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ECONOMICS *of* PROSPERITY

CHARLES STREET SYMPOSIUM | DECEMBER 2014

Why Do Societies Prosper?

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Charles Street Symposium

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ABOUT THE LEGATUM INSTITUTE

The Legatum Institute is a charitable public policy think-tank whose mission is to help people lead more prosperous lives. The Institute defines prosperity as wellbeing, not just wealth. Its *Legatum Prosperity Index*™ assesses a wide range of indicators including education, health, social capital, entrepreneurship, and personal freedom to rank 142 countries. Published annually, the Index has become an essential tool for governments around the world.

Through research programmes including The Culture of Prosperity, Transitions Forum, and the Economics of Prosperity, the Institute seeks to understand what drives and restrains national success and individual flourishing. The Institute co-publishes with *Foreign Policy* magazine, the *Democracy Lab*, whose on-the-ground journalists report on political transitions around the world.

The Legatum Institute is based in London and an independent member of the Legatum Group, a private investment group with a 27 year heritage of global investment in businesses and programmes that promote sustainable human development.

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Foreword

The Legatum Institute's mission is to help people lead more prosperous lives. We do this through our economics programme and annual global Prosperity Index, by studying the culture and history of prosperity and by examining countries in transition. We constantly seek out and engage with a broad spectrum of thinkers. Our annual essay contest, the Charles Street Symposium, is an important part of this. The symposium provides us with an opportunity to give a platform to young researchers who bring fresh insights to problems old and new. The competition is in its third year and once again we are astounded by the quality of the entries. They have all helped us further our mission and I am grateful to all those who entered.

Sian Hansen

Sian Hansen
Executive Director

Introduction

This year's Charles Street Symposium poses a fundamental question: why do societies prosper?

This question is at the heart of our mission at the Legatum Institute, one we have asked since 2007 when we first published the *Legatum Prosperity Index*™. Our work shows that without democracy, the rule of law, free markets, supportive communities, and entrepreneurial vigour, individuals and societies will fail to prosper. This list is not, of course, comprehensive, but it identifies some of the foundations of national prosperity.

Another question is: what is prosperity? For the Legatum Institute it is more than just material wealth. Prosperous citizens will enjoy physical and material security, but, perhaps more importantly, they will also enjoy personal and social wellbeing. A quick comparison bears out this point. Brazilians and Iranians are equally wealthy, as measured by GDP per capita, yet only Brazilians can vote, speak freely, and dress how they please: surely the former are more prosperous.

Given the importance of the two questions above, we are delighted to have received so many thought-provoking essays for this year's Symposium. Essayists were drawn from over 15 countries, from nearly every continent in the world, hailing from the fields of academia, business, and journalism, among others. All entries have further enlightened the debate about why some people and some societies succeed, while others struggle.

The shortlisted essays in this volume grapple with a wide range of themes. Some explore how we can better understand the world we live in, either by improving the techniques by which we try and disentangle cause and effect, or by understanding more about why people make the decisions they do. Others tackle controversial issues, such as illegitimate children, greed, and the importance of fear in driving social progress. Other authors provide interesting new insights on well-trodden topics, such as the formation of the state and economic development. Finally, some essayists go to the heart of the issue: why should we care about prosperity at all and what is our justification for doing so?

The result is nine essays that traverse the fields of economics, philosophy, sociology, and history. This range embodies another principle dear to the Legatum Institute: the importance of interdisciplinary study. Our programmes reflect this, and by drawing upon a range of expertise, the Institute's work provides novel insights into some of the most intractable public policy issues facing today's world.

These essays provide answers to some big questions and they pose some big questions too. Within them there is much to be learned and much to be savoured. I hope you enjoy reading them as much as I have.

Stephen Clarke
Research Analyst & Editor of the Charles Street Symposium

Judges' Notes

"One of the most fundamental questions economists face is why do some societies prosper whilst others stand still. The stakes are high.

After all, if we can find the right answer, it gives us the key to unlock millions of people from misery across the world today.

On the eve of the financial crisis, economists felt confident that they had arrived at the right answer: free market capitalism. Under the political stewardship of Margaret Thatcher in the UK, trade unions had been stamped on, nationalised industries privatised and finance deregulated. Unemployment and inflation receded and productivity surged. The fall of communism in Eastern Europe and the success of free market reforms in China added further credence to the free market promise.

However, when the global financial crisis hit in 2007-8, resulting in a protracted slump from which we are only just emerging, economists views came under fire. The downsides of capitalism came to the surface and the Occupy Wall Street Movement revealed a growing public disquiet with the notion that "greed is good". One could be forgiven for assuming that the way ahead is therefore clear—that re-regulation and growing intervention to tackle inequality will very soon be signed, sealed and delivered. A better balance between the state and the market is on many a peoples to do list. Lord Digby Jones has even called for a covenant between business and government to help rebuild public trust. However, as the dust settles, the voices of free market capitalism are once again gathering strength. In fact, John Allison of the American CATO Institute has recently argued that it was too little market freedom—not too much—that resulted in the global crisis and that what we need is a "free market cure".

With forces pulling in two very different directions, there is no better time to be debating the roots of prosperity. Our future path has yet to be decided upon and so now more than ever the contributions we all make to the debate—including those of the Charles Street Symposium—could spell the difference between carving out the right—or the wrong—route ahead. The stakes have never been as high as they are right now."

Victoria Bateman, Fellow and College Lecturer in Economics, University of Cambridge

"This is an engaging and eclectic set of essays which respond to the set theme in diverse ways. They roam free across more conventional economic discussions through to more philosophical approaches. The essays also look at issues in different countries and in relation to various historical time periods. Many take approaches that are unconventional and provocative."

Tim Besley, Professor of Economics and Political Science, London School of Economics

"The question this symposium asks is not only the most important in economics, but also the most interesting. Attempts to answer it can range through all the branches of the discipline and well beyond, through governance, culture and psychology. The essayists took a breathtaking variety of approaches to the subject and provided the judges with a difficult but fascinating task. This is the sort of brilliant initiative I have come to expect from Legatum."

Emma Duncan, Deputy Editor, *The Economist*

ECONOMICS *of* PROSPERITY

1 JUSTIFYING PROSPERITY

The Ethics of Disutility

Mats Ekman
Doctoral Student of Economics at the Helsinki Swedish School of Economics (Hanken)

More on the What and Less of the Why

Bernardo Teles Fazendeiro
Research Associate at the Centre for Critical Thought at the University of Kent

The Ethics of Disutility

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MATS EKMAN

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If you prefer having a Coke and reading Honoré de Balzac to drinking a Sprite while perusing Gustave Flaubert but still choose to do the latter, you have failed to maximise your utility. It is very likely that the only difference in global utility resulting from your suboptimal decision falls on you, but nevertheless it is true that the world is not quite as prosperous as it could have been, if prosperity is defined in the broad economic and utilitarian way to mean "yielding utility" (a definition used throughout this essay). If the maximisation of such prosperity for all mankind is everyone's moral duty, it would seem plain from the fizzy-drink-and-literature example that you acted *immorally* when, with no change to the utility of anyone else, you failed to maximise your own wellbeing.

This essay argues two things. The first is that the above illustration reveals the poverty of the utilitarian fixation on broadly defined prosperity as an end in itself (indeed, the only end). The implied demand, if utilitarian normative ethics were the basis for policy, is that even decisions affecting only oneself are not up to the individual. Secondly, to sound moral theory, striving for prosperity is optional. Morality encourages prosperity to the extent that people want it and as long as the dignity of the individual is not violated, but prosperity itself is no foundation for sound ethics. These arguments form the bases of the following two sections.

THE TYRANNY OF PROSPERITY

When the Soviet Union was industrialised, material production increased amid terrifying human suffering, indicating how conventional methods of estimating prosperity are better suited for judging progress in liberal democracies. But even there, many things of utility are unmeasured, such as a loving family and good health. If everything that yielded utility were measurable and labelled "general prosperity", GDP accountancy would be improved. Still, it would be a serious error to view the maximisation of such a measure as the essence of normative ethics; it would confuse the good with the right.

That we as individuals choose more utility over less may be thought so obvious that it must follow that the same should be the basis of policy. However, if an individual is not *wrong* to choose suboptimally in any moral sense, the extension to policy is tenuous. (One may also object that it is improper to treat society as a single organism in which the welfare of the few may be sacrificed for that of the many, but this essay concentrates on the individual's relationship with utility.) The example at the beginning of this essay is one way of showing that it is indeed morally permissible to fail to optimise.

Another such example is to imagine that the utility others derive from your life is the same under the following three scenarios:

(1) your life gives utility of, say, 1 to you and lasts 80 years;

(2) your life lasts forever and gives utility of 0.999… to you (awarded every "period" as elements from the infinite sequence 0.9, 0.09, 0.009, for instance); or

(3) your life gives utility of 2 minus 0.999… to you, but lasts only 30 years.

Large compensations might be required, but such choices are clearly imaginable. If considered judgement leads you to take options (1) or (2), broadly defined prosperity is not the (sole) basis of morality. The same conclusion would be reached if the utilities were equal and considered judgement led you to prefer one over another.

These hypotheticals hardly demonstrate that more utility is wrong, but they do show that it is not obviously right. “Right” and “good” are separate qualities. If an all-inclusive prosperity measure existed, it would capture the latter but not the former. Thus, it is right that each individual has moral licence to pursue values other than good, such as refusing soma in Aldous Huxley’s *Brave New World*, or preferring reality to Robert Nozick’s Experience Machine.

Some may object, arguing that utility is that which our actions seek to attain and that the chosen option was utility-maximising by dint of being chosen, so the numbers must have been wrong. While this is a useful view in many situations, philosophy is not one of them, because human beings would then be unable to do or think anything that failed to maximise utility as they conceived it. For instance, a person might think that he cared about truth, but such thoughts would maximise his utility and so have no independent epistemic value. Thus, that person cannot really have epistemically good reasons to believe a proposition to be true or not. It follows that discussing the ethics of different actions—such as those that augment prosperity—is pointless if we are after the truth.

If we can choose not to maximise our own utility (while holding everyone else’s utility constant), the foregoing discussion suggests that there is no good argument to show why it would be immoral to do so and that there are values other than utility. Since ethical policy should not go against the individual’s morally innocuous will and since many non-maximising decisions are introspectively appealing, it follows that moral policy does not demand prosperity. An all-inclusive prosperity measure is insufficient for guiding behaviour.

A SELF-IMPOSED TYRANNY IS NO TYRANNY

To say that choosing less utility for oneself (with utility for others held constant) is immoral is to deny the individual the dignity of making his own decisions. It is right that one may forego the good; but if what is good is not the sole basis of sound moral theory, how big a part does it play? Put differently, how free should the individual be to choose suboptimally? In the example above, the lowest utility of the three scenarios was 0.999..., barely lower than that of the maximal-utility scenario. Would choosing less be permissible even if it were much less? The answer must be affirmative, as logic fails to make utility commensurate with other values and therefore offers no way of limiting their “weight” in decisions.

When the agent’s decisions affect only himself, utilitarianism implies ethical egoism, according to which it is one’s duty to maximise one’s own utility. But anything implying a false proposition is itself false. The lack of a moral imperative to maximise one’s own utility therefore provides an aperture for the individual to fail to maximise others’ utility too; to enhance others’ utility is no duty if values other than utility are important and incommensurate with utility. We regress to a negative-rights situation in which individuals choose freely for themselves what to do. We cannot, however, regress to the point of allowing them to violate one another's ability to do likewise.

Legislation should not violate sound ethical principles and so should favour negative rights rather than prosperity. Logically, this choice is not hard if one believes that freedom encourages prosperity. If individuals desire prosperity but are prevented from getting it by, say, free-riding or common-pool problems, a policy to resolve these problems may be morally permissible; but with the exception of such cases, policy aimed at the pursuit of prosperity is at best superfluous and at worst immoral.

Before concluding, it is worth asking whether broadly defined prosperity could be justified if it helped individuals pursue what is right. Greater affluence can make us work more (as more labour brings greater remuneration) or less (as the concomitant income effect makes us choose—or "afford"—other things beside work, like moral thought). For moral thought to be encouraged by increasing prosperity, the latter effect must dominate. That this is so is suggested, though not proved, by the "expanding circle" which is said to have widened our moral concerns as we have gained free time.[1]

However, the increased complexity that tends to come with prosperity[2] also makes moral problems (seem) more difficult. For instance, many consumers are concerned that their purchases might encourage unwholesome activities far down the production chain. If riches bring greater moral concern, it is possible that complexity thwarts its aim, for error is harder to detect the more complicated the issue. On balance, it is hard to determine whether prosperity encourages morality or ethical error.

The general justification for prosperity, then, must be that free individuals have decided that they want it. What would be a tyranny if imposed upon us is then the rightful enjoyment of the fruits of voluntary exchange. In this view, prosperity comes because people want it, provided that they are free to pursue it; in itself, it is worthy neither of praise nor of blame.

CONCLUSION: MORALITY JUSTIFIES PROSPERITY; PROSPERITY DOES NOT JUSTIFY MORALITY

In sum, it would be wrong, other things being equal, to force a person to maximise his own broadly defined prosperity. It follows that its maximisation is not all that matters in morality, and that in the absence of commensurability between prosperity and other values, sound morality can permit only negative rights. It has also been argued that prosperity is not a means to other ends in ethics but simply a felicitous outcome of free human action. Thus, it is sound ethics if humans pursue prosperity, but sound ethics must not compel them to do so.

More on the What and Less of the Why

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Providing or at least seeking a tentative answer to the question "why do societies prosper?" is one of the ubiquitous tasks of our era. We are surrounded by technocrats, managers, consultants, advisers, and analysts who all propose, in one form or another, recipes for prosperity, particularly ways of achieving material success. They are modern sages—knowledgeable about production, risk, profit, competitiveness, sustainability, productivity, and efficiency, among other things—and make a living by espousing the causes of material wellbeing and the means by which to maintain it. They explain why material wellbeing decreases here but not there, and very often determine the careers of politicians and even the future of nations. Recently in Britain, it was not the least bit surprising nor even controversial that Scottish independence hinged more upon the pound and wealth than on nationalism; in the south of Europe politicians defend austerity by promising future material wellbeing; and in India, Narendra Modi based his election campaign on increasing national wealth.

There are obvious sociological reasons why questions of prosperity dominate our field of deliberation. In a world beset by substantial income disparities, where even rich countries face challenges in redistributing and continuously accumulating wealth, global awareness is also increasing, and the question therefore remains poignant. But asking why societies prosper has both a history and a philosophical basis that can reveal that something may be somewhat amiss: that perhaps prosperity is not solely material and that the answers begotten by causal (or "why?") inquiry are neither especially mysterious nor likely to be definitive and fulfilling. If that is the case, are we actually asking the right questions?

Nevertheless, the majority of us continue to be driven by that "why" question, as is evident from the sustained interest in economics and business studies. According to the OECD's *Education at a Glance*, university students tend on average to select "business studies" as their specialisation, which, like economics, is there to explain the causes of material success and the skills necessary for attaining it.[1] But there are still no definitive answers as to ***why*** societies prosper. Economists agree on the ingredients for economic growth—capital, labour, technology, expertise, reliable institutions, and so on—but not on their arrangement, and so Solow–Swan and endogenous growth models are subject to ongoing dispute.

That said, inquiring into material success is not especially daunting, for we do so in our daily lives and have been doing so since at least the dawn of writing. Cuneiform tablets dealt first with business transactions. And in the fourth century BC Xenophon showed in his *Oeconomicus* how Critobulus was eager to know the secrets of material success. Socrates rather reluctantly helps Critobulus in this endeavour and suggests motivating a workforce, delegating tasks, being diligent, and investing in "know-how".

Likewise, in the present era, inquiring into material prosperity is not a nebulous task by any means, and Socrates' words resonate to this day. This is not to say, however, that modern economics, born out of the Enlightenment, is redundant: quite the contrary. In a time of increased technical complexity, when specific financial instruments can be comprehended only by experts, the discipline of economics both engages with and sheds light upon our world. For example, "moral hazard", "externalities", and "Tobin taxes" were novel concepts springing from economics and revealing the pernicious consequences of particular market distortions and the solutions to them. And, no doubt, the answers to be found through the study of economics are not always obvious. Henry George's classic, *Progress and Poverty*, for example, took a stance against the widespread belief that material progress was the solution to poverty, arguing instead that it was the cause thereof.

Considerable insights aside, we persist with a material and causal line of inquiry because it is now an entrenched tradition passed down to us from the 18th-century Enlightenment. Prosperity, in the sense of material wealth, was the topic of Adam Smith's most renowned work, *An Inquiry into the Nature and Causes of the Wealth of Nations*, published in 1776. We have subsequently sought to unpack prosperity accordingly—through causes and materialism—yet from a philosophical perspective the task is likely to remain unfulfilling, even in spite of the obvious positive results of nearly 300 years of studying material and technical progress. Amartya Sen—a Nobel Prize laureate for economics—hints precisely at that growing dissatisfaction by looking beyond material wellbeing. Economists have begun, consequently, to speak less of growth than development and less of income per capita than the human development index (HDI), in order to capture the rather elusive notion that is "quality of life".

Yet, if we speak of quality of life and realise the limited scope of inquiry into the causes of material wealth, we ought to take a step back and first consider what sort of question ought to be asked. Granted, prosperity is to an extent determined by a material condition: we cannot be well if we starve, by which we mean that lack of food causes a decrease in prosperity. But that same cause—lack of food—tells us little about prosperity in the broader sense: the Latin ***prosperitas***, or "desirable condition".[2] A condition of this sort evidently signifies more than modern material prosperity: "the state of being successful usually by making a lot of money."[3]

Extending the notion of prosperity beyond material wellbeing towards something like a "suitable good" raises a new question: what is desirable and, to that effect, what is good? It makes little or no sense to continue inquiring into the causes of a suitable condition without a preliminary notion of what that condition is. Indeed, asking why is actually asking for the cause of something, and if we do not agree on what that something is, we end up looking at everything or nothing at all. And that is why nowadays we are barely able to define the aim and scope of academic economics: from the subfields of "legal" to "behavioural" economics, the discipline is only identifiable by its commitment to falsification and consequentialist, utilitarian reasoning.

Looking at development has nevertheless decreased the purely material focus of economics, though the interest in underlying causes remains, in part as a consequence of our reluctance to ask "what?" questions. For in the West in particular, we adhere to the maxim "to each their own version of the good", which is there to remind us of the crimes of totalitarianism—the arrogant, unthinking attempt to inflict one set of ideas upon all fellow humans. While important to bear in mind, the maxim does not preclude questioning the good; not least because in our daily lives we regularly admonish those who do not abide by some version of "good". For example, most of us would surely agree that taxing only the poor is an unfair manner of obtaining government revenue, and Michael Sandel in *What Money Can't Buy* points precisely at that reaction: how we almost intuitively grasp moral goods—levied on us since childhood—but remain reluctant to discuss them openly.

It is not just a version of scepticism or tolerance, however, which hampers questioning the good. The resistance also derives from how we have come to understand it. Alasdair MacIntyre in *After Virtue* and Charles Taylor in *Sources of the Self* have shown how, especially after the Enlightenment, the good was increasingly regarded as subjective and emotional, which in turn decreased our willingness to articulate and differentiate goods objectively. For if the good is merely a thing springing from each and everyone's contingent experiences, all discussions of the good become rather pointless. Causes, instead, and material causes for that matter, seem less haphazard and eventually become the new objective categories with which to inquire about prosperity.

But thinking about the good is not entirely subjective, as Taylor and MacIntyre have demonstrated. Conversations about the good require arguments and comparisons of one good with another. Aristotle, in the *Nichomachean Ethics*, is the paradigmatic example of that attempt. He distinguished between several virtues and argued coherently about their qualities, relating them to each other, without necessarily explaining their origin—their root material or ideological cause.

Addressing the question "why do societies prosper?" without asking "what is prosperity?" leads to a persistent search for a good that is problematically taken for granted, often as some sort of material wellbeing. So if prosperity is, on the one hand, mainly material, then economics, and other social sciences for that matter, are there to find causes and solutions with which to assist societies in their pursuit of material wellbeing. If, on the other hand, there is something more that we are searching for, beyond material wellbeing, then "why" questions are likely to remain rather unrewarding. Taking a step back is more necessary than ever, so that we can deliberate on versions of the good, whatever that may be, and thus question our assumptions about prosperity and their appropriateness in attaining it.

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The Ethics of Disutility

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2. César Hidalgo and Ricardo Hausmann note that more complex economies tend to be richer; "The Building Blocks of Economic Complexity", *Proceedings of the National Academy of Sciences*, vol. 106, no. 26 (2009), 10570–10575.

More on the What and Less of the Why

1. The full text of the OECD's *Education at a Glance* is available at www.oecd.org/edu/eag.htm.
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2 UNDERSTANDING PROSPERITY

Three Dead-Ends and a New Direction

Daniel Susskind
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Nudge Nudge—Who's There?
In Defence of Nudge Theory: Accepting Behavioural Economics in the Application of Public Policy Toolkits to Achieve Social-Purpose Goals

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Three Dead-Ends and a New Direction

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Although human societies are more prosperous than ever, we do not seem to know why. Three influential economic traditions—rival theories, models, and tests—have led us to dead-ends. In what follows, I suggest a change of direction. I call this alternative the "hunt for exogeneity".[1]

In the last two centuries, three currents of economic thinking have flowed stronger than others: the "grand theory" of the classical social theorists; the "formalism" of the mathematical economists; and the "empiricism" of the data scientists. Each remains influential, but none satisfactorily answers our question—why do societies prosper?

The classical social theorists explained prosperity with grand theories and all-encompassing sweeps. Karl Marx, a standard bearer for this school, believed he had uncovered not only the inner workings of particular economies, but the fundamental dynamics of history, both past and future.[2] Nor was this spirit confined to the 19th century; Walt Rostow, a 20th-century economist, developed his infamous "take-off model" of economic development in the same manner. He considered his approach to be a "way of generalizing the sweep of modern history" and explicitly contrasted his proposal with the Marxist offering.[3]

Yet these grand theories, despite their notoriety, share a problem. By positing that the forces they identify are inescapable and inevitable, the theses themselves become unfalsifiable.[4] If revolution fails to arrive as expected, a Marxist can argue that it is "just around the corner". If a country does not pass through the five stages of growth at the right pace or in the proper order, a Rostovian can side-step criticism by saying that take-off was "delayed, but will resume shortly". Critics are powerless in the face of such evasion tactics. These theses cannot be tested, and so related disagreements over the origins of prosperity cannot be resolved.

The second current is the formalism of the mathematical economists. They draw their insights from formal models. Economic activity is reduced to a set of equations and the important relationships are described in a terse and exacting way. Unlike the all-embracing grand theories, these models deliberately leave things out. The hope is that what remains is illuminating: "all models are wrong …", wrote the British statistician George E. P. Box, "but some are useful."[5]

Many of these models are variations on the same equation—the "Cobb–Douglas production function". This function describes how an economy's output depends upon the number of people, the stock of capital, and the level of technology that make it up. In 1987 Robert Solow won the Nobel Prize in Economics for showing that "technology" is the most important part of this function. In his theory, technology is the only factor that matters in ensuring our incomes continue to grow. (In practice, he showed it was responsible for about four-fifths of growth.)[6]

Yet despite the clarity of his conclusion, Solow remains a "tease".[7] He gives a seductive glimpse of what matters (technology) but says little about what it is and why it changes. Formally, his theory holds that technology is "exogenous"—dropped in from outside and put to use. In response, some try to make it "endogenous"—to use the model to explain what technology is and how it can change. Robert Lucas, for example, does this by building "human capital" and skills into his adaptation of Solow's model,[8] and Paul Romer injects "innovation" and R&D into his.[9]

However, these attempts suffer a similar flaw to Solow's: the factors they use to explain the origins of technology are, themselves, unexplained. Little is said about ***why*** certain countries develop better educational systems or stronger innovation institutions. As the economist Daron Acemoglu puts it, these models are built only on "proximate causes" of growth, and are not "fundamental explanations".[10] In spite of their bewildering and often beautiful complexity, they can ultimately only offer us a superficial glimpse of the deeper origins of prosperity.

The third current is the empiricism of the data scientists. They use "Barro-style growth regressions" to tease out relationships in data.[11] Running regressions seems to show which factors (the "right hand side" variables) affect growth (the "left hand side" variable). The simplicity is intoxicating—if a variable can be measured, it can be put on the right-hand side and tested for influence on what is on the left. Almost two decades before the concept of "big data", the economist Xavier Sala-I-Martin celebrated that he had run "two million regressions".[12]

Yet this technique is also problematic. Partly, this is because so many things seem to matter: in a survey, Steven Durlauf found 145 factors said to be significant determinants of growth (and 43 different accompanying "theories").[13] This bounty is also suspicious, and points to a second problem: these techniques are overstating their discoveries. They uncover ***correlations*** in the data and not ***causation***; they tell us what is ***related*** to our prosperity, but not what ***causes*** it. The latter question, though, is the important one.

In different ways, then, these three currents of thought enlighten but also obscure. In response, a new field has emerged, building on the failings of the other three: it is modest rather than all-explaining, it focuses on fundamental rather than proximate factors, and it tries to isolate causation rather than correlation. This field is engaged in a "hunt for exogeneity".

The main tool used in this hunt is "instrumental variables". It is a statistical technique where we find a new factor, called the "instrument", which is directly related to one of the factors we are interested in (it is "informative") but is not directly related to the others (it is "valid"). To see why this helps, imagine the following setting. You are standing in Trafalgar Square, it is raining, and there is a crowd of people holding umbrellas. Common sense suggests that the rain ***causes*** the umbrellas to appear. But suppose the person standing beside you leans over and says that it is the umbrellas that ***cause*** the rain. You appeal to common sense, but he notes that our common sense is often wrong. You present theories and models, but he presents his own, too. You present a simple regression, but he points out that they only show that rain and umbrellas are related, not whether one ***causes*** the other.

To show that umbrellas do not ***cause*** rain, we instead hunt for this new factor, the instrument, which is directly related to the number of umbrellas, but is ***not*** directly related to the amount of rain—for example, the price of umbrellas. We then proceed in two stages. First, we look at how past variations in prices affected the number of umbrellas. Then we look at whether these particular variations in umbrellas were related to variations in rain. Since we know that the rain did not ***cause*** these particular variations in umbrellas—that was due to the change in prices—we also know that if the rain is related to these particular umbrella variations, it must be that these umbrella variations ***caused*** the rain. (But of course, they will not.) This is a hunt for exogeneity since the variation in umbrellas used is "exogenous", caused by an external factor, in this case the price.

In practice, this technique is useful as common sense often works in both directions. We can think of reasons, for example, why certain institutions might ***cause*** economic prosperity (for example, property rights provide the security that people need to invest), but also why economic prosperity might ***cause*** certain institutions (for instance, the more things that people have, the more they want to secure them as their own). Without finding exogenous variations in institutions, we cannot distinguish between the two.

Many of the new factors used are ingenious. Daron Acemoglu uses "disease mortality" to get exogenous variation in African institutions.[14] Alberto Alesina uses the "Berlin Wall" to get exogenous variation in German institutions.[15] Nathan Nunn uses "distance from the coast" to get exogenous variation in the number of slaves taken in African regions during the slave trade.[16] The results emerging from this field are promising. They offer greater insight, not only into how different institutions are responsible for causing our prosperity, but also how different cultures and geographies, and a host of other factors, matter too.

This path, however, is not without its problems. The first is technical: finding exogenous variation in variables is a specialist task. The second is practical: as yet, the literature is focused more on identifying the factors that cause growth, rather than how in practice we can change these factors. And the third is conceptual: we can only consider things that we can express quantitatively.

We can take comfort that the first two limitations are temporary; with attention and effort they can be resolved. Yet the third is a permanent problem. Our measures of prosperity and its causes will, necessarily, be incomplete. And yet, even if this only gives us a partial view of the truth, we should still relish the challenge of pursuing this question. It is too important to ignore.

Nudge Nudge—Who's There?

In Defence of Nudge Theory: Accepting Behavioural Economics in the Application of Public Policy Toolkits to Achieve Social-Purpose Goals

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Political theorists and economic philosophers, from Plato to Popper, have long been debating the role of the state in fostering social and individual flourishing, and the importance of institutions in economic and societal prosperity.[1] But that is precisely what the state, or the British one at least, has been doing largely without fanfare for almost the last half-decade. It's nearly Halloween, so let's talk about something ominous: that shadowy government-backed organisation which studies how you think and secretes little nudges into the atmosphere—an apple in your eyeline here, a "this sugary drink contains a zillion calories" there, the odd plain-packaged cigarette packet. It's unsettling. Hang on—what's that knocking downstairs? That strange little letter in your letterbox, rustling just out of sight? Are you being nudged right as we speak? Step forward the Behavioural Insights Team (BIT), colloquially known as the "Nudge Unit", with a new way of thinking (see box).

This handful of academics is working to subtly alter the ways we act, look after ourselves, and obey the law, with a simple premise at heart: instead of using clunky legislation or the top-down, blanket blunderbuss of regulation to threaten people into forced compliance, they employ small, clever prompts. Combining economics with behavioural science, these "nudges" not only foment a more responsible population, but also make us as individuals feel happier and more informed about the choices we make.[3] Policy models traditionally are based on a naive understanding of what drives behaviour: building a more intelligent, nuanced, bottom-up account of how people make decisions can design policy that is more effective, is less costly, and makes life easier for most citizens, at a time when, worldwide, governments' instincts generally are for less legislation and regulation and more frugality.

Nudges by definition are simple to implement, hugely efficacious, and highly cost-effective, and in many cases they are simply a matter of changing the default, or reframing the architecture of the choice, in order to help people make better choices for themselves. We are surrounded by default rules everywhere, and they are usually invisible. You will have already encountered one choosing how to read this essay. Unfortunately invoking moral-suasion usually has an effect close to zero in saving the environment. Classical economists prefer to employ incentives: a corrective 10 percent tax will reduce usage by 2 percent. However, switching the default from printing single-sided to printing double-sided affords a 10 percent reduction in paper usage—and, most importantly, is costless for institutions to implement.[5] Defaults, to print one- or two-sided, are irrevocably always there, and the choice to print single-sided is not removed. Indeed, people are not alarmed by default rules: default-tipping nudges already accrue far greater incomes than otherwise to the service industries, by as much as 10 percent.[6]

Millsian advocates of liberty maintain that individuals must reject "customs" and "actively choose", deciding each time whether to opt in or out, or to print single- or double-sided, as the most welfare- or liberty-maximising option.[7] However, compulsion to choose in itself is no liberation, and in daily life this argument overstates humans' capacity as rational choice-making animals; ironically, freeing with more choice actually diminishes liberty with the increasing practical impossibility of overcoming everyday interactions. Like all muscles, the choice-making one is at as much risk of overuse. Would you like to accept cookies?

CHALK UP THESE SCIENTIFIC RESEARCH-ORIENTED SUCCESSES, MEASURABLE IN BILLIONS OF POUNDS, TO BIT[2]

- Most people claim they would like to save for their pension, but whether their company scheme is opt-in or opt-out is a much more powerful driver of whether they actually do; it transpires that automatic enrolment increases saving rates for those employed in large firms by as much 20 percentage points.
- Informing people who fail to pay their tax on time that most of their peers have already paid increases payment rates by over 5 percentage points.
- Reducing jobseekers' paperwork and encouraging them to proactively commit to undertaking job-search activities in the next two weeks, rather than asking what job-search activities they have undertaken in the preceding two, makes them 20 percent more likely to be off benefits within 13 weeks.
- Asking patients to fill in their own appointment cards leads to a 30 percent drop in missed appointments.
- Requesting signatures at the beginning, not the end, of forms increases honesty in respondents' responses.
- Prompting people to join the organ donor register using reciprocity messages (like "if you needed an organ, would you take one?") increases annual registration by 10 percent.
- Rephrasing public health campaigns (for instance on sexually transmitted diseases—replacing warning or educational statistics with questions such as "What would your girlfriend think of you if you say you don't want to use a condom?") greatly reduces otherwise avoidable disease incidence rates. Half of UK health spending goes on treating the consequences of unhealthy behaviour such as drinking, smoking, and unprotected sex; however, as yet only 0.5 percent of NHS spending goes on promoting healthy behaviour.
- Defaults are unavoidable; harnessing nudge has great potential to deliver rapid progressive change in areas where it is desperately needed, from recycling and green energy use, to tackling smoking and childhood obesity.

Which is why humans have evolved certain instinctive behavioural traits, or bounded rationality, of aversion to risk and to loss, of heuristics, to follow compelling social norms, the crowd, and the status quo. In real life people eat doughnuts, decide not to go to the gym, never change their ringtone, and put off making payments into their pension fund. The incumbent challenge of government is to tweak defaults to encourage people to act in their own and society's long-term interest, while respecting individual liberty.

For all libertarianism's desire for lack of governmental interference, default rules are as much a ubiquitous institution as property rights. But in a default-rule framework, people are free to choose that framework, and a truly free people cannot do without such rules.

FOUNTAIN BY MARCEL DUCHAMP, 1917

'Ceci n'est pas une pipe': by far nudge's most famous example involves a fly and a urinal. In the 1990s at Schiphol airport, rather than putting up a sign politely asking men to avoid peeing on the floor, a toilet attendant simply etched the outline of a fly onto the porcelain. Spill-over effects plummeted by 80 percent.[4] Nudges, then, may not only include the use of personalisation or the desire to conform; the employment of large, coloured fonts is equally a nudge. A satnav is a prime example: it never coerces you to turn right, merely shows the most efficient outcome.

Such frameworks may be mandated to encompass what informed choosers want, while maintaining their dignity, autonomy, and freedom of choice. In the case of organ donation, the welfare of choosers may be weighed against the welfare of third-party interests, namely recipients. Hayek's chief argument for liberty is that planners cannot know what people want; however, in the era of modernity and big data this simply no longer remains the case.[8] The classical liberal harm principle is that it is only legitimate for society to intervene when an individual poses harm to others; much less clear is the role of soft "libertarian paternalism" in encouraging pre-emptive healthcare.[9] Individuals suffer from herd mentality because in most situational instances they actually have little expertise and will rely upon nudges as informational signifiers.

Of course, people have inherent and not unreasonable fears of government getting inside their heads, of governments getting away with failing to remove bad choices, of liberals secretly manipulating choices towards their paternalistic agendas, of evil dictators. Indisputably, many people simply desire no interaction with government whatsoever, and there is an inevitable nudge backlash. What is the point in Her Majesty's Revenue and Customs changing the wording on income-tax letters to indicate local percentage rates of repayments of peers paying their tax on time (increasing repayment rates by 15 percent), or the British Courts Service utilising personalised text messages to remind people to pay their fines on time (saving millions of pounds in bailiff interventions) if these go unread? Uncomfortably, it is apparent that default rules (like wages) are stickier, and nudges much more effective, for poorly educated, low-income individuals from socially deprived backgrounds, perhaps either through mechanisms of lack of confidence in following social defaults, or cognitive overload.[10]

In defence of nudge, then (an expansion of arguments presented in the box opposite), just as government legislative, economic, and fiscal incentive pressures are transmitted through the public press, there must also be nudge transparency; which is why the BIT was privatised last year in order to be more open to public scrutiny and indeed able to offer its research to other nations. There remain concerns, however, about whether it is right to treat citizens as consumers who may be “manipulated” into making “correct” choices, and about how ethical such scientific research is, particularly when it is the government carrying out trials to find out which nudges work or are acceptable. Medicines are trialled in this way, but only with a huge raft of ethical safeguards, including obtaining consent, full disclosure, and deciding in advance when the trial should be halted. Relying upon behavioural insights, however, does not mean not using any other policy tools; no one is proposing removing laws against murder and replacing it with nudge. While nudge may be winning adherents, the public often requires a legislative “shove” also.[11]

But in protecting against malevolent, self-interested choice architects, with strong antecedent preferences (such as in the experimental default case of saving over 10 percent of income to an opt-out pension plan), default rules are not sticky, and over three-quarters of individuals still choose to do what they want (and opt out in preference of higher immediate net income).[12] Indeed, hundreds of thousands of women annually choose to reject their default rule, and undergo name change upon marriage (in itself because of strong social norms).[13] This exemplifies that nudges are also at their most effective when applied within a well-defined, bounded time period, before new behavioural habits, procrastination, or inertia can be established, and when they confer associated positive effect. Nudge belies some basic commonsense and human instincts: our impulses for embarrassment, pride, and the desire to fit in. You make it easy, attractive, social, and timely.

Governments that remain desperate to influence how citizens behave without removing choices or spending too much money have seized upon nudge. Following suit, the US has similarly already tried administering it in helping its citizens make better choices. In 2009, realising that many Americans were, without necessarily having explicit knowledge or giving consent, being enrolled by default into hugely expensive overdraft protection programmes by their commercial banks—which, like payday lenders, were then charging annual compound interest at a level of many thousands of percent—the Federal Reserve forced commercial banks to write a disclosure to each customer to force them to make an explicit choice as to whether they wanted to remain in the scheme. These institutions, of course, recognising their customers’ aversion to loss, promptly turned around and employed nudge theory against them in their own right, asking their customers whether or not they would wish to “lose, or continue to have, the overdraft protection they had long enjoyed”.[15]

IN DEFENCE OF NUDGE[14]

- Individuals' situations are highly diverse; by allowing people their own choices, nudge reduces the costs of one-size-fits-all solutions.
- Public officials have access to limited information; if nudges are based on mistakes, fallout is far less in severity than in the case of banning options, because people retain the freedom to ignore them.
- Public officials do not necessarily always have the purest of motivations, and may be affected by the influence of well-organised private groups; nudge then provides a major safeguard for people to inform their own choices.
- In providing information or offering warning, government simultaneously is informing citizens that they inherently retain the dignity, respect, and right to make their own decisions.

Nudge is inevitably here, and here to stay. It is hardly news to marketers and the mad men from Saatchi who, since time immemorial, have been covertly utilising nudges and scientific trialling to get us to do things in their best interests.[16] Except now, it's about time they were used in ours.

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3 THE ECONOMICS OF PROSPERITY

Liquidity Provision under Commitment in Monetary Policy
When Did an Epstein–North Consensus Become Possible?

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The Chinese Resurgence
Lessons on Economic Development and Institutional Change

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Liquidity Provision under Commitment in Monetary Policy

When Did an Epstein–North Consensus Become Possible?

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The literature on the causes underlying the "great divergence" (Pomeranz 2000) has been converging to an increased understanding of the critical role that state-building played in the process. One well-known strand of literature influenced by the work of Douglas North emphasises the problem of expropriation of property by states that are too strong or absolutist (deLong and Shleifer 1993, Acemoglu et al. 2005). However, as eloquently emphasised by Epstein (2000), only states that could gradually centralise administration and implement a system of broad taxation were able to make provision for a sufficient amount of public goods, which permitted the overcoming of externalities and allowed economies to survive interstate competition under an investment-friendly environment of decreased uncertainty and ambiguity.[1]

I concentrate on one neglected aspect of the cost which was imposed on societies where the state was "too weak": the inadequate provision of a liquid means of exchange which could support market participation and ease the collection of taxes. I discuss the relationship between the comparative emergence of a modern system of state finance and the public provision of money which was able to support continued economic growth. I start with the remarkable case of China, which, after an early experiment with paper money, failed to develop a commitment mechanism to keep the supply of fiat limited, and as a result made the supply of liquidity which could support economic growth altogether impossible. The interaction of monetary and political institutions in China did allow for the development of a system comparable to that which Europe was able to develop gradually, and would in due course support the transition to modern economic growth.

CHINA: FROM PRECOCIOUS INDUSTRIALISER TO SLEEPING DRAGON

> *Uncoined and largely obtained from foreign sources, silver resisted all efforts to subordinate it to imperial will. The rise of the silver economy during the late imperial era dealt a devastating blow to the state's sovereign authority over the livelihood of its subjects.*
>
> **Richard von Glahn (1996)**

Early Chinese empires had the problem of chronic shortage of currency. This is a problem China shared with late classical Europe, but one which (unlike the latter) it managed to largely solve in medieval times during the Song (960–1279) and Yuan (1271–1368) dynasties. The Song period, in particular, witnessed not just intensive growth and technical change (Jones 1988), but also a remarkable monetary development: the world's first issuing of paper money, which was inconvertible after 1160. Initially, public confidence was limited and the notes circulated at moderate to high levels of discount, but after an experiment in 1166–7 which suggested that the government was committed, they circulated until 1190 at close to face value (von Glahn 1996, pp. 49, 53, and 57).

Policy changed once the empire faced a serious threat of invasion. In such circumstances, the government financed deficits using printed fiat money—during the Song–Jin War of 1206–8 the previous ceiling of 20 million ***guan*** was in quick succession raised to 139 million, and by 1233 about 329 million were circulating. Despite attempts at fiscal prudence between 1240 and 1264, Mongol invasions then quickly led to massive emissions of paper money and inflation (von Glahn 1996, p. 53). Hence by the time the first Portuguese arrived by sea in the early 16th century, the fiat money which had so amazed Marco Polo was no longer circulating. Less than a century earlier, following a series of hyperinflation processes triggered by the government's failure to commit in monetary policy, fiat lost all credibility. Public confidence had been lost by 1425 and the state was unable to prevent the spontaneous and widespread use of silver as a store of value and means of exchange. By the mid-1430s the state had accepted the de facto usage of silver by the public and eventually itself adopted it as a means of labour-tax payments; a unified tax system known as Single Whip was established in the 1570s. It consolidated all labour taxes into one and specified that they were to be paid in silver (von Glahn 1996, p. 79; Atwell 1998, pp. 381–8). China would not use paper money again until well into the 19th century—and when it next did, it was, significantly, set up by the Hong Kong and Shanghai Banking Corporation and backed by foreign reserves.

Ming–Qing China was a remarkable example of the disastrous consequences of Buchanan's "starve the beast" principle if taken to the limit. During this period, as the population increased by a factor of at least three, taxation revenues actually declined (Table 1). The failure to adequately tax commerce and agriculture has been pointed out as a "permanent flaw" of early-modern and 19th-century China (Spence 2013, p. 5). What was causing this process of "inverse state formation" just as the opposite was happening in Europe? Ideological and institutional constraints surely contributed (Brandt et al. 2014). But I emphasise that the lack of monetisation also prevented appropriate levels of taxation of the economy, since it is much harder to tax a less monetised economy (Figure 1).[2]

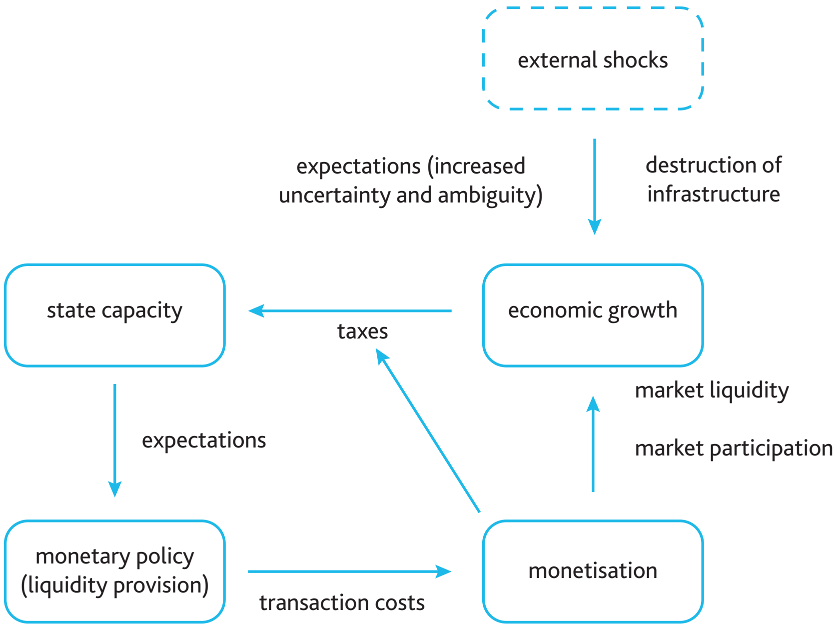
TABLE 1: SIZE OF LEVIATHAN: PER CAPITA GOVERNMENT REVENUE IN DAY'S WAGES FOR UNSKILLED WORKERS

	China	Ottoman empire	Russia	France	Spain	England	Dutch Republic
1650–99	-	1.7	-	8.0	7.7	4.2	13.6
1700–49	2.26	2.6	6.4	6.7	4.6	8.9	24.1
1750–99	1.32	2.0	8.3	11.4	10.0	12.6	22.8
1800–49	1.23	-	-	-	-	17.2	-
1850–99	1.99	-	-	-	-	19.4	-

Source: Brandt et al. (2014, p. 69)

FIGURE 1: CHANNELS OF CAUSALITY

This is a problem of multiple equilibria, with joint causality of state capacity, policy, monetisation, and economic growth. Ultimately, state capacity in China was not sufficiently robust to withstand external military pressure and hence avoid dynamically inconsistent monetary policies. China switched from the "good" to the "bad" equilibrium: insufficient monetisation and high transaction costs set in, and these caused reduced levels of both state formation and economic growth.



ENGLAND: DANGER TO THE OLD LADY OF THREADNEEDLE STREET?

> *The stability of the Bank of England is equal to that of the British government … It acts, not only as an ordinary bank, but as a great engine of state.*

Adam Smith (1776)

England was the underdog which discovered more gradually the route towards a stable monetary system (Sargent and Velde 2002, Neal 2000). More specifically, England's per capita money supply had already been steadily rising since at least the mid-17th century.[3] However, until the late 18th century most of this rise was due to increases in coin under a commodity money system, hence the supply was necessarily limited by access to precious metals.[4] I focus here on one episode at the end of the 18th century, when war with revolutionary and then Napoleonic France led to a massive expansion of fiat in an extraordinarily short amount of time.[5] This episode can be contrasted with the apparently similar measures of the Yuan and Ming, but nonetheless led to completely different results.

The response of the Bank of England during this period was massive, and in fact after 1797 convertibility was completely suspended—and would remain so until 1819–21—with the result that the notes became pure fiat (Figure 2). Yet, quite unlike the response of the Chinese public under apparently similar circumstances, the public accepted the notes, despite the whisperings of French-alarmists, who claimed that they would be worthless once the French landed (Figure 3).[6] This comparative experience suggests that the emergence of an efficient monetary system was conditional on agents' internalisation of the states' capacities and institutional background.[7]

FIGURE 2: ENGLISH PER CAPITA M0 AND M2 AT CONSTANT PRICES OF 1700

The lower line corresponds to England's currency supply; the upper line, M2, includes bills of exchange bank-notes, both of the Bank of England and of provincial banks. The difference corresponds to what we may call, as a first approximation, the "size of financial intermediation".

Source: O'Brien and Palma (2014); source for the underlying data: Palma (2015)

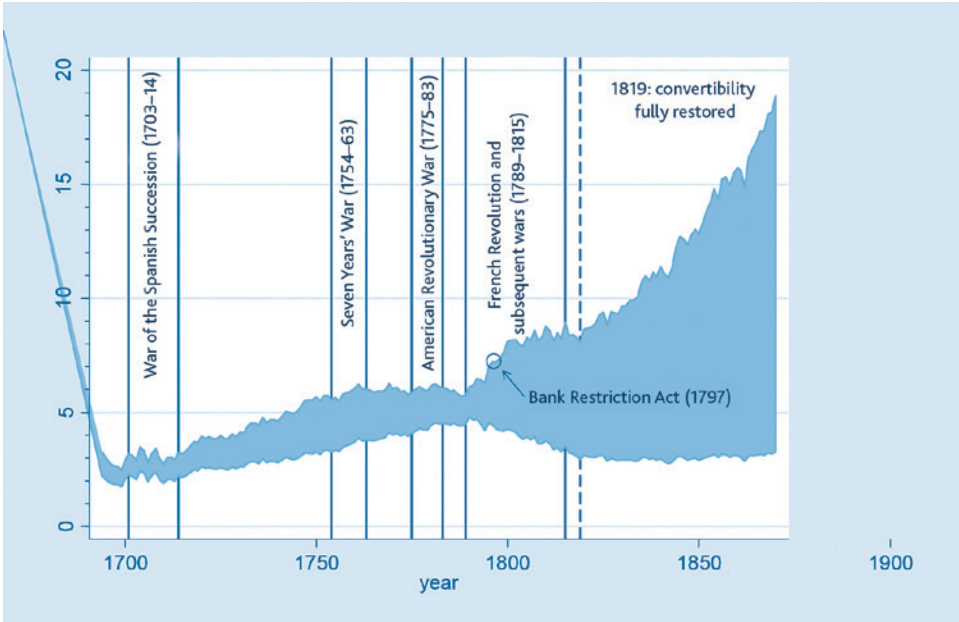


FIGURE 3: BANK-NOTES, PAPER MONEY, FRENCH-ALARMISTS, AND POOR JOHN BULL

Hand-coloured etching by James Gillray, originally published March 1, 1797.

The success of Britain's unorthodox monetary policy convinced the public that fiat was viable, and with the additional liquidity support growth continued (O'Brien and Palma 2015).[8] The lead in providing liquidity to the economy pursued by the Bank of England was widely considered an enviable success in policy circles and was eventually followed by the rest of Europe (Roberds and Velde 2014).

CONCLUSION

More advanced economies tend to have more advanced monetary and financial systems, though the direction of causality is a matter of debate (Levine 2005). In fact, per capita income in Song and Yuan China was much higher than in contemporaneous Europe (Broadberry et al. 2014), and China had fiat money—a remarkable innovation for its time, which should rank alongside other "great inventions" of China such as the printing press, paper-making, the compass, and gunpowder.

The advancement of Europe's economy during the early-modern period happened at a time when China was regressing to a basic uncoined, silver-based system; simultaneously, the Chinese government's share of the economy was steadily shrinking to a negligible size just as in Europe the opposite was taking place. I argue that a comparison of the respective historical experiences of Europe and China suggests that continued growth requires a mechanism capable of providing adequate amounts of liquidity while at the same time credibly committing not to over-expand in order to residually balance government deficits.

The Chinese Resurgence

Lessons on Economic Development and Institutional Change

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China's remarkable resurgence and swift economic transformation since the 1980s is one of the main success stories in modern economic growth. Nowadays, China plays a systemic role in the global arena as a "poor superpower". It is the second-largest economy in terms of GDP and its population amounts to nearly 20 percent of the world total. As the McKinsey Global Institute puts it, since the mid-1980s the world's centre of economic gravity has notably shifted from the United States and Europe towards Asia.[1] China's spectacular economic performance can be illustrated by the following data: its GDP as a share of global GDP has increased from about 2 percent in 1980 to about 15 percent today.[2]

China's rise has had tremendous practical implications not only for the Chinese people, but also for the world as a whole. It has had a dramatic impact on a wide array of different global markets, including commodities, products, and labour, and has also changed the geopolitical landscape, in ways that seem uncertain to us by now.

Thus, understanding the fundamental reasons underlying China's outstanding economic performance is extremely important in order that we gain a better grasp of the current world. Furthermore, such understanding can also benefit other countries that need to initiate a process of structural and institutional change on the path to economic development.

For some economists, the main lesson to be learned from China's experience is that state-led capitalism can work fine and even outperform free-market capitalism—if, that is, it is applied carefully, as Chinese policy-makers allegedly have. The implications of this idea are important for other transitioning and emerging economies, which may take China as a model.

However, we believe this is the wrong conclusion to draw. The Chinese economic success cannot be attributed to the strong role played by the government. On the contrary, if we look back at recent history, the remarkable growth of the past decades has been associated with a gradual but continuous process of pro-market reforms, progressively liberalising and opening up the economy to the rest of the world. This change is of historic proportions, given that throughout its history China had deliberately chosen to turn its back on the world.

After the utter failure of the central-planning experiment under Mao Zedong, who led China from 1949 until his death in 1976, in 1978 Deng Xiaoping ushered in an era of reforms that marked a turning point in Chinese history. Deng's pragmatism led him to follow a path opposed to that of his predecessor, and in essence it is that path to which today's Chinese leaders still adhere.

Nonetheless, it would be incorrect to assert that the transition process was the result of the precise and deliberate planning of Deng and the policy-makers. Rather, it was the result of interactions among Chinese economic and political actors who were operating in a much freer and more competitive environment than existed under Mao.

The best illustration of this idea is the story of how the reform started within the agricultural sector. It was not a top-down initiative by the new leadership, but a bottom-up revolution led by a group of desperate farmers who were suffering the consequences of the infamous communal system imposed by Mao. These farmers and their families agreed secretly—as it was a violation of the law—to divide their farmland into plots assigned to each family individually. Once the corresponding share of the quota was covered, the surplus would go to each of these families, who could thereby benefit from the fruits of their own efforts. This kind of agreement spread all over the rural population and finally brought an end to the previous anti-economic system. Unsurprisingly, as these bottom-up institutional innovations improved the system of incentives and the flow of information, agricultural production increased massively, which generated a surplus that then could be used to industrialise the country. All Deng had to do to make a genuine Great Leap Forward towards prosperity, in a process of decollectivising the land and reintroducing private property de facto in rural China, was basically laissez-faire, allowing these spontaneous and home-grown developments — which Mao would have strongly repressed—to succeed.

Another key feature of the new Chinese leadership was the decentralisation push, which gave greater administrative and fiscal autonomy to local governments. Given the huge size of China and the corresponding regional heterogeneity, a decentralised government structure was essential for different regions to exploit their particular competitive advantages in a context of increasing global integration.

Furthermore, Chinese scholars Li, Li, and Zhang claim that decentralization fostered cross-regional competition, which eventually—as an unintended consequence—triggered privatisation and the establishment of new private firms. They conclude that the Chinese experience "demonstrates that the invisible hand is not only powerful in allocating resources; it is also powerful in creating institutions".[3]

By introducing market dynamics through increased competition and global integration, Chinese economic agents could acquire new knowledge by interacting with foreign firms, which helped them adopt better skills, technologies, and organisational forms. Thus, a swift process of structural change was initiated.[4]

This approach to policy reform echoes the ideas of economist F. A. Hayek. One of the main areas of interest in his work is the important role social institutions play in determining economic outcomes, as well as institutional evolution. On the latter, Hayek's thesis is that it is not deliberate top-down institutional design, but the bottom-up interaction of economic agents within a framework of general and abstract rules, that tends to generate better results in co-ordinating our economic plans in a complex social order. This message is a warning against claims to knowledge in institutional reform, as central planners cannot fully grasp or create the knowledge necessary to successfully co-ordinate a process of comprehensive institutional change.[5]

What has been said above does not mean that China is a free economy. Rather, it can be considered a dual economy with two different regimes co-existing and co-evolving: a very dynamic and competitive market-based sector on the one hand, and a tightly state-controlled sector on the other. The crucial point is that the former has greatly increased in the past few decades, while the latter has declined.[6]

However, in this generally positive long-term reform process there have been serious policy mistakes that have caused problems. One example is the one-child policy introduced in 1979, which, besides having negative social consequences, has restricted population growth and contributed to the present demographic problem.[7]

Furthermore, the current economic conditions are quite challenging in the short term as a consequence of misguided policies. The Austrian business cycle theory can explain the situation, at least partly: a credit expansion over the previous decade that was both too rapid and too large—and was exacerbated after the 2008 crisis by a massive stimulus package—led to an unsustainable boom characterised by widespread fixed-capital malinvestments. The Chinese economy should go through a restructuring and deleveraging process whereby bad investments are liquidated. At the same time, a structural shift from currently excessive investment to domestic consumption is needed.

For this transition to succeed and in order that China may become a more mature and efficient economy, it needs to accelerate the pace of structural reforms, targeting (among other areas) the financial sector and state-owned enterprises (SOEs), as well as governance issues. Chinese policy-makers have no better experience of institutional change to look at than their own: a gradualist, decentralised, bottom-up reform aimed at making market processes the predominant form of economic organisation, consistent with local cultural and political constraints.

This is a very important lesson not only for the Chinese but also for other developing countries, which are now coping with the challenge of further institutional change in order to foster and/or sustain economic growth.

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4 OBSTACLES TO PROSPERITY

Greed Works

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Social Norms, Illegitimacy, and Liberty

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Individual Fear and Collective Prosperity in Democracies

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LEGATUM INSTITUTE

Greed Works

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In the classic 1987 movie *Wall Street*, there is a memorable scene in which Gordon Gekko, the film's charismatic villain, addresses the other stockholders of a large corporation that he controls. With straw-coloured hair slicked back from his forehead and a conspicuously expensive suit, he stalks through the crowd like a roaring preacher at a revival. His parables are of corporate morality and of how selfishness has left the domain of vice and entered that of virtue.

"Greed, in all of its forms—greed for life, for money, for love, knowledge—has marked the upward surge of mankind," he growls. "Greed is right. Greed works." The grey-haired and suited members of his audience listen raptly as Gekko self-justifies. "Greed," he declares with a sweeping gesture, "for lack of a better word, is good."

In the late 1980s the case for "greed is good" was a plausible one. In 1987 the United States was already four years into the greatest economic expansion that country had ever seen. Unemployment had decreased by one-third, to just over 6 percent, in five years. This market surge occurred contemporaneously with deregulation under President Ronald Reagan, a process that unleashed self-interested actors upon the market and saw an enormous boom in the services and financial sectors.

Greed incentivised people and, so incentivised, they expanded businesses and created jobs. However uncomfortable some may have been with the excesses of the financial markets—and *Wall Street* was implicitly critical of the ruthlessness and materialism of many participants—greed was embraced as a mechanism by most people because economic growth was so much needed after the stagflation of the 1970s. Twenty-five years later, greed has fallen under a cloud in the wake of scandals and more recent economic troubles. Greed is blamed for inequality, risky financial practices, and austerity. The effects of this change in the morality of greed should concern anyone interested in the causes of prosperity.

In the 1980s greed was good because it brought results. Crucially, however, greed brought results to more than just the greedy. When we say that "greed is good", we do not just mean that "being greedy will make you money"—a statement that borders on the self-evident. What we mean is that individual greed is collectively beneficial—that a society will prosper when its individual members work in a self-interested manner. There is therefore an essential additional element to "greed is good". If greed is good, it is because it (i) incentivises people (ii) to create economic value (iii) in a way that promotes general prosperity in society. Self-interested economic actions that generate financial returns are not inherently good, but they become good when they take place within a system that allocates these returns in a way that society deems equitable.

The third part of this test is the most difficult to satisfy. It is a truism in economics that people are self-interested and that left unobstructed they will pursue their self-interest in ways that are economically worthwhile. Greedy investors create jobs, generate returns, and promote innovation. This eliminates the need to worry about (i) and (ii) above. The question of whether the economic benefits of greed accrue to society as a whole is more difficult. Wealth creation is disruptive—not only are there winners and losers, there are wide gulfs between the takings of different winners. How these takings are shared determines the net social impact of greed.

The social impact of greed is important because societies prosper when they align individual incentives with collective wellbeing—when they make greed good.

The 1980s was a long economic experiment in which greed was repositioned from enemy to agent of government policy. The effects were staggering, even by the standards of deregulation's proponents. The loosening of regulations meant that vast sums of money stood to be made in newly opened markets, and these financial incentives brought years of sustained growth. In the climate of that economic recovery, the prevailing notion of the public good encompassed any actions that helped the economy to grow; nearly any practice was acceptable so long as it grew the pie.

This narrative continued, largely unaltered, until 2008. As selfish individuals pursued their own ends, businesses and markets were created and taxes were paid. Investors and ordinary workers saw tangible benefits. Indeed, even at the lowest points of the subsequent economic crash, this mentality persisted in the hope shared by many that we might be able to return to the way things were, and that ordinary people might eventually benefit if government could simply refrain from disrupting market forces.

The demise of this laissez-faire mentality should, if anything, be traced to September 17, 2011. On this date a collection of different anti-poverty, anti-austerity, and related groups converged on New York's financial district, responding to calls for a mass protest from a Canadian anti-consumerist publication. Barricaded out of several more attractive positions, the protesters settled on Zuccotti Park. A video from the first day shows smiling protesters milling about and chanting slogans, carrying placards proclaiming "People Before Profits" and "Bailouts = No Bonuses" while onlookers laugh and cheer. This joyous mood would harden into an ardent determination to have their demands met as the Occupy Wall Street movement became a popular American flashpoint in the new focus on inequality.

The immorality of what they called "corporate greed" was a fixture of the Occupy movement, and the demonstrators chose Wall Street as the target of their passions and what they saw as the nucleus of this greed. They voiced their opinion that greed is not good in a system that is unequal, riddled with systemic risk, and not believed to be delivering returns for ordinary people. They wished to handicap greedy individuals and, whether they admitted it or not, to opt for a lower level of overall prosperity so long as it was more evenly shared. For the demonstrators of the Occupy movement, their supporters and sympathisers, the social impact of greed had become decidedly negative.

The comedic writer Daniel Handler (pen name Lemony Snicket), on observing the Occupy Wall Street protest, noted that "historically, a story about people inside impressive buildings ignoring or even taunting people standing outside shouting at them turns out to be a story with an unhappy ending". Since he wrote these lines, many of the concerns voiced on (or, more accurately, near) Wall Street have migrated inside those impressive buildings, into the halls of government and academia. The causes of inequality are the subject of impassioned public debate, and the world has been captivated by the tale of unavoidable inequality that is Thomas Piketty's *Capital in the Twenty-First Century*.

The thesis of Piketty's book can be taken as his conclusion on the moral status of greed today. Where the rate of return on capital exceeds the rate of economic growth, as Piketty believes to be the case today, the author predicts that wealth will become concentrated in ever fewer hands. Instead of the actions of a greedy individual radiating outwards in their financial effect, they compound disproportionately for that individual. Piketty's timing was perfect, transforming the man into a sensation and his ideas into conversation around even those dinner tables that once snickered at the earnest protesters of "#occupy". The public mood has shifted. Where once people were concerned only about growing the pie, they are now increasingly concerned about how that pie gets sliced up, and there is a feeling that greed has not delivered.

The implications for greed's place in our society will depend on how we respond to this change in the balance of priorities. If an increase in GDP is no longer *prima facie* desirable, absent considerations of its distribution, we risk Handler's "unhappy ending" by continuing to behave as though it is. The increased concern about inequality has brought forth a variety of proposed solutions. While neither wealth and financial transaction taxes, increased public spending, or other forms of redistribution will completely resolve the problem, inequality must be addressed if people are to continue to accept the disruptions of economic growth. In a society where greed is not good, or where inequality is so exaggerated that public perception turns against greed, we risk destroying prosperity simply because it cannot be satisfactorily shared.

In the six years since the 2008 crash, Western society has quietly and collectively redefined prosperity. Greed is still there, and its effects haven't changed. It will always be a motivator and a source of economic growth, as surely as young men and women will always be drawn to the wages exchanged for long hours on Wall Street. But how we measure prosperity has come to depend more on who shares its benefits.

As Gordon Gekko says, "Greed works." It should work for all of us.

Social Norms, Illegitimacy, and Liberty

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Robust social norms help foster individual liberty because there is often societal chaos when such norms are absent. The government then steps in to fill the void. Rather than tackling this issue in the abstract, this essay will address a particular example: illegitimacy among the American lower class. In the absence of strong families, the government intervenes with welfare payments, child welfare services, and the justice system. Individuals, families, and entire communities become more dependent on government and are subject to more government oversight than they otherwise would be.

THE ILLEGITIMACY CRISIS

America is suffering from an illegitimacy crisis. In 2013 the American illegitimacy rate was 40.6 percent.[1] Children born out of wedlock are far more likely to experience a host of social ills than are children from intact families.[2]

Upper-middle-class professionals are still very likely to marry before having children,[3] to be employed,[4] and to attend religious services regularly.[5] They belong to a thick web of social institutions that come with a set of social expectations, including marriage before children. People being what they are, they want to live up to those expectations, and being involved in those institutions provides them with support to do so. The institutions and the expectations are mutually reinforcing.

At the bottom of the socioeconomic scale, it is a very different story. In the lower class, happy marriages are rare,[6] illegitimacy is the norm,[7] and work is often sporadic.[8] Not only are these people disengaged from civil society, they are often disengaged from normal human relationships.[9] There are few positive social norms in these communities.[10]

REVIVING THE NORM OF MARRIAGE FOR THE SAKE OF CHILDREN

Protecting individual liberty does not mean that people are protected from social coercion. Social norms can only exist if there are consequences for violating them. A society with strong social norms will hopefully have less government regulation, but it will not be a society where anything goes. There will be some people who feel stifled and some who experience the community's censure. But this is preferable to incurring governmental censure or meddling in your life. The people in your community can shun you, but they cannot put you in jail or put your children in foster care. The benefits both individuals and society receive as a result of strong social norms outweigh the costs incurred by some members of the community.

How can we encourage the development of positive social norms? Social norms are established when society offers a vision of the good life and encourages certain behaviours that are conducive to living that life. Conforming to these behaviours results in societal approval. On the other hand, people must experience negative consequences for violating these norms if they are to be effective. For example, in the United States the First Amendment protects racist speech. Yet the social consequences of making racist remarks are so severe that people go to great lengths to avoid saying anything that could possibly be construed as racist. Racist speech was common in the United States 50 years ago, so this is a relatively rapid change in social norms.

Richard Reeves has suggested that one way to save marriage among the poor and lower-middle class is to urge a transition to the child-centred marriage model prevalent among societal elites.[11] The advantage of urging the poorer members of society to adopt this model is that it is congruent with some attitudes that already exist among them. In an extensive study of single mothers, the women repeatedly stressed the paramount importance of being considered a "good mother".[12] Providing for a child's material needs and keeping him or her off the street were primary signs of good mothering. The sad irony is that by choosing to have children out of wedlock—and the vast majority of these births were not planned and yet were not unwanted; rather, they were the eventually expected outcome of unprotected sexual activity[13]—these women have put their children at a disadvantage from the moment of their birth.

Elites should preach what they practise:[14] present the picture of a married couple raising their biological children as the paradigmatic example of the good life; be explicit about why fathers are important; emphasise the benefits to children in terms of staying in school, avoiding abuse, avoiding drugs, and avoiding involvement with the justice system. People who are married and those delaying childbearing until marriage should be frank about why they are doing so. This should be done in a sensitive manner. But sheepishly muttering the truth, rather than explaining it in a straightforward manner, doesn't make it any less true. It just means that those who most need a clear plan of life to follow will not understand it.

Out-of-wedlock childbearing among societal elites is frowned upon not necessarily because it is considered immoral, but because it is considered irresponsible. This norm of responsibility needs to be adopted by poorer women. It may be that the only way to transmit this norm is through schools, after-school programmes, and public service announcements, especially given the women's social alienation. Such a campaign should present women with facts regarding the poor life outcomes of illegitimate children in order to try to counteract the all-too-human belief that they can beat the odds. A controversial example of this sort of marketing occurred in New York City, where public service announcements included statistics about the poor outcomes of children born to teenage mothers, along with a healthy dose of reality regarding the likelihood that the parents' relationship would endure.[15] Women who fall pregnant should be supported by their communities and encouraged to bring their children to term, but it would be beneficial to encourage women to avoid premarital pregnancy and to choose their sexual partners more carefully.[16]

Promoting government messaging may seem counterintuitive. Don't we want to foster strong social norms in order to enhance individual liberty? Unfortunately, many people simply do not have robust social networks. Many of their cues about the right way to live come from the government. The success of the government's decades-long anti-tobacco campaign is a prime example. Tobacco products are legal and will remain so, but tobacco use has fallen dramatically.[17] In the absence of effective alternatives, government exhortations to engage in behaviours that reduce the likelihood of government intervention promote individual liberty.

The mothers in the earlier-mentioned study eventually realised that their children were unlikely to beat the odds, just as they themselves had failed. The goal is to persuade women that their children will not beat the odds ***before*** they become pregnant. Being a "good mother" means waiting until after marriage to have children, and self-sacrifice means delaying childbearing even if that means the desired children never come. This is of course a demanding standard, but it is one that many American women manage to meet.

OBSTACLES TO ESTABLISHING POSITIVE SOCIAL NORMS

We encounter several difficulties in establishing positive social norms. First, positive social norms often require the exercise of virtue—work, continence, delayed gratification. Virtue does not come easily to most of us. Developing virtue requires sustained effort and self-denial. For this reason, it is much easier for negative social norms to develop than to establish positive social norms. So the first difficulty in establishing positive social norms lies in the difficulty of conquering ourselves. And this difficulty is inherent to the human condition in all times and cultures.

The second difficulty in establishing positive social norms is perhaps peculiar to our own time. This is the social norm against judging someone else's behaviour, particularly when it coincides with traditional standards of morality regarding sexual behaviour. So it is perfectly all right, indeed expected, to judge someone for racist speech. Criticising someone for smoking cigarettes is socially acceptable. But criticising people for having children out of wedlock is not.

Third, our culture often sides with the individual who is either unjustly harmed by social pressures or struggling to free himself from societal expectations. Hester Prynne, the protagonist of Hawthorne's *The Scarlet Letter*, is unjustly punished by society and proves nobler than her persecutors. The young person struggling to break free from stifling social conformity is the subject of a thousand songs and stories. It is romantic to be on the side of the heroic individual struggling against unfashionable society. It is boring to be on the side of society.

These stories capture something important. They remind us that social norms can stifle, and people can be cruel. Yet in contemporary American society, we have swung too far away from the enforcement of social norms. We must find a balance between anarchic individualism and stifling conformity.

It would benefit children, society, and liberty to revive the social norm against illegitimacy. But we should realise that when we ask people to delay childbearing until marriage, we are asking them to exercise virtue. We are not asking them to delay childbearing out of sheer pragmatism. We are offering them a positive vision of the good life that they can achieve through virtue.

Individual Fear and Collective Prosperity in Democracies

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The question the symposium has chosen this year, "Why do societies prosper?", is misleading in its simplicity, for within that question lies the darker fact that not all societies prosper, and those that do prosper do not prosper equally. The question to be addressed is then less a question of how any arbitrary society prospers, and more a question of why only certain societies prosper. This may seem to be a point both elementary and unnecessarily nitpicking, but by following it I believe that the original question can be answered.

I call this inequality of societies a dark fact because of what it implies. Without quibbling over exactly what is meant by society, it will suffice to point out that of any possible definition, one thing must be true. Societies are composed of individuals. Therefore, if, as stated, the question can be rephrased as "Why do some societies prosper when others do not, and why do those that prosper do so unequally?", then the question that must first be answered is why do some individuals prosper where others fail? For if the individuals in a society fail to prosper, then the society itself also fails, and vice versa.[1]

Seen through a more classical lens, a society is just a macro-reflection of the individual, an example of the human soul writ large and laid bare. To understand a society's prosperity, it is the nature of individual success that must be further investigated.

Since societies are composed of individuals, one method of looking for an answer to the question of prosperity would be to examine how those individuals interact with each other to form a society. This requires looking at the structural constraints of a social system. Whether full credence is given to the Hobbesian theory of a social contract or not, clearly the answer, like the question, is intrinsically political. Indeed, the prevailing research focuses on the clear relationship between a liberal, democratic regime and the prosperity of the regime's citizens.[2] To summarize, this research appears to take two general forms.

The first focuses on economic data demonstrating the symbiotic relationship between industrialisation and democracy in creating a prosperous state, with the examples of former Soviet bloc countries creating a highly focused subgenre. This aligns with the historical generalisation that democratic countries with free-market economies are more successful than other types of regime, and is in accordance with Adam Smith's prescription for prosperity, that "Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice: all the rest being brought about by the natural course of things."[3]

There are, of course, exceptions to that generalization, and this is the focus of the other general form of research into the question of prosperity. Some exceptions, such as oil-rich autocracies, are easier to explain. Other exceptions, most notably China after economic reform (*gaige kaifang*), are more impenetrable.[4]

Although this type of analysis is instructive, ultimately its reliance on economic data ignores the more fundamental question of the individual. There clearly exists a high coefficient of correlation between democratic regimes and prosperity, but democracy is not a guarantee of prosperity, nor is prosperity dependent on democracy.[5] Although prosperity is ultimately measured in economic terms, economics alone cannot satisfactorily explain the reasons for success in so many divergent democratic societies across space and time. This holds true at the individual level. Most people are born into circumstances that heavily weight the odds of achieving future success, but the many examples of people rising or falling in class prove that the lottery of birth is not the answer.

So what is it, if not birth or economic freedom, that causes some individuals to prosper when others do not, and how is this linked to democracy? In a word, the answer is fear; in a phrase, that democracy, through fear, best spurs a society to prosper.

How does this happen? Here, Tocqueville's *Democracy in America* provides an answer that is as intuitive to the classical mindset as it is anathema to the modern one.

In a chapter entitled "Why the Americans are so Restless in the Midst of their Prosperity", Tocqueville describes how democracy's equalizing nature causes such frenzied anxiety and work ethic in Americans. To summarise his argument, when the vast majority of citizens are guaranteed no measure of fortune or advantage from their birth, it is vital that they secure a prosperous life through hard work.[6] Individual merit becomes the only means of rising to the top, even with a generous head start based on fortuitous circumstance.[7]

This is especially true in modern democracies. With the increasing atomisation of society—an effect compounded by technology's curtailment of traditional human interaction—feelings of insecurity are the status quo, even for the wealthiest. Thus life devolves into a rat race of trying to outwork everyone else, with no guarantee that present success will lead to future prosperity. Combined with the inevitable atrophy of shared morality that comes with any liberal, democratic society, individuals are encouraged to take advantage of one another economically whenever the risk–reward ratio is favourable for both the individual and the society. To quote Morgenthau, "What the individual is not allowed to want for himself, he is encouraged to seek for ... the state."[8]

This is "Statecraft as Soul-craft"[9] and is the dark side of egalitarian meritocracy. Through the noble goal of equality, people are inspired to seek supremacy over others as a conscious goal. Apart from eroding civic virtue, the ultimate effect of this democratic ethos is to deny the individual a lasting sense of satisfaction. Rather than encouraging a feeling of greater security, success now engenders fear of complacency and falling behind. The girl who bested thousands for a scholarship to Oxford cannot celebrate, for despite her advantage over the thousands, she has no relative advantage over her classmates; as a woman, perhaps she is even disadvantaged, and she has no choice but to work even harder for a top job, lest she be perceived a failure.[10]

Democracy does not allow time for resting on laurels. The prosperous individual must work ever harder simply to maintain what has been gained. It is not so much that democratic society allows for upward mobility, as it is the possibility of rapid descent that creates such desperate success. Between the globalised job market and economic turmoil, neither talent nor wealth offers a bulletproof security blanket. With prenups and progressive social mores, even the traditional security afforded by marriage no longer offers any firm warranty of prosperity. Consequently, a society's prosperity is decided by how effectively it utilises fear to motivate its populace to innovate and produce.

This also explains the criticisms of welfare programmes in traditionally less socialised democracies, such as the United States. Though often framed in more technical economic language, the argument that too comfortable a safety net discourages innovation and encourages long-term unemployment fits perfectly within this fear–prosperity paradigm.

Taken as a collective, the democratic society prospers, but it prospers from negative encouragement. By destroying the link between success and satisfaction, democracy channels today's prosperity into the pursuit of tomorrow's. This key element is absent from societal models where social position is more entrenched. Removed from the possibility of satisfaction without anxiety, democratic citizens are forced into a cyclic "keeping up with the Joneses" existence to demonstrate their self-worth, not least because perception is reality in the capitalist marketplace, where every aspect of the individual becomes part of a public curriculum vitae.

The downfall of religion due to democracy and modernity contributes to this cycle. Once all concerns and values of a society are worldly and the material replaces the spiritual, then the ephemeral has swallowed the eternal. This robs people of a needed psychological escape and abandons individuals to the anomic conditions of modernity. Faced with our own mortality and without religion's transcendental promise of life after death, an existential crisis arises that no amount of beach villas can fix. Yet at least in the pursuit of that next villa, the crisis can be ignored and temporarily placated. Prosperity becomes an antacid for a permanent heartburn. Success provides a temporary relief, then the pain returns and more success is required. Thus the cycle expands with each revolution, progressively enslaving more to an ultimately futile game, even as that game defines and promotes prosperity for the society.

Admittedly, this theory relies on a classical political philosophy argument that does not easily translate into a scientifically testable hypothesis, nor does it divide neatly into separate social science disciplines. However, I believe that only by examining the a priori nature of prosperity can a full understanding of why societies prosper be reached. That some might fear the answer should only motivate researchers to examine the question in greater depth.

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   No matter what the outcome being examined—the quality of the mother-infant relationship, externalizing behaviour in childhood (aggression, delinquency, and hyperactivity), delinquency in adolescence, criminality as adults, illness and injury in childhood, early mortality, sexual decision making in adolescence, school problems and dropping out, emotional health, or any other measure of how well or poorly children do in life—the family structure that produces the best average outcomes for children, on average, are two biological parents who remain married. Divorced parents produce the next-best outcomes. Whether the parents remarry or remain single while the children are growing up makes little difference. Never-married women produce the worst outcomes. All of these statements apply after controlling for the family's socioeconomic status.
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8. BLS, *Employment Status of the Civilian Population*. The September 2014 seasonally adjusted labour force participation rate among civilians aged 25 and up with less than a high-school degree was only 44.3 percent and the unemployment rate was 8.4 percent.
9. Kathryn Edin and Maria Kefalas, *Promises I Can Keep: Why Poor Women Put Motherhood Before Marriage* (Berkeley: University of California Press, 2005), p. 34. "Trust among residents of poor communities is astonishingly low—so low that most mothers we spoke with said they have no close friends, and many even distrust close kin."

   Many Americans believe that though the poor do not have much in the way of economic resources, they compensate by forming unusually rich social and emotional ties. But in the neighbourhoods we studied, nothing could have been further from the truth. Indeed, many mothers tell us they cannot name one person they would consider a friend, and the turmoil of adolescence often breeds a sense of alienation from family as well.

   See also Robert D. Putnam, *Bowling Alone: The Collapse and Revival of American Community* (New York: Simon and Schuster, 2000), p. 62.

   If we take into account the rapid growth in educational levels over this period, all these slumps in associational involvement (leadership involvement, meeting attendance, time spent, and so on) are even more dramatic. Among the burgeoning members of college graduates, the average number of club meetings per year fell by 55 percent (from thirteen meetings per year to six), while among high school graduates, the drop in annual meeting attendance was 60 percent (from ten meetings per year to four), and among the dwindling number of Americans who had not completed high school, the drop in annual meeting attendance was 73 percent (from nine meetings per year to two per year).
10. Edin and Kefalas, op. cit., pp. 149–61.
11. Richard V. Reeves, "How to Save Marriage in America", *The Atlantic*, February 13, 2014, accessed November 4, 2014, www.theatlantic.com/business/archive/2014/02/how-to-save-marriage-in-america/283732.
12. Edin and Kefalas, op. cit., pp. 138–67.
13. *Ibid*., pp. 37–42.
14. Murray, op. cit., p. 238.
15. Michelle Castillo, "New York City's new teen pregnancy PSAs use crying babies to send message", *CBS News*, March 14, 2013, accessed November 1, 2014, www.cbsnews.com/news/new-york-citys-new-teen-pregnancy-psas-use-crying-babies-to-send-message.
16. Tennessee Williams, *A Streetcar Named Desire* (New York: New Directions, 1980), p. 81. "A man like that is someone to go out with—once—twice—three times when the devil is in you. But live with? Have a child by?"
17. Centers for Disease Control (CDC), *Trends in Current Cigarette Smoking Among High School Students and Adults, United States, 1965–2011* (November 14, 2013), accessed November 1, 2014, www.cdc.gov/tobacco/data_statistics/tables/trends/cig_smoking/index.htm.

Individual Fear and Collective Prosperity in Democracies

1. I take it that individual prosperity is not a red line in someone's financial ledger, but rather a positive economic motion specific to the individual's situation and relative to their society's economic mean. If a person is raised as a millionaire and lives their entire life as such, but never contributes further, how can this be called prosperity? In contrast, the individual born to drug-addled parents who rises no farther than from poverty to the bottom rung of the middle class is far more prosperous than the listless trust-fund baby, for by rising against the odds such a person has truly prospered. Prosperity for a society is understood in the same fashion, as a type of motion.
2. Joel Kotkin, "Prosperity Index Shows That Democracy Still Works Best", Forbes, October 26, 2010, accessed October 5, 2014, www.forbes.com/sites/joelkotkin/2010/10/26/prosperity-index-shows-that-democracy-still-works-best.
3. Carl Gershman, "Democracy and Prosperity: An Inevitable Link?", National Endowment for Democracy, June 6, 2012, accessed October 5, 2014, www.ned.org/about/board/meet-our-president/archived-presentations-and-articles/democracy-and-prosperity-an-inevi.
4. China seems to offer a strong counterexample to the prevailing pro-democratic arguments. However, as China has only recently produced a strong, educated middle class and is in the midst of evolving its economic model, it remains to be seen if the Chinese Communist Party can continue with its social contract of prosperity for most over freedom for all, or if the ruling elite will ultimately become a victim of its own success.
5. An overlooked factor is the differences between liberal democracy and popular democracy.
6. Alexis de Tocqueville, *Democracy in America*, trans. Harvey C. Mansfield and Delba Winthrop (Chicago: University of Chicago Press, 2000), pp. 511–14 (vol. ii, sect. ii, ch. 13).
7. Here, "circumstance" should be read broadly to include sex, race, family, class, etc.
8. Hans J. Morgenthau, "The Evil of Politics and the Ethics of Evil", *Ethics*, vol. 56, no. 1 (October 1945), 15, accessed September 2014, www.jstor.org/stable/2988705.
9. "Statecraft as Soul-craft" refers to the classical understanding of the relationship between the nature of a regime and the nature of its citizens' souls. Here it could be called the "LCD [lowest common denominator] Affect" of egalitarianism. Instead of focusing the society's attention up at

greatness, egalitarianism points down; it places Cephalus in charge instead of Socrates. Consequently, standards are lowered in a democratic society. This is what the classical writers understood: that although democracy is more free, aristocracy is more virtuous. At the individual level, this leads to a focus on the LCD of the tripartite soul, the beastly and appetitive, which is where Fear resides. As the democratic society does not demand high standards of its citizens, neither does the individual demand it of him- or herself, leaving the thymos untamed by the logos and free to ally with the appetitive. One consequence of this is to create a permanent anxiety that under the right circumstances can result in positive economic action. A liberal, democratic regime is one such circumstance, for it focuses that psychological motion into economic motivation.

10. Patrick J. Deneen, "Democracy, Greed, and the Perils of Equality", The Imaginative Conservative, September 20, 2014, accessed September 21, 2014, www.theimaginativeconservative.org/2014/09/democracy-greed-perils-equality.html.

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At a time when free market capitalism is on trial, there is no better time to be debating the causes of prosperity. The contributions to this years Charles Street Symposium help not only to provide a whole series of possible answers to the question of what breeds economic success, but also help to identify the issues we still need to grapple with if we are to be in a sufficiently informed and enlightened position to forge a new path ahead for the global economy as it emerges from troubled times.

Victoria Bateman, Fellow and College Lecturer in Economics, University of Cambridge

This is an engaging and eclectic set of essays which respond to set theme in diverse ways.

Tim Besley, Professor of Economics and Political Science, London School of Economics

The essayists took a breathtaking variety of approaches to the subject and provided the judges with a difficult but fascinating task. This is the sort of brilliant initiative I have come to expect from Legatum.

Emma Duncan, Deputy Editor, *The Economist*

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