

REIMAGINING CAPITALISM IN A WORLD ON FIRE

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moved their entire economy more than a thousand miles to the east—in less than a year. A hundred years ago, the idea that women or people with black or brown skin were just as valuable as white men would have seemed absurd. We're still fighting that battle, but you can see that we're going to win.

Last, I am convinced that we have a secret weapon. I spent twenty years of my life working with firms that were trying to transform themselves. I learned that having the right strategy was important, and that redesigning the organization was also critical. But mostly I learned that these were necessary but not sufficient conditions. The firms that mastered change were those that had a reason to do so: the ones that had a purpose greater than simply maximizing profits. People who believe that their work has a meaning beyond themselves can accomplish amazing things, and we have the opportunity to mobilize shared purpose at a global scale.

This is not easy work. It sometimes feels exactly like climbing down a metal ladder into a hole cut through foot-thick ice. But here's the thing: while taking the plunge is hard, it is also exhilarating. Doing something different makes you feel alive. Being surrounded by friends and allies, fighting to protect the things you love, makes life feel rich and often hopeful. It is worth braving the cold.

Join me. We have a world to save.

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“WHEN THE FACTS CHANGE,
I CHANGE MY MIND.
WHAT DO YOU DO, SIR?”

Shareholder Value as Yesterday's Idea

The real problem of humanity is the following:
we have Paleolithic emotions; medieval
institutions; and god-like technology.

—E. O. WILSON

What is capitalism?

One of humanity's greatest inventions, and the greatest source of prosperity the world has ever seen?

A menace on the verge of destroying the planet and destabilizing society?

Or some combination that needs to be reimagined?

We need a systemic way to think through these questions. The best place to start is with the three great problems of our

time—problems that grow more important by the day: massive environmental degradation, economic inequality, and institutional collapse.

The world is on fire. The burning of fossil fuels—the driving force of modern industrialization—is killing hundreds of thousands of people, while simultaneously destabilizing the earth's climate, acidifying the oceans, and raising sea levels.¹ Much of the world's topsoil is degraded, and demand for fresh water is outstripping supply.² Left unchecked, climate change will substantially reduce GDP, flood the great coastal cities, and force millions of people to migrate in search of food.³ Insect populations are crashing and no one knows why—or what the consequences will be.⁴ We are running the risk of destroying the viability of the natural systems on which we all depend.⁵

Wealth is rushing to the top. The fifty richest people among them own more than the poorer half of humanity, while more than six billion live on less than \$16 a day.⁶ Billions of people lack access to adequate education, health care, and the chance for a decent job, while advances in robotics and artificial intelligence (AI) threaten to throw millions out of work.⁷

The institutions that have historically held the market in balance—families, local communities, the great faith traditions, government, and even our shared sense of ourselves as a human community—are crumbling or even vilified. In many countries the increasing belief that there is no guarantee that one's children will be better off than oneself has helped to fuel violent waves of anti-minority and anti-immigrant sentiment that threaten to destabilize governments across the world. Institutions everywhere are under pressure. A new generation of authoritarian populists is taking advantage of a toxic mix of rage and alienation to consolidate power.⁸

You may wonder what these problems have to do with capitalism. After all, hasn't the world's GDP quintupled in the last fifty years, even as population has doubled? Isn't average GDP per

capita now over \$10,000—enough to provide every person on the planet with food, shelter, electricity, and education?⁹ And, even if you think business should play an active role in attempting to solve these problems, doesn't it seem, at first glance, an unlikely idea? In the majority of our boardrooms and our MBA classrooms, the first mission of the firm is to maximize profits. This is regarded as self-evidently true. Many managers are persuaded that to claim any other goal is to risk not only betraying their fiduciary duty but also losing their job. They view issues such as climate change, inequality, and institutional collapse as "externalities," best left to governments and civil society. As a result, we have created a system in which many of the world's companies believe that it is their moral duty to do nothing for the public good.

But this mind-set is changing, and changing very fast. Partly this is because millennials are insisting that the firms they work for embrace sustainability and inclusion. When I first launched the MBA course that became "Reimagining Capitalism," there were twenty-eight students in the room. Now there are nearly three hundred, a little less than a third of the Harvard Business School class. Thousands of firms have committed themselves to a purpose larger than profitability, and nearly a third of the world's financial assets are managed with some kind of sustainability criterion. Even those at the very top of the heap are beginning to insist that things have to change. In January 2018, for example, Larry Fink, the CEO of BlackRock, the world's largest financial asset manager, sent a letter to the CEOs of all the firms in his portfolio that said the following: "Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."¹⁰

BlackRock has just under \$7 trillion in assets under management, making it among the largest shareholders in every major publicly traded firm on the planet. It owns 4.6 percent of Exxon, 4.3 percent of Apple, and close to 7.0 percent of the shares of JPMorgan Chase, the world's second-largest bank.¹¹ For Fink to suggest that “companies must serve a social purpose” is the rough equivalent of Martin Luther nailing his ninety-five theses to Wittenberg Castle's church door.¹² The week after his letter came out, a CEO friend reached out to me to confirm that surely he didn't—really—mean it? My friend was in a state of shock. He had based a long and successful career on putting his head down and maximizing shareholder value, and to him Fink's suggestion seemed ludicrous. He couldn't imagine taking his eye off the profit ball in today's ruthlessly competitive world.

In August 2019 the Business Roundtable—an organization composed of the CEOs of many of the largest and most powerful American corporations—released a statement redefining the purpose of the corporation: “To promote an economy that serves all Americans.” One hundred and eighty-one CEOs committed to lead their companies for “the benefit of all stakeholders: customers, employees, suppliers, communities, and shareholders.”¹³ The Council of Institutional Investors (CII)—a membership organization of asset owners or issuers that includes more than 135 public pension and other funds with more than \$4 trillion in combined assets under management—was not amused, responding with a statement that said, in part:

CII believes boards and managers need to sustain a focus on long-term shareholder value. To achieve long-term shareholder value, it is critical to respect stakeholders, but also to have clear accountability to company owners. Accountability to everyone means accountability to no one. BRT has articulated its new commitment to stakeholder governance . . . while (1) working to diminish

shareholder rights; and (2) proposing no new mechanisms to create board and management accountability to any other stakeholder group.¹⁴

One of the world's largest financial managers insists that “the world needs your leadership,” and some of the world's most powerful CEOs publicly commit to “stakeholder management,” while many businesspeople—like my (hugely successful) CEO friend and many large investors—think they are asking for the impossible. Which of them is right? Can business really—and I mean really—rescue a world on fire?

I've spent the last fifteen years of my life working with firms that are trying to solve our environmental and social problems at scale—largely as a means of ensuring their own survival—and I've come to believe that business has not only the power and the duty to play a huge role in transforming the world but also strong economic incentives to do so. The world is changing. The firms that change with it will reap rich returns—and if we don't reimagine capitalism, we will all be significantly poorer.

I started this journey with an appropriately British degree of skepticism; but I am now surprisingly optimistic—in the “if we work really hard, we might just succeed” sense of optimistic. We have the technology and the resources to build a just and sustainable world, and doing so is squarely in the private sector's interest. It is going to be hard to make money if the major coastal cities are underwater, half the population is underemployed or working at jobs that pay less than a living wage, and democratic government has been replaced by populist oligarchs who run the world for their own benefit. Moreover, embracing a pro-social purpose beyond profit maximization and taking responsibility for the health of the natural and social systems on which we all rely not only makes good business sense but is also morally required by the same commitments to freedom and prosperity that drove our original embrace of shareholder value.

A mere decade ago the idea that business could help save the world seemed completely crazy. Now it's not only plausible but also absolutely necessary. I'm not talking about some distant utopia. It's possible to see the elements of a reimagined capitalism right now, and to see how these elements could add up to profound change—change that would not only preserve capitalism but also make the entire world better off. Indeed this book is an attempt to persuade you to give your life to the attempt.

How We Got Here

A central cause of the problems we face is the deeply held belief that a firm's only duty is to maximize "shareholder value." Milton Friedman, perhaps the most influential intellectual force in popularizing this idea, once stated that "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits." From here it's not far to the idea that focusing on the long term or the public good is not only immoral and possibly illegal but also (and most critically) decidedly infeasible. It is true that the capital and product markets are ruthless places. But in its current incarnation, our focus on shareholder value maximization is an exceedingly dangerous idea, not just to the society and the planet, but also to the health of business itself. Turing Pharmaceuticals' experience with Daraprim illustrates the costs of chasing profits at the expense of everything else.

In September 2015, Turing, a small start-up with only two products, announced that it was raising the price of the generic drug Daraprim from \$13.50 to \$750 a tablet—an approximately 5,000 percent increase. Daraprim was widely used to treat complications from AIDS. It cost approximately \$1 per pill to produce and had no competition.¹⁵ Anyone wanting to buy Daraprim had to buy it from Turing. The move unleashed a media storm. Martin Shkreli,

Turing's CEO, was vilified in the press and accosted in public. But he was unrepentant. Asked if he would do anything differently, he replied:

I probably would have raised prices higher. . . . I could have raised it higher and made more profits for our shareholders. Which is my primary duty. . . . No one wants to say it, no one's proud of it, but this is a capitalist society, capitalist system and capitalist rules, and my investors expect me to maximize profits, not to minimize them, or go half, or go 70 percent, but to go to 100 percent of the profit curve that we're all taught in MBA class.¹⁶

It's tempting to believe that Shkreli is an outlier. He is a deeply eccentric person and currently in jail for defrauding his investors.¹⁷ But he expressed in the starkest terms the implications of the imperative to make as much money as you can, and Daraprim is not the only generic drug to have had its price hiked. In 2014, Lanett, another generic pharmaceutical producer, raised the price of Fluphenazine—a drug that is used to treat schizophrenia and is on the World Health Organization's list of most essential medicines—from \$43.50 to \$870—a 2,000 percent increase.¹⁸ Valeant increased the prices of Nitropress and Isuprel—two leading heart drugs—by more than 500 percent, reportedly leaving the firm with gross margins of more than 99 percent.¹⁹

Surely this can't be right. Do managers really have a moral duty to exploit desperately sick people? Purdue Pharma's decision to aggressively promote the prescribing of OxyContin was—at least in the short term—hugely profitable.²⁰ Does this mean that it was right or even good business? Do firms have a duty to pursue the maximum possible profit, even when they know that doing so will almost certainly have significantly negative consequences for their customers, their employees, or society at large? Since December

2015, when the Paris Climate Agreement was signed, for example, the world's fossil fuel companies have spent more than a billion dollars lobbying against controls on greenhouse gas (GHG) emissions.²¹ Lobbying in favor of heating up the planet may have maximized shareholder value in the short term, but in the long run, was it a good idea?

Taken literally, a single-minded focus on profit maximization would seem to require that firms not only jack up drug prices but also fish out the oceans, destabilize the climate, fight against anything that might raise labor costs—including public funding of education and health care, and (my personal favorite) attempt to rig the political process in their own favor. In the words of the cartoon: “Yes, the planet got destroyed, but for a beautiful moment in time we created a lot of value for shareholders.”



Tom Toro

“Yes, the planet got destroyed, but for a beautiful moment in time we created a lot of value for shareholders.”

Business was not always wired this way. Our obsession with shareholder value is relatively recent. Edwin Gay, the first dean of the Harvard Business School, suggested that the school's purpose was to educate leaders who would “make a decent profit, decently,” and as late as 1981, the Business Roundtable issued a statement that said, in part: “Business and society have a symbiotic relationship: The long-term viability of the corporation depends upon its responsibility to the society of which it is a part. And the well-being of society depends upon profitable and responsible business enterprises.”

A Beautiful Idea

The belief that management's only duty is to maximize shareholder value is the product of a transformation in economic thinking pioneered by Friedman and his colleagues at the University of Chicago following the Second World War. Many of their arguments were highly technical, but the intuition behind their work is straightforward.

First, they argued that free markets are perfectly efficient, and that this makes them a spectacular driver of economic prosperity. Intuitively, if every firm in an industry is ruthlessly focused on the bottom line, competition will drive all of them to be both efficient and innovative, while also preventing any single firm from dominating the market. Moreover, fully competitive markets use prices to match production to demand, which makes it possible to coordinate millions of firms to meet the tastes of billions of people. Friedman himself brought this idea to life using a very ordinary example:

Look at this lead pencil. There's not a single person in the world who could make this pencil. Remarkable statement? Not at all. The wood from which it is made . . . comes from a tree that was cut down in the state of Washington. To cut down that tree, it took a saw. To make the saw, it took steel. To make steel, it took

iron ore. This black center—we call it lead but it's really graphite, compressed graphite . . . comes from some mines in South America. This red top up here, this eraser, a bit of rubber, probably comes from Malaya, where the rubber tree isn't even native! It was imported from South America by some businessmen with the help of the British government. This brass ferrule? I haven't the slightest idea where it came from. Or the yellow paint! Or the paint that made the black lines. Or the glue that holds it together. Literally thousands of people co-operated to make this pencil. People who don't speak the same language, who practice different religions, who might hate one another if they ever met!²²

If Friedman were trying to make the same point today, he might use a cell phone—each of which contains hundreds of components that are manufactured all over the world.²³ But the key point is that truly competitive markets allocate resources much more effectively and much more efficiently than anything else we've tried. Indeed, pathbreaking work in the fifties and sixties established that under a number of well-defined conditions—including free competition, the absence of collusion and of private information, and the appropriate pricing of externalities—maximizing shareholder returns maximizes public welfare.²⁴

The second argument behind the injunction to focus on shareholder returns rests on the normative primacy of individual freedoms, or the idea that personal, individual freedom is—or should be—the primary goal of society and that an individual's ability to make decisions about the disposition of her resources and time should be one of society's highest goals. This idea is deeply rooted in the post-Enlightenment, classical-liberal tradition of the eighteenth and nineteenth centuries. Milton Friedman and Friedrich Hayek drew from this tradition as a way to articulate an intellectual counterpoint to the Soviet Union's philosophy of centralized economic control.

Freedom, in this context, is "immunity from encroachment" or "freedom *from*"—the ability to make decisions free from the interference of others. Friedman and his colleagues suggested that free markets create individual freedom because, in contrast to planned economies, they allow people to choose what they do and how they do it and give them the resources to choose their own politics. It is difficult to be truly free when the state—or a small group of oligarchs—controls whom you work for and how much you're paid.

Third, Friedman and his colleagues argued that managers are agents for their investors. Acting as a trustworthy agent is a moral commitment in its own right, rooted in the widely shared idea that one should keep one's word and not misuse funds with which one has been entrusted. Since managers are agents, they argued, they have a duty to manage the firm as their investors would wish—which Friedman assumed would in most cases be "to make as much money as possible."

Together these three arguments make a powerful case for shareholder value maximization and are the moral force behind many businesspeople's belief that to maximize profits is to fulfill deep normative commitments. From this perspective, failing to maximize shareholder returns not only constitutes a betrayal of your responsibility to your investors but also threatens to reduce prosperity by compromising the efficiency of the system and reducing everyone's economic and political freedom. To do anything other than maximize returns—to pay employees more than the prevailing wage for no obvious benefit, for example, or to put solar panels on the roof when local coal-fired power is cheap and abundant—is not only to make society poorer and less free but also to betray your duties to your investors.

These ideas are, however, the product of a specific time and place, and of a particular set of institutional conditions. Given the realities of today's world, they are dangerously mistaken. Friedman and his colleagues first formulated them in the aftermath of

the Second World War. At the time it seemed there was a serious risk that a reliance on the market would be replaced by centralized planning. Governments—after conquering economic depression and war—were popular and powerful. Capitalism was not. Enduring memories of the Great Depression that had preceded the war—at its height US GDP fell by 30 percent, while industrial production fell by almost 50 percent, and a quarter of the working population was unemployed²⁵—meant that for the next twenty years, unregulated, unconstrained capitalism was regarded with suspicion nearly everywhere. This was the dominant view in Europe and in Asia. In Japan, for example, the business community explicitly embraced a model of capitalism that stressed the well-being of employees and a commitment to the long term, while in Germany, firms, banks, and unions cooperated to create a system of “co-determination” that routinely sought to balance the well-being of the firm with the well-being of employees and of the community.

This meant that for roughly thirty years after the war, in the developed world the state could be relied on to ensure that markets were reasonably competitive, that “externalities” such as pollution were properly priced or regulated, and that (nearly) everyone had the skills to participate in the market. Moreover, the experience of fighting the war created immense social cohesion. Investing in education and health, “doing the decent thing,” and celebrating democracy seemed natural.

Friedman’s ideas did not get much traction until the early seventies, when the turmoil of the first oil embargo ushered in a decade of stagflation and intense global competition, and the US economy came under significant pressure. Under these conditions, it was not crazy to believe that “unleashing” the market by telling managers their only job was to focus on shareholder returns would maximize both economic growth and individual freedom.

The Chicago-trained economists blamed the economy’s lackluster performance on the fact that many managers were putting

their own well-being before their duty to their investors. Their suggested solution—to tie executive compensation to shareholder value—was eagerly embraced by investors. Managers were told that they had a moral duty to maximize profits—indeed that to do anything else was actively immoral—and CEO pay was linked tightly to the value of the company’s stock. GDP took off like a rocket and with it, shareholder value and CEO pay.²⁶

But . . . meanwhile, the environmental costs of this growth—trillions of tons of greenhouse gases in the atmosphere, a poisoned ocean, and the widespread destruction of the earth’s natural systems—remained largely invisible. Worldwide inequality fell as several of the developing economies—most notably China—began to catch up to Western levels of income. But in the developed world income inequality has increased enormously. The vast majority of the fruits flowing from the productivity growth of the last twenty years have gone to the top 10 percent of the income distribution, particularly in the United States and the United Kingdom.²⁷ Real incomes at the bottom have stagnated.²⁸ The populist fury that has emerged as a result is threatening the viability of our societies—and of our economies. What went wrong?

In a nutshell, markets require adult supervision. They only lead to prosperity and freedom when they are genuinely free and fair, and in the last seventy years the world has changed almost beyond recognition. Global capitalism looks less and less like the textbook model of free and fair markets on which the injunction to focus solely on profit maximization is based. Free markets only work their magic when prices reflect all available information, when there is genuine freedom of opportunity, and when the rules of the game support genuine competition. In today’s world many prices are wildly out of whack, freedom of opportunity is increasingly confined to the well connected, and firms are rewriting the rules of the game in ways that maximize their own profits while simultaneously distorting the market. If firms can dump toxic waste into

the river, control the political process, and get together to fix prices, free markets will not increase either aggregate wealth or individual freedom. On the contrary, they will wreck the institutions on which business itself relies.

Why Markets Are Failing Us

The Turing Pharmaceutical example illustrates the essential nature of the problem—but we can be even more precise. Markets have gone off the rails for three reasons: externalities are not properly priced, many people no longer have the skills necessary to give them genuine freedom of opportunity, and firms are increasingly able to fix the rules of the game in their own favor.

Energy is cheap because we don't pay its full costs. American consumers pay roughly five cents per kilowatt-hour (¢/kWh) for electricity from coal-fired power plants. But burning coal emits enormous quantities of CO₂ (coal is essentially fossilized carbon)—one of the leading causes of global warming. Producing a kilowatt-hour of coal-fired electricity causes at least another four cents of climate-related damage. Moreover, burning coal kills thousands of people every year and destroys the health of many more. The extraction, transportation, processing, and combustion of coal in the United States cause twenty-four thousand lives to be lost every year due to lung and heart disease (at a cost of perhaps \$187.5 billion per year); eleven thousand additional lives are lost annually due to the high health burdens found in coal-mining regions (an annual cost of perhaps \$74.6 billion).²⁹ Calculating an aggregate, global figure for the health costs associated with burning fossil fuels is enormously difficult since costs differ significantly depending on a wide range of factors, including the type of fuel and on how and where it's being burned. One estimate suggests that every ton of CO₂ emissions is associated with current health care costs of about \$40, which would imply a cost per kWh of about four cents, but my

colleagues who work in this area remind me that these costs can vary enormously and are often much higher.³⁰ When you add these costs back in, the real cost of a kilowatt-hour of coal-fired electricity is thus not 5¢ but something more like 13¢. This means we are only paying about 40 percent of the real costs of burning coal. Fossil fuel energy looks cheap—but only because we're not counting the costs we are imposing on our neighbors and on the future.

Every coal-fired plant on the planet is actively destroying value, in the sense that the costs these plants are imposing on society are greater than their total revenues, let alone their profits. For example, Peabody Energy, the largest coal company in the United States, shipped 186.7 million tons of coal in 2018 for total revenues of \$5.6 billion.³¹ The combined climate and health costs of burning 186.7 million tons of coal are about \$30 billion, so—taking total revenue as a measure of total value creation, which is conservative—Peabody is destroying at least five times the value that it is creating.

Every time you use fossil fuels—whether it's to drive a car or to take a flight—you are creating lasting damage that you are not paying for. The production of every ton of steel, every ton of cement, and every single hamburger—to focus on a few products that are particularly energy intensive to produce—creates significant damage that isn't included in the price. The production of every cheeseburger generates approximately the same emissions as half a gallon of gasoline, and beef consumption alone is responsible for about 10 percent of global GHG emissions (and only about 2 percent of calories consumed).³²

When you add these costs to the bottom line, it turns out that nearly every firm is causing significant damage. In 2018, for example, CEMEX, one of the largest cement companies in the world, emitted more than forty-eight million tons of CO₂—despite the fact that in 2018 about a quarter of the electricity used in its cement-producing operations was generated from renewables.³³ That's at

least \$4 billion worth of damage.³⁴ Its Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) that year was \$2.6 billion.³⁵ In fiscal year 2019 the total emissions of the UK retail chain Marks & Spencer—a company that has been working hard to reduce emissions for years—were equivalent to 360,000 tons of CO₂.³⁶ That's about \$32 million in damages. Pretax profits in the same year were £670 million.³⁷

The distortion caused by the failure to price GHG emissions is enormous. Prices across the entire economy are completely out of whack. If the free market works its magic through the fact that prices capture all the information one needs to know, in this case there isn't much magic in evidence.

Markets only create genuine freedom of opportunity if everyone has the chance to play. When unchecked markets leave too many people too far behind, they destroy the freedom of opportunity that is fundamental to their own legitimacy. The world is immeasurably richer than it was fifty years ago, and inequality between countries has fallen significantly. In the 1950s half the world's population lived on less than \$2 a day. Now only 13 percent live at this level, and most people have a decent subsistence.³⁸ But within countries inequality has jumped to levels not seen since the 1920s. In the United States and the United Kingdom, for example, the benefits of productivity growth have gone largely to the top 10 percent while real incomes have stagnated.³⁹

In the United States social mobility is now significantly lower than it is in Canada and northern Europe, but it has fallen nearly everywhere.⁴⁰ The winners from the economic boom have increasingly found ways to pass on their success to their children, so that a child's success is increasingly a function of the zip code where they were born and their parents' income. Only 2–4 percent of students in the eight Ivy League schools' class of 2013 were from the bottom 20 percent of the income distribution, while between 10 and 19 percent of the class had been born to families in the top 1 percent.

A student born to the top 5 percent of the income distribution has about a 60 percent greater chance of joining the 1 percent than a student whose parents' income was in the bottom 5 percent, even if they both attended one of America's most highly regarded universities.⁴¹ Your health is increasingly determined by your zip code. To take just one example: In 2017, the life expectancy of the residents of the poorest sections of New Bedford, Massachusetts, was slightly less than life expectancy in Botswana and Cambodia.⁴²

It has also become significantly harder for entrepreneurial firms to succeed. Between 1997 and 2012, the four largest firms in every sector increased their share of their sector's revenues from 26 to 32 percent.⁴³ Young companies were 15 percent of the economy in 1980 but only 8 percent in 2015.⁴⁴ This increase in concentration is also reducing workers' bargaining power—and with it, both benefits and compensation—while driving up profits and prices.⁴⁵

Markets are only free and fair if the players can't fix the rules in their own favor. In 2014, for example, two political scientists published a study exploring the relationship between popular support for a policy and the odds of it becoming law. The views of the "average citizen" in the United States, they found, don't matter at all. Proposals supported by 90 percent of the general population are no more likely to pass than proposals supported by 10 percent.⁴⁶ But if the rich wanted something done, it got done.

Spending the money to change the rules of the game in your favor can be a fantastically effective way of making money—even as it imposes significant costs on everyone else. In 1997, for example, the Walt Disney Company lobbied heavily in support of an obscure piece of legislation called the Copyright Term Extension Act (CTEA).⁴⁷

Giving artists and authors (and filmmakers) copyright in their creations allows them to profit from their ideas—giving them the incentive to create more. But copyrights are limited so that after some reasonable period of time, other artists and authors can build

on the ideas of those who have come before them. In Disney's case, for example, the movie *Snow White* is based on an old European folktale. So is *Beauty and the Beast*. The CTEA promised to extend US copyright to the life of an author plus seventy years, and to extend corporate copyrights to ninety-five years. For Disney, which was facing the risk that its most beloved—and most profitable—characters would start coming off copyright in 2023, the bill offered an additional twenty years of protection.

Disney spent slightly more than \$2 million⁴⁸ lobbying for the bill—pushing so aggressively for its passage that it became laughingly known as the “Mickey Mouse Protection Act.”

The bill ultimately sailed through Congress and was signed into law on October 27, 1998. My rough estimates suggest that at the time it passed, it might have been worth as much as \$1.6 billion of additional income to Disney—not a bad return on slightly more than a \$2 million investment.⁴⁹ There is no evidence, however, that it increased the general welfare. Rather, the reverse. Disney had argued that delaying the moment until competitors could copy its films would increase Disney's incentives to create new ones. But a group of prominent economists—including five Nobel laureates—argued that the extension had had essentially no effect on the incentives to innovate.⁵⁰ In their words, “In the case of term extension for existing works, the sizable increase in cost is not balanced to any significant degree by an improvement in incentives for creating new works.”⁵¹

In plain language, Disney—a firm that prides itself on its wholesome family image and whose theme parks are practically a required stop for every family in the United States—had essentially laid the groundwork for charging these very families somewhere north of a billion dollars to enrich its own investors without generating anything like a comparable social benefit.

Still, this is just money. The fossil fuel companies have been pursuing a similar strategy with much graver consequences for the

world. Between 2000 and 2017, the fossil fuel industry as a whole spent at least \$3 billion lobbying against climate change legislation, and millions more backing groups and campaigns that denied the reality of climate change.⁵²

As of this writing, Marathon Oil, the largest oil refiner in the United States, publicly acknowledges the reality of climate change and claims that it has “invested billions of dollars to make our operations more energy efficient.” But it has been a vigorous supporter of the current administration's attempts to roll back existing regulations on automobile emissions, suggesting on one call to investors that the rollback could increase industry sales by 350,000 to 400,000 barrels of gasoline a day.⁵³ Such an increase would impose costs of between \$4.3 and \$4.9 billion on the rest of the world, but at a price of roughly \$56/barrel would increase industry sales by between \$6.9 and \$7.9 billion.⁵⁴ In Washington State, oil interests outspent their opponents by two to one to defeat a measure designed to impose the first ever US carbon tax, with BP alone contributing \$13 million to the effort.⁵⁵

It's not only money that allows firms to buy favorable rules. In many situations the issues are so highly technical, so narrow, or so dull that neither the media nor the general public cares much about them. For example, changes in accounting standards are hard to understand and rarely arouse much public interest. But seemingly minor changes in accounting rules were one of the causes of the Great Crash of 2008.⁵⁶

Profit maximization only increases prosperity and freedom when markets are genuinely free and fair. Modern capitalism is neither. If massive externalities go unpriced or uncontrolled, if true freedom of opportunity is more dream than reality, and if firms can change the rules of the game to suit themselves at the expense of the public good, maximizing shareholder value leads to ruin. Under these conditions firms have a moral duty to help build a system that supports genuinely competitive, appropriately priced markets

and strong institutions. They also have a compelling economic case to do so. A world on fire threatens the viability of every business.

The Danger Ahead

For years, the proponents of the unchecked free market have been attacking government. But the alternative to strong, democratically controlled government is not the free market triumphant. The alternative is crony capitalism, or what the development economists call “extraction,” a political system in which the rich and the powerful get together to run the state—and the market—for their own benefit. Extractive elites monopolize economic activity and systematically underinvest (when they invest at all) in public goods such as roads, hospitals, and schools.

There’s always a trade-off. Too much focus on the public good stifles the entrepreneurial dynamic that is the lifeblood of well-functioning markets. Too much focus on economic freedom leads to the destruction of the social and natural world and to the steady degradation of the institutions that hold the market in balance.

Russia’s experience illustrates this dynamic. The Soviet economy under communism grew much more slowly than the Western economies, while also greatly restricting personal and political freedoms. Following the fall of the Berlin Wall and the collapse of the Soviet empire, Russia moved aggressively to embrace a completely unconstrained market—Chicago economics in its purest form. For a golden moment it seemed as though Russia would become a developed market economy. But no one stopped to price externalities, build the institutions that would enforce the rule of law, provide decent education and health care, or ensure that firms couldn’t set their own rules. Behind the smiles, the men with guns were still in charge. The Russian state sold its holdings—the vast majority of the economy—to a small group of cronies, creating a form of crony capitalism. The United States has

a population of 327 million and a GDP of \$21 trillion.⁵⁷ Russia has roughly half the population and a GDP of only \$1.6 trillion.⁵⁸ Free markets need free politics: functioning institutions are great for business.

When we told the leaders of firms that their sole duty was to focus on shareholder value, we gave them permission to turn their backs on the health of the institutions that have historically balanced concentrated economic power. We told them that so long as they increased profits, it was their moral duty to pull down the institutions that constrained them—to lobby against consumer protection, to distort climate science, to break unions, and to pour money into efforts to roll back taxes and regulations. We pushed businesspeople into alliance with populist movements that actively campaigned against government, and that rejected fundamental democratic values. In the short term these alliances yielded seductive returns, but in the long term they threaten the fundamental pillars of our societies and our economies. Brexit will not be good for business. Neither will a global trade war or the end of immigration. The problem is not free markets. The problem is *uncontrolled* free markets, or the idea that we can do without government, and without shared social and moral commitments to the health of the entire society on which effective government depends.

We know what needs to be done. The United Nation’s seventeen Sustainable Development Goals lay out a coherent road map—widely embraced by the business community—for building a just and sustainable world.⁵⁹ We have the technology and the brains to address our environmental problems, and we have the resources to reduce inequality. The question is not *what* should be done. The question is *how*.

Business must step up. It is immensely powerful. It has the resources, the skills, and the global reach to make an enormous difference. It also has a strong *economic* case for action. Left unchecked, global warming seems likely to shrink the American economy by

roughly 10 percent by the end of the century⁶⁰ and to create almost unimaginable suffering. In the words of David Wallace-Wells, writing in *The Uninhabitable Earth* about the effects of different levels of increase in long-run average temperatures:

Because these numbers are so small, we tend to trivialize the differences between them—one, two, four, five. . . . Human experience and memory offer no good analogy for how we should think of those thresholds, but, as with world wars, or recurrences of cancer, you don't want to see even one. At two degrees the ice sheets will begin their collapse. 400 million more people will suffer from water scarcity, major cities in the equatorial band of the planet will become unlivable, and even in the northern latitudes heat waves will kill thousands each summer. There would be 32 times as many extreme heat waves in India, and each would last five times as long, exposing 93 times more people. This is our best case scenario. At three degrees, Southern Europe would be in permanent drought and the average drought in Central America would last 19 months longer. In the Caribbean, 21 months longer. The area burned each year by wildfires would double.

By 2050 as many as a billion people could be on the move.⁶¹ This is not a world you want to live in—and it's one that threatens the roots of our economic system. In the words of Ray Dalio, the founder of Bridgewater Associates, one of the world's largest hedge funds:

I think that most capitalists don't know how to divide the economic pie well and most socialists don't know how to grow it well, yet we are now at a juncture in which either a) people of different ideological inclinations will work together to skillfully re-engineer the system so that the pie is both divided and grown well or b) we will have great conflict and some form of revolution that will hurt most everyone and will shrink the pie.

As Ray suggests, this is not a problem that business can solve on its own. We will only be able to tackle problems like climate change and inequality with state help—and this will require rebuilding our institutions and bringing markets and governments back in balance. Business can make an enormous difference, but only if it works together with others to build the healthy, well-run governments, vibrant democracies, and strong civil societies that will be essential to making real progress.

A reimagined capitalism—a reformed economic and political system—has five key pieces, none sufficient on its own, but each building on the other and each a vital part of a reinforcing whole. We can begin to see what this looks like in practice through the story of the transformation of a single firm.