he would, for example, deposit banks who received deposits would, in fact not engage in proprietary trading. Is that a good idea?

STEPHEN GREEN: I think what is important is to think about how you would define proprietary trading. What is I think common consent is that banks that depend on depositor confidence but have a social function to perform -- they provide credit to the modern economy -- should not become casinos.

And we need to make sure that they are properly stable, properly risk-managed. And it's very clear from what has happened in the last three or four years that there are a few lessons to be learned here.

I think that the detailed discussion now going on in an international context focused particularly in Switzerland, will result in an approach to the capitalization of the system which will leave with us a much more robust system than we've had in recent years.

CHARLIE ROSE: The president of France at Davos suggested we need another Bretton Woods and we need to do something about the dollar as a reserved currency.

STEPHEN GREEN: Well, I think that's a very different issue, and I don't think myself think you can go back to Bretton Woods, meaning fixed exchange rates regardless of what's going on in different economies of the world.

And, indeed, there's an interesting point. For all of the trauma of the recent years of crisis, one of the markets that continued to function in a reasonably satisfactory man we are plenty of liquidity was the foreign exchange market.

I don't myself think that the lessons that we have had to learn recently have to do with the foreign exchange market or currency relativities.

CHARLIE ROSE: What were the lessons we had to learn?

STEPHEN GREEN: They are about suitability of product, complexity of product, over-complexity of product. They are about a capital market in which banks were being encouraged to over-leverage themselves, to over-gear themselves, to expect unreasonable rates of -- unrealistic and unsustainable rates of growth and unsustainable levels of profitability.

And there were distortions in the market that need to be ironed out.

I think it's also true at the level of purpose and values, and here I think the important part of the discussion. I mean, there's plenty of technical debate going on, but the important part of the discussion for now, I would suggest, is this important question about purpose and values.

It's as if what we had known in the last 20 years was a form of market fundamentalism which created a sort of atmosphere which kind of said if I've got a product, if there's a market, I've got a contract and it's legal, I don't need to ask any other questions about rightness or suitability or fairness.

That won't do. We all know it won't do. It isn't the way we run the rest of our lives, why should it be acceptable in business?

So there's a real sense in which the market became too fundamentalist -- that's not a bad word to use -- too convinced of its own efficiency, its own self-policing ability, and too convinced that there were no other questions that were relevant to daily business.

CHARLIE ROSE: So therefore you need regulation and you need financial system reform?

STEPHEN GREEN: I do think you need both those things. I would also go on to say regulation is both necessary and absolutely not sufficient. You cannot by law or by rules guarantee the appropriate behavior in the markets. You need to focus on the kinds of values that are brought to bear, the ethics that people do their business with.

And indeed there's another reason I think that's true, and that is at the end of the day people who, let's face it, spend 90 percent of their creative energy and potential in that work lives, and in this case what we're talking about is the financial markets, need to have a sense that they are making a contribution, this that there is a contribution to the common good that lies behind all this.

So I think it's in the interests, the psychological, spiritual interests, if you will, of the people who are at work in the markets that we address sneeze questions as well as it being in the social interest.

CHARLIE ROSE: It's a whole interesting philosophical question. Can you impose values is one. Can you legislate values is another. And a third is, as in most institutions there are people who have the values you're talking about and some that don't. That's human nature.

STEPHEN GREEN: That is human nature. And what is also human nature is that none of us are perfect, and we need never to forget that rather important point. But there is a real sense in which you can't legislate for values. You can legislate to set expectations, to set social norms.

And I absolutely believe the markets are not self-policing. You cannot just leave it to the markets to correct their own deficiencies. So you need the legislative environment. You need the regulatory supervision.

But at the end of the day, as I said, this is necessary but not sufficient. What you cannot do is legislate to guarantee the right sort of behavior.

CHARLIE ROSE: Do you believe that we have made the changes so far, learned the lessons so far that this kind of bubble will not occur again and this kind of system failure will not occur again?

STEPHEN GREEN: I think we have learned a lot of lessons from the crisis, and I think there are lessons still being processed, if you will. There's an important debate going on at the international level this year, 2010, which will result I believe in a framework of capital adequacy and so forth to be much more robust. So those kinds of lessons I think are being learned.

CHARLIE ROSE: You point out in this book among other things that was amazing was the rapidity of the decline, unlike that depression.

STEPHEN GREEN: And another lesson -- I'm not an economist, but I suspect economic historians as they get into what happened, they will focus on precisely that fact, how fast a financial crisis turned into a real economic downturn.

I suspect that has something to do with the impact of a very globalized interconnected economy and just-in-time management, which the corporate world has been working on for many decades, honing and honing and honing.

And if you got global just-in-time management, it's not particularly surprising that a financial crisis leads to a loss of confidence, leads to a very rapid downturn.

CHARLIE ROSE: There is some populist rage in this country, as you well know, against Wall Street and the financial sector because, they say, you know, we had to bail you out and you made all these mistakes, and at the same time you have engaged in these compensation practices that were unreal and you continue to do so even today.

STEPHEN GREEN: Well, I think looking backwards it's very clear that there were compensation practices around in parts of the industry, not all of the industry, by the way, but parts of the industry that were, to use your phrase, unreal.

That is to say they were distorted. They were based, for example, compensation being paid on gross income instead of net income minus the capital charge, compensation on first day PNL with no allowance for the tail risk that stayed with the institution and therefore compensation that was not aligning the interest of the individual with the interest of the shareholder that led to the wider public interest.

These were clearly prevalent looking backwards. The G-20 has addressed this, they've announced some principles. In my country, in the U.K., the FSA, the banking regulator in that country, has produced a code which they have made mandatory. That code will require compensation to be structured in a way that aligns the risk left with the institution,

properly with the incentives of the trader.

So I think as that beds down you're going to see a marketing compensation which is more effective, more reasonable. I can't tell you what that means in terms of quantum, but as it beds down you can at least be sure that if you like -- put it this way -- proper pay is being paid for proper performance.

CHARLIE ROSE: What's the biggest misconception about the compensation issue?

STEPHEN GREEN: Look, I think it's a real issue. To say there are misconceptions, I think there are real issues of the kind I've just described looking backwards.

CHARLIE ROSE: Right.

STEPHEN GREEN: I think the important thing with compensation is to eliminate those distortions. I think the regulatory environment has moved substantially in that direction, and therefore looking forward you will see compensation environments that are much more aligned to real performance and the incentives are aligned with real risk.

So there's definitely work to be done looking backwards, definitely issues to be addressed. But I think the global community, both the regulators and the regulates, are on the right track on this.

CHARLIE ROSE: OK, but you mentioned the G-20, that there's kind of a global agreement on many of the issues, and there was, and everybody was kept informed in terms of governors of banks and central bankers kept each other informed and communicated well.

There are different kinds of proposals for financial reform now. For example, in your own -- in Britain the governor of the Bank of England has suggested breaking up large financial institutions as I understand it.

STEPHEN GREEN: You're correct. And others have talked about the issue of whether certain institutions are "too big to fail." And that's a discussion that needs to be had.

CHARLIE ROSE: But can you have an international agreement on that?

STEPHEN GREEN: There's a lot of international discussion going on that, and in order to reach some kind of practical resolution you need the international agreement.

CHARLIE ROSE: So the capital won't flow to one place or other, among other things.

STEPHEN GREEN: I also think it is important to think carefully through what you actually want to implement as legislative and regulatory reform.

One thing for sure is that the markets are too important for us all for us not to get this right. I do believe it's more important to get this

thoroughly talked through, debated, the development of a consensus that makes sense in relation to the needs, than to say we have to have all this place in three months flat.

CHARLIE ROSE: The subtitle is "Reflections on Money, Morality, and an Uncertain World." Clearly we live in an uncertain world, even more so I suspect today as a kind of realignment --

STEPHEN GREEN: There's some very fundamental changes taking place.

CHARLIE ROSE: So it is an uncertain world. Do you have any crystal balls you'd like to share with us in term of how it will shape up and the relative significance of the American economy and the European economy and the Latin American economy?

STEPHEN GREEN: I do. Crystal ball, you never kid yourself you've got a crystal ball. But I do have some views on some of the fundamental shifts taking place in the world today.

And this is a shift that's been on the way for some time. The financial crisis has, if anything, accelerated it, and that is the shift in central gravity from west to east. This is about the rise of Asia. This is talked about as if China is the only topic of agenda but it's not. This is the rise of Asia as a whole, parts of Latin America. I believe that Africa is beginning to show quite significant signs of growth now. So there's a lot going on in the emerging market.

CHARLIE ROSE: So should we talk about that -- exactly my point -- emerging markets rather than a shift to Asia, because Brazil is not in Asia.

STEPHEN GREEN: Yes, you should talk about it as a shift of emerging markets, although it is true that the critical mass is Asia and is likely to remain so.

CHARLIE ROSE: And the population mass.

STEPHEN GREEN: And this has implications. It has implications at the level of coordination on the world stage of all sorts of matters of common interest. The emergence of the G-20 as the coordinating mechanism for international response to the crisis is in my view very significant.

The G-7 has in some ways been marginalized, and what you're seeing is the emergence of a group of nation, which includes, of course, the developed nations, but also the likes of China and India, Saudi Arabia, Brazil, because that's the new reality.

The new reality is that the world's economy is more broadly spread, as it should be, actually, from the wider perspective. There's no kind of God-given right for the Europeans and Americans to own 60 percent of world output.

CHARLIE ROSE: Exactly.

Is it immoral for Europe and the United States to own 60 percent of

the world's output? Morality is on the cover of your book.

STEPHEN GREEN: We understand why it happened. The industrial revolution took place.

CHARLIE ROSE: But was it immoral for so much --

STEPHEN GREEN: Well, at least let me put it this way. Whilst that's true, the wealth is concentrated in a small --

CHARLIE ROSE: And consumption of energy resources and everything else.

STEPHEN GREEN: You cannot regard that as the new Jerusalem. You cannot say we've reached utopia. You have to say there's a challenge, because so much of the rest of the world has been left out of it.

Now, the good news is that's beginning to change. The challenge is that change does represent a challenge for countries in Europe, Japan, and North America, yes.

CHARLIE ROSE: How are they adjusting to it?

STEPHEN GREEN: Well, it will be -- it's a process that will take some time. It changes a lot of things. It's a challenge at the level of countries and their policies. It's a challenge at the level of practically every business you can think of. Every business you can think of has got to ask itself the question, what does it mean for me that Asia is rising as an economic producer and consumer? Does this mean threats, opportunity? Can I outsource?

CHARLIE ROSE: The smartest business people I know believe it represents an opportunity.

STEPHEN GREEN: And I believe it does. But it's also a challenge for many businesses, let's be realistic. And then at the level of the individual, it represents a challenge and an opportunity.

The world is opening up. There is no turning back on in this in my view. You could not, we should not want to, you could not in practice turn the clock back to some simpler, less connected world.

CHARLIE ROSE: Put a name on it. That you believe globalization is past the point of being able to change the progress of globalization, and we shouldn't, because it's lifted more people out of poverty in the last 20 years than ever in the history.

STEPHEN GREEN: That's what I believe.

I would in the next breath want to say there are plenty of issues, there are plenty of stresses and strains both within the richer countries and the poorer countries. We are a long way from perfection, and there are plenty of aspects of modern social and economic development that raise obvious concerns.

Yet nevertheless, the broad truth is as you stated. Globalization is not stoppable. It has brought huge benefits to hundreds of millions of people around the world, and we ought actually every now and then in the midst of all of the concern we have about the difficulties we face, every now and then we must remind ourselves to celebrate that fact.

CHARLIE ROSE: Suppose someone had come to you and said, understanding how you feel about values and morality and understanding that you come to the job with a variety of experiences, can I urge you as the CEO of this financial institution not to make quarterly earnings as your guide, and I urge you to view with a larger percentage of your profits a contribution to the larger -- the larger good.

Could you do that and keep your position for your company?

STEPHEN GREEN: Look, I'd say --

CHARLIE ROSE: And how would be the next question.

STEPHEN GREEN: I would like to believe you're preaching to the converted on this point. Why do I say that? Because, actually, I think the -- there had been a shift of emphasis. It's not hard to precisely date it, but let's say 20 years ago for the sake of roughly putting a timeframe on it, whereby the prevailing ethos shifted from being one in which you understood your purpose in business life as being able to provide services or product that were wanted by the consumer and which could be priced in a way that you could produce a profit, and the overall profit performance of the country was, if you will, the result of that and not its main purpose.

You've moved from that ethos to one in which shareholder value maximization, bracket short-term, is the only objective in life. That I think is part of that market fundamentalism we were talking about.

CHARLIE ROSE: And is that still with us?

STEPHEN GREEN: I think it has now been called in question in a rather fundamental way.

CHARLIE ROSE: By, among others, you?

STEPHEN GREEN: Well, I think more generally, much more generally --

CHARLIE ROSE: But among others.

STEPHEN GREEN: As a result of the searing experience of the crisis. People now are not the first people to say this. Peter Drucker reminded us all some while ago that the shareholder value maximization is not the main purpose, it's not the be all and end all. I think he used the word "by-product." I may not be right on that, but he certainly saw this as not the primary *raison d'être* of the business.

CHARLIE ROSE: And how did we get to where stockholder maximization became the end all?

STEPHEN GREEN: It's a good question. Somehow we all became very

short-termist and very focused on realization of asset values, leverage as much as you possibly can. We all know the story.

We need to get back to -- and I do believe the current climate is one in which this conversation can be seriously had, which may not have been true five or ten years ago back to a focus on -- One way of putting this is sustainable business development.

What is the objective of a board to which the shareholders have trust the capital. It is sustainably developed with profitable business. And how do you do that? Clearly you can't be sustainably profitable unless you're providing real services to customers.

Secondly, you need people engagements. Your own people need to be engaged and committed to a business, and that carries a whole load of implications in management terms, including implications for culture and values within the institution.

And then thirdly, and very important, absolutely not as an optional add-on there is the corporate social responsibility to the communities within which you do the business. All of that hangs together in my view. All of that is entirely consistent with your fundamental objective of earning a return for your shareholder.

But it does mean a long-term focus and not on the next quarter's results as the be-all, end-all.

CHARLIE ROSE: Why did you write this book?

STEPHEN GREEN: Why did I write the book? I was encouraged to by some friends. But that's the --

CHARLIE ROSE: Because they knew the depth of your own feeling about the issues?

STEPHEN GREEN: I kind of wanted to think through some of these issues for myself. I wanted to explore the wider context. It does start not with the financial crisis but the globalization. Where does that originate from? And it's not a product of the last 50 years or the last 200 years. It's as old as human history. And there's something --

CHARLIE ROSE: When traders went around the world looking for --

STEPHEN GREEN: Well, as humanity spread out around the sphere --

CHARLIE ROSE: Looking for a better life and better products and everything else.

STEPHEN GREEN: Sometimes they fight when they meet up with each other, but equally as often, and rather more interestingly they trade. And from very early times, thousands of years ago, you can see trading connections across the face of Europe, across the face of Eurasia.

And there's something profoundly essential to the human spirit in this. Urbanization goes with it as it spread round the world, so people

gathered in cities and urbanization is the big phenomenon of modern times. The year before last we passed the point where more than half the world lives in cities. By the year 2050, over three quarters of the world --

CHARLIE ROSE: You make a very interesting point about that.

STEPHEN GREEN: This is profoundly changing human society, but also the individual. How do we think about ourselves? How do we interact with other people? All of this is being changed by the fact of globalization, by the fact of urbanization.

The more I get into this, the more interested I am in it, the more fascinating I think it is as a human phenomenon. I think there are spiritual issues that arise out of it. There are financial and technical issues that arise out of it, but I'm interested in the spiritual issues, and that led me to write the book.

CHARLIE ROSE: Thank you for coming.

STEPHEN GREEN: Thank you.

CHARLIE ROSE: The book again is called "Good Value: Reflections on Money, Morality, and an Uncertain World." Stephen Green, chairman of HSBC.

Thank you for joining us. See you next time.

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