

## **Teatro Series – Risk and the Future of the Global Economy**

The 3<sup>rd</sup> annual speakers series, held at Teatro Restaurant, Calgary Alberta, explores the key issues facing the economy.

**April 29, 2010**

### **How the West dominated the world for 500 years**

Niall Ferguson

*The following is an edited transcript of Niall Ferguson's speech at Teatro Restaurant. Dr. Ferguson is a professor of history at Harvard University and the Harvard Business School. He is also an acclaimed author, contributor to many journals and publications and an Emmy Award winner. His latest book is the best-seller Ascent of Money.*

Thank you very much Leonard (Waverman), for that generous introduction. Some of you may be thinking, with a certain dread, that I am going to talk at tedious length about the global financial crisis and use words like "leverage," "basis points," "credit default swaps," "collateralized debt obligations" and "synthetic collateralized debt obligations squared." But I'm not.

I'm not going to talk about that. Because it seems to me we hear altogether too much about that these days. We're so focused on the small print of this financial crisis. "Did Goldman Sachs materially mislead in an inappropriate way some idiots who wanted to buy...?" From a historian's point of view, under the gaze of eternity, who really

cares?

If I had to choose between the following two institutions, and say which was more responsible for the financial crisis -- a) Goldman Sachs or b) the SEC -- I think I might plump for b. But when I look at that case I'm reminded of Henry Kissinger's great observation about the Iran-Iraq war, "A pity they both can't lose."

Let's reflect for a moment on what this financial crisis -- that we're still in, 'cause it ain't over -- signifies historically. What will it look like, a hundred years from now? How will it be written about? I want to suggest to you that its true significance lies in the fact that it has accelerated a fundamental shift in the global balance of economic and geopolitical power from the West to the rest.

I'm not talking about the west of Canada, just to be clear. I'm talking about the Western world. The West, that group of societies that originated at the Western end of Eurasia and western Europe and proliferated out across the Atlantic down into Australasia. That relatively small group of societies that in 1500 accounted for little more than 10 or 15 percent of mankind has, for the last five hundred years, for half a millennium, dominated the world.

The big historical story of modern history, the one thing that stands out, over a millennium, is the rise of the West. That's the story. And you would not have predicted it if you had been able to go on a world tour in the year 1500.

Now only tenured professors at Harvard are allowed to use the Harvard time machine and we're not really supposed to disclose its existence, as it is proprietary technology. But when I use the Harvard time machine and go back to 1500 and take a world tour it's not the West that impresses me. It's Beijing, the world's biggest city with a million or so population, probably more than ten times the size of London. It's the great cities of the Indian subcontinent that blow me away. It's the temples, not to mention the ornamentation of the Inca and Aztec Empires. These are the things that are impressive.

Go to England. Go to London. And you encounter a small, very unhygienic and smelly little town with rubbishy architecture -- very little of which, incidentally, can still be seen. By comparison with what they had at that time in Beijing, it was nothing.

What an incredible historical upset, that that little town became

the nerve centre of the world's biggest empire covering 25 percent of the world's land surface, governing roughly the same proportion of its people, ruling through a civil service of less than a thousand Britons the entire Indian subcontinent, and carving up the trade of China via cities like Hong Kong, cities that we British created.

How do we explain this? How can we explain the fact that the West dominated the rest, that the great Oriental empires of 1500 succumbed, one by one, to direct or indirect Western dominance? How come? That's such an interesting question, because if we can answer it then we can have some inkling of whether it's over. Is it over for Western primacy? That's the big question this financial crisis raises. Have we so discredited our financial system, so bankrupted our governments and so damaged our reputation that we can no longer credibly claim to be the masters of the world?

Ladies and gentlemen, the Chinese think so. Listen to the new tone that emanates from Beijing and Shanghai. Some of you may have encountered it firsthand. I have. It's an astonishing thing that as this financial crisis progressed, so the tone of Chinese public utterances, particularly towards the United States, hardened, became more assertive – indeed, became positively rude. That is a symptom of a

profound historical change.

And our problem is, and by “our” I mean everybody in the Western world, our problem is we can’t imagine it. It’s so beyond our experience. We grew up in a world that we dominated. We took it for granted that the rest of the world was a place where you went for exotic holidays. We grew up steeped in all the assumptions of Western superiority. And we can’t imagine that after roughly five hundred years the jig could be up.

So I don’t want to talk to you about CDOs squared or any of that. I want to talk to you about whether the mainsprings of Western ascendancy have corroded away and whether they are in the process of disintegrating. That’s what I want to talk about. And just in case you’re wondering, wait a second, I didn’t read that book...I haven’t written it yet.

I want to talk to you about a book you can’t buy. I want to talk about it because a) I think it’s more interesting than the books you can buy and b) I want you to buy it when it comes out.

The Ascent of Money, which is the most recent book I’ve written,

suggested that Western financial institutions were part of the story of Western ascendancy. It suggested banks, the bond market, the stock market, insurance, the mortgage market -- these institutions invented in the West, beginning incidentally in Northern Italy, through the Netherlands into England across the Atlantic to the United States and Canada -- it suggested these institutions were a part of the explanation, but only part.

I want to suggest to you that there were six killer applications, killer apps, that the West had, that the rest didn't have. And these are the things that explain Western dominance. And once we've identified these we need to ask ourselves the simple question, do we still have these? Do we still have them and do we still monopolize them?

I'm going to run you through them and then I'm going to invite you to ask me difficult questions about them. And the object of this explanation is to be comprehensive. If you can think of something that I've missed that was a necessary part of Western ascendancy, then bring it on.

Number one -- one thing that made the West different from, say, China, 500 years ago, was competition, political and economic

competition. We sometimes say to ourselves, we have capitalism. That's not quite right. It wasn't just competition in the economy that differentiated us from the East. It was competition. It was political and economic fragmentation. No single emperor ruled the whole of Europe. Ever. People tried, they never succeeded.

Let me give you an example of what I mean. In the middle ages, even before 1500, the city of London, where I taught for many years, was an autonomous entity. The King, the crown, did not have much power over it. And within that autonomous corporation -- and it was called a corporation -- the great trades and crafts of the medieval economy were also self-governing. The livery companies still exist today and rather exotic things they are. They are survivals of literally centuries of economic autonomy, self-regulation and self-government.

Long before the first joint stock company was founded in Amsterdam by the Dutch, the East India Company, the idea of autonomous corporations doing their things free from royal intervention was central to the political and economic culture of Western Europe.

And London was by no means unusual. There were a great many

cities that were autonomous all across Europe. Think of the great Hanseatic ports -- Lubeck, Hamburg, et cetera. Competition. The Chinese had an emperor. If the emperor wanted Admiral Zheng He to go on transoceanic voyages, he could go. And we know that the Chinese clearly beat Europeans to the punch when it came to oceanic exploration.

Zheng He was all over the place -- certainly sailing right down the coast of Africa. We know that he landed quite far down the East African coast. He brought back a giraffe. And then, the Emperor, having looked at the giraffe, and obviously not being very impressed, cancelled the program. No more oceanic voyages. We Confucians -- and remember, everybody running China has gone through the Confucian training, they've sat the imperial service exam -- we don't need this stuff. We don't need it. End. Close. The large ships were literally prohibited. It was illegal to build them.

Nobody could do that in the West. No single person had the power to close down exploration and trade. So competition and political weakness, paradoxically, turned out to be sources of strength. That's killer app one.

Number two -- how many people in this room have degrees in science? Well, be proud, because you are killer app number two. Science. Yes, the Oriental world had good math, it had astronomy though it was kind of shading into astrology most of the time. But what they did not have was the scientific revolution of the 17<sup>th</sup> century. They did not have Isaac Newton, moreover they did not communicate with Isaac Newton.

Scientific revolution was a network. It was a network of connected brains. It wasn't really about universities -- though Isaac Newton of course was at one -- it was more about communication between independent scientific scholars who were completely free to ask big questions about how the universe worked and nobody stopped them. In fact, they were encouraged. A royal society was founded in England -- still today the most distinguished of all scientific bodies, forget the Nobel committee -- and that royal society encouraged Newton and his friends to think big.

The East was cut off from this. They were not part of the network. The enlightenment and the scientific revolution extended ideas throughout the Western world across the Atlantic. There were scientists participating in this revolution in the Americas. But in the

Ottoman Empire, right next door to Europe? Zip. Nothing. They didn't even have a printing press in the Ottoman Empire until the 18<sup>th</sup> century and they used it to print...guess what? The Koran.

Killer app number two was science.

Number three, well, you know we tend to say democracy was crucial, but that is not right. Democracy was a by-product of something much more fundamental that was in fact most successfully established in North America. Namely, a society based on private property rights and the rule of law. That was the third killer app, without which the West could not have dominated the rest.

John Locke was the philosopher who saw most clearly the nexus between property ownership and citizenship, the link from freedom to property and back. That idea was, in that sense, British in origin. But it took a new world to be tried out in an ideal form without all the encumbrances of hereditary privilege that had characterized English society since the Dark Ages.

Once you have a society based on the rule of law and private property rights then you can indeed transition to a representative

government that is ultimately democratic. But the foundation is the private property rights, is the rule of law. That's the big difference between North and South America.

This was a wonderful experiment, wasn't it? Let's take two continents that are joined and then we'll send Europeans to each one and we'll get the Europeans to implant their institutions and impose them on the native populations and let's see what happens. We'll send the Spaniards and the Portuguese south and we'll send the British north and we'll see what happens. What happened in South America is fascinating because it's not what happened in North America.

From the outset in North America, property was subdivided and new settlers could acquire property very quickly -- usually after a few years of indentured servitude. In South America from the get-go, large estates were concentrated in the hands of a few lucky conquistadors and their chums. It was a highly unequal distribution of property. New settlers didn't get anything, nor did the indigenous peoples.

Rule of law? No way. That never really gets established. Ask yourself the question why was Simon Bolivar not George Washington? He aspired to be but failed completely. Time and again in South

America the attempt to leap to a democratic institution failed because the foundation wasn't there. You didn't have that society that proliferated in North America, spreading westwards and spreading westwards successfully regardless of whether the settlers accepted or rejected the crown of Great Britain.

One of the great non-differences of all time, I hate to tell you this, is the difference between Canada and the United States. Running the experiment of not having the king and having republican institutions made no significant difference to the trajectory of the history of the United States. It would have been, I would guess, in economically exactly the same place, if 1776 had only been notable for the publication of Adam Smith's book *The Wealth of Nations*.

So that wasn't a significant deviation. The significant things had already been established early on in the process of the British settlement of North America.

Killer app number four? Are there any doctors in the house? Medical doctors, I mean. I guess not. They're all far too busy. Well, I'm talking about medicine. Modern medicine is our fourth killer app.

Now, I call it a killer app but of course the real significance about modern medicine is that it is not a killer. It actually keeps you alive, more than doubles average male life expectancy. And it's a relatively recent phenomenon. It's only really in the 19<sup>th</sup> century that we start getting the key things right about infection, for example, about epidemics. Up until that point people had no clue.

Most people had very short lives. But with the great advances of modern medicine -- and I speak with feeling as the son of a doctor -- the West took another great leap ahead of the rest. Life expectancy in India stayed in the 30s, right into the mid 20<sup>th</sup> century by which time people born in the West could confidently expect to make it into their mid-60s, if not beyond. Modern medicine is the fourth killer app.

The fifth killer app might strike you as rather trivial. Let's call it the consumer society. Now, every person in this room has multiple suits, multiple outfits, multiple shirts, multiple blouses and yes, multiple pairs of underpants. And that's a very remarkable thing, historically, because for most of history, people basically had two sets of clothes at most.

The significance of the consumer society is this -- that the

demand for clothes of human beings is infinitely elastic, particularly the ladies. That has huge economic implications beyond the impact on your domestic finances, or wardrobes filled with designer outfits. The significance is this -- once you have a consumer society, with that infinitely elastic demand for clothes, you are nearly at the Industrial Revolution.

That's what the Industrial Revolution was really all about -- mass production of textiles. It's not the spices of the East India Company of Amsterdam that mattered. Our demand for spices is inelastic. There are only so many cloves that you can eat in a year. But the East India Company based in London which specialized in importing silks and other clothes from India was onto a far more elastic market. The sky was the limit.

And once people saw the money that could be made in the consumer society, they started to work out, you know, how they could make this stuff cheaper than the Indians and the hand-loomed weavers of Bengal -- the Industrial Revolution.

Every single Industrial Revolution that has happened has been propelled by the textile sector -- it's still true, folks. That's how you do

it -- you get people making clothes. It's not complex. You open a textile mill. They look pretty much the same today as they did even 50 years ago. But it's the key to creating a consumer society, because those people with their wages that are better than from subsistence agriculture, pretty quickly start buying clothes.

So the consumer society -- another Western killer app -- was crucial to propelling the West onto an income trajectory far, far different from that of the rest of the world. That's really what made us rich.

I'm going to mention one final killer app. And it's the most controversial.

About a hundred years ago a German sociologist named Max Weber took a trip to North America. And after the trip he wrote an essay called *The Protestant Ethic and the Spirit of Capitalism*. And everyone should read this. In it, Weber hypothesized that there was a relationship between the culture of Protestantism -- not the theology itself but the culture of the Protestant sect -- which he observed in North America and the extraordinary work ethic and saving ethic and thrift ethic that characterized the societies of the West.

That work ethic is our sixth killer app.

I followed Weber's footsteps recently to Springfield, Missouri, which has the highest concentration of churches per capita in the Western world, and I saw his point. This link seemed suddenly a very compelling one between a people who feel themselves godly and a people who work really hard. He went from the St Louis World Fair to Springfield and he saw the connection.

Well, he was half right. There was an ethic of capitalism. There was a work ethic and a savings ethic, a capital accumulation ethic that was quite different from anywhere else. In Eastern societies people a hundred years ago found it was hard to get workers to work. Whenever they tried to set up textile mills in India and China a hundred years ago, it failed. It shouldn't have, because the labour costs were laughably low compared to the West. But so too was the productivity.

Experiment after experiment in Asian industrialization failed with the sole exception of Japan. The Japanese did something very interesting. Under the Meiji dynasty, they simply copied everything

that the West did. They didn't really know what the killer apps were so they copied everything. The haircuts, the clothes, they even started to brush their teeth like us -- everything. The naval uniforms -- copied. They decided to replicate Western society. And you know what? It worked. It worked amazingly well.

And that's when Weber's thesis began to break down. Because it turned out you didn't need to be a Protestant. That wasn't actually the point. The point was the set of behaviours -- the behaviours that make you work 14 hours a day. The point was a bit of a sense of a moral compulsion. The point was the behaviour that makes you accumulate income and only spend half of it. That behaviour turns out not to be specific to any religion. It can be replicated.

And that brings me to my punch line. I've told you about six things that made the West dominate the rest: Number one, competition; number two, science; number three, rule of law, private property rights; number four, medicine; number five, the consumer society; number six, the work ethic. How many of those do we still monopolize? Answer -- none.

The rest of the world, let's call them the resterners, got

it...eventually. They saw that you should download these killer apps and that they were the key. And one by one, society after society is copying us and downloading our killer apps. And that is why Western ascendancy is coming to an end. There's just one exception to this rule, and it may already have struck you.

They say that China will overtake the United States in terms of GDP. But the Chinese haven't downloaded all the killer apps, have they? Oh yes, they've downloaded the competition up to a point. They've certainly downloaded the science. That they're doing on a massive scale. They've got the medicine. That was one of the things that Communist societies turned out to be quite good at. The consumer society, it's taking off there too, slowly but that's what they want.

What about the work ethic? Well the people who work hardest at Harvard are the Chinese students. I have to tell them to stop. It's enough. You don't need to work all night, as well.

But they don't have number three. They don't have private property rights they don't have the rule of law. They don't have representative government. They think they can do without number

three.

The most interesting question that I can leave you with, the question that we all face today as we look ahead is, are they right? Can they get away with five, or maybe four and a half, out of six of the killer apps? The answer to that question, ladies and gentlemen, is vastly, vastly more important than the outcome of SEC vs. Goldman Sachs.