ON THE RISE AND FALL OF NATIONS

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I recently had the opportunity to speak with Ruchir Sharma about his new book The Rise and Fall of Nations, which is an excellent book outlining Ruchir's thoughts on the global economy. Below is a summary of our discussion and highlights from his book. ***Ruchir, what was the motivation for your latest book?*** The main driver for writing the book: Following the global financial crisis in 2008, we have been living in a world that has been badly disrupted. Forces that were driving the global economy before 2008 are now ebbing. Over the last decade pre-2008, many countries were exhibiting boom conditions, especially in emerging markets. Now, that boom has come to an end and we have forces coming in like de-globalization, de-population, debt and de-democratization—the four D's—that are really disrupting the world right now. What do we do? In this world, how do we pick the winners from the losers? There is so much pessimism out there, it is easy to be bearish. In my 25 years of writing and investing, I have always been following some rules for figuring out whether a country will do well or not do well. I have put this through a rigorous research process to come up with the 10 things that will matter most over the coming five to ten years. And most importantly, I try to eliminate from focus what does not matter. ***Ruchir, you suggest in your book that investors should not expend energy on daily or quarterly blips in data but rather that "SLOTH is a virtue." What are the data that you do like to look at over the long run?*** I believe there are two drivers of economic growth: the growth in the labor force and the increase in productivity. To measure and forecast productivity is extremely difficult. Even today, we are debating: Are we correctly capturing improvements in technology? But demographics are equally important. If we look at the U.S. over the last 50 years, half of the economic growth came from an increase in the labor force and half came from productivity. People matter. My analysis of demographic data suggests the United States is one of the very few developed world countries that has good demographics, even though population growth and working-age population have fallen over the last decade. There is so much debate today over why U.S. economic growth is now so slow. The deceleration of the working-age population growth is a primary factor contributing to this weak growth environment. ***One way to offset slowing population growth is to allow immigration, which is currently a hot-button issue for the 2016 election. On the subject of immigration, Ruchir draws attention to certain aspects of immigrant populations: due to a decline in the working-age population in Mexico, Mexicans have less of a reason to seek work in the U.S. In the four years before 2015, net migration from Mexico had already fallen to zero. Ruchir, can you talk a bit about how this relates to population growth?*** If you look at nations across the world, from Canada to Australia, they had low population growth, but they were able to augment growth through immigration. One of the key differentiators in economic growth between the United States and Europe over the last 20 years have been population growth rates. It is sad that the U.S. and Europe are now turning toward populist politics. ***In your book, you discuss how investment levels and growth are a key indicator of an economic landscape. Can you expand on what you mean by this?*** While investment typically represents a much smaller share of the economy than consumption, often around 20 percent, it is the most important indicator of change, as recessions tend to be associated with big drops in investment. Countries that are able to invest well, particularly in the emerging markets, are the ones that have grown well over time. Take Russia and Brazil, for example. It is apparent that they have not made the level of investment necessary for prolonged growth. Whereas in Asia, the economic miracle stories of Korea, Japan, China over their history were driven by their expenditures in investment. ***What do you think explains the productivity puzzle?*** One issue is that manufacturing is a big driver of productivity growth, and manufacturing has been increasingly driven out of China, so investment in manufacturing productivity is not showing up in the U.S. or developed world productivity statistics. Another issue could be that the very easy-money interest rate policies of the developed world may be leading to the extension of "zombie" companies' lifelines and helping companies that otherwise would have gone bankrupt. This was a worry for Japan in the 1990s and for China more recently. There has also been a big rise in government spending and an extension of a more meddlesome state everywhere, and that is a real problem. Finally, the increase in debt is also less and less productive. This year it takes $6 of debt to create $1 of gross domestic product (GDP) growth in China. All these factors are contributing. ***On China, they are clearly an important driver of the global economy. What's your view on China?***

China may be able to avoid the type of financial crisis we had here in 2008–2009 by shifting debt from one hand (the banks) to another (the government). I don't think that is a healthier or better outcome. A crisis sounds like a scary word, but it also helps to clear the system of bad debts so one can then move on. I don't think China's economy is growing at the reported 6.5%, it is more like 4% to 5%. The debt build-up process is not over, in my view—they keep taking on more debt to grow. They had a stock market bubble, a real estate bubble, potentially a commodity bubble. Because the banks are state owned and nationalized, the bad debt problem may not lead to a crisis, but the economy could be run more efficiently.

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Bear market : A sustained downturn in market prices, increasing the chances of negative portfolio returns.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Zombie Companies : A term used for companies that are operating in debt, near bankruptcy.

Bubble : when market participants drive stock prices above their "fair value" in relation to some system of stock valuation.