The Outlook: Oct. 13, 2016

Zoo animals in the wild: Saudi Arabia versus China.

Dairy Farm, Saudi Arabia, 110 degrees in the shade

Here's a picture worth a thousand words. It says something about a lot of things, from the price of milk in Saudi Arabia to the risk of financial meltdown in China. Here's the story.

A New York Times reporter did a piece on Saudi Arabia's "milk industry" recently. This picture captures it, pretty much: awful desert heat; dairy cows which would become cooked beef on hot sand if not for the Saudi government's billions in subsidies to build water-cooled sheds for the cows, import grain from Argentina and farmers from Kenya; and on and on nearly infinitum ("infinitum" being the normal cost outcome in government-supported businesses.) The result has been low-cost milk for the people of Saudi Arabia. Since the Saudi's triggered the 2014 collapse in world oil prices, though, which also triggered a collapse in Saudi government revenues and a cliff-dive of 25% in its pool of accumulated capital, it seems the milk business has been losing even more money than normal, as the Times reported.

> *Still, the business is getting squeezed. While utility and feed prices are rising, the dairy has not been allowed to raise the price of milk. "We've tried in the past, and the king sort of tapped us on the shoulder and said, 'What are you doing?'" said Stuart Gouk, manufacturing manager at the plant here. Higher milk prices could have political repercussions. The kingdom's subsidy cutbacks are expected to deepen. There may well come a point where, as with wheat farming, policy makers will have to decide whether it really makes sense to produce milk in the desert.*

Saudi Arabia, as the Times noted, has been a welfare state for around 40 years—since it first jacked up the price of oil in 1974 and began raking in mountains of dollars which would make Scrooge McDuck blink in awe. The result has been 2 major phenomena: first, an incredible array of money-losing, state-supported industries, paid for by that Niagara Falls of oil dollars; and second, a young population and workforce markedly lacking in the kind of drive, initiative and ingenuity which the people of free-market economies need in order to survive. There is a 31-year-old Prince in Saudi Arabia who has become the

power behind the throne recently. Recognizing the problem, he published a "Plan 2030" for the nation, which aims to diversify and vitalize the economy by that year. The Times' "milk story" strongly suggests that plan might need a relabeling . . . "Plan 2130," perhaps.

What does all this have to do with financial meltdown in China? That's the recurring nightmare which spooked the stock market once again, today, after China reported weaker exports than expected.

China has a lot of debt—government and private business debt—though not much consumer debt . . . and it's been rising fast lately, along with property prices in the thriving cities (though not the stagnant ones.) China's political leaders have been hanging onto the tail of the economic tiger they unleashed decades ago, when Communism was dropped like a hot rock in everything but name. Like the Saudi's, the Chinese government has sponsored many boondoggles: businesses essentially owned by the government, and so well-protected from competition that they've been able to dig deeper and deeper money-losing holes for themselves, over the decades. It is all those boondoggles, and all that debt, which battalions of outside experts focus upon, when they write the daily "China will collapse" stories which have become such a recurring thorn in the market's side, for the past couple of years.

As Outlook has remarked in the past, we think they're missing the big picture. By far the most important part of that missing view is the difference between most of Saudi Arabia's people, and most of China's. Nobody ever remarks about a lack of drive, initiative and ingenuity in China. Around 25 years ago the Chinese were handed a choice: find a way to better yourselves, without being crushed by too much government oversight; or go fairly hungry. The result was the Chinese economic miracle. For the Saudi's, though, the choice was more like: "Here are your monthly checks and subsidized prices . . . find a way to relax and be happy."

When zoo animals are released to the wild, they get eaten. That's the difference between Saudi Arabia's problem with its government-subsidized economic "zoo," and China's so-called "problem" with economic growth "slowing" from "hyper-drive" to merely "strong." In Outlook's long-forgotten days in economics graduate school, such a summary, in place of statistics and formulas, would have triggered an instant "F." But we are operating in the real world, thank goodness, not the academic world—so we can observe, with a good deal of confidence, that an economy mainly built on a driving engine of individual initiative, like China's, will take an awful lot of heat before "melting down."

Outlook Capital Management, LLC
125 S. Wilke Road, Suite 200E
Arlington Heights, IL 60005
847-797-0600