

# The Dream Of A Modern Saudi Arabia

WASHINGTON – Bloomberg Businessweek placed Saudi Arabia's Deputy Crown Prince Mohammed bin Salman on its cover (April 25 – May 1) underneath a caption that says he is "*preparing Saudi Arabia for the end of oil*". The lengthy cover story is all about this energetic young Prince who –all alone– is determined to spearhead a series of bold initiatives and reforms aimed at re-engineering a country whose vast richness come from gigantic oil revenues, and not the skills of its citizens. Of course, being the son of the King helps a bit in what is still a top-down, absolute monarchy.

## **Plan to diversify the economy**

The long article explains how the Deputy Crown Prince plans to diversify the economy. He wants to start selling shares of Saudi Aramco, probably the single largest oil company in the world. He would then invest the proceeds in a number of global companies. After this diversification, in the future Saudi Arabia's economic fortunes will be less tied to the ups and downs of oil prices.

## **No more subsidies**

At a different level, the Prince wants to cut back the vast web of subsidies provided by the Royal Family to almost every Saudi citizens. But this may be a bit tricky. It is an open secret that direct or indirect payments to millions of people are the means through which the Saudi government keeps a lid on Saudi society. In a region marred by unrest and civil wars, not much anti-government unrest in Saudi Arabia, since almost every citizen gets a regular check from the government.

## **Problem: no real middle class**

Well, so far so good. Except for one thing. Even assuming that all these reforms will work, at best Saudi Arabia can become more efficient. But it simply cannot become a modern society the way we understand it. For the very simple reason that Saudi Arabia does not have basic political freedoms and a modern middle class that can act as the engine of self-sustaining growth.

Here is the simple truth. Except for vast amounts of easy to extract and therefore highly profitable oil, Saudi Arabia does not have a real economy. Saudi Arabia does not have a sizable educated middle class with a fair number of entrepreneurs engaged in profitable, innovative businesses.

### **Monarchy controls oil**

Saudi Arabia is an oil Kingdom (second largest crude reserves in the world) essentially "owned" by a mostly parasitical elite. This elite, (the extended Royal Family), controls all the oil wealth. The same leadership distributes some of the oil revenue proceeds to the rest of the country, in many cases via bogus government jobs that produce no value. It is fair to say that most Saudis do not do any real work. In the Kingdom real labor is provided by foreign workers.

### **No modern middle class**

Now, given this picture, I submit that unless these fundamentals are drastically transformed it is essentially impossible to re-engineer the Saudi society. Capitalistic economies succeed mostly because of the existence of basic political freedoms and because of a solid, entrepreneurial middle class. By that I mean large numbers of reasonably well-educated, driven individuals who engage in money-making enterprises. Their activities are supported by bankers, lawyers, accountants, marketers, public relations professionals and what not.

In other words, modern competitive economies do not exist

without a vibrant middle class that can produce at least some capable entrepreneurs. These entrepreneurs understand the value of innovation. They understand competition within a rules based system fairly managed by an independent judiciary that can act as a reliable referee in case of disputes.

### **Oil is the only productive sector**

Well, guess what, none of this exists in Saudi Arabia. And I sincerely doubt that any of this can be created –essentially out of nothing– by an energetic Crown Prince eager to modernize a rent based economy in which, with the exceptions of the few skilled people who are in charge of the highly profitable energy sector, nobody has done anything even remotely approaching real, productive work for decades.

### **Rules based democracy**

You want modernity? Well, then you need a rules based democracy in which people really understand and agree upon the proper balance between private and public, in which all players agree that the private sector is the driver of economic growth, while all economic actors appreciate the need to have and follow clear rules. You also need a government that is efficient, open, transparent, and fully accountable. Finally, you need basic freedoms, including laws that guarantee freedom of expression, and therefore truly free media.

### **Tinkering is possible; but no transformation**

I see none of this in Saudi Arabia. Despite formidable constraints, I can see that some tinkering is definitely possible within the existing environment. If his reforms work, Prince Mohammed may be able to make the existing system less wasteful, less corrupt, and less dependent on the price of oil. And this is a good thing.

But he cannot create a brand new country and a new Saudi

society. And without these two prerequisites in place, there will be no modern country.

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## **In Japan Corporate Losses Are Not Revealed**

**WASHINGTON** – The WSJ commented in an editorial, (*Japan's Sharp Turn*, March 31, 2016), that the Foxconn (Taiwanese electronics giant) acquisition of the beleaguered Japanese consumer electronics icon Sharp may represent a turning point for Japan.

### **No help from the state**

Sharp was in deep financial trouble. But the company decided not to seek help from the state backed Innovation Corporation of Japan, so that it could arrange a merger with another Japanese electronics manufacturer, this was probably getting to an honorable settlement, while hiding its awful conditions. Sharp decided instead to seek a foreign buyer.

This however created problems. When Foxconn gave a second look at Sharp's books, huge additional (and previously undisclosed) losses were exposed. Foxconn demanded and obtained a deep discount on the original price in order to go ahead with the purchase.

### **A turning point?**

The WSJ argues that Sharp did something that most Japanese companies would not do. It went abroad with the hope that a foreign buyer would be able to inject not just capital but a

different corporate culture and managerial style that would revitalize the electronics company. The editorial argues that this may be a turning point for insular Japan whose under performing economy is in part the outcome of its secretive and opaque way of conducting business.

### **Do not tell the truth**

I would not be so sure. Indeed, reading between the lines of this WSJ editorial we get a positively unflattering, in fact alarming picture of Japanese big business. This is a world in which essentially the truth is never told.

As the editorial itself puts it, the Japanese economy is an elaborate system of cross-shareholding structures designed to prevent real outside control on corporate activities. This system in which all the big companies have investments in other corporations created a web of shared interests. The net outcome is that no one has any real incentive in revealing other companies embarrassing secrets. *"I cover you, because I know that will you cover me"*

### **Discretion?**

This "discretion" may be a wonderful recipe for the survival of the Japanese corporate elites. But it is also a perfect tool for hiding poor management and worse. For example, there was a huge scandal involving Toshiba last year when it was revealed that the company had engaged in a major \$ 2 billion accounting fraud that had gone on for quite a long time, undetected. With adequate corporate governance control systems in place, along with internationally recognized disclosure standards, keeping this massive fraud secret for so long would have been impossible.

The WSJ argues that Sharp's decision to let everything out in the open, exposing its own bad management and huge losses before being taken over by a foreign firm, shows courage and therefore a major transformation in Japan's corporate culture.

This means that from now on there will be more openness, more transparency, while more foreign investors will be welcomed.

### **Sharp is the exception**

I wish this were true. I really do. But I suspect that Sharp is an exception, may be a big one; but not the beginning of a new trend. Sadly, Japan is an ossified society run mostly by old people afraid of change. Corporate leaders know one another very well, and instinctively cover for one another.

I do praise the courage of Sharp's managers who in fact took a bold new direction. But they were also desperate. Others who may not be in such dire straits probably see nothing wrong in cooking the books and hiding their tracks with the help of complicit boards all composed of other corporate managers who also have something to hide.

### **This is the root of Japan's decline**

if you want to know what is at the root of Japan's economic decline, it is right here: a risk averse corporate culture in which lying is actually considered good manners, because the truth may be too embarrassing. This approach may be good for smoother social relations. But it is a lousy way to run a profit based capitalistic economy.

Real capitalism needs true numbers. Hard to get those in Japan.

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## **The Moral Case For Capitalism**

**WASHINGTON** – Would Hillary Clinton make a moral case for American capitalism? I am not so sure. First of all, let's point out that Hillary Clinton will not be Bill Clinton 2.0.

Remember that Bill Clinton came along in 1992 as a “sobered up” new centrist Democrat who proclaimed the end of the era of Big Government and actually as President passed welfare reform, notwithstanding the fierce resistance of the left of the party. (More on this later).

But that was then. Today, strongly challenged from the left by a vociferous Bernie Sanders openly advocating wealth redistribution, Hillary Clinton’s message is about expanding benefits, subsidies, tax breaks to the poor, the disadvantaged and the minorities. Her presidency will be about more of the neo-Keynesian deficit-spending stuff that failed over and over again, and yet seems to be the only medication in the cabinet of most Western left of center political forces.

### **More failed neo-Keynesian remedies**

Therefore, should Clinton become President, this will be America’s death by a thousand cuts. More public programs, more welfare, more aid and assistance to this or that needy constituency. More unproductive publicly funded jobs. More stupid and counter productive regulations; and, of course, higher taxes needed to finance all this ill-advised social engineering. The combination of ad instincts and bad policies will stifle innovation, enterprise and private sector jobs creation.

### **Nobody makes the case for capitalism**

***Here is the real tragedy of American politics. In this critical election year, no one has been able to articulate in a simple, clear and cogent manner the moral case for free market capitalism. (In fact those who tried, mostly Jeb Bush and John Kasich, did not do it well, and got no attention)***

By this I mean the ability to convince people, especially the poor and disadvantaged, that capitalism and free enterprise are good for everybody, including those who are currently at the bottom of the pile. And by that I do not mean that people

should be convinced that on balance capitalism delivers better results than social democracy. This is true in principle. But this truth does not resonate with people who are and feel helpless because they believe that they do have any open path forward.

***By “morally superior” I mean the ability to explain how capitalism empowers people, and therefore makes them better human beings.***

Here is the simple truth. Even if well-intentioned, welfare programs make recipients perpetually dependent and listless. Whereas a system that fosters personal responsibility encourages people to take charge of their own lives. And this makes them more self-confident, more optimistic.

### **Bill Clinton’s welfare reform worked**

Let’s go back to Bill Clinton’s partial welfare reforms. That was about public aid to single mothers. These were mostly uneducated, poor African American young women with small children, trapped in an endless cycle of dependence on public subsidies.

Being poor, they were entitled to get enough money to survive. But the programs as designed provided no incentives so that recipients had to do something in order to get out of poverty. The reform passed by Clinton was about sun setting benefits, while giving the women tools, so that they could find work.

**“It will not work”**

***The critics cried that this would never work. This bad reform was about taking the life jackets away from shipwrecked, defenseless women, thereby drowning them.***

***Well, the reformers argued instead that the goal was to teach these women how to swim before taking their life jackets away.***

And, on balance, it worked. With assistance, women found jobs.



There were lots of testimonials by women who had received training, and found work, so that they could care of themselves and their children. As a result, they felt more optimistic and more confident.

### **The “moral case” for capitalism**

This is what I mean when I talk about “the moral case for capitalism”. An economic system that encourages people to become self-reliant and independent is morally superior.

If we recognize this basic premise, then the purpose of enlightened public policy should be to make sure that all citizens “learn how to swim”, so that they do not need the perpetual life jacket of public assistance.

In today’s ultra competitive world, this means that all children should have access to quality public education. And meaningful adult education and/or training should be made available to all adults who did not have a chance to get an education as children.

### **Educated citizens do not need welfare**

I am not suggesting that this is easy. It is not. But deep down this is the case for a rules based competitive system in which all participants have a fair shot at doing something and making a decent living without help, because they are empowered by a good education that gives them the tool to become active participants.

Of course, there are special circumstances in which public assistance is warranted. But these should be the exceptions, not the rule. Temporary relief should not morph into a permanent subsidy.

### **Making a case**

What both Democrats and Republicans have failed to do is to make a moral case for free market economics and the role of

public policy in enabling and fostering it. Indeed, if we are convinced that free market capitalism on balance works, then public policy should be about making sure that everybody can and will participate.

### **Public policy is about giving everybody a good chance**

Good public policy is not about more subsidies or about creating fake jobs. It should be about making sure that all citizens get into adulthood “knowing how to swim”. And this means that everybody –all Americans– should be reasonably healthy and educated.

It is obvious that education is the functional equivalent of knowing how to swim. Without good to superior public education, the poor do not have a chance to get out of poverty. They really do not. Again, if we want capitalism to be fair, then all people should have good tools, so that they will be able to participate.

Until now we have tried to deal with poverty attacking the symptoms. While well-intentioned, this approach has done nothing to eliminate it, or substantially reduce it.

### **Capitalism works well if all citizens are active participants**

The “moral case” for capitalism is about reaffirming the superiority of a free market economy, because it empowers people; making them self-reliant and self-confident, therefore better human beings.

At the same time, the goal of public policy, (this is the job of elected officials), must be to enable everybody to participate. Sound public policy will focus on health and education, so that all Americans can do their best, without the burden of feeling perennially disadvantaged.

### **It is going to be difficult**

I realize that transforming our value systems and the content

of public policy so that it will focus on these objectives is very difficult. But this is a worthwhile cause. Perhaps the most critical one we can think of.

In the end, a successful moral case for capitalism is about more prosperity, and about self-confident citizens who know that they have the ability to take care of themselves.

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## **All Is Well In China?**

**WASHINGTON** – A detailed report prepared by a major Western international economic consultancy pointed out that the doomsday predictions about the Chinese economy about to fall apart are truly exaggerated.

### **All is well**

The analysis maintains that China may be experiencing some problems now, but it is nothing out of the ordinary. The author points out that it is not true that the Chinese economy is dragged down by a bloated public sector. On the contrary, private enterprise is dominant and the long term trend indicates that it will continue to get bigger. (No mention that the state controls all the key strategic sectors, like energy and banking).

### **Plenty of innovation**

It is also untrue that the Chinese cannot innovate. There are plenty of examples of successful innovators. So much so that many western companies want to partner with them.

And it is also not true that rapid industrialization destroyed

the environment. China went through phases quite similar to those experienced by other fast growing economies. Yes, there has been some environmental damage. But it is not catastrophic.

Besides, the government is acting fast, and remedial action is underway. (No mention about the lack of publicly available, reliable data on pollution. No mention that until a few years ago the government released false data on air pollution with the clear objective of hiding the extent of toxic emission in large urban areas).

### **Debt is manageable**

It is also untrue that the massive amount of debt created to counter the effects of the 2008 global financial crisis has undermined the foundations of the Chinese economy. Yes, the author concedes, there is a lot of bad debt. However, China has massive cash reserves. The government can intervene and fix all the financial problems.

### **There are some issues, but no crisis**

Anyway, you get the picture. Yes, there are issues. But, hey, every country has got issues. And China's shortcomings are pretty much the same as those experienced by Taiwan or South Korea at comparable times during their successful economic development.

Alright. So, here we have an optimist. Yes, China's economy is slowing down. But, in truth, the glass is half full, and not half empty.

Fair enough. When dealing with such a large country it is not easy to get it absolutely right. May be the author is closer to the truth than other, more pessimistic observers.

### **No mention about the political and institutional context**

However, reading this rather upbeat China analysis you are

bound to notice something really important. At no point is there is any mention of China as a non democratic one party state in which any political dissent is actively repressed.

No mention about routine media and internet censorship. No mention about a judiciary system that operates according to political instructions. No mention about a massive anti-corruption campaign orchestrated in secrecy, according to secret rules, by the Chinese Communist Party leadership. No mention that this fight against corruption, in a country where corruption is endemic, can be used as a tool to destroy political enemies.

In other words, there is not even the slightest mention about the fact that lack of political freedom, political pluralism and individual freedoms may have an impact on current and future economic performance. This is not just a small detail.

This connection between political freedom, economic freedom and eventually good economic performance is at the core of what we believe to be the underpinnings of modern, self-renewing societies. Free societies allow the free expression of human talent. And this talent is at the source of innovation, and ultimately prosperity.

## **Democracy and Capitalism**

***Indeed, we say in the West that political freedom is the oxygen that allows private enterprise to exist, flourish and unleash a virtuous cycle of growth. It is not an accident that we call our system "Democratic Capitalism".***

***We passionately argue that innovation is predicated upon the freedom to search, to pursue unorthodox paths, to go out of the box, to seek new partners, and so on. Hard to do this consistently in a top-down society in which few dare to go against the rules, written or unwritten as they may be.***

**Illiberal China will thrive**

It would appear that this China expert does not think that political freedoms have any connection whatsoever with the quality and long term sustainability of economic performance. In other words, a one party state can deliver prosperity just as much as a democracy in which basic individual and economic freedoms are constitutionally protected.

Although this point is not openly made in his analysis, implicitly we are to understand that China, a one party state, is doing quite well and –going forward– there are no major issues or minefields its self-appointed leaders will have to deal with. This means that you can have censorship and innovation. Political prisoners and social media. Non transparent judicial proceedings and intellectual property protection. No problem.

### **It never happened**

In the final analysis, we are told that the Chinese economy, while not booming anymore, is basically fine; and all looks good. Which is to say that one party rule can create the necessary conditions for sustained prosperity.

Again, the author does not openly say this. But by implication this is precisely what we get. The numbers (according to him) look good, and so the system must be good. I find this scary.

The fact is that in the modern era we do not have other examples of one party states that produce self-sustaining innovative economies.

But this simple fact does not seem to bother the author. Again, I find this scary.

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# WSJ To Pope Francis: Our Prosperity Stems From Freedom

WASHINGTON – Here is how The Wall Street Journal, the unofficial protector of American capitalism, greets Pope Francis on the eve of his visit to Washington, (*The Politics of Pope Francis*, September 22, 2015):

*“Like many Argentines of the left, Pope Francis seems given to suspicion about American wealth. But liberty and not coercion is the source of our [American] strength and of the wealth that has lifted millions out of poverty.[...] The U.S has prospered by respecting property rights and relying on the voluntary decisions of individuals. The rule of law here means that unlike countries such as Argentina, an American can build a large, successful business even if no one in government likes him. And unlike in Argentina, capitalist success creates millions of jobs that allow men and women without political connections to support their families and live in dignity.”*

## **Freedom includes economic freedom**

So, here is the thing. In America we have built a society whose corner stone is the constitutional protection of individual freedoms. Among these freedoms there is economic freedom. People are free to start a business.

As long as they play by the rules, respecting all the laws and the rights of others, all Americans are free to work and prosper. In so doing, they bring along many others employed by them. Wider prosperity means less poverty.

And it all starts with freedom. In Cuba, the first stop in Pope Francis' trip, there is no freedom, including no real

economic freedom, (despite minor reforms). And so, while the political elites are taken care of, the people suffer. They are poor in large part because they are not free.

### **God-given rights**

In America we created widespread prosperity as a result of the enterprise and hard work of free people, and not political favors and kickbacks. This is the good outcome of the exercise of “natural rights” that our Founding Fathers believed to be given to each human being by God.

Yes, in America we do believe that the Almighty blesses hard work and its fruits. And, yes, we also believe that the best tool to fight poverty is not redistribution policies or chastising the rich, but broad-based growth.

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## **Pope Francis And His Anti-Capitalist Message**

**WASHINGTON** – Interestingly enough, Pope Francis is coming to America after visiting Cuba, (a true bastion of progress and human rights?). While here, we can expect that he will exhort American evil capitalists to finally see the light, recognize their unprincipled lives as sinful, and decide to give more, lots more, to the poor. Yes, the very poor they have been exploiting all along.

### **Poor, just like Saint Francis**

I understand that this is over simplification. But overall this is the message that this Pope has been delivering. He adopted the name of Saint Francesco (Francis) of Assisi (the



Saint of the poor) as a reminder to the entire world that the Catholic Church, just like the original Francis, is about extreme frugality and service to the poor.

## **Saint Francis**

Saint Francis of Assisi, (1181-1226), was born in Umbria (Central Italy) as Giovanni di Pietro di Bernardone; but became known as "Francesco", a nickname given to him by his family. He was the son of a wealthy merchant. But he gave up his comfortable life in his own personal pursuit of a Christian spiritual path.

Much later he created the monastic order of the Franciscan Friars. Francesco became known as "Il Poverello", "The Little Poor Man". This was not meant as an insult or mockery. Living just like the poor, and this included extreme frugality, was in fact a badge of honor. The Franciscan Friars living with almost nothing were seen as an example of truly good Christian conduct. This Order intended to bring the people back to the original Christian spiritual message.

The message was that this earthly life is mostly about preparing oneself to meet God in the true eternal life that will begin after death. From this perspective, caring for wealth and possessions is at best a distraction, at its worst, it is a sin.

## **Applicable model?**

Well, given all this, frankly it is quite difficult to transfer the example of the extraordinary life of Saint Francis (who lived almost a thousand years ago) and his many followers into modernity. The notion that you can apply the Franciscan example to our times, just as if we were living in the pre-industrial Middle Ages, is silly.

More broadly, the entire Catholic social and economic doctrine based on suspicion for the rich and a constant reminder to

help the poor with donations is flawed, and outdated. Taken literally, it becomes an enemy of progress.

### **“Cattocomunismo”**

*Indeed, this anti-capitalist bias stems from silly ideas that during the 1970s in Italy, (home of the Catholic Church and of the largest Communist Party in the western world), were labelled “Cattocomunismo”. The term indicated that Catholics (“Catto”) and Communists (“Comunismo”), although this sounds most improbable, have one fundamental thing in common: a strong anti-capitalist prejudice.*

The Communists, of course, believed that capitalism was just one (inferior) phase of a necessary historic evolution. They believed that it had to be replaced by socialism, a much better form of economic and social institutions.

The Catholics, deep down, always believed that capitalism is mostly about bad stuff: profits, greed and exploitation. For a good Catholic, all in all, those who make money are suspect. If they make lots of money, they are even more suspect. We learn from the Gospel that Christ loved the meek and the poor, not the rich.

### **Populist message**

And this leads us to Pope Francis and his clever populist message replete with exhortations to help the poor, while chastising those who are engrossed in money-making activities.

This may be a good political message for a Catholic Church caught in the downward spiral of its historic decline. But it is a horrible, in fact destructive, message for the world.

*The fact is that where there is no capitalism, or where capitalism is not allowed to advance, usually there is massive poverty.*

**Capitalism is not perfect**

Capitalism is by no means perfect. And yes, within capitalism we have plenty of examples of greed, speculation, manipulation, and fraudulent activities. But this is not about “capitalism” *per se*. This is about unethical people –plenty of them in many societies– who twisted the system to their advantage, usually in violation of existing laws.

### **Poverty is Holy**

But here is the real problem. According to the Church, poverty is sad but Holy. Capitalism, as a rule, is bad and devilish. The only way in which the rich can atone is by giving more, a lot more, to the poor.

That said, this approach postulates that the world can do perfectly OK without growth, or that sustained economic growth –the only proven way to lift people out of poverty– can be achieved without capitalism. It also assumes that it would be a good thing if poverty continued permanently. Otherwise, if the poor can get rich, how do you turn the poor into well off people without poisoning their souls with capitalistic greed?

### **The Medieval order**

The fact is that the world is better off with capitalism. Saint Francis lived and preached within a primitive and quite horrible Medieval society of rigid hierarchical stratification that he certainly never challenged. At the top there were kings, aristocrats and the Church leadership. Then there was a very small urban middle class of merchants, craftsmen and bankers. And at the bottom the multitude of eternally poor serfs, the semi-slaves who had the obligation to cultivate the land for the benefit of the nobles, the Church and the merchants. This ghastly social and economic order that condemned the poor, their children and the children of their children, to remain poor was presumed to be eternal, and in fact ordained by God.

**Capitalism: personal and economic freedom, plus technology**

Capitalism disrupted all this. It was the child of revolutionary ideas. The first one was that human beings could and should be “free” and change their circumstances. The second was that new discoveries in science and technology had created new and more effective ways of doing things, from soil cultivation to the production of garments. The third was that it was perfectly alright for free people to engage in profit-making new activities.

### **What capitalism produced**

Well, fast forward to the Industrial Revolution and then to our times and we see the cumulative “ill effects” of capitalism. Indeed, this is what greed and exploitation produced. We have incredible rates of economic growth and enhanced productivity due to ever improving new technologies. And, last but not least, hundreds of millions were lifted out of poverty because of the opportunities created by the combination of personal liberty, science and new technologies. Add to this mix enhanced access to education; and –yes– the powerful incentive represented by the understanding that you can make an honest profit by engaging in honest money-making activities, to the best of your abilities.

This is capitalism. Altogether a good thing. With this, we do not condone people who break laws or otherwise engage in shady activities. But capitalism as such is good.

### **Bad ideas recycled to attract new followers**

“Cattocomunismo” and other assorted Catholic social doctrines are instead musty relics of a flawed past. It is this thinking, with its principled opposition to capitalism, (the only system that truly promotes progress), that (ironically) contributed to condemn millions of people to never-ending poverty.

I am sure that Pope Francis knows all this. But he is deliberately talking to the only constituency the Catholic

Church now has: the poor in mostly poor countries. This message may resonate with them.

He knows perfectly well that the larger audiences in (once Catholic) developed countries stopped listening to this nonsense long ago. The empty churches prove this.

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## **In China The Economy Is Still Run By The State**

**WASHINGTON** – The highly regarded The Economist weekly magazine has a Leader (we call it Editorial in America) about economic reforms in China, (*The quiet revolution*, April 18th, 2015). Leaving aside the analysis on recent and announced changes, what is most extraordinary is what the Leader does not say.

### **Is China a capitalist country?**

I do not know whether this is due to a deliberate attempt at obfuscation, sudden amnesia, or stupidity. But the fact is that The Economist never mentions in its Leader “China’s Communist Party”, “state controlled economy”, “state-owned enterprises”, or “party’s control over economic policy”.

In other words, if you did not know anything about China’s post war history and current politics, by reading this Leader you could very well think that China is just another capitalistic country now undergoing some reforms aimed at creating a more sustainable foundation for future economic growth.

And yet we know that this is not the case. China is

not another capitalistic country. And it can be argued that China's current economic problems are in large part due to its unwillingness to become a "normal" capitalistic country.

### **The party controls the economy**

And why is China reluctant to "go all the way"? Because true capitalism is founded on real economic and political freedoms. There is no doubt that China changed a lot during the last 30 years. There has been immense liberalization. The previously non-existent private sector has been allowed, and it has become an impressive force for wealth creation and modernization.

But none of this occurred spontaneously. This transformation happened because the Communist Party permitted it. It has been clear from day one that the entire economic change process, while broad, was not and is not open-ended. It has taken place and it will continue under the direction and within the limits imposed by the ruling Communist Party.

### **The political role of State Owned Enterprises**

And here is one gigantic limit. Whatever some honest reformers in China may say, for the time being, the state will continue to control the economy, while running directly some of its most strategic sectors via its own State Owned Enterprises.

***For the time being, the party-state will not privatize the public sector. And here is the clear political reason. Despite well documented malinvestment and inefficiencies, the publicly owned strategic sectors, (banking, insurance, telecoms, energy, steel and more), allow the party to retain control over the rest of the Chinese economy, and therefore over China.***

### **Deliberate obfuscation?**

All this is to say that any analysis about "reforms" in China

that does not refer to the broader political and policy context outlined above, (a one party state, not another capitalistic country), is either meaningless, or a deliberate attempt to obfuscate.

Either way, given its reputation, The Economist could and should do better.

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# The Hong Kong Demonstrators Cannot Win Against Beijing

**WASHINGTON** – As I look at the developing story of the extremely large Hong Kong pro-democracy protests, my sense is that, despite the huge numbers of people in the streets, the movement lost. It will all be over very soon.

## **Resist orders from China?**

My sense is that Hong Kong is not ready for violent street battles for the sake of democracy. The students know that with their protests they are challenging Beijing's authority, and not just the legitimacy of C. Y. Leung, the Beijing approved Hong Kong Chief Executive.

Indeed everybody in Hong Kong knows that the issue at hand, the decision to have an undemocratic system for "electing" a new Chief Executive, did not originate in Hong Kong. Everybody knows that it was mandated by Beijing.

## **Beijing will not back off**

This being the case, it is theoretically possible, (but extremely unlikely), that the Chinese Communist Party, faced with these unexpected massive street protests in Hong Kong,

will accept defeat and back off, allowing genuine elections in the territory.

But it is much more likely that China will not back off. It is likely that the Chinese Communist Party leadership will order a crackdown, even though any use of force in Hong Kong will look very bad, as it will invite comparisons with the June 1989 repression of the mainland pro-democracy movement in Tiananmen Square in Beijing.

Most people in Hong Kong understand that for Beijing reasserting its authority is much more important than any (most likely temporary) public relations setback.

### **What will the demonstrators do?**

So, here is the dilemma for the protesters. Option one: they will decide to fold, because they know that they are ultimately doomed. Or, option two: they will stand firm, as they believe that Beijing is bluffing, because in the end China does not want to resort to violence, for fear of being blamed for dead people in the streets of Hong Kong.

I suspect that most people believe that when pushed to the brink China will act with all the force that will be necessary in order to assert its authority. Therefore, deep down they know that they have no chance of winning. A strong show of defiance is one thing, risking one's own life to make a point about democratic elections is quite another.

### **The world does not care**

More broadly, while there has been some international sympathy for the young Hong Kong pro-democracy demonstrators, quite frankly I do not believe that the world cares so deeply about the issue of establishing a genuine electoral system in the former British Colony. (Look, the world does not care that much even about Putin grabbing pieces of Ukraine, a sovereign country. I cannot believe that the problem of a non



democratic Hong Kong's electoral system inspires more outrage than a Moscow-led insurrection, with thousands of dead people in Eastern Ukraine).

After all, as far as the world knows, the people of Hong Kong have a good life. Since the end of British rule in 1997 China has not interfered with the capitalistic economy. Standards of living are much higher than anywhere else in Asia. The system still allows the enjoyment of basic freedoms.

It is true that the electoral system mandated by Beijing is not democratic, as it would allow only vetted, pro-China candidates to run. This is clearly a sham. But is this really such a big deal?

### **Law and order better than chaos caused by a just struggle**

In the end, what do Hong Kong citizens care the most about, free elections, or law and order, so that they continue to conduct business and make money? I believe that most people will opt for law and order and getting back to business.

Therefore, while some hardliners will probably try to resist and not disband, despite police orders to do so, most Hong Kong demonstrators, having made their point, will fold and go back home.

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## **At The Root Of the Hong Kong Protests: Economic Prosperity**

# Is Founded On Political Freedom

**WASHINGTON** – Will the Hong Kong protesters demanding true democratic elections for the special status territory win in the end? Who knows. Probably they will not. And yet this surprisingly large grass-roots “rebellion” should be noted, because it is an open challenge to Beijing’s will to control Hong Kong’s politics.

## **Guided democracy**

The Chinese government wants to establish a “guided democracy” in Hong Kong. The people will be able to vote. But the candidates for the top executive position will be vetted and approved by an ad hoc committee. Quite simply, this means that only candidates that have proven pro-Beijing credentials need apply.

Hong Kong citizens could have accepted this farce, recognizing that a semi-democracy is better than no democracy at all. But they did not. Unexpectedly, they staged protests. And the protests grew bigger and bigger.

## **Embarrassment**

This is a huge embarrassment for the current pro-Beijing Hong Kong leadership. But it is also a problem for Beijing, since it is the Chinese Communist Party itself that mandated the new elections procedures for Hong Kong.

At this point, giving in to the street demonstrators in Hong Kong may be impossible. This would amount to a loss of face and prestige. However, crushing the protesters in a violent manner would not look good. It would invite unpleasant comparisons with the brutal 1989 Tien An Men repression of pro-democracy protesters.

Be that as it may, one thing is clear. China, while respecting Hong Kong's special status, intends to tighten political control. *"Hong Kong people: You get to vote; but only for candidates we have pre-approved."* The people in Hong Kong saw this and resist.

### **Prosperity and political freedom go hand in hand**

Even though we do not know how all this will end up, (probably badly), this phenomenon of large pro-democracy demonstrations in Hong Kong underscore a point that most Western China observers try to avoid.

Indeed, despite the undeniable economic progress made by China in the last 30 years, this is still an illiberal autocracy, unwilling to transform itself.

The citizens of Hong Kong know this. And therefore, without challenging the basic reality that China is ultimately in control of the former British colony, they fight to protect what makes them different: political freedom.

While most mainland Chinese may feel differently, (they have never known democracy), in Hong Kong people believe that economic prosperity and political freedom are inseparable.

I think Thomas Jefferson would agree.

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# Ukrainian Prime Minister Yatsenyuk Both Defiant And Conciliatory In A Speech At The Atlantic Council

By Paolo von Schirach

March 12, 2014

**WASHINGTON** – The Western world seems to be united in its support for the embattled (and truly broke) Ukraine. Regarding the unprovoked Russian invasion of the Crimean peninsula, The G 7 issued a statement indicating that territorial changes in the Ukraine arrived at without following the proper constitutional process will not be recognized: *“Any such referendum [on the secession of the Crimea] will have no legal effect”*. The EU, on its part, also condemned the Russian military occupation and Moscow’s moves aimed at the annexation of the Crimea.

## **Obama’s support**

President Obama added his open support when he received at the White House Arseniy Yatsenyuk, the Ukrainian Prime Minister, on March 12, just days prior to the planned referendum on joining Russia to be held on March 16 in the Crimea now under Russian military occupation (in violation of the Ukrainian constitution). So, the message to Putin is clear: *“We, Europe and America, stand firmly with the new government in Kiev. What Russia has done is unacceptable. Moscow has to order its troops to go back to their barracks”*.

## **Prime Minister Yatsenyuk at the Atlantic Council**

The young (39 years old) and affable Prime Minister Yatsenyuk,

speaking at a packed event hosted by the Atlantic Council, a prestigious, non partizan Washington foreign policy think tank, talked confidently about all the support his country has received.

And yet, the general tone in the West, and even in the words articulated by the Prime Minister, is not bellicose. Yatsenyuk opened his remarks at the Atlantic Council referring to the Russians as past and future “partners”. He repeatedly indicated that this unprecedented crisis created by the invasion should be resolved through dialogue and diplomacy. He pointed out that the Ukrainian government is eager to work on new laws and regulations that will further enhance the autonomy of the (mostly Russian speaking) Crimea. He pledged that there is and there will be no discrimination in the Ukraine against the large Russian minority.

### **Autonomy to the Crimea**

In other words, he *almost* said (anyway this is what I read between the lines) that the Ukraine is willing to give the Crimea *virtual* (even though not legal) independence. (Any formal secession could be arrived at only by following a prescribed constitutional process).

Yatsenyuk did everything he could in his remarks at the Atlantic Council to reassure the Russian government in Moscow, the Russians in the Crimea and in the rest of the Ukraine that they have nothing to fear. The government in Kiev does not and will not discriminate against anybody.

Which is to say that if indeed the Russians have intervened militarily because of a genuine concern about the welfare of the Russians in the Crimea, *there is really no issue*. The Ukrainians are committed to protecting all citizens equally, regardless of ethnicity.

### **The Russians can get reassurances**

If the Russians have indeed acted in good faith, out of fear about the fate of their brethren in the Ukraine, then they should seize this opportunity and start a dialogue with Kiev aimed at spelling out how the Russians in the Crimea and elsewhere in the Ukraine will be protected by the new government.

If this were indeed the real issue, then it could be addressed and solved, since the Ukrainians, according to the Prime Minister, are willing to concede (almost) *everything* when it comes to additional autonomy to the Crimea. Yatsenyuk pointed out that this would not require a major effort, as there was no violence or discrimination against ethnic Russians in the Crimea prior to the Russian military occupation.

### **The alleged persecution of Russians is just an excuse**

The problem is that Putin used the alleged persecution of ethnic Russians in the Ukraine as a convenient excuse. I doubt that he believes any of what he said publicly to justify Russia's military intervention. The fact is that for his purposes of power consolidation and reaffirmation at home, seizing the Crimea after having lost (politically) the Ukraine seemed the clever thing to do. This notion of "saving" oppressed Russians unjustly separated from the Motherland has a certain ring among Russian nationalists, and so this was a politically astute move. In Russia and among most Russians, Putin now looks very good.

But Putin is now in a bind abroad. The West is against all this. There is no way that an open land grab that violates key principles of international law, along with a multilateral treaty that guarantees Ukrainian sovereignty co-signed by Russia, can be ignored. Berlin, London and Washington simply cannot continue business as usual with Moscow.

### **What will the West do?**

That said, it is unclear to me, despite the declared support

for the Ukraine, what exactly does the West plan to do. Are we ready to go to the next level: ***namely serious economic sanctions against Russia?*** We certainly could, starting with the seizure of bank accounts and properties owned by the Russian oligarchs (most of them friends of Putin) who have stashed their loot in London and Geneva and who bought luxury homes in Paris or the Riviera.

### **Sanctions, anybody?**

We could really hit Russia where it hurts. And let's remember that Russia does not have a lot of staying power. It has a relatively weak economy that is almost totally dependent on the revenue provided by selling oil and gas abroad.

Of course, there are also clear European vulnerabilities. The Russians know that Europe depends on Russia's gas. Therefore, if Europe freezes economic relations with Russia, and gas stops flowing west, what will happen in Germany or Poland? How will they keep the lights on without Russian gas? No easy answer for this, as there is no immediate alternative to Russian gas. This energy dependence makes it very unlikely that Germany, Sweden or Bulgaria are prepared to enforce really tough economic sanctions against Russia.

In the US the picture is only marginally better. (By the way, we have all the gas we need here at home). President Obama, notwithstanding his recent show of support, has no special interest in prolonging a foreign crisis that most Americans do not even begin to understand, just a few months before the November congressional elections in which his party already stands to lose a lot of seats.

### **Putin's calculations**

All in all, my sense is that the Russian "Crimea Gamble" included the calculation that there would be no Western united front against Russia. If this is so, Putin may really believe that he will get away with this unprecedented land grab.

I would love to be wrong on this, but I suspect that Putin's assessment is correct. There will be a split within the West. If Putin is right, in the end he will prevail. He is a bully willing to take risks. The "peace-loving" Europeans are not in the same league.

### **Western verbal support**

For the moment, everybody is saying the right things. But when it comes to "**action**" I suspect the music will change –a lot. The poor Ukrainians will realize that they are pretty much on their own on the Crimea.

They will get (some) money from the EU, the US and the IMF to stabilize the economy, and more help down the line for structural fiscal and institutional reforms. But nobody is going to engage in serious, prolonged actions –let alone military actions– against Russia, in order to restore law and order in the Crimea.

Without real (as opposed to verbal) support, the Kiev government will have to settle. It is obvious that the Ukraine cannot afford to be in a state of permanent crisis with Russia. There are just too many intertwined interests, too many relationships. Eventually some face-saving formula regarding the final status of the Crimea will be devised.

The world will nod and we shall all move on.