



CAN KONDRATIEFF CYCLES GUIDE US? REFLECTIONS ON KOPALA AND BUDDEN'S *THE DOG BONE PORTFOLIO*

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Vol. 46, Issue 1, Mar 2016

Introduction

Margret Kopala is an Ottawa writer and public policy analyst who lost money in the 2008 stock market crash, and decided to find out why this happened. The book she wrote is a personal odyssey into the first Kondratieff winter of the 21st century. For this work, she has enlisted the help of her co-author, John Budden, an experienced investment strategist and financial broadcaster who, in turn, enlisted the advice of internationally recognized financial experts such as former chairman of the *Bank Credit Analyst*, J. Anthony Boeckh, and former *London Times* editor, Lord William Rees-Mogg. So this is *not* your usual casual financial commentary by lackadaisical observers.

The book examines the post-2008 global economy from the perspective of the Kondratieff long cycle and the challenges it presents particularly to investors, corporations and policy makers in the Western world. Given persistent risks to the global economy, including the precipitous decline in resource prices, that have not only not abated but increased since the 2008 financial crisis, declining demographics and a banking sector that remains “too big to fail,” the book concludes that the first Kondratieff winter of the 21st century has arrived in full force, and will impact Canada for some time to come. Accordingly, it recommends that investors of all disciplines should, like a dog burying its bones, allocate their assets to various parts of the world and ensure a portion of these include gold, the only continuous basis of wealth across history and around the world.

What is the Kondratieff cycle?

Nikolai Kondratieff was a distinguished post-Russian revolutionary economist who was executed by Stalin in 1938 for opposing land collectivization, and for his pro-market convictions. He became a world-renowned economist for having identified the so-called “long waves,” the 50-60 year cycle of expansion, crisis and contraction by which capitalist economies renew themselves. Known today by Kondratieff wave scholars as the technological transition cycle, it was recognized by Josef Schumpeter as foundational to his concept of “creative destruction.”

Kondratieff's long cycle also aptly describes the process whereby an old economy, characterized by the rusting out, wearing out and running out of capital goods, entrepreneurship and labour relations – is replaced by a new economy built on transformational innovations, new, inexpensive energy sources and new monetary systems.

From the era of canals to those of railroads, automobiles and information technology, the book documents those technologies that seeded previous new economy springs and probes today's innovations most likely to seed the next new economy that will be necessary to overcome a global economy that is now stagnating in the Kondratieff winter phase.

It also explores the global, national and personal effects of overconsumption, underproduction, energy and innovation, competitive devaluations, deflation, reflation and stagflation and, the ultimate economic crisis, war.

Two questions

First, a conceptual one is whether the Kondratieff long waves, as many other supposedly law-like movements in economics and similar social sciences are realities or merely fictitious, intellectual constructs. Assuming they have a real foundation, as the book implies, the second question is whether they can serve as a guide for economic policies, governance, large-scale investments by private companies, etc.

Kondratieff long waves: reality or fiction

For a long time the prevailing view was that human society, including its economic behaviours, follows some kind of law, not unlike in the natural world, and that the future can be predicted on condition that such a law can be established. The great French mathematician and philosopher, Marquis de Condorcet, went so far as to claim that if man is able to predict, with almost complete assurance, those phenomena whose laws he understands, he could, using the experience of the past, predict the future of human evolution with a high probability.

Yet, in spite of all the accumulated knowledge on how social, including economic, processes work or rather have worked in the past, and with all the analytical sophistication at our disposal, attempts to predict the future are not very encouraging. Unlike some natural processes, social processes are evolutionary, irreversible, non-repetitive and hence unpredictable. And then how do the claims of repetitive experiences, such as Kondratieff waves, square with the much acclaimed nowadays chaos theory implying non-linearity in the social process and as such unpredictable?

This particular reader's position is somewhat in the middle between chaos theory or unpredictability of the future events, and law-like evolution of social processes, economics included. While social processes are not pre-ordained or law-like, neither are they chaotic and mindless. They are teleological in the sense of goal-triggered human

action. Inherent to all social processes are certain systemic properties: inertia, coherence and structural stability. There are, as we alluded in one of the previous paragraphs, in economics path breaking undertakings, such as the textile industry, followed by transportation (rail and automobile), and more recently computer technology and wireless communication, with all their derivatives, that have involved heavy capital investments. All that has triggered successions of economic activities, economic waves such as those theorized by Kondratieff.

In these and similar cases, we can also speak of Kondratieff's long economic waves as a succession of logistic growth cycles, implying a three-stage growth – initial take off with capital investments triggering a strong economy growth-expansion which culminates in a crisis (and a stock market crash) from which corporate losers are culled and winners survive to reach the saturation stage and become utilities in the next economy, Then, triggered by a new round of heavy capital investments, another cycle of logistic growth recommences, and so on in succession.

As to the seeming incompatibility between linearity theory and chaos theory, one can argue that, at a minimum, the combination of the two perspectives may help a better understanding of the complexity of the real processes. Indeed Kopala takes this a few steps further by citing K-wave experts who argue that the more we move into the transition from an industrial society, the more we try to avoid its inherent risks – particularly those presented by global terrorism, pandemics and climate change. Yet by combining future studies with evolutionary theory (which posits that system stability depends on the ability to tolerate complexity), and chaos theory (which maintains there is a subtle order in which bifurcation allows for 'jumps' to different evolutionary states – i.e., the technological transition cycle) with K-wave theory ... “we may not only mitigate risk but also surf the wave to bigger and better things ... the clue lies in the generational and cognitive or ... learning capacities of any given system or organization ... Only a community that has the physical and intellectual capacity will be able to ride (the Kondratieff wave)” (Kopala and Budden 160-161). In other words, not only are chaos, complexity, evolutionary and K-wave theories compatible, an understanding of each is vital to a successful navigation of future waves.

The following chart provides an overview and features of the fourth “Infotech Era” wave, which is now in the process of completing and in which information technology is approaching its diffusionary/saturation stage that will see its inflationary peak at the top of the next wave. The second chart provides generic and successive renderings of the K-wave, with features that are characteristic of each wave.

It should be noted here that Kondratieff's wave studies commenced at the beginning of the Industrial Revolution as reliable data only became available from that time. Though Kondratieff simply referred to the cycle he identified as the “long cycle,” Schumpeter referred to them as Kondratieff waves. He also assigned titles to each wave or, era, such as Railroadization, etc., titles which have been simplified to those indicated below. Recently, the individual wave has been divided into seasons – spring, summer, autumn and winter.

Can this sort of knowledge be of use?

For investors, academics, corporations and policy makers, the implications for understanding and managing economies, capital expenditures and investment portfolios are significant.

For the investor, riding the wave of the next new economy could mean untold riches, but the vast majority of us need mostly to understand how competitive devaluations affect our purchasing power and what liquidity flows are doing to our real estate and other asset prices in various K-wave seasons, particularly the winter season.

For academics, Kondratieff wave theory adds value to already well-entrenched cyclical theories while its integration with future studies and chaos theory could bring new dimensions to economic thinking. Corporations will understand the crucial role they, not governments, play as the final arbiters of whether or not an upswing in the wave will take place and the circumstances that must exist before they will make capital expenditures necessary to help trigger the process.

For policy makers, the question is whether governments, with tools like Keynesian interventionism, long-wave theory and digitization, can mitigate economic disaster or whether digitization will be the individual's ultimate protection against government profligacy and failure.

To be sure, the long wave teaches us about how crises, whether in the form of war or a stock market crash, are the result of disequilibria within the economy. It also reveals the perils of credit expansion and the need for prudence and restraint, whether as governments, corporations or as individuals. The challenges to the continued viability of the market economy, nation state, and liberal democracy are also placed under scrutiny, as these too may be affected by the transition cycle, and not necessarily for the better. The question again is whether we have the physical and intellectual capacity to ride the Kondratieff wave and make the system leap that takes a society and its economy to new levels of understanding, production and effective governance.

Kondratieff and the future of Western world

I would like to conclude this discussion of the Kopala/Budden book about Kondratieff long waves with a few thoughts that concern the future of the Western world nations and Canada more specifically.

Whether the script of “the first Kondratieff winter” fits fully or only tangentially the reality, as the world steps further into the 21st century, is debatable. But there can be little doubt that Western civilization countries are no longer the epicenter of the world, and that they are under considerable strain, geopolitically, civilizationally, demographically and not the least economically (Romaniuk 1998: 2012).

Geopolitically, the western world is facing the two demographic and, potentially, economic and military, giants, China and India, with their populations respectively 1.4 and 1.3 billion, as well as with Sub-Saharan Africa galloping demography, expected to reach some 2 billion people by the mid-century (May 2012). Yet, at the same time, Western countries' population, in the absence of massive immigration, stands to shrink (Statistics Canada 2001; Trovato 2015).

First thought – immigration

In Canada and in western world countries, immigration has been elevated to the status of an all-out panacea: the solvent to all western civilization societies' ills like failing birth rates and population declines, labour force shortages and so on, including the sustainability of pension funds for the growing elderly population (Lux 1995; Dubreuil and Marois 2011; Termote 2011; Paquet 2008; Trovato 2015; Dion *et al.* 2015).

In an environment of economic depression of “Kondratieff winter,” growing immigration is seen by some as an economic stimulus (investment in the housing construction). To be sure, in the upturn or “Kondratieff spring” phase, immigration amplifies the expansionary effects of innovations and energy sources, thus contributing to overall wealth creation. In an economic downturn, however, the danger is that immigration amplifies its effects as well, thus generating growing numbers of unemployed, unskilled immigrants who would be net wealth consumers.

This was certainly the case in the US where immigrants were major participants in the unsustainable sub-prime, mortgage-borrowing boom prior to the 2008 crash. This would also explain why, between 1987 and 2004, the “Kondratieff autumn” and early “winter” phase, net fiscal transfers to immigrants in Canada reached \$16 billion annually, that is, in excess of what they paid in taxes, while immigrants arriving from 1970, the “Kondratieff summer” phase, was a factor in their superior earning capacity (Grubel and Grady 2012).

Whatever economic returns immigration may generate, they must be balanced against the potential social costs. Yet, the social consequences of immigration are often overlooked, specifically where social cohesion and national identity are concerned.

At stake is *the social capital* that made western countries prosperous and fostered civil democratic society (Fukuyama 2007). New comers to Canada and their first generation children demonstrate a fertility rate that is even lower than that of Canadians generally. A country whose population no longer reproduces itself and has to rely on a continual influx of immigrants for its renewal, let alone for its growth in size, is bound to become in the long run “a nation of immigrants” with no history, no national identity, vulnerable to internal destabilizing conflicts and external threats (Ferguson 2011).

Today's enthusiasm for multiculturalism and the virtue of diversity (Habermas 2000; Yuzyk 1973) must ultimately fade in the face of more recent disturbing events surrounding immigrants and refugees in Europe. The growing cosmopolitization of

western societies carries with it the seed of their dislocation. There are indeed some perceived parallels between the Western world at its current stage and the later phase of the Roman Empire so poignantly described by the great British historian, Edward Gibbon (1848) in his *The Decline and Fall of the Roman Empire*.

Hence, to reduce the problem to a concern emanating from a fringe of the “extreme right” is simply misleading. “For if we look to the European Union as a catchall solution chanting Europe as a mantra and waving the banners of ‘Europe’ in the face of the recalcitrant ‘nationalist’ heretics, we may wake up one day to find that far from solving the problems of our continent, the myth of ‘Europe’ has become an impediment to recognizing them” (Judt 2015: 46). These words are those of the renowned British historian, Tony Judt, whom hardly anyone could suspect of hyperactive nationalism.

Nor is immigration as important a factor in economic growth as it is often claimed to be. Post war Japan and Germany are the best illustrations thereof. Germany’s economic recovery, *Wirtschaftswunder*, was triggered by the monetary reform in 1948 under the good governance of the post-war Western Germany. Only later were immigrants brought under “*Gastarbeiter*,” guest worker program, first from Southern Italy and then from Turkey and other southern countries. As for Japan’s economic miracle, this came about with *no immigrants at all* (Kono 2009).

Much in economic terms can today be generated without labour. Spectacular advances in labour-saving automation, robotic technology, and advances in wireless communication make possible the almost instantaneous transfer of knowledge and skill (Sowell 1996). Japan already makes great use of these labour-saving technologies (Kono 2009). Much of the work can and actually is outsourced to labour cheap countries, for their benefit. Finally yet importantly is the significant productive potential of a growing elderly population that enjoys good health in highly developed countries (McDaniel 1996; Légaré 2001).

Second thought – status of women and fertility rate

My second thought concerns the status of women and reproduction. Women in developed countries, and throughout the modern world, are now faced with many deterrents to maternity (marital instability, financial insecurity through motherhood), on the one hand, and many fulfilling opportunities, professionally and financially, on the other. Women nowadays are left with little incentive to trade these liberating forces against the burdens and uncertainties of motherhood. So no wonder the fertility rate throughout the economically developed countries fell well below the generational replacement level of *two* babies per woman on average. Of the modern woman, we ask the impossible. We want her to be at par with man in all spheres of life, even as a fighting force in war, yet we still expect her to be life giving, bear and raise children, without which there is no humanity.

Third thought – stationary population

And this leads me to a third thought and question. At what kind of demographic configuration ought population policy to aim, if any? The answer is a *stationary population*, which is zero growth population (Mill 1965). The current fertility rate of 1.5 babies in Canada falls short of the two babies per woman required to ensure an integral replacement of each generation and hence a stationary population (Trovato 2015). So what is the alternative? Well, we have to reassess the place of motherhood in modern society. Motherhood ought to be rewarded, morally and materially, commensurably, and this more so now than ever, precisely because of the prevailing conditions in the modern world.

A stationary population (that is zero growth and a stable age distribution) would bring some stability to the volatile world of the Kondratieff economic winter scenario and might be achievable if young people were to consider today's vastly increased longevity prospects, the time this allows for a fulfilling family life as well as a fulfilling career, and that child-rearing is a tag-team match between mother and father spread over years, not hours and minutes.

Furthermore while we cannot allow an exponential decline of population, neither should we postulate an ever-growing population in the name of *national power* projection. No western nation in isolation, or even collectively, can ever match the size of China or India's populations. Nor can we claim, as some populationists do, that ever growing population stimulates economic growth as measured by per capita income (Denton and Spencer 2003; Beaujot and Kerr 2004). As Germany and Japan illustrate, per capita income growth can only be reliably achieved through productivity gains. Moreover, the Western world has reached by now the stage of development where "quality" of life concerns should prevail over "quantity" of production considerations (Jackson 2009).

Fourth thought – potential economic and social investments

And my fourth and final thought or rather question is whether we see emerging on the horizon a window of opportunities for new massive capital investment that could bring a speedy end of the prevailing "Kondratieff winter" and propel Western civilization, and the whole humanity with it, into a new wave of economic growth and prosperity, that is a "Kondratieff spring" or "summer." I could think of two such possible epoch breaking developments.

One is the space exploration industry. Yet, unlike, the railroads or more recent revolution of wireless communication, involving massive investments that changed the economic picture of the world, space exploration industry, in the foreseeable future at least, is of an intellectual nature, research-intensive rather than one that would call for massive investments.

The other possible windows of opportunity are massive investments by economically advanced countries in the 'have not' countries so as to trigger there an economic take-off which lifts them out of the Malthusian poverty cycle and thus brings about economically a more egalitarian world. This would be an ideal solution to many problems, including

massive migration, and internal and external conflicts of the kind that are now brewing in Europe. Yet social instability in Third World countries makes problematic the realization of such a resolution. Furthermore, there is great scepticism as to its resolution, at least in its ‘government foreign aid’ approach. For a critique of foreign aid, see the book by Nobel Prize winner, economist Angus Deaton’s, *The Great Escape* (2013).

Conclusion

These are only a few considerations and questions that the reading of this excellent, thought provoking book, versatile in its public policy and governance implications, inspired in the writer of this article. Questions of personal, institutional and corporate investments aside, the fundamental question that the book invites us to consider is how, in the broadest political and social contexts, should Western civilization nations respond to the Kondratieff economic winter? The situation is being compounded by the very fact that they are no longer the world leaders they once were. Yet we have to find ways to preserve prosperity and democratic civil society in a world that is undergoing far-reaching geopolitical transformations.

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