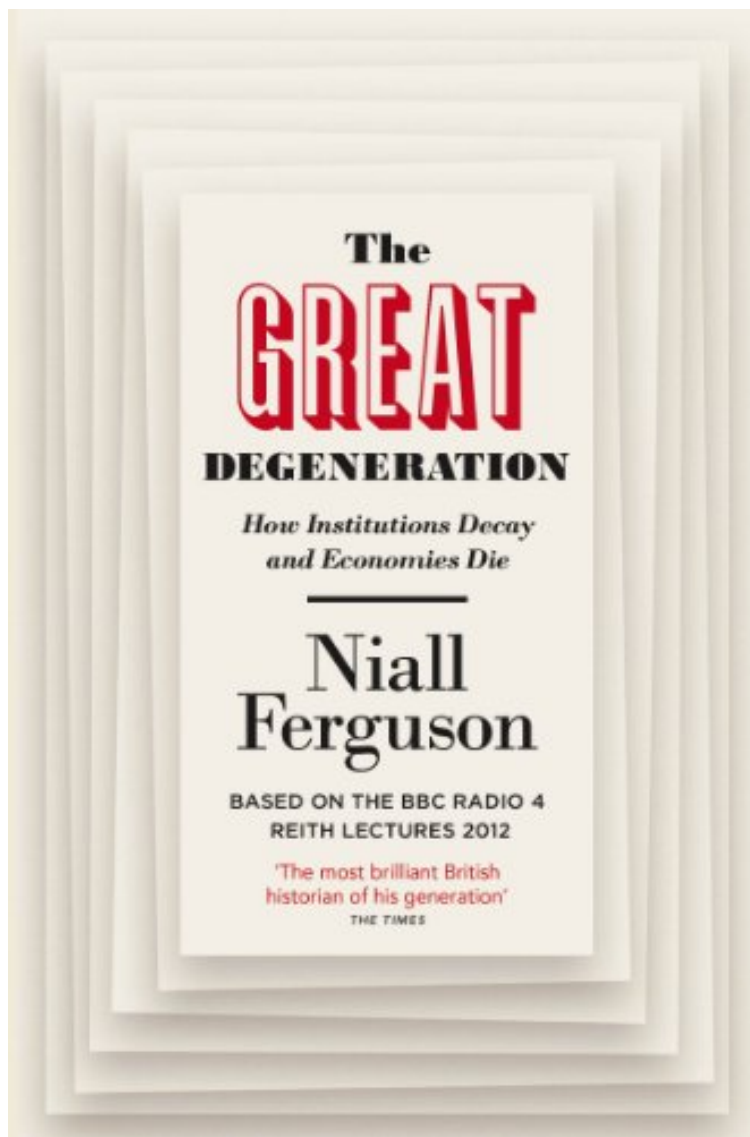


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# The Great Degeneration: How Institutions Decay and Economies Die



Par Niall Ferguson  
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## Description :

Prsentation de l'diteurThe latest work from Niall Ferguson, bestselling author of Empire, The Great Degeneration is based on his 2012 BBC Reith Lectures 'The Rule of Law and Its Enemies'The decline of the West is something that has long been prophesied. Symptoms of decline are all around us today, it seems: slowing growth, crushing debts, aging populations, anti-social behaviour. But what exactly is amiss with Western civilization? The answer, Niall Ferguson argues, is that our institutions - the intricate frameworks within which a society can flourish or fail - are degenerating. Representative government, the free market, the rule of law and civil society: these were once the four pillars of West European and North American

societies. It was these institutions, rather than any geographical or climatic advantages, that set the West on the path to global dominance after around 1500. In our time, however, these institutions have deteriorated in disturbing ways. Our democracies have broken the contract between the generations by heaping IOUs on our children and grandchildren. Our markets are increasingly distorted by over-complex regulations that are in fact the disease of which they purport to be the cure. The rule of law has metamorphosed into the rule of lawyers. And civil society has degenerated into uncivil society, where we lazily expect all our problems to be solved by the state. The Degeneration of the West a powerful - and in places polemical - indictment of an era of negligence and complacency. While the Arab world struggles to adopt democracy, and while China struggles to move from economic liberalization to the rule of law, Europeans and Americans alike are frittering away the institutional inheritance of centuries. To arrest the degeneration of the West's once dominant civilization, Ferguson warns, will take heroic leadership and radical reform. Extrait Almost a quarter of a century ago, in the summer of 1989, Francis Fukuyama could boldly predict an unabashed victory of economic and political liberalism... the Triumph of the West and proclaim that the end point of mankind's ideological evolution was the universalization of Western liberal democracy as the final form of human government.<sup>1</sup> How different the world looks now. Economic liberalism is a tarnished brand, while the proponents of state capitalism in China and elsewhere openly deride Western democracy. The West is stagnating, and not only in economic terms. In 2013 the World Bank expected the European economy to contract and the US to grow by just 1.6 per cent. China would grow four times faster than that, India two and a half times faster. By 2018, according to the International Monetary Fund, the gross domestic product of China would approach that of the United States.\* Those who invested in the West in 1989 have been punished (they have made nothing since 2000), while those who invested in the Rest have been richly rewarded. This great reconvergence is a far more astonishing historical event than the collapse of communism that Fukuyama so astutely anticipated. At the time he wrote, the world's centre of economic gravity was still firmly in the North Atlantic. Today it is beyond the Urals, and by 2025 it will be just north of Kazakhstan on roughly the same line of latitude as it was in 1500, on the eve of Western ascendancy.<sup>2</sup> The voguish explanation for the Western slowdown is deleveraging: the painful process of debt reduction (or balance sheet repair). Certainly, there are few precedents for the scale of debt in the West today. This is only the second time in American history that combined public and private debt has exceeded 250 per cent of GDP. In a survey of fifty countries, the McKinsey Global Institute identifies forty-five episodes of deleveraging since 1930. In only eight was the initial debt/GDP ratio above 250 per cent, as it is today not only in the US but also in all the major English-speaking countries (including Australia and Canada), all the major continental European countries (including Germany), plus Japan and South Korea.<sup>3</sup> The deleveraging argument is that households and banks are struggling to reduce their debts, having gambled foolishly on ever rising property prices. But as people have sought to spend less and save more, aggregate demand has slumped. To prevent this process from generating a lethal debt deflation, governments and central banks have stepped in with fiscal and monetary stimulus unparalleled in time of peace. Public sector deficits have helped to mitigate the contraction, but they risk transforming a crisis of excess private debt into a crisis of excess public debt. In the same way, the expansion of central bank balance sheets (the monetary base) prevented a cascade of bank failures, but now appears to have diminishing returns in terms of reflation and growth. Yet more is going on here than just deleveraging. Consider this: the US economy created 2.4 million jobs in the three years beginning in June 2009. In the same period, 3.3 million Americans were awarded disabled worker benefits. The percentage of working-age Americans collecting disability insurance has risen from below 3 per cent in 1990 to 6 per cent.<sup>4</sup> Unemployment is being concealed and rendered permanent in ways all too familiar to Europeans. Able-bodied people are classified as disabled and never work again. And they also stay put. Traditionally around 3 per cent of the US population moves to a new state each year, usually in pursuit of work. That rate has halved since the financial crisis began in 2007. Social mobility has also declined. And, unlike the Great Depression of the 1930s, our Slight Depression is doing little to reduce the yawning inequality in income distribution that has developed over the past three decades. The income share of the top 1 per cent of households rose from 9 per cent in 1970 to 24 per cent in 2007. It declined by less than 4 percentage points in the subsequent three years of crisis. You cannot blame all this on deleveraging. In the United States, the wider debate is about globalization, technological change, education and fiscal policy. Conservatives tend to emphasize the first and second as inexorable drivers of change, destroying low-skilled jobs by offshoring or automating them. Liberals prefer to see widening inequality as the result of insufficient investment in public education, combined with Republican reductions in taxation

that have favoured the wealthy.<sup>5</sup> But there is good reason to think that there are other forces at work forces that tend to get overlooked in the slanging match that passes for political debate in the United States today. The crisis of public finance is not uniquely American. Japan, Greece, Italy, Ireland and Portugal are also members of the club of countries with public debts in excess of 100 per cent of GDP. India had an even larger cyclically adjusted deficit than the United States in 2010, while Japan faced a bigger challenge to stabilize its debt/GDP ratio at a sustainable level.<sup>6</sup> Nor are the twin problems of slow growth and widening inequality confined to the United States. Throughout the English-speaking world, the income share of the top 1 per cent of households has risen since around 1980. The same thing has happened, albeit to a lesser extent, in some European states, notably Finland, Norway and Portugal, as well as in many emerging markets, including China.<sup>7</sup> Already in 2010 there were at least 800,000 dollar millionaires in China and sixty-five billionaires. Of the global 1 per cent in 2010, 1.6 million were Chinese, approaching 4 per cent of the total.<sup>8</sup> Yet other countries, including Europe's most successful economy, Germany, have not become more unequal, while some less developed countries, notably Argentina, have become less equal without becoming more global. By definition, globalization has affected all countries to some degree. So, too, has the revolution in information technology. Yet the outcomes in terms of growth and distribution vary hugely. To explain these differences, a narrowly economic approach is not sufficient. Take the case of excessive debt or leverage. Any highly indebted economy confronts a narrow range of options. There are essentially three: raising the rate of growth above the rate of interest thanks to technological innovation and (perhaps) a judicious use of monetary stimulus; defaulting on a large proportion of the public debt and going into bankruptcy to escape the private debt; and wiping out of debts via currency depreciation and inflation. But nothing in mainstream economic theory can predict which of these three or which combination a particular country will select. Why did post-1918 Germany go down the road of hyperinflation? Why did post-1929 America go down the road of private default and bankruptcy? Why not the other way round? At the time of writing, it seems less and less likely that any major developed economy will be able to inflate away its liabilities as happened in many cases in the 1920s and 1950s.<sup>9</sup> But why not? Milton Friedman's famous dictum that inflation is always and everywhere a monetary phenomenon leaves unanswered the questions of who creates the excess money and why they do it. In practice, inflation is primarily a political phenomenon. Its likelihood is a function of factors like the content of elite education; competition (or the lack of it) in an economy; the character of the legal system; levels of violence; and the political decision-making process itself. Only by historical methods can we explain why, over the past thirty years, so many countries created forms of debt that, by design, cannot be inflated away; and why, as a result, the next generation will be saddled for life with liabilities incurred by their parents and grandparents. In the same way, it is easy to explain why the financial crisis was caused by excessively large and leveraged financial institutions, but much harder to explain why, after more than four years of debate, the problem of too big to fail banks has not been solved. Indeed, despite the passage of legislation covering literally thousands of pages, it has got markedly worse.<sup>10</sup> Today, a mere ten highly diversified financial institutions are responsible for three-quarters of total financial assets under management in the United States. Yet the country's largest banks are at least \$50 billion short of meeting new capital requirements under the new Basel III accords governing bank capital adequacy. Again, only a political and historical approach can explain why Western politicians today call simultaneously for banks to lend more money and for them to shrink their balance sheets. Why is it now a hundred times more expensive to bring a new medicine to market than it was sixty years ago a phenomenon Juan Enriquez has called Moore's Law\* in reverse? Why would the Food and Drug Administration probably prohibit the sale of table salt if it were put forward as a new pharmacological product (it is after all toxic in large doses)?<sup>11</sup> Why, to give another suggestive example, did it take an American journalist sixty-five days to get official permission (including, after a wait of up to five weeks, a Food Protection Certificate) to open a lemonade stand in New York City?<sup>12</sup> This is the kind of debilitating red tape that development economists often blame for poverty in Africa or Latin America. The rationale for the FDA's rigid standards is to avoid the sale of a drug like thalidomide. But the unintended consequence is almost certainly to allow many more people to die prematurely than would have died from side-effects under a less restrictive regime. We count and recount the costs of such side-effects. We do not count the costs of not allowing new drugs to be made available. Why exactly has social mobility declined in the United States in the past thirty years, so that the probability has more than halved that a man born into the bottom 25 per cent of the income distribution will end his life in the top quartile?<sup>13</sup> Once the United States was famed as a land of opportunity, where a family could leap from rags to riches in a generation. But today, if you are born

to parents in the bottom income quintile, you have just a 5 per cent chance of getting into the top quintile without a college degree. What Charles Murray has called the cognitive elite, educated at exclusive private universities, intermarried and congregated in a few super zip codes, looks increasingly like a new caste, equipped with the wealth and power to override the effects of mean reversion in human reproduction, so that even their dimmer progeny inherit their lifestyle.<sup>14</sup>

**The Stationary State**In two seldom quoted passages of *The Wealth of Nations*, Adam Smith described what he called the stationary state: the condition of a formerly wealthy country that had ceased to grow. What were the characteristics of this state? Significantly, Smith singled out its socially regressive character. First, wages for the majority of people were miserably low: Though the wealth of a country should be very great, yet if it has been long stationary, we must not expect to find the wages of labour very high in it... It is in the progressive state, while the society is advancing to the further acquisition, rather than when it has acquired its full complement of riches, that the condition of the labouring poor, of the great body of the people, seems to be the happiest and the most comfortable. It is hard in the stationary, and miserable in the declining state. The progressive state is in reality the cheerful and the hearty state to all the different orders of the society. The stationary is dull; the declining melancholy.<sup>15</sup>

The second hallmark of the stationary state was the ability of a corrupt and monopolistic elite to exploit the system of law and administration to their own advantage: In a country too, where, though the rich or the owners of large capitals enjoy a good deal of security, the poor or the owners of small capitals enjoy scarce any, but are liable, under the pretence of justice, to be pillaged and plundered at any time by the inferior mandarins, the quantity of stock employed in all the different branches of business transacted within it can never be equal to what the nature and extent of that business might admit. In every different branch, the oppression of the poor must establish the monopoly of the rich, who, by engrossing the whole trade to themselves, will be able to make very large profits.<sup>16</sup>

I defy the Western reader not to feel an uneasy sense of recognition in contemplating those two passages. In Smith's day, of course, it was China that had been long stationary: a once opulent country that had simply ceased to grow. Smith blamed China's defective laws and institutions including its bureaucracy for the stasis. More free trade, more encouragement for small business, less bureaucracy and less crony capitalism: these were Smith's prescriptions to cure Chinese stasis. He was a witness to what such reforms were doing in the late eighteenth century to galvanize the economy of the British Isles and its American colonies. Today, by contrast, if Smith could revisit those same places, he would behold an extraordinary reversal of fortunes. It is we Westerners who are in the stationary state, while China is growing faster than any other major economy in the world. The boot of economic history is on the other foot.

**This book is about the causes of our stationary state. It is inspired by Smith's insight that both stagnation and growth are in large measure the results of laws and institutions. Its central thesis is that what was true of China in Smith's day is true of large parts of the Western world in our time. It is our laws and institutions that are the problem. The Great Recession is merely a symptom of a more profound Great Degeneration.**

**The Four Black Boxes**To demonstrate that Western institutions have indeed degenerated, I am going to have to open up some long-sealed black boxes. The first is the one labelled democracy. The second is labelled capitalism. The third is the rule of law. And the fourth is civil society. Together, they are the key components of our civilization. I want to show that inside these political, economic, legal and social black boxes are highly complex sets of interlocking institutions. Like the circuit boards inside your computer or your smartphone, it is these institutions that make the gadget work. And if it stops working, it is probably because of a defect in the institutional wiring. You cannot understand what is wrong just by looking at the shiny casing. You need to look inside. Perhaps, on reflection, that electronic metaphor is the wrong one. After all, most institutions evolve organically; they are not designed in California by the historical equivalent of Steve Jobs. A better analogy might be with the collective structures we see in the natural world. Beehives are the classic example. Ever since the satirist Bernard Mandeville's book *The Fable of The Bees: or, Private Vices, Public Benefits*, published in 1714, people have drawn parallels between humans in a market economy and bees in a hive. The parallel has its merits, as we shall see, though it is actually in our political organization rather than our economic organization that we most closely resemble bees (a point Mandeville well understood). The simple point is that institutions are to humans what hives are to bees. They are the structures within which we organize ourselves as groups. You know when you are inside one, just as a bee knows when it is in the hive. Institutions have boundaries, often walls. And, crucially, they have rules. For some readers, I dare say, the word institution still conjures up a Victorian vision of lunatic asylums: poor old Niall, he's in an institution now. That is not the kind of institution I mean. I am talking about, for example, political institutions, like the

British Parliament or the American Congress. When we talk about democracy, we are in fact referring to a number of different interlocking institutions. People sticking pieces of paper into ballot boxes, yes. Their elected representatives making speeches and voting in a large assembly hall, yes. But those things alone do not automatically give you democracy. Outwardly, the legislators of countries like Russia and Venezuela are elected, but neither qualifies as a true democracy in the eyes of impartial observers, not to mention those of local opposition leaders. Just as important as the act of putting crossed or stamped papers in ballot boxes are the institutions usually parties that nominate candidates for election. Just as important as the parties are the officials civil servants, judges or ombudsmen whose responsibility it is to ensure that the elections are fair. And then it matters hugely how the legislature itself actually operates. A body of elected representatives can be anything from a wholly sovereign entity, as the British Parliament was until European law began to encroach on it, to an impotent rubber stamp, like the old Supreme Soviet. Its members can stoutly uphold the interests of their constituents (including those who voted against them), or they can be in hock to the vested interests that financed their election campaigns. In August 2011, as Colonel Gaddafi's regime in Libya was falling apart, a BBC correspondent in Benghazi spotted some remarkable graffiti on a wall. On the left side of the wall there was a classically straightforward revolutionary message: The tyrant should fall, he's a monster. Direct and to the point. But on the right side, the message was anything but simple. It read: We want constitutional rule and for the president to have less authority and the four-year presidential term should not be extended.<sup>17</sup> As that (quite correctly) suggests, the devil in any political transition lies in the detail of the constitution, not to mention the rules governing the constituent assembly that designs it. How does the legislature stand relative to the executive and the judiciary? Most constitutions spell that out. But how do the organs of civilian government relate to the military, a question of burning importance in Egypt? Nor can one stop there. Modern nation-states have developed a whole range of institutions that were undreamed of as recently as a hundred years ago, dedicated to regulating economic and social life and redistributing income. The welfare state is not part of democracy as the ancient Athenians conceived of it. In bee terms, the welfare state seems to create an ever increasing number of dependent drones whom the worker-bees have to support. It also employs a great many bees simply to transfer resources from the workers to the drones. And it seeks to finance itself by accumulating claims on future bees, in the form of public debt. In Chapter 1, I will consider this and other distributional aspects of democracy. In particular, I will ask if we are witnessing a fundamental breakdown in what Edmund Burke called the partnership between the generations. These days, nearly everyone claims to be democratic. I have even heard it claimed that the Chinese Communist Party is democratic. Capitalist, by contrast, is a word too often used as a term of abuse to be much heard in polite company. How do the institutions of the democratic state and those of the market economy relate to one another? Do corporations play an active part in politics, through lobbyists and campaign contributions? Do governments play an active part in economic life, through subsidies, tariffs and other market-distorting devices, or through regulation? What is the right balance to be struck between economic freedom and government regulation? Chapter 2 will address these issues. The specific question I ask is how far very complex regulation has become the disease of which it purports to be the cure, distorting and corrupting both the political and the economic process. A crucial institutional check on both political and economic actors is the rule of law. It is inconceivable that either democracy or capitalism could function without an effective system of justice, where the rules devised by the legislature can be enforced, where the rights of the individual citizen can be upheld and where disputes between citizens or corporate entities can be resolved in a peaceful and rational manner. But which system of law is better: common law? or some other form? The rule of sharia is clearly very different from the rule of law as the English political philosopher John Locke understood it. In some ways, the key to comparing different codes of law is what might be called the law of rules: the way that law itself is made. In some systems, like Islam, the rules have been prescribed in considerable detail, for eternity, by a divinely inspired prophet. According to the stricter schools of Muslim thought, they cannot be changed. In others, like the English common law, the rules evolve organically, as judges weigh up the competing claims of precedent and the changing needs of society. Chapter 3 will ask the question whether one system of law in particular, the common law is superior to the others. I will also ask how far the English-speaking world still enjoys an advantage in this respect. In particular, I want to warn that the rule of law is in danger at least in parts of the Anglosphere of degenerating into something more like the rule of lawyers. Are Americans really better served by their legal system than Englishmen were by theirs at the time of Dickens's Bleak House? Finally, there is civil society. Properly understood, it is the realm of voluntary associations: institutions established by citizens with an objective

other than private profit. These can range from schools although in modern times most educational institutions have been absorbed into the public sector to clubs dedicated to the full range of human activities, from aeronautics to zoology. Once again we encounter the importance of rules, though here they may seem trivial, like the obligation on members of most London clubs to wear ties and keep their jackets on at dinner, even on a sweltering-hot evening. There was a time when the average Briton or American belonged to a startlingly large number of clubs and other voluntary societies. It was one of the features of the English-speaking world that most impressed the great French political theorist Alexis de Tocqueville. But in Chapter 4 I shall ask why that is no longer true, and how far it is possible for a truly free society to flourish in the absence of the kind of vibrant civil society we used to take for granted. Are the new social networks of the internet in any sense a substitute for traditional associational life? I shall argue that they are not.

Why Institutions Fail  
If we are like bees in the realm of politics, playing our assigned parts in an essentially hierarchical hive, we have more freedom of action in the economic sphere. There, our institutions recall the wildlife of the Serengeti, the endless plains of northern Tanzania and southern Kenya. Some of us are wildebeest, grazing as we move in the herd. Others of us (rather fewer) are predators. I am afraid there are some scavengers and parasites, too. The whole thing is an ecosystem in which Darwinian forces are constantly at work, naturally selecting the fittest from the unfit. Likewise, in civil society, we form our groups and bands rather in the way that chimpanzees and baboons do. Like the clubs we humans used to be so fond of joining, a baboon troop has its rules and its hierarchies.

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