For five centuries, the West dominated Eastern economies. But, beginning with the fall of the Berlin Wall in 1989, the East has now caught up, according to Niall Ferguson. It did so by downloading six “killer apps” from the West.

Those killer apps are institutional ideas that the West cultivated and embraced to promote wealth, stability and innovation: political and economic competition, the scientific revolution, the rule of law, modern medicine, education and the work ethic.

But now those apps are no longer monopolized by the West, Ferguson said. That is why the average American is now only five-times richer than the average Chinese. (The gap was 23-times in 1979.) And it is why the IMF projects that China’s GDP will exceed that of the US sometime in the next four decades.

Ferguson welcomes the change. What worries him is that, while the East has been downloading those apps, the West has been deleting them, with a lack of leadership largely to blame.

Ferguson is a professor of history at Harvard and the author, most recently, of Civilization: The West and the Rest. He spoke on May 3 at the Strategic Investment Conference in San Diego, hosted by John Mauldin and Altegris Investments.

Six questions will determine the future balance of power between the West and the East, according to Ferguson. But before we get to those, let’s first see what evidence Ferguson marshaled to show that the “download” he talked about has already taken place.

The six killer apps

Evidence that the West’s edge in fostering political and economic competition (the first “app”) has eroded comes from surveys taken at the World Economic Forum, which is held in Davos, Switzerland each January. Those surveys produce a competitive index for each country, in what Ferguson called “a very sophisticated exercise.”

Since 2004, the US’s competitiveness score has declined 7%, while China’s has increased 14%.
The Scientific Revolution was a uniquely Western phenomenon, Ferguson claimed. Now, however, innovations that we think of as uniquely American actually owe much of their success to Asian economies. The iPhone, for example, was designed in California but assembled in China – and that will be the model for technology breakthroughs in the future, Ferguson said.

Moreover, Japan leads all countries in the number of patents issued, and Korea has overtaken Germany for second place. China is not far behind.

Presenting data from the World Economic Forum, Ferguson found that, across 15 different measures of the quality of the rule of law, the US was among the top 20 countries in only one category. On many measures, he said the US ranked “dismally low.” Those measures included things such as whether property rights are protected, whether corruption is under control, and if bribery is a problem.

Hong Kong beat the US in every measure. “This is a huge problem,” Ferguson said.

The US has lost its edge in the rule of law, Ferguson said, because it has succumbed to a “rule of lawyers.” One-third of the members of Congress are lawyers, he said, and “they enact legislation of unbelievable complexity,” such as the 2,000-page Dodd-Frank bill. It is “filled with ambiguity and complexity that only lawyers can interpret” and “is the biggest job-creation scheme for the legal profession in the history of mankind” he said.

As for medicine, Ferguson granted that since the middle of the 20th century, life expectancy in the West has doubled. But over the last 30 to 40 years, he said, some parts of the West have experienced a “massive deterioration” of healthcare. In his home town of Glasgow, Scotland, Ferguson said that life expectancy is now less than in Bangladesh, a statistic he attributed to alcohol use, smoking and poor diet.

Not only do the Japanese have higher life expectancy than Westerners, so do Hong Kong and some parts of China.

The West has lost its edge in education, according to Ferguson. He cited OECD data, based on standardized test results for students up to age 15. Shanghai now ranks number one in terms of math and science performance, he said. The gap between Shanghai and the US is the same as between the US and Albania.

“The US has a disadvantage, in that a substantial number of our potentially talented young people who had the misfortune to live in poor zip codes are not being educated to nearly a high enough standard in basic math and science,” he said. “I can't think of a single bigger thing for us to worry about than that.”

Vigorous work ethic used to be a Western phenomenon, he said. But now the average South Korean works about 1,000 hours more per year than the average German.
“Whichever of the killer apps you consider,” he said “it is striking how we no longer lead.”

Six questions investors must answer

Whether Asia catches up or the West the falls further behind depends on the answers to six questions, according to Ferguson.

His first was whether the rule of law will come to China. Property rights are very weak in China, he said. Developers and corrupt party officials can effectively steal one’s property. This is a bigger question, he said, than whether China has a real estate bubble.

Can India go from being a tortoise to a hare? Ferguson said that India has better institutions and a more evolved democracy than China, and his second question was whether India will develop the necessary infrastructure to make its economy attractive to investors.

Ferguson’s third question was whether the Arab world can have a reformation that will separate church and state, and take religion out of politics and economics. The vast majority of Libyans and Egyptians still believe that only Islamists can achieve power, he said.

Question number four was whether the US can solve its “clash of generations.” The pressing divide is not the 1% versus the 99%, he argued, but the baby boomers versus their children and grandchildren. Specifically, Ferguson said that the younger generation needs to be persuaded that the Tea Party and Paul Ryan are more aligned with their interests than the Occupy movement. “They should be radically and enthusiastically endorsing the Ryan plan to reform Medicare and Social Security before they end up having to pay for these programs,” he said.

His fifth question was whether Africa can overcome the population explosion it faces. Unless Africa can cope with this challenge, its population problem will “overwhelm all the opportunities that we see today,” he said.

Finally, Ferguson asked whether our resource “curse” can become a blessing. Some countries, including the US, he said, have been able to transform their natural resources into a blessing. But for others – particularly among emerging economies – it has become a curse, fostering totalitarian regimes in countries such as Venezuela.

The leadership gap

Ferguson did not offer answers to those questions, but the tone of his presentation had only hints of optimism for the US.
Not only is the West losing to the East, but he said we are in denial about it. We suffer from a “massive institutional deficiency” that has failed to recognize and confront the areas in which we are most seriously lagging behind.

The speed of the West’s demise is far greater than Westerners appreciate, he said. “After 500 years of Western predominance, it is over.”

Ferguson said he is more optimistic about the US than Europe, though, since it has the best track record for reinventing itself. Better leadership is necessary. He said that the US cannot afford “four more years of pretending to address its problems.”

“Leadership can deliver extraordinary change,” he said. “But that requires going against the polls and the trend of public opinion.”