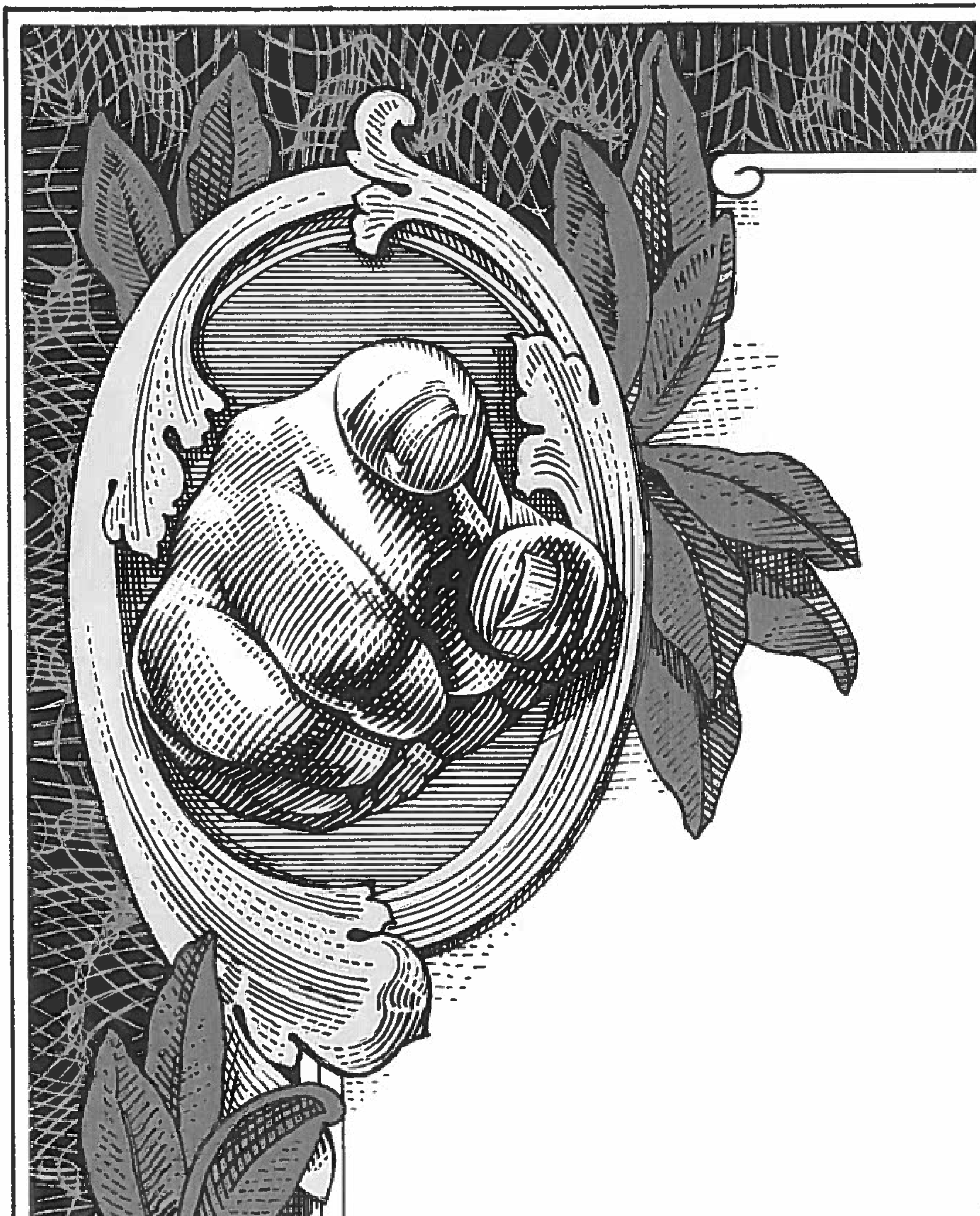

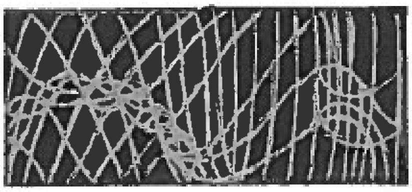

Global Capitalism at Risk

What Are You Doing About It?

Business must confront the new challenges to the free market.

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ILLUSTRATION: KENT BARTON

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MARKET CAPITALISM has proven to be a remarkable engine of wealth creation, but if it continues to function in the next 25 years as it has in the past 25, we are in for a violent ride or, worse, a serious breakdown in the system itself. That sounds dire, and it is. The threats to market capitalism are diverse. When the gap between the rich and the poor continues to widen, when millions of have-nots migrate from poor countries to rich ones and wealthy nations respond with increasingly strident protectionism, when global financial systems are fragile and less than transparent, and when society's traditional protectors—business, industry, government, and international institutions—are unable to address these and other first-order problems, we have a recipe for disaster. The failure of the financial market system in 2008 is an example of what can happen, as is the recession that ensued in the developed world.

Additionally, careful long-term projections indicate that climate change and increasing environmental degradation will have far-reaching political, social, and economic consequences.

As part of the preparation for Harvard Business School's 100th anniversary Global Business Summit, in 2008, which focused on the future of market capitalism, we asked small groups of business and government leaders around the world what issues should inform the school's agenda for the coming century. The long-term sustainability of global market capitalism was a primary concern for virtually all of them. But we heard surprising differences among them in how they thought they, as business leaders, should respond. Some said that changing their behavior would be unnecessary or even inappropriate. Others said changes were critical but were unsure how to respond to issues seldom thought to be the responsibility of individual firms.

Economic theory holds that in a market system characterized by perfect competition, the resulting pattern of output and consumption cannot be improved. The leaders we spoke with, however, did not believe that the markets in which they participated were perfect in any way. The financial markets, they said, were too volatile, free trade was undermined by industrial policies and state capitalism, and the benefits of the market were unevenly distributed. As they saw it, outcomes like these would threaten the system.

We contemplated what we were hearing from the perspective of our decades of experience as researchers, teachers, consultants, advisers, and company directors. And we concluded that, to preserve market capitalism as we know it, both companies and their leaders must change. Instead of seeing themselves as narrowly self-interested players in a system that is tended and overseen by others, business leaders must take a more active role in protecting and improving the system. Indeed, they need to spearhead entrepreneurial activity on a massive scale. They must help devise strategies that provide employment for the billions now outside the system, which, in turn, means changing how they think about the relationship between productivity and profit. They must invent business models that make better use of scarce resources and even take advantage of looming resource shortages. And they must create institutional arrangements for coordinating and governing neglected and dysfunctional aspects of market capitalism.

Some companies are already combining technology and good management to deal with the challenges. They have found ways to provide education and access to finance, jobs, goods, and services so that large numbers of people are brought into the market system. Other companies are pioneering the search for new sources of energy and more-efficient uses of critical resources. But there is a long way to go and many serious problems to address. We believe that if enough companies develop business strategies that help tackle these problems, the entire

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There is diff between what you want and what you need

Idea in Brief

The past 50 years have seen unprecedented economic growth, attributable largely to the spread of market capitalism across the globe. Business leaders asked to identify the issues of deepest concern to them pointed to forces that could disrupt the global market system in the coming decades: inequality in income within countries and across regions, migration, deterioration in the environment, a fragile financial system, and the inability of local, national, and international institutions to mitigate the problems.

For market capitalism to prosper, business must lead—as an *innovator*, developing strategies that turn systemic problems into opportunities for sustainable growth, and as an *activist*, mobilizing coalitions of companies and governments to develop institutions that can support and strengthen the system.

system can be strengthened, the forces of disruption mitigated, and market capitalism as a wealth-creating system for society preserved.

The Forces of Disruption

The leaders we talked to identified various forces that could severely disrupt the global market system in the decades ahead. Because market capitalism is part of a complex sociopolitical system, these forces arise from multiple sources. Some are fueled by negative consequences of the market system and feed back into it in disruptive ways. Others arise from sources external to the system. Still others relate to the conditions that must be in place for the market system to function effectively. Whatever their origins, the forces are interrelated and cannot be considered in isolation. (See the exhibit "The Ecosystem of Market Capitalism.")

The fragility of the financial system. Trillions of dollars move around the world daily, at high velocities. The financial crisis of 2008 showed that if these flows are unmanaged and unregulated, transparency can be reduced and risk compounded, with devastating consequences.

Breakdowns in global trade. The financial collapse of 2008 also demonstrated that trade can break down precipitously and with far-reaching effects. The freeze in trade finance and collapse in demand for goods was reflected in a 2.8% drop in global trade in 2009, the first decrease since World War II.

Inequality and populism. Within countries and across regions, income and wealth disparities are increasing—a trend that concerned the business leaders in our forums. The growing gap makes a mockery of the idea that economic growth benefits all. And the resulting populist politics could lead to harmful government interventions, such as overregulation of market transactions, confiscation of property, and other abrogations of property rights.

Migration. Massive migration, either domestically (from rural areas to cities) or across national boundaries, is often a consequence of inequality. Cross-border movements of people tend to trigger protectionism and anti-immigrant political reactions, which frustrate would-be immigrants, undermine potential solutions to labor needs in developed nations, and generate social conflict.

Environmental degradation. The evidence is more than circumstantial that industrial growth is associated with climate change, which affects the availability of water, the health of crops, air quality, and sea levels. The consequences could be seen in migration, the disruption of manufacturing and trade, and political instability.

Failure of the rule of law. The rise of corruption, extortion, thuggery, and expropriation in some parts of the world makes it difficult to operate a capitalist system that respects property and human rights and upholds contracts. When bribes rather than competition determine winners, investment in innovation ceases to be worthwhile.

The decline of public health and education. The size of the labor force depends in part on its health, and its productivity depends on its education as well as its health. In parts of the developed world, the quality of education is in decline, and health care costs have become unmanageable everywhere.

The rise of state capitalism. For centuries, developing nations have adopted variations of mercantilist policies to accelerate economic growth. But in the 21st century, some developing nations are giants. To the extent that Russia, China, and India play by their own rules, they have the potential to disrupt market capitalism as it is practiced in the developed world.

Radical movements, terrorism, and war. The increasing challenge of maintaining sufficient peace and security for capitalism to prosper threatens the