Strained Relations between Economics and Politics: China and South Africa

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Introduction

In his book** The Next 100 Years **George Friedman (2010) makes a forecast for the 21st century. The book is interesting because he "… tries to transmit a sense of the future by identifying the major tendencies and to define the major events that might take place." Geopolitics motivated him to look at the 21st century thereby being in a position to judge our own time by distinguishing between what will matter in the long run and what matters now. There are many things that matter and many things that don't. Presidents come and go (not necessarily so in Africa), but the long-run processes that truly change our lives are still there, and these are not always the things that people are expecting or discussing.

Friedman's approach to answer that problem is by examining the geopolitical faultlines of the 21st century, and without pushing the analogy with geological faultlines too far, he tries to identify such lines that could help to recognize areas where friction might built up into conflict. He distinguishes between five such faultlines, viz. (1) the Pacific Basin, (2) Eurasia, (3) Europe, (4) the Islamic world, and (5) Mexican-American relations. Surprisingly, he does not seem to regard Africa as a possible faultline.

Political economy

Modern political economy studies how rational self-interested people combine within or outside existing institutional settings to affect social outcomes (Frey 1980), unless this freedom is denied. In this paper I dwell on China in particular (as discussed under faultline 1, pp 88-100) and only by implication on South Africa. The reason is that China is a good example of a country whose economy and polity are closely linked. This feature has given the South African government reason to seek closer ties with that part of the world. As is well-known China has been affected by communist ideology for a long time, which in many important ways has contributed to the present state of its political economy. More often than not economic development and the quest to become prosperous depend on political factors, and economic factors have a strong influence on political decisions. China wants to become wealthy but under a single powerful government. This power it derives from the dominance of a single political party which hardly tolerates any criticism on or divergence from its political course including the economic one. In the Chinese case it is the Communist Party that pulls the strings, and the South African government tries to emulate this system through an all-powerful national party, the ANC.

However, governments risk being thrown out of office if they fail to achieve a favourable state of the economy. Ever since South Africa became a fully democratic society in 1994 government economic activity has increased both absolutely and relative to the private sector and this interaction has become much more intensive. There is almost no section of the economy that is not directly or indirectly influenced by the state. In some areas the distinction between the state and the economy has become untenable, particularly in areas dominated by public enterprises (Eskom is a case in point) and with goods and services of which the supply is met and actually undertaken by the state. The state is then given a role in the allocation of such goods. These are mostly public goods and services belonging to the infrastructure such as education, healthcare, defense, police, public transport, environmental protection, roads and harbours, water and electricity supply, to mention a few. Although it is true that government makes people better off by providing goods and services that will be absent in a market economy, it does not mean that the state should place itself at every profitable opportunity between private citizens who might have conducted their transactions themselves perfectly well. The result will be that governments do, or try to do, what either does not need to be done or should not be done by government, while they neglect that which only governments can do and which, therefore, they should be doing (Meyer 1991).

This separation between payment and use of production and service provision leads to a grave problem, namely that each individual and each group in society has an incentive to secure an advantage at the cost of the whole community, meaning that the system is open wide to corruption.

Private versus public goods

In a market economy only those goods are produced for which a price can be asked from the consumers of a particular product, and those who do not pay may not consume. With public goods this condition does not hold; nobody can be excluded from consumption, even if he does not want to pay or is not able to pay a price. For this reason everybody tries to avoid paying a price, i.e. tries to act as a 'free rider' in order to benefit from the payment by others. It follows that the means required for public goods is usually not by specific contributions, but through a system of direct and indirect taxes. This separation between payment and use of production and service provision leads to a grave problem, namely that each individual and each group in society has an incentive to secure an advantage at the cost of the whole community, meaning that the system is open wide to corruption. Under those circumstances it will be difficult to balance the public budget since a small number of political decision makers jointly consider the income and expenditure side of the public accounts. For South Africa these accounts have been showing ever increasing deficits that have to be financed through loans from domestic and foreign lenders amounting to billions of rand, as shown in Table 1.

Table 1: South African Debt 2010 – 2015

YEAR	TOTAL (R MILLION)	% GDP
2010	805 100	31.6
2011	996 171	35.2
2012	1 187 763	38.6
2013	1 365 646	41.0
2014	1 584 669	43.9
2015	1 798 812	46.8

Source: SA Reserve Bank, Quarterly Bulletin, March 2016

The importance of the state in economic affairs is also due to the demands for an equitable (or fair) distribution of income. Consequential to the requirement for rapid economic growth (because of strong population growth) in order to prevent and reduce poverty, the aspect of income distribution took second place. Today most people agree that the state has a duty to meet the humanitarian demand to guarantee a reasonable income to those members of society whose incomes are below the minimum level. In general, the state – i.e. all public authorities – are relied upon to make decisions that affect the welfare of others.

It is evident that in a modern society economics and politics depend closely and intimately on each other (Frieden 1991). However, this fact is not sufficiently accounted for in current economics.

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Economics

Economics is mainly the science of the price system which is supposed to drive the economy to an optimal allocation of scarce resources in a competitive market economy. This theory teaches that private interests of individual suppliers, viz. the maximization of private advantage, at the same time leads to the maximization of social welfare. The price mechanism has the property that it harmonizes private and social advantage. However, the classical dictum of 'private vices, public virtues' has seldom been substantiated.

Proposals claiming to further social welfare in a direct way – by government regulation – appear to be more effective than the indirect way by the price system. However, there is little evidence for believing that the politicians and public bureaucrats involved in government intervention and regulation are interested in promoting abstract social wellbeing. One must rather assume that they are more interested in their own welfare.

The ever rising government debts imply ever rising interest payments on those debts which may soon prove to be unsustainable. If this is allowed to continue South Africa's credit worthiness is becoming questionable and its ability to attract foreign investment and loans will be downgraded by the credit-rating agencies like Moody or Standard and Poor and this may push the South African economy further into recession.

Economic theory hardly concerns itself with the very complex political area and the economy is treated as a system isolated from the political process. Politics belongs to the 'institutional givens' which is assumed to lie outside the scope of economics proper, i.e. the efficient allocation of scarce resources. But when the economic order – that is the framework and setting in which the economy operates – is studied, an authoritarian political order is assumed as a starting point, that is, a 'benevolent dictator or elite' maximizes social welfare. The state is taken to be a godlike institution with complete knowledge and information about all the wishes and wants of the people with no preferences of its own and yet always capable of achieving its will. The democratic process in which individuals can reveal their wishes by participating in party politics is not considered. The pursuit of one's own private interests, the fundamental principle of market behavior, has come to be neglected in the political area.

There was a time that economists paid almost all their attention to the properties of the system of market competition and under what circumstances prices are able to guide private interests in the direction that the results are also advantageous for society as a whole. However, the price system alone is neither able to bring about a just income distribution nor an automatic stabilizer of business cycles, and ensure full employment and economic growth. It was Keynes (1936) who argued that aggregate demand determines the level of economic activity in the economy, and so caused a revolution in economic thinking. That is, a country's production and employment depend on the amount of spending by consumers, investors and government. Too little spending will lead to unemployment and more spending will stimulate firms to produce more and employ more labour. Too much spending will cause inflation.

Because of the problems of both the market and the command economies of old, all real-world economies are a mixture of the two systems, i.e. most present-day economies rely both on the price mechanism and involve some degree of government intervention.

Keynesian economics paved the way for governments to play a much more active role in the economy. Keynes did not abolish markets (as Marx wanted), but showed how a government can stimulate, balance or slow down production, depending on prevailing conditions of the business cycle. In recent times it has become evident that the much greater power of governments to interfere with the economy is often used, and abused, to the advantage of the public sector (the state) and to the detriment of the private (business) sector.

Because of the problems of both the market and the command economies of old, all real-world economies are a mixture of the two systems, i.e. most present-day economies rely both on the price mechanism and involve some degree of government intervention. The problem is that 'some degree' is an extensible concept varying between one and one hundred percent.

China's polity

Why does Friedman think that China constitutes a geopolitical faultline where political tensions could spill over into conflict, and questions its ability to manage the building up of internal forces in China? His concern is about the effects this may have on the international system in the 21st century. Will China remain in the global trading system and, if so, will it disintegrate again?

China has always wanted to realize its dream of being a powerful and wealthy nation. To that end, when Mao Tse-tung was the political leader of the People's Republic of China (1949-1971) he led the Cultural Revolution in order to establish a more Chinese form of communism. Under Mao China was united and dominated by a strong government, but isolated and poor. His successor, Deng Xiaoping (1976-1992) was more a pragmatist than an ideologue and realised that China had to open its borders to engage in international trade in order not to be torn apart by internal conflict. The Economist (2011) acknowledged him as the Great Stabilizer whose politics led to massive economic growth for a few decades "enough to satisfy enough people for now". That growth was realised by exporting inexpensive products and this trade created wealth, mainly for the big cities like Shanghai, but the interior remained impoverished. Tensions between the coast and the interior increased, but the government stayed firmly in control of all the regions. The open question now is whether the internal tensions building up in China can continue to be managed.

A country, like a human being, does not develop by only growing. The result was that China has had one of the lowest rates of return on capital in the industrialised world.

China's economy

Underlying this is another, and maybe even more, threatening problem. China appears to be a capitalistic country with private property, banks and all the other paraphernalia of capitalism, but is not truly capitalist in the sense that the markets do not determine capital allocation. Who you know counts for much more than whether you have a good business plan. Between Asian systems of family, social ties and the communist system of political relationships, loans have been granted for many reasons, none of them having much to do with the merits of business. As a result a large number of the loans have gone sour, or in banking terms 'non-performing'.

In China these bad debts are managed through very high economic growth rates driven by low cost exports, and the cash coming in from them keeps businesses with huge debts afloat. However, the lower China sets its prices the less profit there is in them and the profitless exports drive a very large part of the economic engine without actually getting anywhere. This very rapid growth has less to do with good management and more to do with China's banking system. China's primary means of financing has not been by raising equity in the stock market (by issuing stocks and shares that carry no fixed interest), but by borrowing money from banks. Growth alone did not really strengthen the economy. What is needed is development, i.e. growth plus economic progress. A country, like a human being, does not develop by only growing. The result was that China has had one of the lowest rates of return on capital in the industrialised world.

China had an impressive economic growth rate because of the way it structured the economy. But when the high growth rate is not sustainable the economy begins to falter and might collapse. Its national debt is estimated at between 30 and 40% of

GDP, which Friedman qualifies as 'staggeringly high'. There are structural limits to growth.

China appears to be caught in a dangerous no-man's land between the market and state control. A looser monetary policy would boost demand, but it would weaken the currency (the yuan) and that would prompt savers to move their currency offshore.

China's political crisis

Friedman claims that the problem for China is political. It is held together by money, not ideology. When the money stops rolling in as the result of an economic downturn (e.g. the international credit crisis of 2008/9 followed by the worldwide recession), not only the banking system will contract, but the entire fabric of Chinese society will shudder. The Economist (January 16, 2016) reports that global markets have fallen by 7.1% since January 2016, and the strains on the currency suggest that something is very wrong with China's politics. Many Chinese people fear that the Communist Party (led by president Xi Jinping) does not have the wisdom to manage the move from Mao to market. The rest of the world looks at the debts and growing labour unrest in China and shudders. China appears to be caught in a dangerous no-man's land between the market and state control. A looser monetary policy would boost demand, but it would weaken the currency (the yuan) and that would prompt savers to move their currency offshore.

Loyalty in China is either bought or coerced, but without money only coercion remains. Business slowdowns can lead to general instability due to business failure and unemployment. In a country where poverty is endemic and unemployment widespread the added pressure of an economic downturn will result in political instability. The poorer people in the interior of the country will either try to move to the coastal cities or pressurise the government to tax the coast and transfer the money to them. The government then both weakens and loses control or attempts to suppress those pressures so that it falls back into a Maoist enclosure of the country.

Friedman claims that China's regime rests on two pillars. One is the fast bureaucracy that operates the country; the second is the military security complex that enforces the will of the state and the Communist Party. A third pillar, the ideological principles of communism, has disappeared. Egalitarianism, selflessness and service to the people are now archaic values, preached but not believed by the people.

Communist Party officials have been the personal beneficiaries of the new economic order. If the regime should try to bring the coastal regions under control it is hard to believe that it will be very aggressive, because it is part of the same system that favoured and enriched those regions.

Conclusion

In conclusion, Friedman foresees three possible future paths, which mutatis mutandis may apply to South Africa too.

- China continues to grow at very high rates indefinitely. No country has ever done that and China is not likely to be an exception. The high growth of the last thirty years has created huge imbalances and inefficiencies that will have to be corrected. At some point China will have to go through the kind of wrenching readjustment that the rest of Asia already has undergone.
- Another possibility is recentralization, where the conflicting interests that will emerge following an economic downturn are controlled by a strong central government that imposes order and restricts the regions' room to maneuver. However, the fact that the apparatus of government consists of people whose own interests oppose centralization would make it difficult to pull off. The government cannot necessarily rely on its own people to enforce the rules. Nationalism is the only tool they have to hold things together.
- The third possibility is that under the stress of an economic downturn China fragments along traditional regional lines, while the central government weakens and becomes less powerful. Traditionally this is a more plausible scenario in China – and one that will benefit wealthier classes as well as foreign investors. It brings China in a situation with regional competition and perhaps even conflict and a central government struggling to maintain control.

It all boils down to this: internal stresses on the economy and society will give China far greater internal problems than it can handle. The economy will have to undergo a readjustment at some point. This, in turn, will generate serious tensions too, as it would in any other country. The third possibility, according to Friedman, fits most closely with reality and the country's history.

So, whether or not the future will be economically prosperous for China – and possibly South Africa – depends more on variables that are determined by politics rather than by economics.

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