Growth STRATEGIES

Trend Analysis That Builds Business Decisions

LA JOLLA INSTITUTE
Steve PonTell

Dr. Roger Selbert, Editor & Publisher
E-mail: roger@rogerselbert.com

3200 S. Barrington Ave. #4 • Los Angeles, CA 90066
Telephone: (310) 721-6322

IN THIS ISSUE: NIALL FERGUSON AND THE GREAT DEGENERATION

We devote this month's issue to excerpts from Niall Ferguson's new book *The Great Degeneration: How Institutions Decay and Economies Die* and some of his recently published essays. Ferguson makes the case that Western civilization has entered into a period of decline due to the strangling of private initiative by an ever-encroaching state. Further, that we are living through a profound crisis of the institutions that were the keys to our previous success as a civilization. These threatened institutions are representative government, the free market, the rule of law, and civil society.

I do not relish promoting the views of a doomsayer, but I find Ferguson's arguments powerful and persuasive (and he does, fortunately, offer reasons to hope for a turnaround).

1 – THE GREAT DEGENERATION

Why is it getting harder to do business in America? Part of the answer is excessively complex legislation. A prime example is the 848-page Wall Street Reform and Consumer Protection Act of July 2010 (otherwise known as the Dodd-Frank Act), which, among other things, required that regulators create 243 rules, conduct 67 studies and issue 22 periodic reports.

Comparable in its complexity is the Patient Protection and Affordable Care Act (906 pages), which is also in the process of spawning thousands of pages of regulation. You don't have to be opposed to tighter financial regulation or universal health care to recognize that something is wrong with laws so elaborate that almost no one affected has the time or the will to read them.

Who benefits from the growth of complex and cumbersome regulation? The answer is: lawyers, not forgetting lobbyists and compliance departments. For complexity is not the friend of the little man. It is the friend of the deep pocket. It is the friend of cronyism.

We used to have the rule of law. Now it is tempting to say we have the rule of lawyers, which is something different. …

Whatever the root causes of the deterioration of American institutions, smart people are starting to notice it. Last year Michael Porter of Harvard Business School published a report based on a large-scale survey of HBS alumni. Among the questions he asked was where the US was "falling behind" relative to other countries. The top three lagging indicators named were: the effectiveness of the political system, the K-12 education system and the complexity of the tax code. Regulation came sixth, efficiency of the legal framework eighth.

Asked to name "the most problematic factors for doing business" in the US, respondents to the WEF's most recent Executive Opinion Survey put "inefficient government bureaucracy" at the top, followed by tax rates and tax regulations.

All this should not be interpreted as yet another prophecy of the imminent decline and fall of the US, however. There is some light in the gloom. According to the most recent United Nations projections, the share of the US population that is over 65 will reach 25% only at the very end of this century. Japan has already passed that milestone; Germany will be next. By midcentury, both countries will have around a third of their population age 65 or older.

More imminently, a revolution in the extraction of shale gas and tight oil, via hydraulic fracking, is transforming the US from energy dependence to independence. Not only could the US, at least for a time, re-emerge as the world's biggest oil producer; the lower electricity costs resulting from the fossil-fuel boom are already triggering a revival of US manufacturing in the Southeast and elsewhere. …

In a functioning federal system, the pace of institutional degeneration is not uniform. America's four "growth corridors" – the Great Plains, the Gulf Coast, the Intermountain West and the Southeast – are growing not just because they have natural resources but also because state governments in those regions are significantly more friendly to business. There are already heartening signs of a great regeneration in states like Texas and North Dakota. …

We can carry on pretending that our economic problems can be solved with the help of yet more fiscal stimulus or quantitative easing. Or we can face up to the institutional impediments to growth I have described here. Not many economists talk about them, it's true. But that's because not many economists run businesses.

2 – THE REGULATED SATES OF AMERICA

In "Democracy in America," published in 1833, Alexis de Tocqueville marveled at the way Americans preferred voluntary association to government regulation. Unlike Frenchmen, he continued, who instinctively looked to the state to provide economic and social order, Americans relied on their own efforts. What especially amazed Tocqueville was the sheer range of nongovernmental organizations Americans formed.

Tocqueville would not recognize America today. Indeed, so completely has associational life collapsed, and so enormously has the state grown, that he would be forced to conclude that, at some point between 1833 and 2013, France must have conquered the United States. …

The decline of American associational life was memorably documented in Robert Puttnam's seminal 1995 essay "Bowling Alone," which documented the exodus of Americans from bowling leagues, Rotary clubs and the like. Since then, the downward trend in "social capital" has only continued. Instead of joining together to get things done, Americans have increasingly become dependent on Washington.

We have become the regulation nation almost imperceptibly. Excluding blank pages, the 2012 Federal Register – the official directory of regulation – today runs to 78,961 pages. Back in 1986 it was 44,812 pages. In 1936 it was just 2,620.

The last time regulation was cut was under Ronald Reagan, when the number of pages in the Federal Register fell by 31%. Surprise: Real GDP grew by 30% in that same period. But Leviathan's diet lasted just eight years. Since 1993, 81,883 new rules have been issued. In the past 10 years, the "final rules" issued by our 63 federal departments, agencies and commissions have outnumbered laws passed by Congress 223 to 1.

Right now there are 4,062 new regulations at various stages of implementation, of which 224 are deemed "economically significant," i.e., their economic impact will exceed $100 million.

The cost of all this is $1.8 trillion annually – that's on top of the federal government's $3.5 trillion in outlays, so it is equivalent to an invisible 65% surcharge on your federal taxes, or nearly 12% of GDP. Especially invidious is the fact that the costs of regulation for small businesses (those with fewer than 20 employees) are 36% higher per employee than they are for bigger firms.

Next year's big treats will be the implementation of the Affordable Care Act; the Labor Department's new fiduciary rule; the EPA's new Ozone Rule; and the Department of Transportation's Rear-View Camera Rule. …

I wonder if all this could have anything to do with the fact that we still have nearly 12 million people out of work, plus eight million working part-time jobs, five long years after the financial crisis began.

Genius that he was, Tocqueville saw this transformation of America coming. Toward the end of "Democracy in America" he warned against the government becoming "an immense tutelary power . . . absolute, detailed, regular . . . covering society's surface with a network of small, complicated, painstaking, uniform rules through which the most original minds and the most vigorous souls cannot clear a way."

Tocqueville also foresaw exactly how this regulatory state would suffocate the spirit of free enterprise: "It rarely forces one to act, but it constantly opposes itself to one's acting; it does not destroy, it prevents things from being born; it does not tyrannize, it hinders, compromises, enervates, extinguishes, dazes, and finally reduces [the] nation to being nothing more than a herd of timid and industrious animals of which the government is the shepherd."

If that makes you bleat with frustration, there's still hope.

3 – THE END OF THE AMERICAN DREAM

Everyone knows that the United States has become more unequal in recent decades. Indeed, the last presidential election campaign was dominated by what turned out to be an unequal contest between "the 1 percent" and the "47 percent" whose votes Mitt Romney notoriously wrote off.

But the real problem may be more insidious than the figures about income and wealth distribution imply. Even more disturbing is the growing evidence that social mobility is also declining in America.

IT'S HARDER THAN EVER FOR AMERICANS AT THE BOTTOM TO RISE TO HIGHER INCOME LEVELS.

At the ages of 4 to 5, children from the poorest fifth of homes are already 21.6 months behind children from the richest homes in the US. The proportion of 15-year-olds who are functionally illiterate (below level 2 in PISA tests) is 17.6%. Students from the highest social-class groups are twice as likely to go to college than those from the lowest classes.

THE AMERICAN DREAM HAS BECOME A NIGHTMARE OF SOCIAL STASIS.

The primary (and avowed) aim of the Federal Reserve's monetary policy since 2008 has been to push up the price of assets. Guess what? The rich own most of these. To be precise, the top 1% owns around 35% of the total net worth of the United States – and 42% of the financial wealth.

By restoring the stock market to where it was back before the crisis, the Fed has not achieved much of an economic recovery. But it has brilliantly succeeded in making the rich richer. And their kids.

THE "COGNITIVE ELITE" MARRY ONE ANOTHER AND CLUSTER TOGETHER IN FEWER THAN A THOUSAND EXCLUSIVE NEIGHBORHOODS.

According to research published by the German Institute for the Study of Labor, 42% of American men born and raised in the bottom fifth of the income distribution end up staying there as adults, compared with just 30% in Britain and 28% in Finland.

PERHAPS NOT SURPRISINGLY, THE CHILD POVERTY RATE IS MORE THAN DOUBLE THE POVERTY RATE FOR SENIORS.

What has gone wrong? American liberals argue that widening inequality inevitably causes falling social mobility. But to [my] European eyes, this is also a familiar story of poverty traps created by well-intentioned welfare programs. Consider the case highlighted by Gary Alexander, Pennsylvania's former secretary of public welfare. A single mom with two young kids is better off doing a part-time job for just $29,000 – on top of which she receives $28,327 in various benefits – than if she accepts a job that pays $69,000, on which she would pay $11,955 in taxes.

HOW CAN SOCIAL MOBILITY INCREASE IN A SOCIETY THAT CARES TWICE AS MUCH FOR GRANDMA AS FOR JUNIOR?

According to the Urban Institute, the current share of federal spending on the young is around 10%, compared with 41% that goes on the non-child portions of Social Security, Medicare and Medicaid. The only mystery that remains is why this generational conflict has not yet become a serious issue in American politics. Bafflingly, young voters still tend to line up with the very organizations that seem most intent on ratcheting up the future liabilities of government (not to mention the teenage unemployment rate) – notably the public-sector unions.

HOW MANY TALENTED YOUNG PEOPLE WILL NEVER GET A LUCKY BREAK?

The other main reason for declining social mobility is the disastrous failure of American high schools in [poor] places. Despite a tripling of per-pupil expenditure in real terms, American secondary education is failing.

According to the Council on Foreign Relations, three quarters of US citizens between the ages of 17 and 24 are not qualified to join the military because they are physically unfit, have criminal records, or have inadequate levels of education. A third of high school graduates fail the mandatory Armed Services Vocational Aptitude Battery. Two fifths of students at four-year colleges need to take remedial courses to relearn what they failed to master in high school.

THE COGNITIVE ELITE DISCREETLY RIG THE GAME IN FAVOR OF THEIR OFFSPRING WITH WELL-TIMED BENEFACTIONS.

There are disturbing signs that America's elite educational institutions are reverting to their old role as finishing schools for the children of a hereditary elite – the role they played back when F. Scott Fitzgerald was partying at Princeton.

Perhaps those in charge of Ivy League admissions have good reasons for their decisions. Perhaps it is right that they should do more than simply pick the most academically talented and industrious students who apply. But the possibility cannot be rejected out of hand that, whatever their intentions, the net effect of their pursuit of "diversity" is in fact to reduce yet further this country's once unique social mobility. Nor can we dismiss the hypothesis that the "legacy" system may be the key here, as the cognitive elite discreetly rig the game in favor of their offspring with well-timed benefactions.

As a professor at Harvard, I am disquieted by such thoughts. I did not come to the United States intent on making a fortune. Wealth was not my American dream. But I did come here because I believed in American meritocracy, and I was pretty sure that I would be teaching fewer beneficiaries of inherited privilege than I had encountered at Oxford.

Now I am not so sure.