

Henry Ford, *My Philosophy of Industry*

THERE is no denying the fact that life seems to be becoming more complicated. But is it, really? Isn't it rather that we are asked to make decisions more rapidly than before? With our new forms of transportation and communication the whole outlook of man is changed. It is greatly enlarged. He travels more, sees more, comes in contact with more people, does more things. But there is a question in my mind whether, with all this speeding up of our everyday activities, there is any more real thinking. Thinking is the hardest work there is, which is the probable reason why so few engage in it. If it were possible first to teach people how to go to work to think and then to think, there would be hope for all sorts of things.

It is easy to have ideas. But whose are they and what are they worth? Merely having something on your mind is not thinking. Merely wondering is not thinking. Merely worrying is not thinking. Merely listening with all intentness to catch and remember something that some one is offering out of the essence of wisdom is not thinking. We all have intelligence, for intelligence is the ability to receive; but we have little thinking.

Thinking is creative or it is analytical. Intelligence comprehends the outlines of a thing. Thinking breaks it into its elements, analyzes it, and puts it together again. One feels, however, that—regardless of the fact that up to the present time everything has been about all that it could be under the circumstances—there is a sense in which from this moment forward a new era may emerge, if the necessary human components of the new era decide so. Perhaps the most one can hope for now is to drive home a conviction that as a people we have not done much thinking. If we think we have been thinking and then find out that we have not, the jolt of discovery may be of service to us.

The secrets of life are open to the thinker. Thinking is the work of digging to the foundation and has the aid of higher lights. Thinking calls for facts, and facts are found by digging. He who has gathered of this wealth is well equipped for life.

Of course, in the long run we never really create anything new. We merely discover something which has already existed. We know when we have reached Truth. We are on the right road toward Truth when the things that we are doing make men a little freer than they were. We may also know when we are on the right road by examining what our motives are. Of course, mistakes may be committed with right motives, but the general direction is right when the motive is right. These are the things of which we may be perfectly sure. These principles surround the very base of Life.

Right Things in the Wrong Way

In some instances we are doing right things in the wrong way. Because the method is wrong and the trouble begins presently to show the wrong results, people are quick to draw the conclusion that the whole thing is wrong. They want to wipe it all out. They want to overturn all the machinery of social and of political life. If that were the right thing to do, then it would be the right thing to do. We should never be fearful of the cost of the right thing.

Our discovery of Truth will be one of the great surprises of human experience. When the truth comes everywhere, it will be a great surprise to see how near we have been to it all the time without recognizing it and to see how little are the changes to be made in our exterior mode of doing things. Our experience is a great preparation. It is a preparation to know the Truth when we meet it. Of course, there are many ways of arriving at this goal. Men have been striving for it ever since civilization began. All right activity has been contributing to the ultimate result. Books, mechanics, commerce and science, the motor car, the radio, the airplane—all these have helped us on the way.

Our experiences are coming faster than ever before, both in our industrial world and in our domestic life. Many people see in these changes a world constantly growing worse. I do not believe this; I think we are headed in the right direction and that we should learn to interpret our new life rather than protest against it. We are entering a new era. Old landmarks have disappeared. Our new thinking and new doing are bringing us a new world, a new heaven, and a new earth, for which prophets have been looking from time immemorial. Much of it is here already. But I wonder if we see it.

I have no sympathy with those people who believe the world is growing worse. Of course, we all are making mistakes, but we learn by them. It is only when we correct these mistakes, reverse our tracks, and get back on the main road that we make progress. Automobiles that were made fifteen years ago no longer satisfy. We have all progressed, our needs have changed. We demand more, we see a wider horizon, a better type of civilization; and whether you believe that we are the originators of it or whether a wiser destiny has forced us to accept that which best promotes our welfare matters not. That fact is here and we must recognize it and conform our manner of living to it.

The basic things are, of course, very old. Nothing useful ever passes away. If a light-headed group comes along and imagines they have found a new morality and if they draw to their books and plays and strange philosophies a following of other light-headed groups, some serious people are inclined to believe that the old morality has passed away. The good old type of goodness they say is gone. It is a rather foolish position to take and causes needless worry.

There is nothing new except a new appreciation, a new understanding, and this is the result of experience, and the result of experience can only be character. I believe that all we are here for is to get experience and form our character. Although our beginnings may be small, yet daily we are adding to our sum total of knowledge of reality—those eternalities of which real life is composed. I believe that our conscious individuality will never be lost. No matter what plane of thought we may inhabit we shall be in full consciousness of our birthright of thinking, and by each experience we shall improve our character.

Unfortunately, there exists in our day the pretense of a curious prejudice against any view of life that presupposes moral laws or values. The word "moral," like many other terms, has been narrowed in its meaning so that it has been made to serve in the very opposite sense. But when one regards the moral law as merely the law of right action or of truth it becomes quite different from "trying to be good." The universe is set in a

certain direction, and when you go along with it, that is “goodness.” If you don't, you are getting an admonitory kind of experience.

There is a vast difference between a man's being merely *statically* “good” and being *dynamically* good. In one state he is merely good negatively, and in the other he is good for something and puts that goodness into effect. He accomplishes something for mankind. We make no progress so long as we deny this. Our motive cannot be the attainment of some kind of goodness which is apart from life itself, but the attainment of inherent rightness, physically, mentally, spiritually, so that this complex instrument which we call society may efficiently function. The *right* way is the *only* way. The rightness of an attitude or method goes down through all its relations. Rightness in mechanics, rightness in morals are basically the same thing and cannot rest apart.

Matter and Spirit

I make no difference between matter and spirit. They are different degrees of fineness of the same thing. The one is becoming the other, through ascent and descent, and both benefit by the process.

Will the poverty and the injustice and the need of the world force us to adopt this law of higher relations? If so, fortunate are we. When we speak of “morality in progress,” we mean the maintenance by man of his control of the situation, instead of his being overwhelmed by the situation. We mean that he should mold progress to our highest concept of what is right between man and man and of what will work for the service of all, and not merely consent to be molded out of moral shape by the pressure of progress upon him.

Morality is merely doing the sound thing in the best way. It is a larger view and a longer view applied to life. The world is on the whole quite receptive to this implication of progress and we are all waiting for more manifestations of its workings, which are incidentally more numerous now than they have ever been in all the ages of mankind. Regardless of what we name it, this view is surely moving to practical recognition. There is one thing that we know about universal law: it operates for us if we will, against us if it must – but it operates.

Furthermore, I believe that the application of this law is necessary for business success. Just as a clean factory, clean tools, accurate gauges, and precise methods of manufacture produce a smooth-working, efficient machine; so clear thinking, clean living, square dealing make of an industrial or domestic life a successful one, smooth-running and helpful to every one concerned. It has always been surprising to me that so few people realize this great fact. Many people are led astray by gaudily painted substitutes, imitations, when they could have the genuine for the same equivalent of time or money spent – in fact, many times for much less.

The whole industrial world is suffering from many bad practices which we must refuse to use or tolerate. There must be a substitution of right methods, of right motives, the real ideas of service. I am no sentimentalist in this regard, it is just good business. There was a word once spoken which throws light on this: “Seek ye first the kingdom of

God and His righteousness and all these things shall be added unto you.” This is from the Sermon on the Mount. It sounds religious but it is just a plain statement of facts. It means just what it says—the reign, the rule, the law of the highest relations. Get that right way, work by that, and you have the world—a world without poverty, without injustice, without need.

As people wake up in their thinking—and we are even now arriving at this point in some respects—the benefits will be universally ours. Such facts are spreading throughout the whole civilized world. Even foreign lands are feeling the benefit of American progress, our American right thinking. Both Russia’s and China’s problems are fundamentally industrial and will be solved by the application of these right methods of thinking, practically applied.

No Machine Age

Another thing, it is a mistake to think that we are living in a *machine age*. That’s one of those bugaboos which people who do not understand the changing fundamentals of our civilization have set up. They prophesy all sorts of things because we have been freeing men for centuries and making it possible for them to widen their lives. We are *not* living in a machine age, *we are living in the power age*. This power age of ours has great possibilities, depending upon how we use it. Of course it can be abused. But it can also be used greatly to benefit mankind.

Here is where what we call the moral law comes in. Power must be properly used or it will destroy us. But I, for one, do not believe that we are headed in this direction. I believe that, fundamentally, every man has sensed his freedom and is eagerly making way for the new era, which is fast appearing. I think we are due for a big change in educational methods. That is one of the reasons why we are, at present, trying out our trade school form of teaching.

Give men or women the ability to think for themselves and they will soon acquire the facts necessary for the solution of their problems. The ability to recognize truth when you see it and the ability to think a thing through to its logical conclusion—these are important. These will help a man or woman contribute his or her share to the social welfare and progress of the world.

Abraham Lincoln and Benjamin Franklin both thought in fundamentals. They would be just as much at home in our civilization of today—just as valuable contributing members of our society—as they were in the age in which they lived. The Truth they knew still persists. The Truth we discover, know, and use, sets our value in the world.

In the deep, unwritten wisdom of life, there are many things to be learned that cannot be taught. We never know them by hearing them spoken, but we grow into them by experience and recognize them through understanding. Understanding is a great experience in itself, but it does not come through instruction. Nothing ripens that is not first planted, and the very desire, the dream, the ambitions of youth are by way of a planting which will come to fruition some time after these desires are abandoned and

forgotten. For the sown seed goes on growing whether we remember it or not. The wisdom of life, is to keep on planting.

It seems to be the tendency of our coming generation to want things in tabloid form. Our youth want to get their education quickly. They want to find short cuts to knowledge. In some ways this is a desirable tendency. We are making use of it in our trade schools by teaching our boys many things by motion pictures. For example, we teach them how to use a micrometer, how to use gauges. Many of the processes which are hard to describe in words can be made plain in a few moments by good pictures. Pictures speak the universal language. But, on the other hand, observation means little without reflection. In the old methods we observed many things pretty much as they really were. In the present-day radio and movie we observe them as some one desires them to appear.

Such a process is likely to stunt our reflective power. On the other hand, the new methods are stimulants. However, these new mediums of education will gradually find their place and the outworn methods will slip out. This will, of course, happen in individual cases much faster than it will in society generally. As is always the case, individuals can make more rapid progress than society can. One portion of the country or the world may see a thing and use it for months or even years before the rest of the world is willing to adopt it.

To my mind there is little difference between an international problem and a local one. The only difference is that people generally think in local terms instead of thinking in universal conceptions. As I have told many young men who have come to me for advice on how to succeed, it is just as easy to think big as it is to think in small and limited ways. It is just as easy to plow a thousand acres with a tractor as it used to be to plow a ten-acre lot with a horse. And it takes no more time.

Politics Don't Matter

Political boundaries and political opinions don't really make much difference. It is the economic condition which really forces change and compels progress.

I have been asked several times whether I believe that the large cities will continue to grow and drain the country of its small town population, or whether the reverse will be true. Well, I think we shall continue to have large cities and small towns. Each has its advantage, each has its reason for being. There are disadvantages in both, but the good in each will survive.

The father and mother of today, who are not content with the conditions under which they are living, will not be willing to have their children grow up in the same environment. They will try to change it and thus will come about many movements which will be good for both the city and the country.

Our new forms of transportation are making it easy for people to get out to see other localities, to become familiar with the kind of country in which they wish to settle. Such an interchange of social contacts, such a broadening of all people's geographical horizons will ultimately bring about a redistribution in which each person will naturally gravitate to that part of the country in which he is best satisfied to live. The automobile

has done for this country what the airplane and radio may do for the world. A wider circulation of right ideas always breaks down prejudices and helps secure universal understanding.

This, then, suggests a solution of the problem of world peace. A peaceful nation is one that has the means to make war and refrains. Until the means are present, disposition toward their misuse cannot be fully known. In the present world the believers in peace confront the advocates of war and, fortunately, the former are better armed. Their power for peace seems to be in proportion to their power to enforce it.

It sometimes seems that the course of history has been an effort to produce the invincible warrior and through him to dominate the world for peace. The nation must be capable of making war and refrain before its natural peaceableness can be known. Some nations, very great ones, are today physically unable to make war. Maybe they will continue peaceable even when they become capable of this dread ability, but we also know that there are nations able to make war who believe in peace. What the peace-loving forces of the world are facing is the war-loving forces. If that fact could be realized much waste motion would be saved.

It is interesting to study international methods of education. The educational processes differ according to the goal in view. Many of the old civilizations educate their upper classes for a condition of economic freedom and vegetative leisure, while their lower classes are held in industrial slavery. In fact, it is by the use of leisure that we may judge the characteristics of a people. There was a time when leisure was regarded as lost time. Particularly in industry, the creation of leisure time was supposed to be impractical and wasteful. It was said that working men had not been trained how to make the most of it and that a reduction of daily working hours would result in greater poverty and dissipation. We, in America, have changed our thoughts in this regard very much during the last few years. We have come to see that leisure is not waste time, that even from a cold business point of view it pays dividends in greater profits, better health, and a better product. Furthermore, it has been discovered that the workingman very soon finds a desirable and healthy way to use his leisure time to his own personal advancement and for the greater happiness of his family. The second generation is never at a mental loss to improve their time. It has been our experience that even those who come from countries where long, hard working hours were the rule are soon found using their leisure hours in a useful manner.

Man needs leisure to think, and the world needs thinkers. One of the hardest things in the industrial world today is to find enough men who are capable of thinking a problem through, executives who can do the whole job without further supervision or additional prompting. Americans of every class have more spare time than the people of any other nation in the world. But leisure is by no means secure so long as it is regarded as a privilege forced by the demands of the class. It is not secure so long as industry regards it as lost time. There is a law which definitely relates leisure to economic well-being. We are learning to use that law to the betterment of our business, the improvement of our people, and the increased welfare of our country.

Ray Dalio, *Principles for Dealing with the Changing World Order*

Introduction

The times ahead will be radically different from those we've experienced in our lifetimes, though similar to many times in history.

How do I know that? Because they always have been.

Over the last 50 or so years, in order to handle my responsibilities well, I have needed to understand the most important factors that go into making countries and their markets succeed and fail. I learned that to anticipate and handle situations that I had never faced before I needed to study as many analogous historical cases as possible to understand the mechanics of how they transpired. That gave me principles for dealing with them well.

A few years ago, I observed the emergence of a number of big developments that hadn't happened before in my lifetime but had occurred numerous times in history. Most importantly, I was seeing the confluence of huge debts and zero or near-zero interest rates that led to massive printing of money in the world's three major reserve currencies; big political and social conflicts within countries, especially the US, due to the largest wealth, political, and values gaps in roughly a century; and the rising of a new world power (China) to challenge the existing world power (the US) and the existing world order. The most recent analogous time was the period from 1930 to 1945. This was very concerning to me.

I knew that I couldn't really understand what was happening and deal with what would be coming at me unless I studied past analogous periods, which led to this study of the rises and declines of empires, their reserve currencies, and their markets. In other words, to develop an understanding of what is happening now and might happen over the next few years, I needed to study the mechanics behind similar cases in history—c.g., the 1930–45 period, the rise and fall of the Dutch and British empires, the rise and fall of Chinese dynasties, and others.⁵⁰ I was in the midst of doing those studies when the COVID-19 pandemic struck, which was another one of those big events that never happened in my lifetime but had happened many times before. Past pandemics became a part of this study and showed me that surprising acts of nature—e.g., diseases, famines, and floods—need to be considered as possibilities because those surprising big acts of nature that rarely come along were by any measure even more impactful than the biggest depressions and wars.

As I studied history, I saw that it typically transpires via relatively well-defined life cycles, like those of organisms, that evolve as each generation transitions to the next. In fact, the history and the future of humanity can be seen as just the aggregate of all the individual life stories evolving

⁵⁰ To be clear, while I am describing these cycles of the past, I'm not one of those people who believes that what happened in the past will necessarily continue into the future without understanding the cause/effect mechanics that drive changes. My objective above all else is to have you join with me in looking at the cause/effect relationships and then to use that understanding to explore what might be coming at us and agree on principles to handle it in the best possible way.

through time. I saw these stories flow together as one all-encompassing story from the beginning of recorded history up to this moment, with the same things happening over and over again for basically the same reasons, while still evolving. **By seeing many interlinking cases evolve together, I could see the patterns and cause/effect relationships that govern them and could imagine the future based on what I learned. These events happened many times throughout history and were parts of a cycle of rises and declines of empires and most aspects of empires—e.g., of their education levels, their levels of productivity, their levels of trade with other countries, their militaries, their currencies and other markets, etc.**

Each of these aspects or powers transpired in cycles, and they were all interrelated. For example, nations' levels of education affected their levels of productivity, which affected their levels of trade with other countries, which affected the levels of military strength required to protect trade routes, which together affected their currencies and other markets, which affected many other things. Their movements together made up the economic and political cycles that occurred over many years—e.g., a very successful empire or dynasty could have its cycle last 200 or 300 years. **All the empires and dynasties I studied rose and declined in a classic Big Cycle that has clear markers that allow us to see where we are in it.**

This Big Cycle produces swings between 1) peaceful and prosperous periods of great creativity and productivity that raise living standards a lot and 2) depression, revolution, and war periods when there is a lot of fighting over wealth and power and a lot of destruction of wealth, life, and other things we cherish. I saw that the peaceful/creative periods lasted much longer than the depression/revolution/war periods, typically by a ratio of about 5:1, so one could say that the depression/revolution/war periods were transition periods between the normally peaceful/creative periods.

While the peaceful/creative periods are certainly more enjoyable for most people, all these realities have their purposes for advancing evolution, so in the broader sense they are neither good nor bad. The depression/revolution/war periods produce a lot of destruction, but like cleansing storms, they also get rid of weaknesses and excesses (such as too much debt) and produce a new beginning in the form of a return to fundamentals on a sounder footing (albeit painfully). After the conflict is resolved, it is clear who has what power, and because most people desperately want peace, there is a resolution that produces new monetary, economic, and political systems—together, a new world order—and fosters the next peaceful/creative period. Within this Big Cycle are other cycles. For example, there are long-term debt cycles that last about 100 years and short-term debt cycles that last about eight years. This short-term cycle also has within it longer, prosperous expansion periods that are interrupted by shorter recession periods, and within these cycles are shorter cycles, and so on.

Before I get your head spinning with all this cycle stuff, the main thing I want to convey is that when the cycles align, the tectonic plates of history shift, and the lives of all people change in big ways. These shifts will sometimes be terrible and sometimes terrific. They certainly will happen in the future, and most people will fail to anticipate them. In other words, **the swinging of conditions from one extreme to another in a cycle is the norm, not the**

exception. It was a very rare country in a very rare century that didn't have at least one boom/harmonious/prosperous period and one depression/ civil war/revolution period, so we should expect both. Yet, most people throughout history have thought (and still think today) that the future will look like a slightly modified version of the recent past. That is because **the really big boom periods and the really big bust periods, like many things, come along about once in a lifetime and so they are surprising unless one has studied the patterns of history over many generations.** Because the swings between great and terrible times tend to be far apart, **the future we encounter is likely to be very different from what most people expect.**

For example, my dad and most of his peers who went through the Great Depression and World War II never imagined the post-war economic boom because it was more different from than similar to what they had experienced. I understand why, given those experiences, they wouldn't think of borrowing and putting their hard-earned savings into the stock market, so it's understandable that they missed out on profiting from the boom. Similarly, I understand why, decades later, those who only experienced debt-financed booms and never experienced depression and war would borrow a lot in order to speculate and would consider depression and war implausible. The same is true with money: money used to be "hard" (i.e., linked to gold) after World War II until governments made money "soft" (i.e., fiat) to accommodate borrowing and prevent entities from going broke in the 1970s. As a result, most people at the time of my writing this book believe that they should borrow more, even though borrowing and debt-financed booms have historically led to depressions and internal and external conflicts.

Understanding history in this way also raises questions whose answers provide us with valuable clues on what the future will be like. For example, throughout my life, the dollar has been the world's reserve currency, monetary policy has been an effective tool for stimulating economies, and democracy and capitalism have been widely regarded as the superior political and economic systems. Anyone who studies history can see that **no system of government, no economic system, no currency, and no empire lasts forever, yet almost everyone is surprised and ruined when they fail.** Naturally I asked myself how would I and the people I care about know when we are entering one of these depression/revolution/war periods and how would we know how to navigate them well. Because my professional responsibility is to preserve wealth regardless of the environment, I needed to develop an understanding and strategy that would have worked throughout history, including through these sorts of devastating times.

The purpose of this book is to pass along what I learned that has helped me and that I believe might help you. I present it for your consideration.

How I Learned to Anticipate the Future by Studying the Past

While it might seem odd that an investment manager who is required to make investment decisions on short time frames would pay so much attention to long-term history, through my experiences I have learned that I need this perspective. My approach isn't an academic one created for scholarly purposes; it is a very practical one that I follow in order to do my job well. The game I play requires me to understand what is likely to happen to economies better than

the competition does, so I have spent roughly 50 years closely observing most major economies and their markets—as well as their political conditions, since those affect both—trying to understand what is happening well enough to bet on it. From my years of wrestling with the markets and trying to come up with principles for doing it well, I've learned that **one's ability to anticipate and deal well with the future depends on one's understanding of the cause/effect relationships that make things change, and one's ability to understand these cause/effect relationships comes from studying how they have changed in the past.**

I arrived at this approach after the painful learning that the biggest mistakes in my career came from missing big market moves that hadn't happened in my lifetime but had happened many times before. The first of these big surprises for me came in 1971 when I was 22 years old and clerking on the floor of the New York Stock Exchange as a summer job. I loved it because it was a fast-paced game of making and losing money played on a trading floor with people who liked to have a blast with each other—so much so that traders used to have water pistol fights right on the trading floor. I was engrossed in this game of watching the big developments in the world and betting on how they would drive the markets. Sometimes it could be dramatic.

On a Sunday night—August 15, 1971—President Richard Nixon announced that the US would renege on its promise to allow paper dollars to be turned in for gold. As I listened to Nixon speak, I realized that the US government had defaulted on a promise and that money as we knew it had ceased to exist. That couldn't be good, I thought. So on Monday morning I walked onto the floor of the exchange expecting pandemonium as stocks took a dive. There was pandemonium all right, but not the sort I expected. Instead of falling, the stock market jumped about 4 percent as the dollar plummeted. I was shocked. That's because I hadn't experienced a currency devaluation before. In the days that followed, I dug into history and saw that there were many cases of currency devaluations that had had similar effects on stock markets. By studying further, I figured out why, and I learned something valuable that would help me many times in my future. It took a few more of those painful surprises to beat the realization into my head that I needed to understand all the big economic and market moves that had happened in the last 100-plus years and in all major countries.

In other words, if some big and important event had happened in the past (like the Great Depression), I couldn't say for sure that it wouldn't happen to me, so I had to figure out how it worked and be prepared to deal with it. Through my research I saw that there were many cases of the same types of things happening (e.g., depressions) and that by studying them just like a doctor studies many cases of a particular type of disease, I could gain a deeper understanding of how they work. I studied these through my experiences both qualitatively and quantitatively, by speaking with preeminent experts, reading great books, and digging into statistics and archives with my great research team.

From that learning came a visualization of an archetypical sequence of how rises and declines in wealth and power typically happen. The archetype helps me see the cause/effect relationships that drive how these cases typically progress. With that archetypical template specified, I can study deviations from it to try to explain them. Then I put these mental models into algorithms

both to monitor conditions relative to my archetypes and to help me make decisions based on them. This process helps me refine my understanding of the cause/ effect relationships to the point where I can create decision-making rules—i.e., principles for dealing with my realities—in the form of “if/then” statements—i.e., if X happens, then make Y bet. Then I watch actual events transpire relative to that template and what we are expecting. I do these things in a very systematic way with my partners at Bridgewater Associates. If events are on track, we continue to bet on what typically comes next; if events start to deviate from our template, we try to understand why and course correct. This process has helped me both understand the big cause/effect sequences that typically drive their progressions and gain a lot of humility. I do this continuously and will continue to do it until I die, so what you are reading is a work in progress.

This Approach Affects How I See Everything

Seeing events in this way helped shift my perspective from being caught in the blizzard of things coming at me to stepping above them to see their patterns through time. The more related things I could understand in this way, the more I could see how they influence each other—e.g., how the economic cycle works with the political one—and how they interact over longer periods of time.

I believe that the reason people typically miss the big moments of evolution coming at them in life is because they experience only tiny pieces of what's happening. We are like ants preoccupied with our jobs of carrying crumbs in our very brief lifetimes instead of having a broader perspective of the big-picture patterns and cycles, the important interrelated things driving them, where we are within the cycles, and what's likely to transpire. From gaining this perspective, I've come to believe that throughout history there are only a limited number of personality types going down a limited number of paths, which lead them to encounter a limited number of situations to produce a limited number of stories that repeat over time. The only things that change are the clothes the characters are wearing, the languages they are speaking, and the technologies they're using.

Chapter 1

The Big Cycle in a Tiny Nutshell

As explained in the introduction, the world order is now rapidly shifting in important ways that have never happened in our lifetimes but have happened many times before. My objective is to show you those cases and the mechanics that drove them and, with that perspective, attempt to imagine the future.

What follows here is an ultra-distilled description of the dynamics that I saw in studying the rises and declines of the last three reserve currency empires (the Dutch, the British, and the American) and the six other significant empires over the last 500 years (Germany, France, Russia, India, Japan, and China), as well as all of the major Chinese dynasties back to the Tang

Dynasty in around the year 600. The purpose of this chapter is simply to provide an archetype to use when looking at all the cycles, most importantly the one that we are now in.

In studying these past cases, I saw clear patterns that occurred for logical reasons that I briefly summarize here and cover more completely in subsequent chapters. While the focus of this chapter and this book are on those forces that affected the big cyclical swings in wealth and power, I also saw ripple-effect patterns in all dimensions of life, including culture and the arts, social mores, and more, which I will touch on later. Between this simple archetype and the cases shown in Part II, we will see how the individual cases fit the archetype (which is essentially just the average of those cases) and how well the archetype describes the individual cases. Doing this, I hope, will help us better understand what is happening now.

I'm on a mission to figure out how the world works and to gain timeless and universal principles for dealing with it well. It's both a passion and a necessity for me. While the curiosities and concerns that I described earlier pulled me into doing this study, the process of conducting it gave me a much greater understanding of the really big picture of how the world works than I expected to get, and I want to share it with you. It made much clearer to me how peoples and countries succeed and fail over long swaths of time, it revealed giant cycles behind these ups and downs that I never knew existed, and, most importantly, it helped me put into perspective where we now are.

For example, through my research, I learned that **the biggest thing affecting most people in most countries through time is the struggle to make, take, and distribute wealth and power, though they also have struggled over other things too, most importantly ideology and religion.** These struggles happened in timeless and universal ways and had huge implications for all aspects of people's lives, unfolding in cycles like the tide coming in and out.

I also saw how, throughout time and in all countries, the people who have the wealth are the people who own the means of wealth production. In order to maintain or increase their wealth, they work with the people who have the political power, who are in a symbiotic relationship with them, to set and enforce the rules. I saw how this happened similarly across countries and across time. While the exact form of it has evolved and will continue to evolve, the most important dynamics have remained pretty much the same. The classes of those who were wealthy and powerful evolved over time (e.g., from monarchs and nobles who were landowners when agricultural land was the most important source of wealth, to capitalists and elected or autocratic political officials now that capitalism produces capital assets and that wealth and political power are generally not passed along in families) but they still cooperated and competed in basically the same ways.

I saw how, over time, this dynamic leads to a very small percentage of the population gaining and controlling exceptionally large percentages of the total wealth and power, then becoming overex-tended, and then encountering bad times, which hurt those least wealthy and least powerful the hardest, which then leads to conflicts that produce revolutions and/or civil wars. When these conflicts are over, a new world order is created, and the cycle begins again.

In this chapter, I will share more of this big-picture synthesis and some of the details that go along with it. While what you're reading here are my own views, you should know that the ideas I express in this book have been well-triangulated with other experts. About two years ago, when I felt that I needed to answer the questions I described in the introduction, I decided to immerse myself in studying with my research team, digging through archives, speaking with the world's best scholars and practitioners who each had in-depth understandings of bits and pieces of the puzzle, reading relevant great books by insightful authors, and reflecting on the prior research I've done and the experiences that I've had from investing globally for nearly 50 years.

Because I view this as an audacious, humbling, necessary, and fascinating undertaking, I am worried about missing important things and being wrong, so my process is iterative. I do my research, write it up, show it to the world's best scholars and practitioners to stress test it, explore potential improvements, write it up again, stress test it again, and so on, until I get to the point of diminishing returns. This study is the product of that exercise. While I can't be sure that I have the formula for what makes the world's greatest empires and their markets rise and fall exactly right, I'm pretty confident that I got it by and large right. I also know that what I learned is essential for my putting what is happening now into perspective and for imagining how to deal with important events that have never happened in my lifetime but have happened repeatedly throughout history.

Understanding the Big Cycle

For reasons that are explained in this book, I believe that we are now seeing an archetypical big shift in relative wealth and power and the world order that will affect everyone in all countries in profound ways. This big wealth and power shift is not obvious because most people don't have the patterns of history in their minds to see this one as "another one of those." So in this first chapter, I will describe in a very brief way how I see the archetypical mechanics behind rises and declines of empires and their markets working. I have identified 18 important determinants that have explained almost all of the basic ebbs and flows through time that have caused ups and downs in empires. We will look at them in a moment. Most of them transpire in classic cycles that are mutually reinforcing in ways that tend to create a single very big cycle of ups and downs. This archetypical Big Cycle governs the rising and declining of empires and influences everything about them, including their currencies and markets (which I'm especially interested in). **The most important three cycles are the ones I mentioned in the introduction: the long-term debt and capital markets cycle, the internal order and disorder cycle, and the external order and disorder cycle.**

Because these three cycles are typically the most important, we will be looking at them in some depth in later chapters. Then we will apply them to history and the present day so that you can see how they play out in real examples.

These cycles drive swings back and forth between opposites—swings between peace and war, economic boom and bust, the political left and political right being in power, the coalescing and

disintegrating of empires, etc. — that typically occur because people push things to extremes that surpass their equilibrium levels, which leads to swings that get overdone in the opposite direction. **Embedded in the swings in one direction are the ingredients that lead to the swings in the opposite direction.**

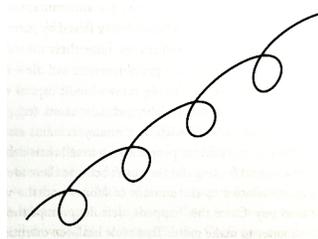
These cycles have remained essentially the same through the ages for essentially the same reason that the fundamentals of the human life cycle have remained the same over the ages: because human nature doesn't change much over time. For example, fear, greed, jealousy, and other basic emotions have remained constants and are big influences that drive cycles.

While it is true that no two people's life cycles are exactly the same and the typical life cycle has changed over the millennia, the archetype of the human life cycle — of children being raised by parents until they are independent, at which point they raise their own children and work, which they do until they get old, retire, and die — remains essentially the same. Similarly the big money/credit/capital markets cycle, which builds up too much debt and debt assets (e.g., bonds) until the debts can't be serviced with hard money, remains essentially the same. As always, this leads to people trying to sell their debt assets to make purchases and finding out they can't because there are far too many debt assets relative to the amount of money and the value of stuff there is to buy. Once this happens, defaults prompt those who manufacture money to make more. That cycle has been essentially the same for thousands of years. So have the cycles of internal order and disorder and external order and disorder. We will explore how human nature and other dynamics drive these cycles in the coming chapters.

Evolution, Cycles, and the Bumps Along the Way

Evolution is the biggest and only permanent force in the universe, yet we struggle to notice it. While we see what exists and what happens, we don't see evolution and the evolutionary forces that make things exist and happen. Look around you. Do you see evolutionary change? Of course not. Yet you know that what you are looking at is changing — albeit slowly from your perspective — and you know that in time it won't exist and other things will exist in its place. To see this change, we have to devise ways to measure things and watch the measurements change. Then, once we can see the change, we can study why it happens. This is what we must do if we are going to successfully think about the changes ahead and how to deal with them.

Evolution is the upward movement toward improvement that occurs because of adaptation and learning. Around it are cycles. To me, most everything transpires as an ascending trajectory of improvement with cycles around it, like an upward-pointing corkscrew:



Evolution is a relatively smooth and steady improvement because the gaining of knowledge is greater than the losing of knowledge. Cycles on the other hand move back and forth, producing excesses in one direction that lead to reversals and excesses in the other, like the swinging of a pendulum. For example, over time our living standards rise because we learn more, which leads to higher productivity, but we have ups and downs in the economy because we have debt cycles that drive actual economic activity up and down around that uptrend. These evolutionary and sometimes revolutionary changes around the trend are not always smooth and painless. Sometimes they are very abrupt and painful as mistakes are made, learning occurs, and better adaptations result.

Together evolution and cycles make the upward corkscrew-type movements that we see in everything – wealth, politics, biology, technology, sociology, philosophy, etc.

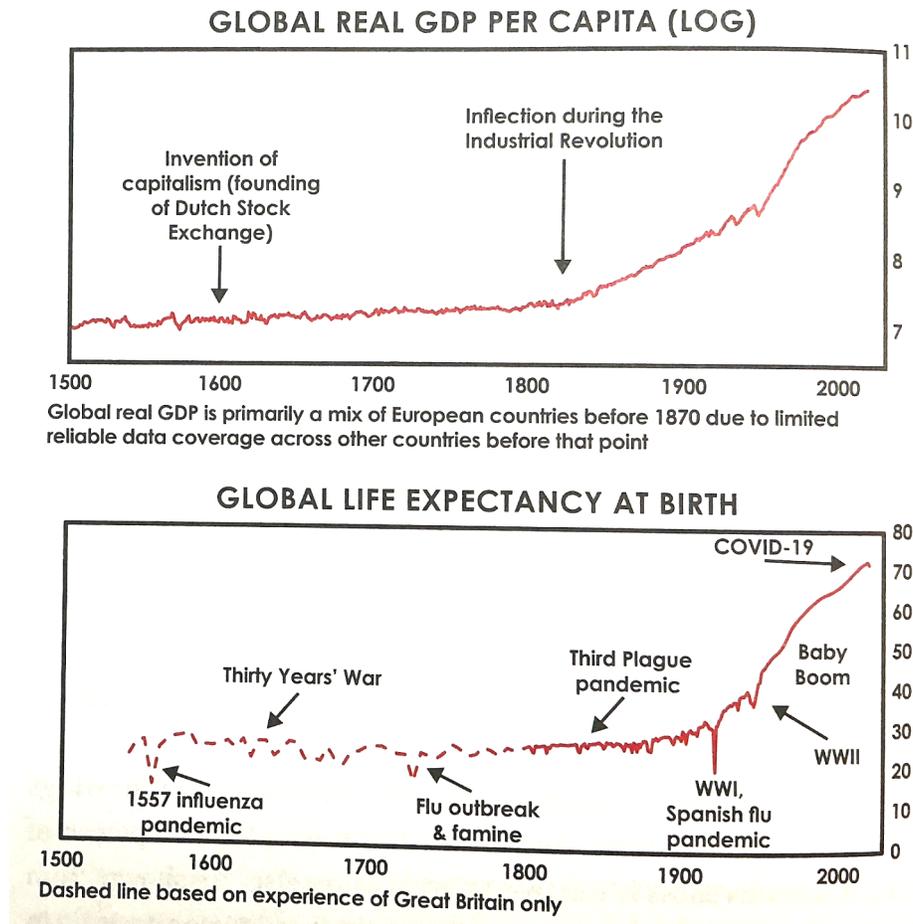
Human productivity is the most important force in causing the world's total wealth, power, and living standards to rise over time. Productivity – i.e., the output per person, driven by learning, building, and inventiveness – has steadily improved over time. However, it has risen at different rates for different people, though always for the same reasons – because of the quality of people’s education, inventiveness, work ethic, and economic systems to turn ideas into output. These reasons are important for policy makers to understand in order to achieve the best possible outcomes for their countries, and for investors and companies to understand in order to determine where the best long-term investments are.

This constantly increasing trend is the product of humanity’s capacity to evolve, which is greater than any other species’ because our brain gives us a unique capacity to learn and think abstractly. As a result, our inventions of technologies and ways of doing things have advanced uniquely. That evolution has led to the continuous evolutions that make up the changing world order. Technological advances in communications and transportation have brought everyone in the world closer together, which has changed the nature of relationships of people and empires in profound ways. We see such evolutionary improvements apparent in just about everything greater life expectancy, better products, better ways of doing things, etc. Even our way of evolving has evolved in the form of coming up with better ways to create and innovate. This has been true for as long as human history has been written. As a result of this, charts of most everything show more upward slopes toward improvement than up and down movements.

This is shown in the following charts: estimated output (i.e., estimated real GDP) per person and life expectancy over the last 500 years. These are probably the two most widely agreed-upon measures of well-being, though they are imperfect. You can see the magnitudes of their evolutionary uptrends relative to the magnitudes of the swings around them.

The fact that the trends are so pronounced relative to the swings around the trends shows how much more forceful the power of human inventiveness is relative to everything else. As shown from this top-down, big-picture perspective, output per person appears to be steadily improving, though very slowly in the early years and faster starting in the 19th century, when the upward slope becomes much steeper, reflecting the faster productivity gains. This shift from lower productivity gains to faster productivity gains was primarily due to the

improvements in broad learning and the conversion of that learning into productivity. That was brought about by a number of factors going as far back as Gutenberg's printing press in Europe in the mid-15th century (printing had already been in use in China for centuries), which increased the knowledge and education available to many more people, contributing to the Renaissance, the Scientific Revolution, the Enlightenment, the invention of capitalism, and the First Industrial Revolution in Britain. We will delve into these shortly.



The broader-based improvements in productivity that came from the invention of capitalism, entrepreneurship, and the Industrial Revolution also shifted wealth and power away from an agriculture-based economy in which landownership was the principal source of power, and monarchs, nobles, and the clergy worked together to maintain their grip on it. The shift moved toward an industry-based economy in which inventive capitalists created and owned the means of production of industrial goods and worked together with those in government to maintain the system that allowed them to have the wealth and power. In other words, since the Industrial Revolution, which brought about that change, we have been operating in a system in which wealth and power have primarily come more from the combination of education, inventiveness, and capitalism, with those who run governments working with those who control most of the wealth and education.

How this evolution with big cycles around it happens also continues to evolve. For example, while ages ago agricultural land and agricultural production were worth the most and that evolved into machines and what they produced being worth the most, digital things that have no apparent physical existence (data and information processing) are now evolving to become worth the most.⁵¹ This is creating a fight over who obtains the data and how they use it to gain wealth and power.

The Cycles Around the Uptrend

While significant, because these learnings and productivity improvements are evolutionary, they don't cause big abrupt shifts in who has what wealth and power. The big abrupt shifts come from booms, busts, revolutions, and wars, which are primarily driven by cycles, and these cycles are driven by logical cause/effect relationships. For example, the forces of increased productivity, entrepreneurship, and capitalism that marked the end of the 19th century also produced big wealth gaps and overindebtedness that led to economic downturns that, in the first half of the 20th century, led to anti-capitalism, communism, and big conflicts over wealth and power within and between countries. What you can see is evolution marching on with big cycles around it. **Throughout time, the formula for success has been a system in which well-educated people, operating civilly with each other, come up with innovations, receive funding through capital markets, and own the means by which their innovations are turned into the production and allocation of resources, allowing them to be rewarded by profit making. However, over the long run capitalism has created wealth and opportunity gaps and overindebtedness that have led to economic downturns and revolutions and wars that have caused changes in the domestic and world orders.**

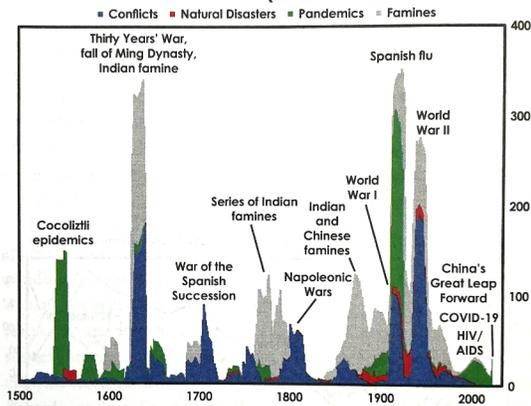
As you can see in the following charts, history shows us that almost all of these turbulent times were due to fighting over wealth and power (i.e., conflicts in the form of revolutions and wars, often driven by money and credit collapses and big wealth gaps), and severe acts of nature like droughts, floods, and epidemics). It also shows that how bad these periods get depends almost exclusively on how strong countries are and their ability to endure them.

Countries with large savings, low debts, and a strong reserve currency can withstand economic and credit collapses better than countries that don't have much savings, have a lot of debt, and don't have a strong reserve currency. Likewise those that have strong and capable leadership and civil populations can be managed better than those that don't have these, and

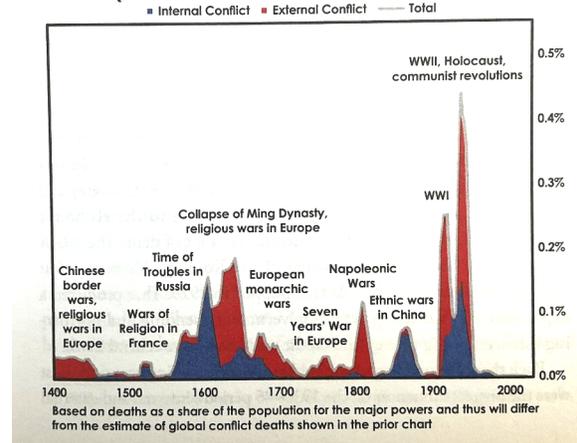
⁵¹ At this time, humanity is evolving its ways of thinking and increasing productivity in more dramatic ways than ever before—even more dramatically than the discovery and usage of the scientific method. We are doing this through the development of artificial intelligence, which is an alternative way of thinking via an alternative brain that can make discoveries and process them into instructions of what should be done. Humanity is essentially creating an alternative species that has enormous capacity to see past patterns and process many different ideas very quickly, has little or no common sense, has trouble understanding the logic behind relationships, and doesn't have emotions. This species is simultaneously smart and stupid, helpful and dangerous. It offers great potential and needs to be well-controlled but not blindly followed.

those that are more inventive will adapt better than those that are less inventive. As you will see later, these factors are measurable timeless and universal truths.

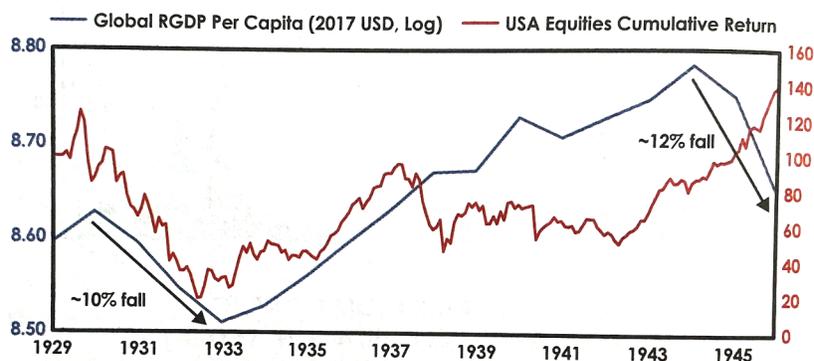
GLOBAL DEATHS BY CATEGORY (RATE PER 100K PEOPLE, 15YMA)



ESTIMATED DEATHS FROM CONFLICT (MAJOR POWERS, %POPULATION, 15YMA)



Because these turbulent times are small in relation to the evolutionary uptrend of humanity's capacity to adapt and invent, they barely show up in the previous charts of GDP and life expectancy, appearing only as relatively minor wiggles. Yet these wiggles seem very big to us because we are so small and short-lived. Take the 1930-45 depression and war period, for example. The levels of the US stock market and global economic activity are shown in the next chart. As you can see, the economy fell by about 10 percent, and the stock market fell by about 85 percent and then began to recover.



This is part of the classic money and credit cycle that has happened for as long as there has been recorded history and that I will explain more completely in Chapter 3. Briefly, a credit collapse happens because there is too much debt. Typically, the central government has to spend a lot of money it doesn't have and make it easier for debtors to pay their debts and the central bank always has to print money and liberally provide credit-like they did in response to the economic

plunge driven by the COVID pandemic and a lot of debt. The 1930s debt bust was the natural extension of the Roaring '20s boom that became a debt-financed bubble that popped in 1929. That produced a depression that led to big central government spending and borrowing financed by big money and credit creation by the central bank.

Back then, the popping of the bubble and the resulting economic bust were the biggest influences on the 1930-45 period's internal and external fights for wealth and power. Then, like now and like in most other cases, there were large wealth gaps and conflict, which when heightened by debt/economic collapses, led to revolutionary changes in social and economic programs and big wealth transfers that were manifest in different systems in different countries. Clashes and wars developed over which of these systems—e.g., capitalism or communism, democracy or autocracy—were best. **There are always arguments or fights between those who want to make big redistributions of wealth and those who don't.** In the 1930s, Mother Nature also gave the US a painful drought.

Looking over the whole of the cases I examined, past economic and market declines lasted about three years, give or take a few years, depending on how long it took to do the debt restructuring and/or debt monetization process. The quicker the printing of money to fill the debt holes, the quicker the closing of the deflationary depression and the sooner the worrying about the value of money began. In the 1930s US case, the stock market and the economy bottomed the day that the newly elected president, Franklin D. Roosevelt, announced that he would default on the government's promise to let people turn in their money for gold, and that the government would create enough money and credit so that people could get their money out of the banks and others could get money and credit to buy things and invest. That took three-and-a-half years from the initial stock market crash in October 1929.⁵²

Still there was fighting over wealth and power within and between countries. The emerging powers of Germany and Japan challenged the existing leading world powers of Great Britain, France, and eventually the US (which was dragged into World War II). The war period raised the economic output of things that were used in the war, but it would be a misnomer to call the war years a "productive" period—even though when measured in output per person, it was—because there was so much destruction. At the end of the war, global GDP per capita had fallen by about 12 percent, much of which was driven by declines in the economies of countries that lost the war. The stress test that these years represented wiped out a lot, made clear who the winners and losers were, and led to a new beginning and a new world order in 1945. Classically that was followed by a lengthy period of peace and prosperity that became overextended so that all countries are now, 75 years later, being stress tested again.

Most cycles in history happen for basically the same reasons. For example, the 1907-19 period began with the Panic of 1907 in the US, which, like the 1929-32 money and credit crisis following the Roaring '20s, was the result of a boom period (the Gilded Age in the US, which was the same time as the Belle Époque in continental Europe and the Victorian Era in Great Britain) becoming a debt-financed bubble that led to economic and market declines. These

⁵² In 2008, it took two months from the crash to the printing of money; in 2020, it took just weeks.

declines also happened when there were large wealth gaps that led to big wealth redistributions and contributed to a world war. The wealth redistributions, like those in the 1930-45 period, came about through large increases in taxes and government spending, big deficits, and big changes in monetary policies that monetized the deficits. Then the Spanish flu intensified the stress test and the resulting restructuring process. This stress test and global economic and geopolitical restructuring led to a new world order in 1919, which was expressed in the Treaty of Versailles. That ushered in the 1920s debt-financed boom, which led to the 1930-45 period and the same things happening again.

These periods of destruction/reconstruction devastated the weak, made clear who the powerful were, and established revolutionary new approaches to doing things (i.e., new orders) that set the stage for periods of prosperity that eventually became overextended as debt bubbles with large wealth gaps and led to debt busts that produced new stress tests and destruction/reconstruction periods (i.e., wars), which led to new orders and eventually the strong again gaining relative to the weak, and so on.

What are these destruction/reconstruction periods like for the people who experience them? Since you likely haven't been through one of these and the stories about them are very scary, the prospect of being in one is worrisome to most people. It is true that these destruction/reconstruction periods have produced tremendous human suffering both financially and, more importantly, in lost or damaged human lives. While the consequences are worse for some people, virtually no one escapes the damage. Still, without minimizing them, history has shown us that typically the majority of people stay employed in depressions, are unharmed in shooting wars, and survive natural disasters.

Some people who struggled through them have even described these very difficult times as bringing about important, good things like drawing people closer together, building strength of character, learning to appreciate the basics, etc. For example, Tom Brokaw called the people who went through the 1930-45 period "the Greatest Generation" because of the strength of character it gave them. My parents and aunts and uncles who went through the Great Depression and World War I, as well as others of their era whom I've spoken to in other countries who went through their own versions of this destruction period, saw it that way too. Keep in mind that economic destruction periods and war periods typically don't last very long—roughly two or three years. And the lengths and severities of natural disasters (like droughts, floods, and epidemics) vary, though they typically lessen in painfulness as adaptations are made. One rarely gets all three of these types of big crises—economic, revolution/war, and natural disaster—at the same time.

My point is that **while these revolution/war periods typically lead to a lot of human suffering, we should never, especially in the worst of times, lose sight of the fact that one can navigate them well—and that humanity's power to adapt and quickly get to new and higher levels of well-being is much greater than all the bad stuff that can be thrown at us.** For that reason, I believe that it is smart to trust and invest in humanity's adaptability and inventiveness. So, while I am pretty sure that in the coming years both you and I and the world order will

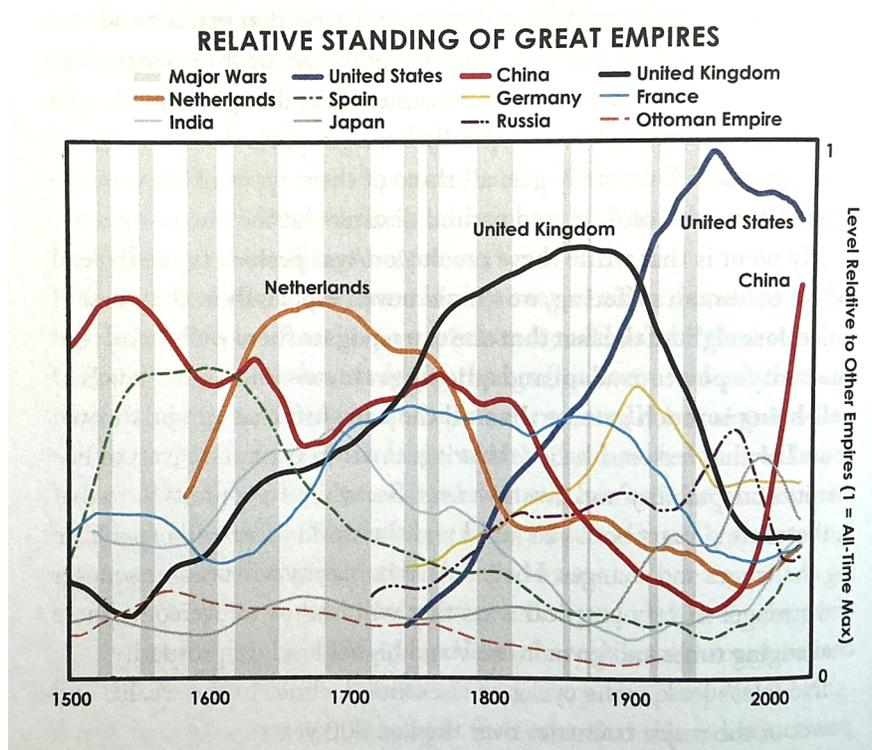
experience big challenges and changes, I believe that humanity will become smarter and stronger in very practical ways that will lead us to overcome these challenging times and go on to new and higher levels of prosperity.

Now let's look at the cycles of rises and declines in the wealth and power of the major countries over the last 500 years.

Past Big Cycle Shifts in Wealth and Power

The chart of rising productivity shown earlier was for the whole world (to the best of our ability to measure it). It doesn't show the shifts in wealth and power that occurred between countries. To understand how those happen, let's start with the big-picture basics. Throughout recorded history various forms of groups of people (e.g., tribes, kingdoms, countries, etc.) have gained wealth and power by building it themselves, taking it from others, or finding it in the ground. When they gathered more wealth and power than any other group, they became the world's leading power, which allowed them to determine the world order. When they lost that wealth and power, which they all did, the world order—and all aspects of life—changed in profound ways.

The next chart shows the relative wealth and power of the 11 leading empires over the last 500 years.



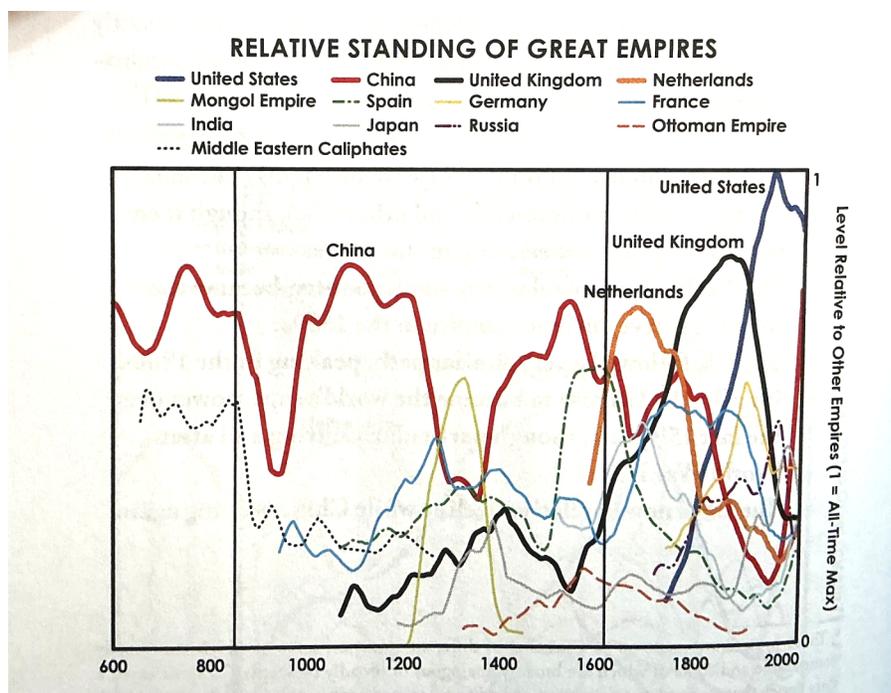
Each one of these indices⁵³ of wealth and power is a composite of eight different determinants that I will explain shortly. Though these indices aren't perfect because data isn't perfectly accurate through time, they do an excellent job of painting the big picture. As you can see, nearly all of these empires saw periods of ascendancy followed by periods of decline.

Take a moment to study the thicker lines on the chart, which represent the four most important empires: the Dutch, British, American, and Chinese. These empires held the last three reserve currencies—the US dollar now, the British pound before it, and the Dutch guilder before that. China is included because it has risen to be the second most powerful empire/country and because it was so consistently powerful in most years prior to around 1850. To very briefly summarize the story this chart shows:

- **China was dominant for centuries (consistently out-competing Europe economically and otherwise), though it entered a steep decline starting in the 1800s.**
- **The Netherlands, a relatively small country, became the world's reserve currency empire in the 1600s.**
- **The UK followed a very similar path, peaking in the 1800s.**
- **Finally, the US rose to become the world's superpower over the last 150 years, though particularly during and after World War II.**
- **The US is now in relative decline while China is rising again.**

Now let's look at the same chart that extends the data all the way back to the year 600. I focused on the first chart (which covers just the last 500 years) rather than the second (which covers the last 1,400 years) because it highlights the empires I studied most intently and is simpler—though with 11 countries, 12 major wars, and over 500 years, it can hardly be called simple. Still, the second is more extensive and worth glancing at. I left out the shading of the war periods to lessen the complexity. As shown, **in the pre-1500 period, China was almost always the most powerful, though the Middle Eastern caliphates, the French, the Mongols, the Spanish, and the Ottomans were also in the picture.**

⁵³ These indices are made up of a number of different statistics, some of which are directly comparable and some of which are broadly analogous or broadly indicative. In some cases, a data series that stopped at a certain point had to be spliced with a series that continued back in time. Additionally, the lines shown on the chart are 30-year moving averages of these indices, shifted so that there is no lag. I chose to use the smoothed series because the volatility of the unsmoothed series was too great to allow one to see the big movements. Going forward, I will use these very smoothed versions when looking at the very long term and much less smoothed or unsmoothed versions when looking at these developments up close because the most important developments are best captured this way.

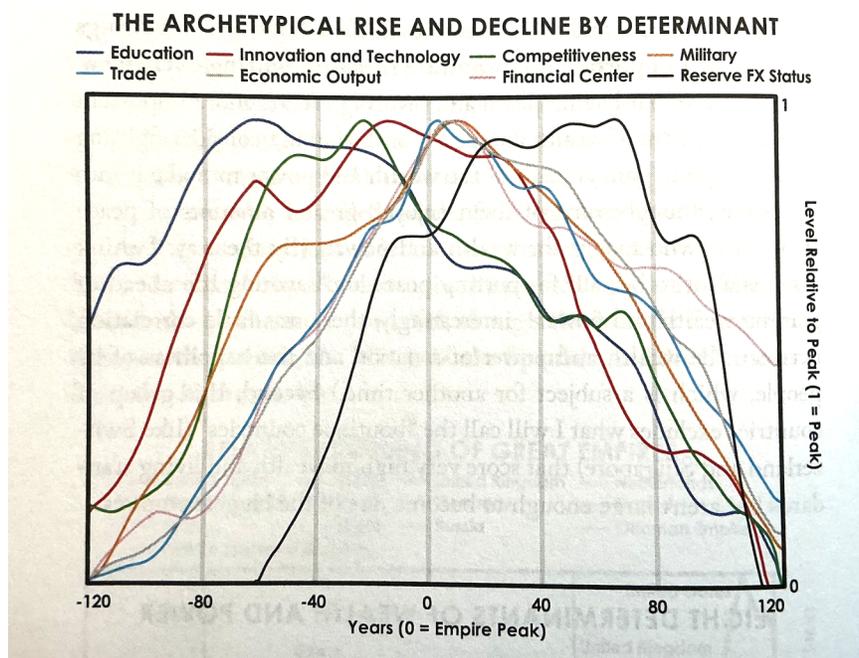


An important thing to remember: while the leading powers covered in this study were the richest and most powerful, they weren't necessarily the best-off countries for two reasons. First, while wealth and power are what most people want and will fight over most, some people and their countries don't think that these things are the most important and wouldn't think of fighting over them. Some believe that having peace and savoring life are more important than having a lot of wealth and power and wouldn't consider fighting hard enough to gain enough of the wealth and power to make it into this study, though some of them enjoyed greater amounts of peace than those who fought for wealth and power. (By the way, I think there is a lot to be said for putting peace and savoring life ahead of gaining wealth and power—interestingly, there was little correlation between the wealth and power of a nation and the happiness of its people, which is a subject for another time.) Second, this group of countries excludes what I will call the “boutique countries” (like Switzerland and Singapore) that score very high in wealth and living standards but aren't large enough to become one of the biggest empires.

Eight Determinants of Wealth and Power

The single measure of wealth and power that I showed you for each country in the prior charts is a roughly equal average of 18 measures of strength. While we will explore the full list of determinants later, let's begin by focusing on the key eight shown in the next chart: 1) education, 2) competitiveness, 3) innovation and technology, 4) economic output, 5) share of world trade, 6) military strength, 7) financial center strength, and 8) reserve currency status.

This chart shows the average of each of these measures of strength across all the empires I studied, with most of the weight on the most recent three reserve countries (i.e., the US, the UK, and the Netherlands).⁵⁴



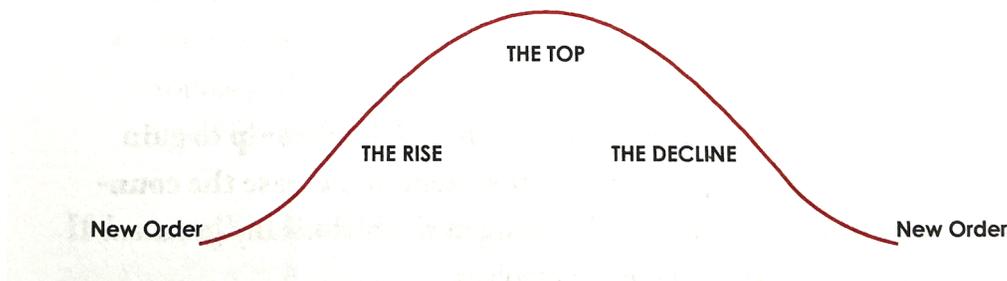
The lines in the chart do a pretty good job of telling the story of why and how the rises and declines took place. You can see how rising education leads to increased innovation and technology, which leads to an increased share of world trade and military strength, stronger economic output, the building of the world's leading financial center, and, with a lag, the establishment of the currency as a reserve currency. And you can see how for an extended period most of these factors stayed strong together and then declined in a similar order. The common reserve currency, just like the world's common language, tends to stick around after an empire has begun its decline because the habit of usage lasts longer than the strengths that made it so commonly used.

I call this cyclical, interrelated move up and down the **Big Cycle**. Using these determinants and some additional dynamics, I will next describe the Big Cycle in more detail. But before I start, it's worth reiterating that all of these measures of strength rose and declined over the arc of the empire. That's because these strengths and weaknesses are mutually reinforcing i.e., strengths and weaknesses in education, competitiveness, economic output, share of world trade, etc., contribute to the others being strong or weak, for logical reasons.

⁵⁴ We show where key indicators were relative to their history by averaging them across the cases. The chart is shown such that a value of 1 represents the peak in that indicator relative to history and 0 represents the trough. The timeline is shown in years with 0 representing roughly when the country was at its peak (i.e., when the average across the gauges was at its peak). In the rest of this chapter, we walk through each of the stages of the archetype in more detail.

The Archetypal Big Cycle

Broadly speaking, we can look at these rises and declines as happening in three phases:



The Rise:

The rise is the prosperous period of building that comes after a new order. It is when the country is fundamentally strong because there are a) relatively low levels of indebtedness, b) relatively small wealth, values, and political gaps between people, c) people working effectively together to produce prosperity, d) good education and infrastructure, e) strong and capable leadership, and f) a peaceful world order that is guided by one or more dominant world powers, which leads to ...

The Top:

This period is characterized by excesses in the form of a) high levels of indebtedness, b) large wealth, values, and political gaps, c) declining education and infrastructure, d) conflicts between different classes of people within countries, and e) struggles between countries as overextended empires are challenged by emerging rivals, which leads to ...

The Decline:

This is the painful period of fighting and restructuring that leads to great conflicts and great changes and the establishment of new internal and external orders. It sets the stage for the next new order and a new period of prosperous building.

Let's look at each of these in more detail.

The Rise

The rise phase begins when there is ...

- ...strong enough and capable enough leadership to gain power and design an excellent system to increase the country's wealth and power. Looking at the historically great empires, this system typically involves...
- ...strong education, which is not just teaching knowledge and skills; it also includes teaching...

- **...strong character, civility, and work ethic development.** These are typically taught in families, schools, and/or religious institutions. If done well, this provides a healthy respect for rules and laws and order within society, leads to low corruption rates, and is effective in encouraging people to work together to improve productivity. The better the country does this, the more there will be a shift from producing basic products to ...
- **...innovating and inventing new technologies.** For example, the Dutch were superbly inventive—at their peak they came up with a quarter of all major inventions in the world. One of these was ships that could travel around the globe to collect great riches. They also invented capitalism as we know it. Innovation is generally enhanced by being ...
- **...open to the best thinking in the world** to be able to learn the best ways of doing things and by...
- **...the workers, the government, and the military all working well together.**

As a result of all of these things, the country...

- ...becomes more **productive** and...
- ...more **competitive in world markets**, which shows up in its...
- **...share of world trade rising.** You can see this happening today as the US and China are now roughly comparable in both their economic outputs and their shares of world trade.
- As a country trades more globally, it must protect its trade routes and foreign interests and it must be prepared to defend itself from attack so it develops **great military strength**.

If done well, this virtuous cycle leads to...

- **...strong income growth**, which can be used to finance...
- **...investments in infrastructure, education, and research and development.**
- **The country must develop systems to incentivize and empower those who have the ability to make or get wealth.** In all of these past cases, the most successful empires used a capitalist approach to incentivize and develop productive entrepreneurs. Even China, which is run by the Chinese Communist Party, uses a state-capitalism approach to incentivize and enable people. To do that incentivizing and financial enabling well, the country...
- ...has to have **developing capital markets**—most importantly its lending, bond, and stock markets. That allows people to **convert their savings into investments to fund innovation and development** and share in the successes of those who are making great things happen. The inventive Dutch created the first publicly listed company (the Dutch East India Company) and the first stock market to fund it. These were integral parts of their machine that produced a lot of wealth and power.

- As a natural consequence, all of the greatest empires developed **the world's leading financial center** for attracting and distributing the capital of their times. Amsterdam was the world's financial center when the Dutch were preeminent, London was when the British were on top, New York is now, and China is quickly developing its own financial center in Shanghai.
- As the country expands its international dealings to become the largest trading empire, its transactions can be paid in its currency, and people around the world want to save in it, so it becomes **the world's leading reserve currency**, which enables the country to borrow more, and at lower rates, than other countries because others want to lend in it.

This series of cause/effect relationships leading to mutually supportive financial, political, and military powers has gone together for as long as there has been recorded history. **All of the empires that became the most powerful in the world followed this path to the top.**

The Top

In the top phase, the country sustains the successes that fueled its rise, but embedded in the rewards of the successes are the seeds of decline. Over time, obligations pile up, breaking down the self-reinforcing circumstances that fueled the rise.

- **As people in the country, which is now rich and powerful, earn more, that makes them more expensive and less competitive** relative to people in other countries who are willing to work for less.
- At the same time people from **other countries naturally copy the methods and technologies of the leading power, which further reduces the leading country's competitiveness.** For example, British shipbuilders hired Dutch designers to design better ships that were built by less expensive British workers, making them more competitive, which led the British to rise and the Dutch to decline.
- **Also, as people in the leading country become richer, they tend to not work as hard. They enjoy more leisure, pursue the finer and less productive things in life, and at the extreme become decadent.** Values change from generation to generation during the rise to the top—from those who had to fight to achieve wealth and power to those who inherited it. The new generation is less battle-hardened, steeped in luxuries, and accustomed to the easy life, which makes them **more vulnerable to challenges.**
- **Additionally, as people get used to doing well, they increasingly bet on the good times continuing—and borrow money to do that—which leads to financial bubbles.**
- Within capitalist systems, **financial gains come unevenly so the wealth gap grows.** Wealth gaps are self-reinforcing because rich people use their greater resources to expand their powers. **They also influence the political system to their advantage and give greater privileges to their children—like better education—causing the gaps in values, politics, and opportunity to develop between the rich “haves” and the poor**

“have-nots.” Those who are less well-off feel the system is unfair so resentments grow.

- **As long as the living standards of most people are still rising, these gaps and resentments don't boil over into conflict.**

During the top, the leading country's financial picture begins to change. Having a **reserve currency** gives it the “exorbitant privilege” of being able to borrow more money, which gets it deeper into debt. This boosts the leading empire’s spending power over the short term and weakens it over the longer run.

- **Inevitably, the country begins borrowing excessively, which contributes to the country building up large debts with foreign lenders.**
- **While this boosts spending power over the short term, it weakens the country's financial health—and weakens the currency—over the longer term. In other words, when borrowing and spending are strong, the empire appears very strong, but its finances are in fact being weakened because the borrowing sustains the country's power beyond its fundamentals by financing both domestic overconsumption and international military conflicts required to maintain the empire.**
- **Also the costs of maintaining and defending the empire become greater than the revenue it brings in, so **having an empire becomes unprofitable.**** For example, the British Empire became massive, bureaucratic, and lost its competitive advantages as rival powers—particularly Germany—soared, leading to an increasingly expensive arms race and world war.
- **The richer countries get into debt by borrowing from poorer countries that save more**—that is one of the earliest signs of a wealth and power shift. This started in the United States in the 1980s when it had a per capita income 40 times that of China’s and started borrowing from the Chinese who wanted to save in dollars because the dollar was the world’s reserve currency.
- **If the empire begins to run out of new lenders, those holding their currency begin to look to sell and get out rather than buy, save, lend, and get in—and the strength of the empire begins to fall.**

The Decline

The decline phase typically comes from internal economic weakness together with internal fighting, or from costly external fighting, or both. Typically, the country’s decline comes gradually and then suddenly.

Internally...

- **When debts become very large, and **there is an economic downturn** and the empire can no longer borrow the money necessary to repay its debts, this creates great domestic**

hardships and forces the country to choose between **defaulting on its debts and printing a lot of new money.**

- **The country nearly always chooses to print a lot of new money,** at first gradually and eventually massively. **This devalues the currency and raises inflation.**
- Typically at those times when the government has problems funding itself at the same time as there are bad financial and economic conditions, and large wealth, values, and political gaps—there are great **increases in internal conflict between the rich and poor and different ethnic, religious, and racial groups.**
- **This leads to political extremism that shows up as populism of the left or of the right.** Those of the left seek to redistribute the wealth while those of the right seek to maintain the wealth in the hands of the rich. **This is the "anti-capitalist phase," when capitalism, capitalists, and the elites in general are blamed for the problems.**
- Typically during such times **taxes on the rich rise, and when the rich fear their wealth and well-being will be taken away, they move to places, assets, and currencies they feel safer in.** These outflows reduce the country's tax revenue, which leads to a classic self-reinforcing, hollowing-out process.
- **When the flight of wealth gets bad enough, the country outlaws it.** Those seeking to get out begin to panic.
- **These turbulent conditions undermine productivity, which shrinks the economic pie and causes more conflict about how to divide the shrinking resources.** Populist leaders emerge from both sides and pledge to take control and bring about order. **That's when democracy is most challenged because it fails to control the anarchy and because the move to a strong populist leader who will bring order to the chaos is most likely.**
- As conflict within the country escalates, it leads to some form of **revolution or civil war to redistribute wealth and force the big changes.** This can be peaceful and maintain the existing internal order, but it's more often **violent and changes the order.** For example, the Roosevelt revolution to redistribute wealth was relatively peaceful, while the revolutions that changed the domestic orders in Germany, Japan, Spain, Russia, and China, which also happened in the 1930s for the same reasons, were much more violent.

These civil wars and revolutions create what I call new internal orders. I'll explore how internal orders change in a cyclical way in Chapter 5. But the important thing to note for now is that internal orders can change without leading to a change in the world order. **It's only when the forces that produce internal disorder and instability align with an external challenge that the entire world order can change.**

Externally...

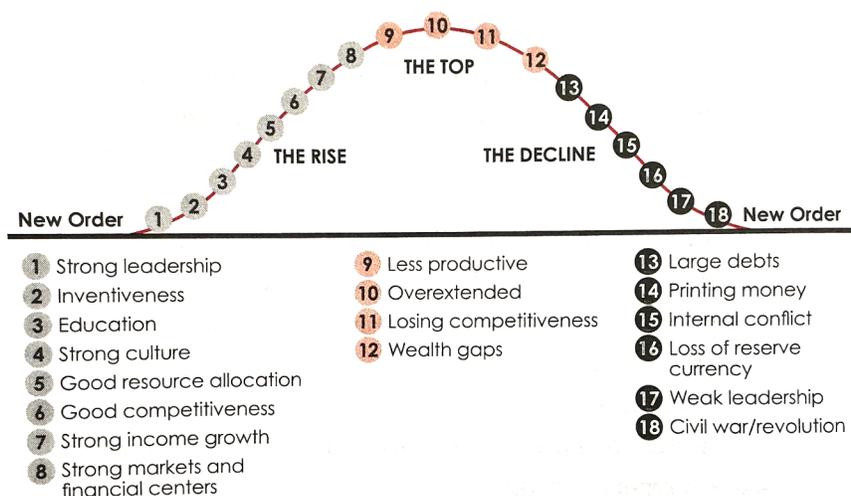
- **When there is a rising great power that is capable of challenging the existing great power and existing world order, there is a rising risk of great international conflict, especially if there is internal conflict going on within the existing great power.** Typically the rising international opponent will seek to exploit this domestic

weakness. This is especially risky if the rising international power has built up a comparable military.

- **Defending oneself against foreign rivals requires great military spending, which has to occur even as domestic economic conditions are deteriorating** and the leading great power country can least afford it.
- Since there is no viable system for peacefully adjudicating international disputes, these **conflicts are typically resolved through tests of power.**
- As bolder challenges are made, **the leading empire is faced with the difficult choice of fighting or retreating.** Fighting and losing are the worst, but retreating is bad too because it allows the opposition to progress and it shows that one is weak to those other countries that are considering what side to be on.
- **Poor economic conditions cause more fighting for wealth and power, which inevitably leads to some kind of war.**
- **Wars are terribly costly. At the same time, they produce the necessary tectonic shifts that realign the world order to the new reality of wealth and power.**
- **When those holding the reserve currency and debt of the declining empire lose faith and sell them, that marks the end of its Big Cycle.**

When all of these forces line up—indebtedness, civil war/revolution at home, war abroad, and a loss of faith in the currency—a change in the world order is typically at hand.

You can see these forces summarized in their typical progression in the following chart.



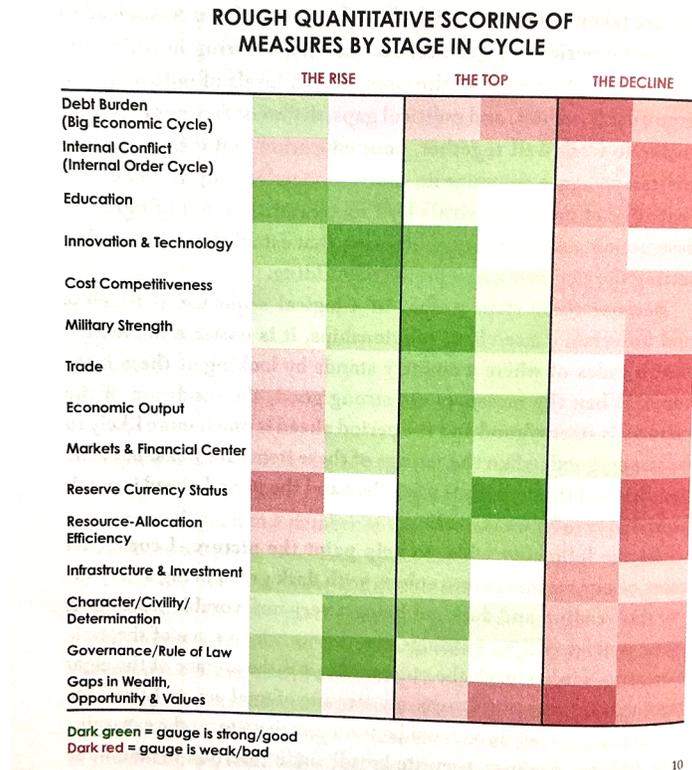
I threw a lot at you in the last few pages. You might want to read them again slowly so you can see if the sequence makes sense to you. Later, we will get into a number of specific cases in greater depth and you will see the patterns of these cycles emerge, albeit not in a precise way.

The fact that they occur and the reasons for them occurring are less disputable than the exact timing of their occurrences.

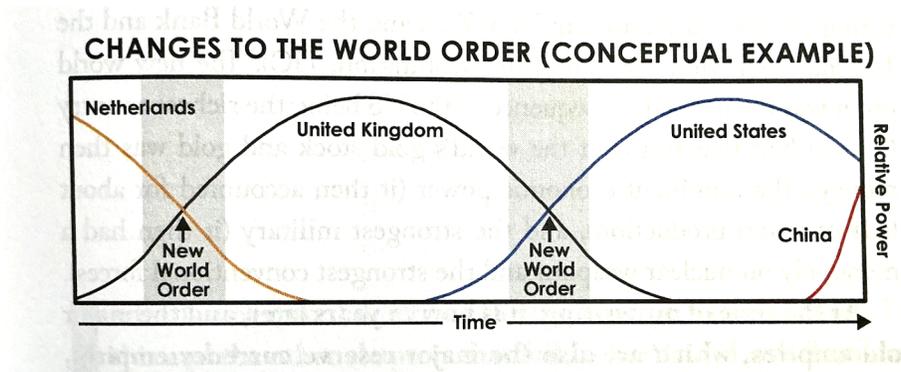
To summarize, around the upward trend of productivity gains that produce rising wealth and better living standards, there are cycles that produce prosperous periods of building in which the country is fundamentally strong because there are relatively low levels of indebtedness, relatively small wealth, values, and political gaps, people working effectively together to produce prosperity, good education and infrastructure, strong and capable leadership, and peaceful world order that is guided by one or more dominant world powers. These are the prosperous and enjoyable periods. When they are taken to excess, which they always are, the excesses lead to depressing periods of destruction and restructuring in which the country's fundamental weaknesses of high levels of indebtedness, large wealth, values, and political gaps, different factions of people unable to work well together, poor education and infrastructure, and the struggle to maintain an overextended empire under the challenge of emerging rivals lead to a painful period of fighting, destruction, and then a restructuring that establishes a new order, setting the stage for a new period of building.

Because these steps unfold in a logical sequence of timeless and universal cause/effect relationships, it is possible to create a health index of where a country stands by looking at these measures. When the measures are strong/good, the condition of the country is strong/good and the period ahead is much more likely to be strong/good; when the ratings of these items are weak/bad, the condition of the country is weak/bad and the period ahead is much more likely to be weak/bad.

In the following table, to help paint the picture, I converted most of our measures into colors, with dark green being a very favorable reading and dark red being a very unfavorable reading. It is the average of these readings that defines which stage of the cycle a country is in, in much the same way as it is the average of the eight readings of power that I use as my measure of total power. Like those power readings, while one could reconfigure them to produce marginally different readings, they are broadly indicative in a by-and-large way. Here, I am showing this to exemplify the typical process, not to look at any specific case. I will however show specific quantitative readings for all the major countries later in this book.



Since all of these factors, both ascending and descending, tend to be mutually reinforcing, it is not a coincidence that large wealth gaps, debt crises, revolutions, wars, and changes in the world order have tended to come as a perfect storm. The Big Cycle of an empire's rise and decline looks like the following chart. The bad periods of destruction and restructuring via depression, revolution, and war, which largely tear down the old system and set the stage for the emergence of a new system, typically take about 10 to 20 years, though variations in the range can be much larger. They are depicted by the shaded areas. They are followed by more extended periods of peace and prosperity in which smart people work harmoniously together and no country wants to fight the world power because it's too strong. These peaceful periods last for about 40 to 80 years, though variations in the range can be much larger.



For example, when the Dutch Empire gave way to the British Empire and when the British Empire gave way to the US Empire, most or all of the following things happened:

**End of the Old, Beginning of the New
(e.g. Dutch to British)**

- Debt restructuring and debt crisis
- Internal revolution (peaceful or violent) that leads to large transfers of wealth from the “haves” to the “have-nots”
- External war
- Big currency breakdown
- New domestic and world order

**End of the Old, Beginning of the New
(e.g. British to American)**

- Debt restructuring and debt crisis
- Internal revolution (peaceful or violent) that leads to large transfers of wealth from the “haves” to the “have-nots”
- External war
- Big currency breakdown
- New domestic and world order

A Preview of Where We Are Now

As previously explained, the last major period of destroying and restructuring happened in 1930-45, which led to the period of building and the new world order that began in 1945 with the creation of a new global monetary system (built in 1944 in Bretton Woods, New Hampshire) and a US-dominated system of world governance (locating the United Nations in New York and the World Bank and the International Monetary Fund in Washington, DC). The new world order was the natural consequence of the US being the richest country (it then had two-thirds of the world’s gold stock and gold was then money), the dominant economic power (it then accounted for about half of world production), and the strongest military (it then had a monopoly on nuclear weapons and the strongest conventional forces).

At the time of my writing, it is now 75 years later, and the major old empires, which are also the major reserve currency empires, are classically approaching the end of a long-term debt cycle when there are large debts and typical monetary policies don't work well. Politically fragmented central governments have recently tried to fill in their financial holes by giving out a lot of money that they are borrowing, while central banks have tried to help by printing a lot of money (i.e., monetizing government debt). All this is happening when there are big wealth and values gaps and a rising world power that is competing with the leading world power in trade, technology development, capital markets, and geopolitics. And on top of all this, as of this writing we have a pandemic to contend with.

Simultaneously, great human thinking, working with computer intelligence, is creating great ways of addressing these challenges. If we can all deal with each other well, we will certainly get past this difficult time and move on to a new prosperous period that will be quite different. At the same time, I am equally confident that there will be radical changes that will be traumatic for many people.

That is how the world works in a nutshell.