The Constituents of Global Economy – Optimism with Caution

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Introduction

Globalization has, and continues to, change the way the economies around the world fundamentally operate. It has made the world economy far more complex due to the multitude of interconnections it has fostered. This has led to increased difficulty in coordinating economic policy on a national, regional, and global level. Holistically, globalization has been good for the world, however there are assuredly upsides and downsides. Through analyzing the effect that globalization has had on the world, this paper aims to explain not just the effect of globalization on the world, but also the effect of the world in determining the path globalization has taken.

Though globalization has been largely positive, the extent of the inter-dependence it has created among countries has led to new problems with far more complex consequences. In 1974, the United Nations General Assembly created the New International Economic Order (NIEO) with the intent to guide global development and capitalize on the interdependence, which increasingly defined the global economy. Their plan argued that through increased cooperation, the developed and developing economies could combine their efforts to address inequalities in wealth. This, they argued, was in both of their best interests. The developing countries would receive increased aid, access to technology, and better access to markets in which to sell their goods. The developed economies would find new sources of income due to the boost in aggregate demand that would come with the development of the poorer countries. As Victor McFarland points out in his analysis of the program, "The idea that wealth redistribution could help end economic crises resulting from inadequate demand was fully in line with the Keynesian orthodoxy of the 1950s and 1960s; the NIEO's innovation was simply to expand the scope of the relevant economic unit from the nation-state to the entire globe" (McFarland). The appeal of the program was lost on most of the developed economies, especially the United States, whose politicians fought the implementation of the program on the grounds that development should be left up to market forces, not the product of wealth transfers to "governments in poor countries [that] may well represent reinforcement of political and social systems that worsen the lot of the typical poor-country citizen"(Johnson). Ultimately, the NIEO's success depended on the support of the developed world behind their agenda.

The program's failure to take hold represents a turning point, both ideologically and economically, with regards to interdependence. The NIEO sought to capitalize on contemporary questioning of the relevance of the nation-state in an age of globalization.

The program envisioned an unprecedented level of global economic planning, a sharp contrast from prevailing nationalistic, adversarial, balance of trade oriented economics. Ultimately, this was far too liberal for the industrial nations, particularly the United States, who agreed that some level of cooperation was necessary to avoid conflict, but saw no value in abandoning the free market principles central to it's development. The recent recession and its impact on the world gives cause to consider how things got this way. The NIEO by no means represents a foregone opportunity to prevent global crisis. However, the contrast it provides helps to frame the development of globalization in its wake.

Globalization has enabled the creation for new economic opportunities all over the world, has expanded international trade, and from 1990-2010 almost a billion people were lifted out of extreme poverty ("Towards the End of Poverty"). However globalization has also created or exacerbated many problems, many of which are only becoming more obvious following the great recession.

The great recession encapsulates many of the issues created by globalization. After the 1970's the US government heavily promoted "the deregulation of worldwide financial markets and the use of market mechanisms to determine exchange rates and the allocation of capital in general" (Fligstein and Habinek). Their success in convincing others has led to a large increase in the size of the global financial market, and especially the cross-border transfer of financial products. These financial products grew to represent a huge portion of the world economy. OECD statistics found in 1970, cross-border transactions in the capital markets with bonds and shares with a percentage of GDP stood under 5% in the US, Germany and Japan. For 1996, the shares corresponding to these countries had grown to 152%, 197% and 83% respectively (OECD, Valeriu Laurenţiu Onose and Ecaterina Necşulescu). Coinciding with this increase in financial market integration was the development of new financial products through practices like securitization (Leyshon and Thrift). Today asset-backed securities markets are some of the largest in the world. In the early 2000's, enabled by low interest rates following the 2001 stock market crash and financial tools like ABCP, American banks invested heavily into mortgage backed securities and made record profits. This drew the attention of banks in other countries that saw the lucrative market as an opportunity for new profits themselves. Enabled by the large financial deregulation of the past few decades, many foreign banks entered into these markets. When the housing bubble burst it came to light that the "AAA" rated mortgage backed securities were much riskier than the major asset rating agencies led investors to believe. Banks found that their ABCP loans were due, but could not find money to finance them. With no liquidity and falling asset prices, the financial markets crashed and banks were forced to declare bankruptcy.

The 2008 recession has had lasting effects and many parts of the world have still not seen their economies recover, however the aftermath has demonstrated the extent to which economies are interdependent on each other. The growth of this interdependence has made economies increasingly sensitive to the dynamics of not only their neighbors and trade partners, but to fluctuations in other foreign currencies and distant markets. In recent empirical studies of this phenomenon, researchers have found that business cycle synchronization across nations has increased to unprecedented levels following the 2008 recession. (Gomez) Additionally, synchronization driven by crises does not dissipate over time, therefore “the trend towards a more integrated world economic output is seemingly driven by episodes of world economic tension and change.” (Gomez).

However, studies have also shown that this synchronization is stronger in developed regions and particularly in regions that have formed regional organizations or unions (Gomez). This is for obvious reasons, as entities like the European union foster enhanced economic integration and coordinate policy in their regions. Their use of a single currency has a huge effect in unifying these countries as a rise or fall in the exchange rate will have huge effects on the competitiveness of every country in the union in the global markets.

Lastly, the worldwide growth in trade volume and has enabled the development of new export-based economies. Many of these new economies are commodities based and are therefore very sensitive to the movements of prices in metals, energy, and other resources. Additionally, large changes in demand for their goods due to changes in importers production levels can potentially have devastating effects on their economies. Therefore, changes in aggregate demand caused by contractions in the new “synchronized” business cycle can cause the impacts of a recession to span the globe, as we saw in 2008. For example, the current slowdown of China is raising concern in many African commodity-trading countries where anticipation of a fall in Chinese imports is hurting commodities prices.

Currency in the context of globalization

The global economy is in the midst of a currency crisis with no apparent end in sight. The currency problems plaguing the economies of the world are as diverse as the currencies themselves. In Britain, the pound has reached new lows in exchange with both the dollar and the Euro due to uncertainty following the recent general election and concerns over “Brexit” negotiations and the general impact it will have on the economy. In Brazil, the Real has suffered from the region’s political instability and economic uncertainty following years of unmet growth expectations. In Nigeria, violent unrest, political uncertainty, and poor economic performance have devastated the Naira. In Canada, the dollar has fallen to new lows following tariffs on lumber, new U.S. tax plans, and falling oil prices. Around the world, currencies are more volatile than usual with the exception of one.

Perhaps the biggest indicator (and perhaps cause) of the currency volatility crisis exists in the scarcity of the dollar in the global market. Extremely high demand for dollars in light of higher US Treasury Bond yields has driven the exchange rate up to recent highs and this has had huge impacts on the world economy. The dollar has long been considered the safest and most secure store of wealth, and as a result many bonds internationally are dollar-denominated. These bonds are particularly popular in emerging markets where bonds issued in local currency are generally less desirable to mass market investors given the generally higher volatility of their currency. However, the rising price of the dollar makes these bonds much more expensive to service, especially in countries with relatively depreciating currencies. The IIF estimates that “2017 will see nearly $890 billion in bonds and loans coming due, almost 30% in USD” (IIF). With every rise in the exchange rate of the dollar these countries have to spend more to service their debt, which pulls money out of the economy, which causes asset prices to fall. Falling asset prices and large amounts of dollar denominated debt have had cause serious problems in some emerging markets, particularly those of Brazil, Chile, Turkey and Egypt, all countries whose currencies have subsequently plummeted in value. The problem is exacerbated by the lack of bond alternatives in the global market that are perceived as safe and high yield. The negative interest rates offered on the bonds of Europe and Japan due to their continued practice of quantitative easing make dollar-denominated assets ever more attractive.

The problems resulting from the currency exchange system have produced a great deal of research and policy proposals that advocate different solutions reflecting different perceptions of the fundamental problem. Some argue that the solution to the problems created by the use of different currencies is through policy cooperation among the major international currencies. There are a number of problems with this solution, aside from the inherent political difficulty in getting these countries to give up their monetary policy independence. Namely that empirical studies have shown that even with said cooperation, the welfare of each country may still decrease due to “the high degrees of trade integration and economic symmetry [which] must be satisfied before an OCA can be established” (Yeh). This problem is the one of the largest underlying problems facing any solution to the current era of currency volatility.

The argument has been made in the past that a global currency would end a lot of the systemic problems facing a global economy. But here again, the insufficient global trade integration and the lack of economic symmetry make this solution undesirable. A global currency would prevent economies from conducting their own monetary policy, which would result in any universal monetary policy having adverse affects on some countries for the sake of another’s benefit. All of the countries would have to agree on this currency and would have to relegate the prescription of monetary policy to an independent body. On a global scale, getting every country to agree to this would be impossible. However, the failure in the European region shows why even if it could be done, it would still be undesirable.

The 2008 recession hit particularly hard in a number of European countries. Undoubtedly the country that fared the worst was Greece, where the country performed worse than every other country in almost every metric of economic performance. During the recession, Greece’s adoption of the euro rendered them unable to conduct their own monetary policy. And they received little support from the ECB, who, under pressure from Germany, gave aid to Greece only after they accepted humiliating austerity measures that are now universally recognized as having further damaged the country’s capacity to recover. The EU experience reflects the difficulty of regionally coordinated monetary policy and shared currency. Greece’s currency is overvalued for their economy, making their labor and goods noncompetitive while Germany’s is undervalued given the strength of their economy, which enables them to generate surpluses. Yet both contribute to the value of the Euro and are subject to the same monetary policy. Germany wants to protect this situation while Greece, Spain, and Italy among others want to change it, reflecting the impossible challenges an independent monetary body faces in simultaneously addressing the diverse needs of economically diverse countries.

The present currency crisis being experienced globally reflects more than the differing economic conditions in the world today. The ability of countries to use non-conventional monetary policy (like quantitative easing), set fixed exchange rates, or artificially devalue their currency creates the constant potential for volatility as countries independently act in what they see to be their best interests. These problems are exacerbated by the political and economic instability present in global markets, both emerging and developed.

Allocation of Capital

Global development, particularly the inequality of global development, has been a major concern for economists, countries, and international monetary authorities like the IMF for a long time. The programs developed by these parties to address global development inequality have had some positive, as well as some negative impacts on developing countries and emerging markets.

One of the largest measures of support has traditionally taken the form of foreign aid. This foreign aid has typically been largest in post-conflict countries where the belief is that it could help reduce the risk of conflict resurgence (Fosu). Over time, total aid has increased, and even during the recent recession it increased substantially, particularly due to new contributions from China (Hynes and Holden). However, research shows uncertainty about the effect of aid on both income inequality and investment quality. The instability and corruption of regimes in some developing countries has historically made aid donors weary of direct government transfers, though in many countries, providing aid by other means can be difficult as it may be blocked or refused. However, as Maria Berrittella points out, direct investment, even when possible, presents its own challenges as it can be difficult for donors to know which investments are right for the recipient country. Failure to recognize this and make appropriate considerations can cause misallocation of resources, destroy economic incentives, and ultimately undermine economic growth. (Berrittella).

Evidence questioning the effectiveness of aid programs is increasingly common. A study in the 2003 showed that while countries in Africa saw aid increasing (in total and as a percentage of GDP), they saw growth falling (Easterly). Angus Deaton, the 2015 Nobel Prize winner in economics studied the effects of aid on growth in developing countries. He argues that providing governments with huge sums of aid weaken the accountability those governments have to their subjects ("Does Foreign Aid Always Help the Poor?"). Additionally, he points out, governments have long been guilty of giving aid to oppressive regimes. While this aid might help the oppressed to get access to food, it also sustains the regimes they live under. Increasing public awareness of these facts has pushed governments to experiment with different, more conditional, delivery methods for aid.

Aid for Trade (AfT), which was organized by the WTO in 2006 has also had mixed effects. The program was designed to help LDCs to develop the infrastructure and trade capacity necessary to conduct trade on a global scale by organizing aid from developed countries. The effectiveness of the program has been questioned due to the emphasis of export-led growth over poverty reduction, which has long been the goal of developmental aid policy (Hynes and Holden). However, the attempts by the WTO to formalize the structure of aid agreements and enhance monitoring have beneficial applications for future improvements. This work is necessary, as research has found that while there is uncertainty about the effect of aid generally, stability in aid agreements does facilitate income redistribution (Berrittella).

Aid represents a commitment from the developed world to the developing world, but organizations like the IMF and World Bank assert that while these commitments are important, to be most effective they necessitate a commitment in return from the developing world to the internal cultivation of internationally accepted practices. This means promoting “good governance, the rule of law, and public sector accountability… to create the conditions for success of its economic policy prescriptions”(Philips). As the UN stated in the Zedillo report, countries have to see to their own growth by “creating the conditions that make it possible to secure the needed financial resources for investment.”(Zedillo) To aid them in this endeavor, the IMF created The Code of Good Practices on Fiscal Transparency, which outlines the benefits of fiscal transparency and instructions on “practical implementation”(IMF). In addition they created the Report on Observation of Standards and Codes(ROSC) which allows countries to voluntarily submit a request for evaluation on their commitment to internationally accepted fiscal norms. Countries can then have the IMF release their report, which can help improve access to credit because the “reports are used by credit rating agencies and private analysts to gauge investment risk”(Philips). These programs are very beneficial to developing economies because they provide tools to develop political and economic infrastructures that promote transparency and accountability, which in turn helps to develop credibility. However, it must be acknowledged that the IMF and World Bank, and by extension the policies they endorse, represent the beliefs and values of the developed world and this does tend to result in policy which simultaneously serves the interests of the developed world, for better or worse.

They have consistently showed preference for market liberalization theory as the means to development, and in the 1980’s this led to disastrous structural readjustment policies that, in promoting said theory, caused per capita incomes in developing regions to collapse (Hickel). World Development Indicators statistics show that Latin America saw no increase in real per-capita income between 1980 and 1994 (WB) and in South Saharan Africa, incomes actually fell year over year. In addition, the United Nations Conference on Trade and Development (UNCTAD) estimates that “because of asymmetries [which favored advanced economies that were] built into the WTO trade system after the Uruguay Round… developing countries were losing around $700 billion annually in potential export revenues.”(Hickel). These and other historical missteps make holistic evaluation of the role of transnational oversight and aid organizations more complicated, particularly in determining their net effect.

Transnational systems have made genuine strides in their quest to give developing economies access to tools and resources that encourage the development of practices and institutions that will enable increased credibility and growth potential. Despite this, the persistence of questionable practices by foreign companies and individuals remains a huge impediment to their realization of full potential. Recent statistics give disheartening evidence to the extent to which money is siphoned out of developing countries. The OECD acknowledges that the volume of illicit financial flows from developing countries likely exceed flows of aid and investment (OECD). In addition, the opening of financial markets allows over $500 billion in profits to be repatriated each year (Hickel). These outflows represent serious losses to the tax base of these developing economies, which limits their ability to implement social programs and make investments in their economy. Countries also lose out on taxes due to the rampant use of offshore accounts. UNCTAD found that by the end of 2010, "roughly 30 percent of world cross-border investment flows had been routed through offshore hubs" (Aguiar de Medeiros and Trebat). In developing countries this results in "revenue losses on the order of 10 percent of total tax payments made by foreign affiliates in developing countries" (Aguiar de Medeiros and Trebat). Finally, while the WTO and IMF promote principles of fair trade and the recognition of intellectual property, these principles are not equally as easy to enforce, which contributes to inequality. Studies of global value chains have found that companies in developed countries are routinely able to leverage their branding and intangible assets and take advantage of highly competitive labor to minimize profit sharing in less developed countries along their value chain (Aguiar de Medeiros and Trebat). The ubiquitous nature of these practices reflects the difficulties transnational fiscal systems face in their attempts to promote fair profit sharing practices in trade between nations with vastly different levels of leverage.

Oil and the global economy

Oil has had an extremely important role in shaping the global economy because it is a component in almost all trade and production. Because of this, it also is a large contributor to the origins of globalization, as international transportation costs fell dramatically in the late 20th century, and this made trade cheaper (Picciolo et al.). Oil prices are extremely important in the movement of the world economy, with research consistently showing a negative correlation between oil prices and real economic growth. The strength of this relationship is due to the many relationships between oil and other factors of growth.

The current research clearly shows that globally, an increase in the price of oil causes GDP contraction (for oil importers) (Timilsina). This is because, as stated before, oil finds its way into all parts of the economy. A recent analysis of the relationship between global value chains and oil prices produced a number of interesting findings as well as support for some existing findings. They found significant relationships between growth and development of global value chains and falling oil prices. They also point out that leaps in fuel efficiency in ground and then air and cargo shipping coincided with developments of more long distance supply chains. Their most compelling finding however is strong support for an economic growth theory in which growth is constrained by energy efficiency; i.e., where growth in production is constrained largely by transportation efficiency (Picciolo et al.). These findings are more technical and further research is necessary to argue that they constitute causality but even in day-to-day business operations the effect of a change in the price of oil has clear implications.

A fall in oil prices is a fall in cost of inputs (energy), which allows for cheaper production (of the product and likely the components that make up the product, particularly if other components are made with oil derivatives), and cheaper transportation costs. Not all of these costs if any are likely to be passed on to the consumer or even to the producer of the final product, but they will result in savings for companies who can pay their workers more, give dividends, or make capital investments. A rise in costs will naturally have the opposite effects. However, it is important to note that a change in the price of oil does not affect all companies equally, nor does it affect all oil importing countries equally. Emerging markets experience the largest losses when oil prices rise as they generally rely on imports for energy supply. Their economic structures are also typically manufacturing based and therefore highly oil and energy intensive. (Timilsina)

The effect of a change in oil prices on consumers also has clear implications for consumer behavior. When oil prices fall, consumer expenditures on fuel (for energy and gas) decline, which gives consumers more discretionary income to contribute to either consumption or investment; which is good for the economy. Higher oil prices lead to less disposable income and that means less consumption of other goods and less investment. Therefore a fall in the price of oil is generally good for consumers' budgets.

An argument has been made claiming the recent positive relationship between oil and equity markets indicates that falling oil prices are not always good for the US economy and therefore the world economy. (Bernanke) However this assertion is dispelled by a recent analysis showing that over very long periods of time, "lower oil prices improve profit opportunities and dividends in the oil importing economies which is overall good for the world economy." (Mohaddes and Pesaran). Following the 2008 recession, the benefits of lower oil prices has had an even larger effect on dividends, and further testing showed that this relationship also existed between oil prices and industrial production (Mohaddes and Pesaran). Resultantly, the relationship between oil prices and the growth of the world economy is pretty clear: lower oil prices are good for importers, and bad for exporters, though as a whole, the world benefits because of the importers higher marginal propensity to consume.

The important issue then, is where the price of oil comes from. The price of oil used to come from OPEC. In the 1970's, America angered many in the Middle East by interfering on the side of Israel in the Arab-Israeli War and OPEC responded by raising their oil prices by about 400%. However, since then a variety of factors have severely diminished the power of OPEC to single-handedly control a price, which has had serious repercussions on their members' economies and the area's stability. The unexpected but consistent growth of Russian oil supply (due to both cheap labor and the ruble which is tied to oil prices) has contributed to an increased global supply. In fact, Russia recently became the largest producer in the world and they are continuing to increase their capacity ("Don't

Bet on Russia Capping Oil Output"). At the same time, the market has seen the addition of other large suppliers such as Canada and the United States. While these suppliers produce much of their supply at higher margins, these margins are still low enough to prevent OPEC from being able to raise global prices much without facing increased competition. Additionally, given the increasing use of natural gas and the rapid fall in the prices of some renewables, the market outlook for oil in general has weakened (EIA). While expectations of sustained high demand from China kept oil prices high for a while, those expectations have fallen with revised growth expectations that reflect a slowing of the Chinese economy. However, it is important to remember that oil price fluctuations are common and prices, though low now, will rise again. This is because we expect to see large increases in the energy needs of emerging and developing markets. According to the World Energy Outlook an estimated 1.2 billion people – 16% of the global population have yet to receive power (WEO). In fact, the US energy information administration predicts prices to be $140/bbl by 2040, or $76/bbl by their low estimate, both of which represent a substantial rise from current prices. (EIA)

In explaining the 2008 crisis, it becomes immediately apparent the effect that oil prices have on the global economy. When the stock market crashed, the ensuing financial market value erosion and uncertainty led investors to flee to the commodities market which, combined with increasing demand from China and India, resulted in a spike in oil prices to their highest level in a decade, about $140/bbl. This jump in oil prices damaged the production outlook in economies already suffering heavy financial losses (Gkanoutas-Leventis and Nesvetailova), and when the oil bubble burst, the markets suffered again. The real losers from the collapse in oil prices are the poorer members of OPEC who have long been reliant on income from oil to support their governments and much of their economy. Many of these countries are in Africa where the strain from falling oil revenues and commodities prices are severely dampening outlook for growth in the coming years.

Stabilizing monetary policy

The great recession has led to the use of more creative monetary policy; particularly notable is the use of quantitative easing. The use of these policies is quite controversial in that, while they have arguably helped the economy recover, they have also created or exacerbated serious problems that will have to be dealt with in the future. The largest of these problems are the accumulation of large levels of government debt and the long-term effects of artificially created liquidity.

The United States and the EU were the most aggressive users of QE, and at the time of writing, expectations are that the EU will continue its use of QE into 2019. Stabilizing monetary policy use is a complicated task in that it goes against what has become the new norm. Modern economic policy has been largely reactionary and reflects a shift away from strict economic principles about the role of policy in regulating the business cycle. Ideally, contractionary economic policies should be used when markets are booming so that government debt can be reduced, households will take on fewer loans and focus on paying back their existing loans, and inflation will be controlled. When the economy stabilizes, then expansionary policies can be enacted to get things moving again. However, strong contractionary policy, at least in the United States, has not really been used extensively since the Clinton administration tax increases in the 90's. This is partly because contractionary policies are not popular, as they require raising taxes and usually result in higher unemployment, but also partly due to increased government spending around the world. As a result, policy makers in countries around the world face pressure to drive the market to overheating rather than try to push policy that will make them unpopular with their electorate. The problem then, in any attempt to stabilize monetary policy, is that it necessarily reflects the need for unpopular policy from time to time. And unfortunately, the benefits of contractionary policy in the long run are rarely explained to the public in terms that are straightforward, which might help to stabilize expectations.

The UN World Economic Situation and Prospects report for 2017 predicts that world gross product will rise by 2.7% in 2017 and 2.9% in 2018, which reflects rising uncertainty about the future of the largest economies in the world. These economies more or less face similar problems; slowing growth, high levels of debt, consistent budget deficits, high leverage ratios, and low inflation. These problems require painful solutions, but they don't necessarily require austerity measures. Developed countries need to come to the understanding that growth is slowing and in order to solve the existing problems, it will have to slow further. This presents a serious conflict for developed countries that have come to expect levels of growth around 3% year after year. In order to ensure long term sustainability, developed economies not only need to adapt to a world economy that is increasingly characterized by interdependence, but also practice monetary and fiscal policy that sometimes has to sacrifice short term growth and curtail government spending in order to maintain stability.

The Economy vs. The Markets

Despite serious concerns about the future of the world economy the financial markets are reaching records highs. This is largely due to the policies of many of the banks around the world following the great recession. The practice of quantitative easing substantially increased the money supply through debt purchasing and cut interest rates to zero or sub zero levels in many developed countries. The low interest rates have made their bonds undesirable as assets but persistent high liquidity created by QE pushed consumers looking to save toward the financial markets. Even after America stopped the practice of quantitative easing, new liquidity kept entering the global market from foreign sources that responded to each new crisis and unmet growth forecast with more debt purchase agreements. This has kept financial market prices from falling to their true equilibrium due to a liquidity shortage, as would normally the case in the absence QE. As a result the numbers are grim; while global GDP has grown by ~22%, equity markets have grown by ~118% (IMF). This puts the global economy in a precarious position where artificial liquidity flows and high savings rates continue to bolster markets while the real economy suffers from low investment and rising debt obligations.

The problem is further complicated by a few additional factors. The first is that falling oil prices and weary banks holding more excess reserves have kept inflation down and have delayed the Federal Reserve in the US from raising interest rates to slow growth. Countries trying to increase demand or deal with overvalued currencies (often due to a fixed rate to the dollar) have also practiced (or passively allowed) currency devaluation in order to become more competitive. These practices have resulted in almost every world currency weakening relative to the dollar. Given that a large portion of world debts are serviced in dollars, costs of repayment go up substantially. This will hurt developing and emerging economies with high dollar denominated debt particularly badly. Falling commodity prices also impact many of the developing markets where commodities exports often correlate highly with currency values due to their large contribution to GDP. If these currencies continue to depreciate to the dollar, developing countries will be forced to spend more of their currency servicing their debts, which means less investment and slowing growth. In the long run, this has the potential to have serious implications on their growth potential. If these countries currencies depreciate to the point where they are forced to default on their loans, and their collateral has depreciated due to a slowdown in growth and therefore demand, investors may question the credibility of these countries as investments in the future.

We are in the middle of a fragile equilibrium. There is not enough real growth in the economy to support the growth in the financial markets, and the areas with the most potential for growth are faced with decreasing global demand and increasing pressure from falling currency values. The eventual EU exit from quantitative easing further adds to the pressure on the markets, as it has the potential to trigger a liquidity crisis. This can be avoided, but it requires the real economy to move closer to the one described by the stock market. The real economy needs to see more investment, and more real growth in order to justify the current stock levels.

Slow Growth

Despite evidence that the developing markets were not impacted nearly as severely as those in the developing world by the great recession, they too are succumbing to the global slowdown in growth. This is partially due to the effects of increased interdependence created by globalization, but also due to rising trends of protectionism in the developed world.

Due to the increasingly interconnected nature of the global economy, changes in growth in one country usually affect the economies of other countries in a similar fashion. This has upsides and downsides. On this upside, it means that growth in a large country can have large and positive effects on a small country it trades with. However, it also means that slowing growth or even negative growth in the developed can have serious implications on the developing world. A top down analysis of the world economy can thus help explain the global slowdown.

The Recession hurt demand severely in much of the developed world. This resulted in the effects of the recession being passed on from the largely consumption based economies of the developed world to the production driven economies of the major emerging markets. These impacts were passed on to the developing world as well, but their lesser exposure to the large financial markets made the impact less severe in these countries in terms of growth rate.

Post recession growth has been slow for a number of reasons, though again, it is increasingly the case that slowing in one region means slowing in other regions, particularly when the slowing occurs in a large producing or consuming economy. One of the large reasons for the slowdown in growth is the general poor performance of the Eurozone (Germany and the UK being the notable exceptions), which has seen slow GDP growth since 2008. This has resulted in an increase in unemployment and a decrease in investment and consumption. The United States also suffered a decline in consumption and investment, though they have recovered better. This large decline in consumption has had a huge impact on China, the world's largest exporter.

Decreasing demand resulted in downgraded growth forecasts in China, and is certainly one of the big catalysts, but the slowdown has been impending for some time. This is because China is facing challenges due to structural reforms as they transition from a manufacturing to service economy, troubling debt levels, rising wages, and increased competition from other developing nations. And while developing nations were largely insulated from the impact of the financial market crash, their intricate relationship China during its recent slowdown is having serious repercussions on their economies growth forecasts.

The slowdown in Chinese production has resulted in numerous tumbles in commodities prices. At the same time, the Chinese have been more active than ever in commodities exchanges, but intense speculation activity has raised concerns about whether this is an attempt to find the price, or influence it (Bloomberg). China is the world's largest commodities importer and its imports of iron, steel, and energy support developing nations in Africa, Southeast Asia, and South America (Tan). The prospect that demand could decrease further into the future has these countries worried about the future.

Developed countries as well as some emerging countries like China are struggling with a shrinking working class due to aging populations, which also raises concerns about a rising dependency ratio. Additionally, many developed countries and particularly the United States are concerned about declining productivity growth, which ultimately is the largest driver of economic growth. Due to the service-heavy nature of their economies, productivity growth is more difficult to achieve. These problems and the slower growth resulting from them have resulted in the election of some world leaders who espouse protectionist policies as the solution. This logic, while clearly appealing to a large number of people, is faulty and ignores the benefits of trade. The IMF points out that in raising trade barriers, the rising costs of goods will lower global output by 2% in the long run.(IMF) Protectionist policies also hurt potential for global growth as they discourage investment in emerging markets and developing economies. This investment is needed to encourage increased global growth. This growth will increase consumption, which is good for developed countries, but it is also necessary to justify the rise in financial market values.

Rising Economies

In the coming years we are likely to see substantial growth in a number of economies in Africa and Asia. South America is currently plagued by political, social, and economic instability, and this makes it less appealing to investors who are already foreseeing difficulties in getting back their existing investments there.

The IMF and World Bank have identified a number of economies that are expected to see large growth in the coming years. The first is Ethiopia, which is predicted to achieve a growth rate of 8.7% through 2019 due to their focus on large-scale energy and infrastructure projects designed to attract foreign investment. Ghana is also predicted to see just over 8% growth in the next three years, as the stable nature of their government makes them appealing to foreign governments who recognize their resources of cocoa, oil and gold. Myanmar is predicted to see 8.6% growth over the next few years due to their commitment to political and economic reforms, which have increased their exports and driven up private investment. The Ivory Coast is predicted to see 8.5% growth due to increasing demand for coffee and cocoa as well as an expected increase in tourism. India is predicted to achieve 7.5% growth over the next few years due to strong economic policy, though the World Bank notes that if they work to increase female participation rate in the economy they could see a much larger growth rate (WorldBank). Laos is predicted to see 7.4% growth over the next few years due to rising demand for energy and metals in its region, both of which it has in abundance. Iraq is also predicted to see 7.2% growth, though this figure is under threat from volatility in oil prices as well as conflict in the region, though at the time of writing, Iraq has removed ISIS from Mosul, which represents a great step in the right direction. Cambodia is predicted to see growth of 7.0% in the coming years due to increased production in agriculture, growth its textile and garment industries and an increase in tourism. The country has been a large recipient in recent years of foreign investment and this has helped increase international trade capacity. Tanzania is predicted to see 6.9% growth over the coming years due to increases in mining, tourism, banking and telecommunications. Bangladesh is predicted to see 6.6% growth in the coming years due to the growth of its garment industry as well as agricultural production. Finally, Senegal is predicted to see 6.6% growth in the coming years due to its increasing sales of commodities and agriculture to the rest of the world.

These estimates are provided by the World Bank and the IMF and reflect the trends in growth they see as most significant. The growth of some of these countries is more volatile than others, particularly those in the commodities market and those who are heavily reliant on oil production for income. These numbers also have the potential to vary greatly with changes in foreign investment, and also with changes in trade policy being pursued by countries flirting with protectionism.

Strength of Dollar and Euro

The strength of the Dollar and the relative strength of the Euro are indicative of the state of the global economy in many ways. The dollar has risen in value substantially since 2015, which has been the result of a variety of factors. First, the fed stopped practicing quantitative easing while many of the other major banks in the world continued the practice, and at the same time other countries were lowering interest rates in response to falling commodity prices. This resulted in relatively high yields on US bonds and investors flocked. In addition, the explosion of natural gas in the US has driven up exports, which raises the value of the currency. The Euro's value has been quite stable recently due to, among other things, declining fears of a breakup. The Euro also represents a large portion of international reserves (19.7%)(IMF) and the number of countries who use it strengthens its stability. Within Europe, not all of the countries are performing as well, with the northern countries doing, on average, substantially better than the southern countries. In fact, countries like Germany are doing so well under the euro that they are arguing that the monetary policy of the ECB is keeping the value of the Euro lower than it should be.("Euro Strength…Tone") Whether or not they continue the practice of quantitative easing will likely impact the value of the euro, however the progress that they have seen so far has been enough to reassure the world of the stability of the Euro. Part of the reason that the major security crises that have shaken Europe in places like Berlin, Brussels, and Istanbul, have done little to hurt the strength of the Euro is that, while they do tend to result in short falls in currency value, the long term viability of the European Union is enough to quell speculators (Monfort). The volatility of the dollar with new statements on international relations, healthcare, and other policy from Donald Trump sometimes have the same effect, though again these movements are short lived. Ultimately, the strength of the Euro and Dollar may be the result of momentum and the security they offer. Historically investors flee to put their assets in historically stable currencies during times of currency or asset volatility, and that tendency, combined with the present attractiveness of US Bond yields may be what is driving the current strength of the Dollar and the Euro.

The War Economy

Many historians argue that the end of the great depression in America came when they involved themselves in World War II. The war drove government spending, created jobs, and motivated spending. This raised productivity, labor participation and investment in government R&D projects like the Manhattan project. The investment in many of these research projects had externalities that were beneficial to the economy. The increase in investment in scientific discovery enabled the development of many products that have since become commonplace.

Recently however, we have not seen the same returns to military investment in the United States, the worlds largest "War Economy". This has resulted in an increasingly fierce argument over the benefits of high military spending. In one of the most recent wars, the invasion of Iraq, the war drew praise in some states and anger in others. Some states, like Utah, saw new defense amounting to $2.35 billion (Semerad). Other states, like Ohio, despite receiving some additional funds in the form of government contracts saw unemployment jump half a percent with the start of the war, which local economists attributed to rise in prices and decline in investment that occurred when it appeared the country would be going to war. (Mark Niquette) So in some ways, war can benefit sectors of the economy, by creating jobs in production and research; and this is largely the argument of the government and businesses receiving defense contracts. There are problems with this argument in the larger picture though. First off, government spending on the wars in Iraq and Afghanistan added over $1.2 trillion dollars to deficits according to the congressional research service(Congressional Budget Office (2011)). This is not inherently bad, as recent recovery programs have spent more than that in order to boost the economy. The problem is that military spending is inefficient due to the high frequency of cost overruns like we have seen with the F-35 project. A study by the University of Massachusetts found that if government spending were allocated to different programs creating jobs in fields like clean energy, health care, or education, every billion spent on these programs would produce between 35-138% more jobs than the same billion spent on the military(Pollin, Garrett-Peltier). In addition, increasing war spending is no longer producing the same large returns in scientific knowledge that once made it valuable. This is partially due to the rise of the private sector investment, but also due to decreasing returns to scale in improvements in weapons like bombs and stealth technology for fighter jets.

While wars aren't necessarily good for governments, developed or developing, they are for the private companies that manufacture arms. The largest of these companies are located in the most developed economies in the world with producers in the EU and United States accounting for over 50% of world arms exports (SIPRI). These arms sales have increased in recent years, reaching their highest levels since the end of the cold war. This is driven largely by countries in the Gulf States, who accounted for 29% of total purchases in 2016 (SIPRI). So while war may have destabilizing effects on the economies of developing countries, efforts to reduce weapons sales are weak, as countries looking for weapons will find suppliers in other countries and international arms sales agreements are weak and non-binding.s

Ultimately, while war and the preparation for war does drive spending and create jobs, the declining efficiency of that spending makes it hard to justify over other programs. But the problem with war is less that it isn't good for developed economies, but that it is extremely destructive to developing ones. The World Bank estimates that the war in Syria has already caused $226 billion dollars in damages to their economy ("Syria's War …'"). The destruction of assets in developing countries hurts their ability to develop, and the instability created by war drives out investors and hurts growth. Studies of similar countries have shown that the countries that had wars performed far worse than the ones that didn't in reducing poverty and generating economic growth ("The Economics of Violence"). While it is not always possible to avoid war, it should be avoided if possible. Countries not fraught with conflict are safer for investment and this contributes not only to their growth, but also to the development of new markets.