

The Wealth of Nations

We often find ourselves pondering the following questions: What is wealth? How do you measure it? How does the United States stack up versus the rest of the world? What other countries are gaining or losing ground relative to the U.S.? Why do people, especially those from Mexico and Canada, desire to come to the U.S. to work? With a sinking currency, a big trade deficit, a war and numerous other challenges, is the U.S.'s competitive position in the world really as bleak as the media portrays? In this Insight, we will further explore these questions.

Two years ago the World Bank's environmental economics department set out to assess the wealth of 120 nations. They believed that measuring the components of wealth for each country was critical if one is to understand the prospects for sustainable development in countries around the world. For example, if a large portion of a country's wealth is in their cropland and pastureland, then efforts to sustain soil quality will be important to that country's long-term development. Their work, titled "Where is the Wealth of Nations – Measuring Capital for the 21st Century" is the source of data for this Insight.

So how do you measure the wealth of a nation? Traditionally it's measured by adding up the value of produced capital and natural capital. Produced capital includes things like buildings, machinery, equipment and infrastructure. Natural capital includes exhaustible resources (e.g. oil, coal, and minerals), renewable resources and agricultural land. But once the value of all these were added up the World Bank economists found that the vast majority of the world's wealth was missing! For most countries, the total value of produced and natural capital doesn't even come close to the present value of the income produced by each country.

Thus, to truly measure wealth, a measure of intangible capital must also be made. Intangible capital includes the value of raw labor, human capital (the value of our skills and know-how), social capital (the trust among people in society) and the quality of institutions (efficient judicial system, clear property rights and effective government). The World Bank researchers found that intangible capital accounts for about 80% of the wealth in developed countries and 60% of the wealth for developing countries.



Jungfrau Cog Railway,
Bernese Oberland, Switzerland

The wealthiest country in the world, measured by wealth per capita, is Switzerland at \$648,200 per person. The United States is fourth on the list (after Denmark and Sweden) at \$512,600 per person. In the United States natural capital only accounts for 3% of the total wealth, while produced capital is 16% and intangible capital is 82%. Most of the wealth distribution of the other countries in the top ten is similar to the U.S., but two of them have notable differences. In Japan (ranked 6th), natural capital accounts for less than 1% of their wealth, while produced capital is double the average of the top ten at 30% and intangible capital is close to 70%. On the other hand, in Norway (ranked 8th), a country with a lot of oil, its natural capital accounts for 12% of its total wealth. Norway's intangible capital is only 63% of its total wealth.

"You have brains in your head, and feet in your shoes. You can steer yourself any direction you choose." Dr. Seuss

For the countries in the bottom ten, natural capital as a share of their total wealth is much higher – at least 25%. Ethiopia ranks last out of the 120 countries measured, with per capita wealth of only \$1,965. Some countries are so badly run, that five of them, Gabon, Syria, Algeria, Nigeria and the Republic of Congo, have negative intangible capital. Through rampant corruption and failing school systems these countries are destroying their intangible capital ensuring that their people will be poorer in the future.



Simien Mountains, Ethiopia

Perhaps this research helps to explain why it's so attractive for Mexican migrants to work in the U.S. As soon as they cross the border, their productivity potential improves by a factor of ten. The average American worker has access to over \$418,000 in intangible wealth, whereas the stay-at-home Mexican's intangible wealth is only \$34,000. Even for Canadians, working in the U.S. can also be attractive, as their access to intangible wealth is about one half that of the average American worker. That said, there is tremendous potential for many countries around the world to increase their intangible capital. The World Bank report even offers some specific advice - time will tell if it's implemented.

What accounts for high levels of intangible wealth? The World Bank researchers determined that the rule of law (e.g. political stability, government effectiveness, control of corruption, absence of violence) and education / human skills collectively explain about 95% of the variation in countries' intangible capital. They estimate the rule of law to account for about 60% of the impact and education about 35%. A case in point is Russia, a country not well known for its rule of law - its intangible capital is estimated at only \$5,900 per person. By focusing on improving the rule of law and educational opportunities countries like Russia can quickly increase their intangible capital.

One interesting conclusion drawn from the study was that for even poorer countries natural wealth per capita actually rises with income. This contradicts the common assumption that development means the depletion of the environment and natural resources. For poor countries, how they manage their natural resources and the environmental impact will be key to building future natural wealth.

The United States' position in the world is still extremely strong. In terms of total wealth (as of the year 2000), the U.S., at \$144 trillion, had more than twice the wealth as the next country, Japan (\$63 trillion). Total wealth in Germany was about 30% of the U.S. at \$41 trillion and in the United Kingdom, total wealth was about 20% of the U.S. at \$24 trillion.

In an effort to understand how sustainable changes in wealth are, the World Bank researchers also examined a concept known as genuine saving. They looked at how much countries were saving, but made adjustments for investments in education, natural resource depletion and the cost of damages from pollution. Of 140 countries they examined, all but 30 had positive genuine savings rates. In the U.S., after adjusting for our large investment in education, the genuine savings rate was about 7%, much higher than the normally reported negative savings rate. China had one of the highest genuine savings rates in the world (about a 25% rate), even after adjusting for energy and mineral depletion and pollution impacts. Countries like Bangladesh, Czech Republic, Finland, Haiti, Ireland, South Korea and Thailand, to name a few, are quickly gaining ground as they all are estimated to have genuine savings rates above 15%. In summary, while other countries are fast catching up with us, the situation isn't so bleak for the United States. In fact, rising wealth around the world creates more opportunity for all.

"My interest is in the future, because I am going to spend the rest of my life there."

Charles Kettering