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WHY DO DEVELOPED ECONOMIES BECOME VULNERABLE TO ECONOMIC CYCLES?

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Abstract. The possible reasons for the intensification of cyclical fluctuations of the economies of the developed countries in the last decade are analyzed in the article. At the same time, the countries with risky markets (emerging markets and developing economies) are experiencing lower GDP losses during cyclical reductions of the economy. This is particularly paradoxical in view of the fact that developed economies are generally considered to be more stable and competitive. Besides, during the twentieth century, mankind has accumulated considerable experience in counteracting the cyclical nature of national economies and learned to smooth the amplitude of cyclical fluctuations. The authors of the article put forward and substantiate the assumption that the reason for the increase in the amplitude of cyclical fluctuations, increase of the depth of cyclical fluctuations of economies of the developed countries compared to the countries with emerging markets and developing economies, is the significant difference in the structure of these economies. The significant predominance of the tertiary sector in the developed economies makes them more vulnerable to cyclical fluctuations due to the greater multiplier effect that is inherent in the tertiary sector industries compared to other sectors of the economy. The conducted correlation analysis showed the presence of the strong relationship between such parameters of the economy as the share of the tertiary sector in the economy and the percentage value of the predicted economic recession in 2020 in the developed economies and emerging markets and developing economies. But it is necessary to keep in mind that the autonomous cost multiplier works in the opposite direction, accelerating the economic decline during the economic cycle. That is why, in our opinion, measures of state regulation of the economy today should be increasingly aimed at regulating the tertiary sector to prevent the increasing cyclicity of the modern global economy, as the leading economic leaders themselves are often becoming generators of the business cycle due to economic financialization and tertiary sector growth in general.

Keywords: economic cycles, economic growth rate, economic structure, tertiary sector, COVID-19.

JEL Classification: E32.

1. INTRODUCTION

State regulation of the economy since the Keynesian revolution of the first half of the last century has become an integral part of the economic life of the vast majority of countries. The activities of the state in maintaining the stability of reproduction and provision of conditions for economic development have traditionally become an important and universally recognized form of the

participation of the state in the economy. This is reflected in the growth of the level of fiscal deductions to GDP and the influence of governments on the distribution of resources and income, the rate of economic development and the level of welfare of the population.

2. LITERATURE REVIEW, GENERALIZATION OF MAIN STATEMENTS

Considering that humanity has accumulated considerable experience in regulating national and world economies, it is worth to expect that over time, governments will learn to smooth out cyclical fluctuations and even foresee the next economic cycles. However, as the experience of the last decade shows, this has not happened. According to forecasts, the economic decline in 2020 will affect most countries. And this can be explained. Mankind has not yet had the experience to deal with the effects of the epidemiological global economic crisis caused by the spread of the COVID-19 virus. During 2020, many attempts have been made in the scientific literature to analyze the effects of the global recession caused by pandemia and to assess its impact on the prospects of global economic growth, international trade, employment and unemployment [1; 2; 3; 4; 5]. The essence, causes, mechanism and consequences of financial crises [6–9], essence, causes and mechanisms of business cycles [10], virtualization of the economy and financial markets [11] are described in modern scientific literature sufficiently in detail as by domestic and foreign economists. In scientific works today are actively analyzed the lessons and consequences of the global financial crisis of 2008 [12, 13], the synchronicity of global cycles in economies of different countries [14] is investigated, the possibilities of cyclical fluctuations in the future [15–17] are estimated.

3. DISCUSSION

Nevertheless, the obvious question remains unanswered: why have developed economies experienced a faster decline in GDP than developing countries and countries with risky markets (emerging markets and developing countries) (Tab. 1)? Besides that, the thing is not in a difference of several percent of GDP reduction. Developed economies in 2020 due to the global economic crisis will lose according to the forecasts 2.7 times more GDP than the above-mentioned countries with risky markets and developing countries [18]. Besides, it is necessary to remember that the percentage of GDP for the developed economies and the percentage of GDP for the other countries mentioned are very different values, given the huge difference in absolute GDP.

	2019	2020	2021
Advanced economies	1,7	-8,0	4,8
USA	2,3	-8,0	4,5
Euro Area	1,3	-10,2	6
Germany	0,6	-7,8	5,4
France	1,5	-12,5	7,3
Italy	0,3	-12,8	6,3
Spain	2	-12,8	6,3
Emerging markets and developing economies	3,7	-3,0	5,9
China	6,1	1,0	8,2
Emerging markets and developing Europe	2,1	-5,8	4,3

Tab.1. Dynamics of real GDP of the world in 2019 - 2021(per cent, 2020, 2021 - forecast). Source: [23].

The World Bank provides somewhat more optimistic but also negative prospects for the development of global and regional economies (Tab. 2). But one thing remains common in the forecasts – countries with developed economies are experiencing a significant economic decline compared to other less developed economies [19].

		2017	2018	2019	2020*	2021*
A. Advanced economies		2,5	2,1	1,6	-7,0	3,9
1.	United States	2,4	2,9	2,3	-6,1	4,0
2.	Euro Area	2,5	1,9	1,2	-9,1	4,5
3.	Japan	2,2	0,3	0,7	-6,1	2,5
B. Emerging market and developing economies		4,5	4,3	3,5	-2,5	4,6
	<i>East Asia and Pacific</i>	6,5	6,3	5,9	0,5	6,6
1.	China	6,8	6,6	6,1	1,0	6,9
2.	Indonesia	5,1	5,2	5,0	0,0	4,8
3.	Thailand	4,1	4,2	2,4	-5,0	4,1
	<i>Europe and Central Asia</i>	4,1	3,3	2,2	-4,7	3,6
4.	Russia	1,8	2,5	1,3	-6,0	2,7
5.	Turkey	7,5	2,8	0,9	-3,8	5,0
6.	Poland	4,9	5,3	4,1	-4,2	2,8
	<i>Latin America and the Caribbean</i>	1,9	1,7	0,8	-7,2	2,8
7.	Brazil	1,3	1,3	1,1	-8,0	2,2
8.	Mexico	2,1	2,2	-0,3	-7,5	3,0
9.	Argentina	2,7	-2,5	-2,2	-7,3	2,1
	<i>Middle East and North Africa</i>	1,1	0,9	-0,2	-4,2	2,3
10.	Saudi Arabia	-0,7	2,4	0,3	-3,8	2,5
11.	Iran	3,8	-4,7	-8,2	-5,3	2,1
12..	Egypt	4,2	5,3	5,6	3,0	2,1
	<i>South Asia</i>	6,5	6,5	4,7	-2,7	2,8
13.	India	7,0	6,1	4,2	-3,2	3,1
14.	Pakistan	5,2	5,5	1,9	-2,6	-0,2
15.	Bangladesh	7,3	7,9	8,2	1,6	1,0
	<i>Sub-Saharan Africa</i>	2,6	2,6	2,2	-2,8	3,1
16.	Nigeria	0,8	1,9	2,2	-3,2	1,7
17.	South Africa	1,4	0,8	0,2	-7,1	2,9
18.	Angola	-0,1	-2,0	-0,9	-4,0	3,1
Real GDP						
	High-income countries	2,4	2,2	1,7	-6,8	3,8
	Developing countries	4,8	4,4	3,7	-2,4	4,7
	Low-income countries	5,4	5,8	5,0	1,0	4,6

Tab.2. Annual average growth rates of real gross domestic product (per cent, 2020*, 2021* - prospects). Source: [24].

At first glance, it seems that the answer lies on the surface: the largest losses of GDP should be suffered by the countries in which the spread of the epidemic has become larger. But in reality, such conclusions would be incorrect. Different levels of testing, non-simultaneity, irregularity and different scales of quarantine restrictions that could affect countries' economies do not give possibilities for an objective quantitative analysis. This forces us to look for the answer on another plane.

In addition, the question of a significant decline in developed economies during the economic cycle compared to the economies of developing countries arises not for the first time. During the global financial crisis of 2009, the economies of developed countries reduced by 4 percent, while developing countries only slowed down their average annual economic growth rate from 6.8 percent to 2.5 percent (Tab. 3).

	1980	2000	2005	2009	2011
Developing economies	3,5	6,1	6,8	2,5	5,8
Developed economies	3,2	1,6	2,4	-4	1,4
Transition economies	3,5	5,7	6,5	-6,5	4,5

Tab. 3. Annual average growth rates of real gross domestic product. Source: [25].

Analyzing the reasons for the cyclical decline in GDP of developed economies in 2009, we concluded that the main reason should be considered the growing financialization of economies in developed countries [20, 21]. The financialization of the economies of the world's leading countries, which occurs due to the growing gap between real and financial capital, not only makes the developed economies vulnerable economic systems but also increases the amplitude of cyclical fluctuations. In our opinion, the coronavirus crisis of 2020 has somewhat expanded the existing ideas about the nature of cyclical economies. The financial sector of the economy is a component of the tertiary sector – the service sector. Services include financial and banking, insurance, wholesale and retail trade, transport, information industry (information technology is often singled out and included in the quaternary sector of the economy), education, medicine, tourism, entertainment industry etc. The tertiary sector of the economy in developed countries is the largest sector both in terms of GDP share and employment and it is growing rapidly. And this is one of the main features and differences of developed economies from the economies of other countries (Tab. 4).

	US	UK	Japan	Canada	Spain	Italy	Germany	France
Agriculture	0,9	0,7	1,1	1,6	3,8	2,1	0,7	1,7
Industry	19,1	20,3	30,1	28,2	23,2	23,9	30,7	19,5
Services	80	79,2	68,7	70,2	74,2	73,9	68,6	78,8

Tab. 4. Structure of the economies of the developed countries. (per cent, 2017). Source: [26].

Thus, for example, the structure of the economies of Central and Eastern Europe (Tab. 4) shows a lag in the services sector (average index is 63.3 percent), while in the Eurozone the services sector comprises in average 70.9 percent of the economy [22].

	Agriculture	Industry	Services
Ukraine	12,2	28,6	60
Russia	4,7	33,2	62,6
Romania	4,2	33,2	62,6
Slovakia	3,8	35	61,2
Slovenia	1,8	32,2	65,9
Poland	2,2	40,2	57,4
Czechia	2,3	36,9	60,8
Croatia	3,7	26,2	70,1
Hungary	3,9	31,3	64,8
Bulgaria	4,3	28	67,4

Tab. 5. Structure of economies of countries belonging to the “Emerging markets and developing Europe” group (per cent, 2017). Source: [26].

Analyzing the above statistics, we assume that the indices of the structure of the economy and economic growth are interrelated. Namely, do the indicators of the share of the tertiary sector in the economy correlate with the dynamics of GDP during the economic cycle? To test this hypothesis, we calculated the Pearson correlation coefficient for these two variables (the share of the tertiary sector in GDP and economic growth forecast indices for 2020) for the most significant leading countries and groups of countries: USA, China, Eurozone countries and Central and European countries. Eastern Europe, classified as “Emerging markets and developing Europe”. The correlation coefficient was 0.8602, which indicates a fairly close relationship between the stated parameters of the country's economy. In favor of the existence of such a relationship, we can also cite a couple of variables for China: GDP forecast for 2020 +1 per cent, with a record low tertiary sector 51.6 per cent [19, 22].

4. CONCLUSIONS

Of course, the results of our study can be considered as preliminary and such which need further verification. But the obtained results provide an opportunity to substantiate some explanations concerning the established dependence. It is obvious that developed economies with a relatively larger tertiary sector have more efficient economies because the service sector generates more value-added per unit of cost, it creates more jobs, it creates longer value-added chains, and it appears as a powerful engine of modern developed economies. It is no coincidence that capital is increasingly flowing into the tertiary sector; it is a global trend in the development of all national economies, which can be explained, inter alia, by higher returns on capital in this sector of the economy. And thus, we can assume that the multiplier effect of the tertiary sector is greater than in other areas. But it is necessary to keep in mind that the autonomous cost multiplier works in the opposite direction, accelerating the economic decline during the economic cycle. That is why, in our opinion, measures of state regulation of the economy today should be increasingly aimed at regulating the tertiary sector to prevent the increasing cyclicity of the modern global economy, as the leading economic leaders themselves are often becoming generators of the business cycle due to economic financialization and tertiary sector growth in general.

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Михайлишин Лілія, Васильченко Сергій. Чому розвинені економіки стають вразливими до економічних циклів? *Журнал Прикарпатського університету імені Василя Стефаника*, 7 (3) (2020), 156–162.

В статті аналізуються можливі причини посилення циклічних коливань економік розвинутих країн світу в останнє десятиріччя. В той самий час країни що розвиваються та країни з ризиковими ринками (emerging markets and developing economies), зазнають менших втрат ВВП під час циклічних скорочень економіки. Це виглядає особливо парадоксально з огляду на те, що загальноприйнято вважати розвинуті економіки стійкішими та конкурентоспроможнішими. Крім того людство впродовж ХХ-го сторіччя нагромадило чималий досвід протидії циклічності національних економік і навчилось згладжувати амплітуду циклічних коливань. Автори статті висувають та обґрунтовують припущення про те, що причиною посилення амплітуди циклічних коливань, зростання глибини циклічних скорочень економік розвинутих країн у порівнянні з країнами що розвиваються і країнами з небезпечними ринками (emerging markets and developing economies), є суттєва відмінність у структурі економік цих країн. Значне переважає третинного сектору в розвинутих економіках робить їх вразливішими до циклічних коливань внаслідок більшого мультиплікаційного ефекту, який притаманний галузям третинного сектору порівняно с іншими секторами економіки. Проведений кореляційний аналіз показав наявність стійкого зв'язку між такими параметрами економіки як частка третинного сектору в економіці і відсоткове значення прогнозованого економічного спаду у 2020 року в розвинутих економіках країн світу та в країнах що розвиваються і країнах з небезпечними ринками (emerging markets and developing economies). Але треба пам'ятати, що мультиплікатор автономних витрат діє і у протилежному напрямку, прискорюючи падіння економіки в період економічного циклу. Саме тому, на наш погляд, заходи з державного регулювання економіки сьогодні мають бути спрямовані все більшою мірою на регулювання третинного сектору, аби запобігати посиленню циклічності сучасної глобальної економіки, оскільки провідні країни – економічні лідери все частіше самі стають генераторами ділового циклу внаслідок фінансiалiзацiї економіки та росту третинного сектору взагалі.

Ключові слова: економічні цикли, темп економічного росту, структура економіки, третинний сектор, COVID-19.