Savings lead, politics follow

What does the construction of a mega-resort in the Bahamas (complete with hotels, golf course, casino, and water park) have to do with SA's infrastructure drive recently announced in Pres Zuma's State of the Nation and the Minister of Finance's budget speeches?

Bahamas

Baha Mar, a resort company headquartered in Nassau, Bahamas, recently secured a $2.4 billion loan from the Export-Import Bank of China to complete a mega-development. After the 2008 financial crisis Baha Mar had run into financing difficulties. The Chinese facility put the show back on the road, but with a difference.

The loan is a form of vendor finance. Baha Mar gave the subcontracting to China State Construction Engineering as well as a US subsidiary of China Construction America. 7 000 Chinese workers were sent to the Bahamas to do the physical building.

It's a win-win-triple win. Baha Mar wins as it gets its resort. The Bahamas win with a huge investment in core industry, tourism. The Chinese score a triple win: the application of (a tiny bit) of their huge forex surpluses, secures orders for production facilities back home (resorts require material, furniture, steel etc) and jobs for its workers.

Game plan

According to the Financial Times Baha Mar is only one example of a long list of beneficiaries to have received some form of financial support from various Chinese state institutions. They vary from countries ("from Angola to Venezuela"), to well-known companies like Reliance in India and Petrobas in Brazil and less well-known ones like a failing bicycle maker in the US, and NGO activities like a social housing project in Venezuela.

The Chinese game plan is very clear. It has vast reserves (more than US$3 trillion and still rising), a huge export machine sending lower value-added goods into the world and many millions of workers. Put the three together and it can use its surpluses to generate overseas demand for its products and workers back home. In the process it piles up more resources (while things are going well) and runs the risk of losing some reserves (should some of these financing arrangements go south). All in all a nice alternative to just buying US and EU treasuries – which they are doing on a large scale anyway. They can now also generate some demand in the real economy of China itself.

No genius, just the immensely comfortable position of being a saver saving much more than it can possibly use at home.

History repeats itself

Countries with huge current account surpluses have all done this in the past. When it was still an empire, the UK exported billions of its surpluses overseas. The US did so after the Second World War. Germany is doing it today, with a lot of its huge surpluses ending up in Greece!! Being surplus saver logically means that the savings must get re-circulated. What else must the saver do with it? If it hoards it in the vaults of Central Banks, money gets withdrawn from the global system, contraction follows and recession/depression sets in. Then the savers and the non-savers lose. No winners.

This happened in 1929 – 1933 and that did nobody any good.

The big savers at the time were the US and France. France became a saver not because they had an efficient and innovative economy like the US, but because they pegged their currency at a lower rate against gold. French goods became very price competitive, visits to Paris and holidays on the Cote d' Azure very cheap, the country generated a surplus and gold streamed in (the whole world was then on a gold standard, since abandoned). Much like China today, which also has an under-valued currency, inter alia, enabling its exports to be super-competitive.

(The UK, in contrast to the French, took the pound back onto the gold standard at too high a value – Winston Churchill *nogal* when he was Chancellor of the Exchequer – foreshadowing the same mistake Margaret Thatcher made 65 years later when she took the pound into the EMU at too high a rate. The UK was forced off the gold standard on 21 September 1933 and George Soros ejected the pound from the EMU on 16 September 1992. What is it with Sterling and September; and valuing the pound too high?!!)

This brief walk through history should remind us that there is no such a thing as "the end of history". One hegemony gets on top, but it does not stay there for ever. Decline and fall is destined. At the moment China is rising, not because of military power, but because of the power of savings.

So What about **SA's infrastructure?**

Infrastructure spending is budgeted to run at about 7.9% of GDP over the next three years and will probably increase substantially after that. It basically reverses a pattern of declining (public) investment that started in the middle 1980s. In the budget review some 43 projects running into potentially more than R1 trillion are listed.

The sources of these funds are taxes, user charges (like Gauteng tolls), borrowings on the capital market, bilateral loans and private capital where public-private-partnerships are undertaken, or any combination of these.

This is where the Chinese enter into the picture. They are now the biggest savers in the world and as the FT reporting indicates, they are very willing to spread their savings around. Of course, one does not just borrow from countries. Savings also sit in pension funds, banks and large companies, which one finds even in countries with struggling economies. But there is no question that China is currently a huge player when it comes to savings.

Given China's status as SA's new best friend, it is logical that a tiny portion of their savings can fund a huge proportion of SA's planned infrastructure spend.

So What?

Firstly, how will they make these savings available? Will it come via the SA bond market or will it be in the form of direct loans (e.g. to build a high-speed train between Durban and Johannesburg) which will include vendor finance as with Baha Mar in the Bahamas? If it is vendor finance, to what extent will Chinese workers and engineers replace SA workers and engineers? Could China State Construction Engineering replace say M&R or WBHO? (I am obviously just speculating here). Could we be treated to the delightful spectacle of construction executives and workers marching and toyi-toying to protest such arrangements? The best deal for SA would simply be debt issued and bought on the capital markets.

The second issue is one of geo-political alignment. Traditionally SA has been in the Anglo-Saxon orbit or sphere of influence. That is clearly changing and we will now move closer to the Chinese sphere of influence. This move will also feed into a natural SA tendency to want thumb a nose at SA's long Eurocentric and Anglo-Saxon ties. But the new SA and China are very different societies when it comes to values, political cultural and world view.

Interesting times ahead.

Sources: Henny Sender, *Fin Times*, 2 March 2012; *Lords of Finance*, Liaquat Ahamed, Windmill Books, 2010.