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The Economic Ferris Wheel

Where countries are in the economic cycle and the determining factors

The following essay is as much a summary as an opinion of the positions of certain countries economically and in what stage of development or economic power these countries are relative to others. The attempts to take a country and categorize it based on what stage or cycle it reflects is based on the certain criteria and information expressed in the paper "Why Countries Succeed and Fail Economically" by Ray Dalio. In a nutshell these stages are as follows:

Stage 1) Countries are poor and think themselves as such. The citizens of the country have low incomes and focus on savings. The currencies, industries, and capital markets are all underdeveloped making it an attractive area for foreign investments, especially because labor costs are so low.

Stage 2) Countries become richer but the mentality is that they are still poor. Although income and productivity growth are rapidly increasing, individuals remain conservative and save rather than spend. The private sector begins to expand, as does lending to both foreign and domestic investors. The country remains an export nation, however.

Stage 3) Countries are rich and individuals think themselves as such. At this stage countries boast high per capita income and productivity gains. Individuals begin to alter their mindset towards spending rather than saving while the country tends to become more of an import economy. Companies start to look elsewhere for cheaper goods and services, but investing remains strong as investors seek higher returns.

Stage 4) Countries become poorer but still see themselves as rich. This is the phase when debt rises and companies/ individuals leverage up. Individuals spend beyond their means despite low income growth rates. Investments decrease and competitiveness deteriorates as bubbles form and spending mounts. The country is an economic force based only on its past reputation.

Stage 5) Countries are poor and go through a decline/ deleveraging phase. By this period the bubbles have burst and companies/ governments begin to deleverage as they struggle to manage their debt. In an effort to maintain control, governments and central banks print money (and therefore weaken the currency) and cut interest rates. Countries see their world power decline.

The economical rises and falls of countries are cyclical events that occur over long periods of time, most taking over a hundred years. A countries' economic power is generally characterized by its percentage share of world GDP, where the more powerful and influential the economy, the larger percentage of GDP the country boasts compared to that of others. As past tendencies tend to predict future events, and as the past illustrates specific cycles economies generally follow, it is easier to narrow down and furthermore predict what stage current countries are, and where they will possibly be in the future. Gains in status are usually attributed to economic growth and surpluses. Contrarily, declines are usually a result of becoming overly indebted. There are countless examples that can be used to demonstrate these cyclical rises and falls, from the decline of China and India because of debt in 1820 to the rise of England and other western European countries due to major increases in productivity growth stemming from the Industrial Revolution. Similarly, the British Empire and its European counterparts began losing economic status giving way for the United States to become a dominant power, which also was because of costly wars and the consequential debts acquired.

As the world's leading economic power since the mid-20th century, the United States seems to be well positioned for further leadership of world economies. The dollar has been the world's reserve currency for over half a decade, and that's bound to remain that way in at least the near future. However, as many are likely to point out, the US is in a questionable situation. This was made evident by the 2008 market crash and subsequent government interventions and expansion of sovereign debt. Although the country seems to have somewhat stabilized economically, upon further inspection one can notice that the health of economy is not as strong as many deem it to be, and indeed seems to follow the outline of a country that is in a stage 4 and 5 cycle, more the latter than the former. After the subsequent housing bubble burst and with the potential implosion of the derivatives markets, the government and institutions scrabbled to deal with the failing and overly leveraged companies. Meanwhile, citizens of the country dealt with unemployment and household debts. Just as described in stage 5 cycles, the US is in a self- induced downward spiral of continuous printing of money and slashed interest rates. Our sovereign debt is growing to unheard of levels and interest rates are so low that it further fuels more borrowing which then fuels more debt. Even on a local level, municipalities are struggling to get their financial houses in order. The only positive aspects to think of are that the private sector is slowly paying down its debts (seemingly because companies don't have any other choice), and that the dollar has remained in a somewhat stable position simply because the European Union is in more trouble financially.

While the US struggles with its debt problems, the world has turned its attention to countries in Europe that are suffering from even worse monetary and fiscal policies, namely the PIGS- Portugal, Italy, Greece, and Spain. Like the United States, these countries are stuck in the same flawed routine- print money, no austerity, more spending, more debt- and every week there seems to be another country that needs some form of a bailout. Again, many of the fundamentals of the PIGS economies seem to be dwelling around the characteristics of a stage 5 cycle economy- private and public debt growth while the ECB prints more money and borrows from the US in an effort to sustain the European Union. This in turn has begun to affect the Euro, as it declines in value relative to other currencies. This outcome was at least partially expected simply because it is almost impossible to keep together a union with one monetary policy but seventeen different fiscal policies. The only real disciplined country in the EU is Germany which fortunately seems to be in a stage 3 or 4. As the stronghold of the European nations, Germany has helped keep the EU intact, many times supporting the other countries in bailouts. This route however, might quickly lead the fourth largest economy towards a decline.

Meanwhile, in the eastern hemisphere, India and China are beginning to once more emerge as economic forces. Having gone from 2% of world GDP in 1950, China has grown to around 15% and shows no sign of stopping as it continues to show strong economic growth with forecasts of 7% growth in the coming years. Although China has passed the initial stage of a poor economy, it is still around economic stages 2 and 3. The Chinese Yuan is pegged to the dollar, and while still a net export economy, Chinese debt is beginning to grow as a result of expansions and investments. While labor costs are still low, the country is passed the stage of rock-bottom priced goods and labor, meaning many foreign investors have begun to look to other countries or regions (like Africa) for even cheaper labor costs. Chinese incomes are increasing and so are spending on material goods and services, something classical of a stage 3 nation. Still, many international companies (like Starbucks) are looking to expand their business in China, making it a stage 2 economy just as much as a stage 3. India is quick to follow suit, and like China, has a huge labor market. However, the country is in somewhat of a unique situation, as it seems to simultaneously be in stages 1, 2, and 3. The nation does produce and offer an immense amount of goods and services, but it seems to be plagued by political corruption and separation of social classes. Many rural areas still lack running water, electricity, and other basic needs.

Currently, half of world GDP is produced in developed world- countries like the US, Japan, nations in Europe, UK, and so forth. An equal amount of GDP is produced throughout the emerging countries- China, India, and Russia, and so on. Going based off of human tendencies to save and be stringent in times of need and then relish in and many times abuse prosperity, it seems like the current world economic powers will fade and make way for the emerging market economies.

As stated in Economics in One Lesson, "the art of economics consists in looking not merely at the immediate, but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups." It is the lack of understanding this fundamental logic that brings many great economic powers to their knees, and only when this lesson is learned and becomes a guiding force in policy decisions, can a country thrive for long periods of time. Until then, they are all subject to rising and falling in one cycle after another.

References:

Ray Dalio, *Why Countries Succeed and Fail Economically* (Bridgewater, June 2011)

Henry Hazlitt, *Economics in One Lesson* (New York: Three Rivers Press, 1962)