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## BOOK REVIEW

# *The Great Degeneration – how institutions decay and economies die*

**By Niall Ferguson**

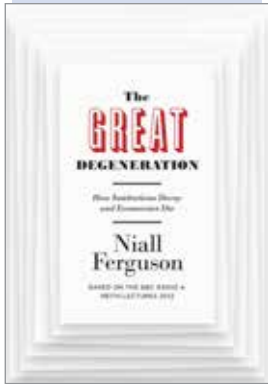
*The Great Degeneration derives from Ferguson's BBC Radio 4 Reith Lectures which were broadcast under the title of the Rule of Law and its Enemies. The series of annual Reith Lectures started in 1948 and are given by selected leading figures of the day. By selection, Niall Ferguson is thus a leading academic of the day; a leading world economic historian. The Great Degeneration is a continuation of his earlier insightful works. It is a short and readable book – a mere 152 pages. It requires little specialist knowledge and the message set out in the book is accessible to the general public. In his earlier book Civilization he attempts to answer the question why the West Won. In this book he gives reasons why he believes the West is in decline.*

*He places his analysis firmly within the institutional framework brought into prominence by the Nobel Laureate Douglass North (p19). The central premise of institutional economics is that Institutions matter. If the West is degenerating then it is because "Western institutions have indeed degenerated (p11)." This review will examine Ferguson's treatment of the institution of the Rule of Law and his application of this degeneration to explain the world financial crisis.*

### The Rule of Law

Ferguson argues that the Rule of Law, as an institution, explains the success of the West after the 1500s (p31). He points out that at the heart of the battle over parliamentary power was the protection of individuals from arbitrary expropriation by the Crown. This differed from states where state power was used by the rent-seeking elite to grab property for themselves. So at that point in time, in line with the philosophy of the age expressed by John Locke, the rule of law started with clear purpose and laws protecting life, liberty and property. In the modern age in developed countries it has degenerated into something vastly different: 'the rule of law has degenerated into the rule of lawyers (p77).' The fundamental basis had changed. The economic approach to the rule of law required that "property rights more than human rights are fundamental (p85).

His detailed analysis of the Rule of Law starts off by pointing out that China does not lack laws. It lacks the rule of law (p78). The existence of laws and rules does not equate to the rule of law. As to what the Rule of Law should be, his analysis uses the recent publication by the late Lord Chief Justice Tom Bingham. It is unfortunate



**THE GREAT DEGENERATION – HOW INSTITUTIONS DECAY AND ECONOMIES DIE**  
 By Niall Ferguson  
 ISBN 978-1846147432.  
 Publisher: THE PENGUIN PRESS (JUNE 13, 2013)

he does not discuss the publication in greater detail. Had he done so he would have pointed out that the late Chief Justice to his surprise found that the idea of rule of law had ceased to have any clear meaning. He set about to redefine its meaning. As to the current state of the rule of law in the US, it reflects the problem: it is over-complex or rigged by legislation and rampant abuse of the system (p99). He laments the fact that at one time the US was the rule of law – a shining example for the world to follow. Now it is simply the rule of lawyers, something vastly different (p109). He doubts if the system can be reformed from within (p110).

He sees a difference in developing countries where the rule of law is developing along the lines it developed in England before the degeneration. It is developing to end violence, protect property rights, and impose constitutional checks on government (p105).

### Explaining the financial crisis

A popular view of the financial crises which started in the US in early 2007 was that it was caused by deregulation. Ferguson will have none of that. To him the ‘excessively complex government regulation of markets is in fact the disease of which it purports to be the cure’. The rule of law he notes has many enemies and among its most dangerous foes are the authors of very long and convoluted regulatory laws (p48). In the US the blame for the crisis is often attributed to the 1999 repeal of the Glass-Steagall Act of 1933 which separated commercial and investment banks. This narrative he holds is mostly wrong (p53). All of the major events of the crisis starting with the collapse of investment banks Bear Stearns and Lehman Brothers, continuing to the collapse of commercial banks such as Countryside, Washington Mutual and Wachovia which would have taken place even if the Act had not been repealed. Investment and commercial banks collapsed; these were not unified institutions. It was not the absence of regulation which caused the crisis he maintains but the existence of over-complex regulation (p54). He discussed the raft of legislation in place at the time of the collapse including the Basel rules, Central Banks’ lopsided monetary policies and distortions created by government sponsored entities such as Fannie Mae and Freddie Mac. He concludes; ‘Banks were the key to the crisis, and banks were regulated (p57).’ Clearly he argues it was not the absence of regulation which caused the crisis. It was the opposite the existence of over-complex regulation.

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The proposed solution to the crisis was the passing of the Dodd-Frank Act in 2010. This, he argues, is simply much more of the same. This is the addition of even more complex legislation on the already existing complex legislation. This is one of the Rule of Law’s enemies – bad law (p59). He illustrates the additional complexity added by this Act. Regulators are to create an additional 243 rules, conduct 67 studies, issue 22 periodic reports. It eliminated one regulator and created two new ones. Section 232 stipulates that each regulatory agency must establish an office of minority and women inclusion to promote minority and women owned businesses. These and many other things contained in the Act have nothing whatsoever to do with the promotion of the financial stability of the United States. Clearly this new wave of legislation simply adds greater complexity – the source of the problem to start with. So, he concludes, the regulators of the post-crisis world are doomed to

fail (p70). They will merely learn from one crisis to create the next.

In short his message is clear. Society started with the ruling rent-seeking elite who used their position of power to expropriate property – an attack on property rights. The West raced ahead when it had simple institutions imposing constraints allowing the development of successful economies protected by the rule of law. The rule of law is now but a ghost of its former self. It now consists of a vast complex of unintelligible rules presided over by regulators and lawyers. The solution to the current crisis is to impose much more of the same. It will not solve the problems. Ferguson's understanding of the financial crisis is vastly different to that usually portrayed in the media as being caused by deregulation, the free market and bankers' greed.