CHAPTER 14

THE BALANCE OF CONFIDENCE

The New Rules of the Game

LATE ONE AFTERNOON in July 1876, along one of Ireland's main railway, a Scottish-born engineer who had become Canada's most prominent citizen missed his train. As a result, Sir Sandford Fleming spent the night in the station, thus failing to make the ferry connection that was supposed to carry him to England. It was not his fault. The problem was with the times on the railway schedule. But that night, stranded in the small Irish station, gave him time to think and brood on what was already a preoccupation—and would end up changing the way the world kept time.

Fleming was very much a man of his own times, which was the first age of globalization. This was the era when new innovations and technologies were knitting the world together—preeminently, the railroad, the steamship, and the telegraph. The trans-Atlantic crossing had been shortened from forty-five days to seven or eight. Instead of a three-month journey around Cape Horn, one could now go from New York to California, sitting in the comfort of a Pullman car, in just five days.

But this tying together of the world confronted a great problem. This new world needed new rules of the game. And that included, as Sandford Fleming had decided in the hours of "monumental vexation" that followed his missed train, new rules for time.

Up until then, the matter of time had been a free-for-all. Each locality set its own time based upon its own high noon—that is, the point at which the sun was at its highest over that particular place. So what was "high noon" in the town of Hadleyville in the famous movie *High Noon* was actually 11:59 twelve miles away—and, if 120 miles away, 11:49. This was fine as long as travel was no faster than a horse or a sailing ship, and most people went no farther afield than the fields they tended.

But with trains and steamships—and the telegraph—it surely was a problem. Railways in the United States, for instance, operated according to the time in their headquarters city. Twelve noon on the schedule of the New York Central took place a little earlier than noon on the one of the Philadelphia Railroad, and both were still different from the local noon in the station in Pittsburgh. St. Louis had six official railway times. High noon in Boston was twelve minutes earlier than high noon in New York City. These differences put enormous pressure on travelers—and created great distress, which may well be why Oscar Wilde had once said that the primary activity of Americans was "catching trains." Europe suffered from the same indignities. As commerce became regional, national, and international, the differences created great turmoil—and worse. Railway accidents were frequent because trains operating on different times shared the same tracks. And ships at sea could not communicate their positions to each other because they were working on different times. In short, as one railway man put it, "time was in the air." The need for something new was critical.

This was a perfect project for Sandford Fleming, the epitome of the nineteenth century engineer and rationalist. Promoter par excellence of the establishment of a unified Canada, chief engineer of the two biggest railway projects in Canada, he set out to create "standard time"—a global system for time. "Through force of circumstances, we are now obliged to take a comprehensive view of the entire globe in considering the questions of time-reckoning," he wrote. "We should not confine our view to one limited horizon, to one country, or to one continent."

His labors paid off eight years later when an international conference, with representatives from twenty-six independent nations, gathered in Washington, D.C. It created what is still the world's time system—twenty-four time zones defined by longitude lines, with the prime meridian passing through Greenwich, England. Agreement was not easily achieved. The French vigorously objected to the meridian's line being through Greenwich, rather than Paris (whose high noon preceded that in Greenwich by nine minutes and twenty-one seconds).

But all obstacles were overcome, and the Prime Meridian Conference of 1884 provided new rules for time that a much more connected world required. Fleming had achieved his lasting objective—agreement on "principles so sound as to obtain the acceptance of the generations which are to follow us." With that project resolved, Fleming, ever the visionary of globalization, turned to his other great cause: the promotion of trans-Pacific underwater telegraph cable and the establishment of a worldwide telegraph system that would link the entire world together.

There is a lesson here from this development of global rule making for something generally taken for granted—time—heretofore a subject of local regulation. What was true for the first age of globalization—as demonstrated by Fleming's pursuit of standard time—is also true for the second. New circumstances, new technologies, new connections, new interactions—all these create the need for new rules of the game. Making them—and getting them right—stands as one of the great challenges of this age of globalization.

As much as globalization pushes governments to address new risks and capture new opportunities, it challenges them even more forcefully to cooperate with one another to develop the "new rules of the game"—the institutions and the mechanisms required to manage a global marketplace. Economic activity takes place, after all, not in a vacuum but rather within a structure of laws, regulations, standards, norms, and values. Since economic activity crosses borders in ever-increasing volumes, the international economy requires new and revised rules of the game that may be followed by nations and companies—as well as reliably enforced. Such sets of rules and procedures for a given economic sector or activity are frequently called "regimes." They may involve laws, treaties, and some sort of international organization that acts as clearinghouse or coordinator. Or they may involve commonly observed standards.

There's nothing new about international regimes, of course. Some of the earliest—required by the first age of globalization—include the International Telegraph Union (now the International Telecommunications Union), founded in 1865, and the Berne Copyright Convention of 1886, which provided rules regarding the ownership and use of intellectual property. And in between, of course, was Sir Sandford Fleming's Prime Meridian Conference. Bretton Woods and other agreements, at the end of World War II, created the regimes by which the postwar international economy could function and flourish. The regime governing aviation, for instance, had its origins in the Chicago Convention of 1944 and the government-to-government bilateral arrangements that followed.

Today, in sector after sector, the revision of existing regimes and the creation of new ones are at the top of the international agenda. They typically involve complex negotiations among governments, private companies, international organizations, and nongovernmental organizations (NGOs). The rapid pace of globalization in all its dimensions requires new rules of the game—to harmonize existing systems, to ensure efficient functioning of the marketplace, and to provide legitimacy and guidance. This is happening across the board. Despite the many differences among sectors, there are two common trends: toward more market-based rules and toward larger scale, to accommodate and indeed make possible a much bigger game.

This is most obvious in international trade. Since the late 1940s, trade liberalization had been managed through GATT. The World Trade Organization (WTO), established in 1995, inherited GATT's agreements but has expanded on the concept of rules. It added a new dispute resolution mechanism that was much stronger and introduced the possibility of authorized punishment of nations that violated its rules. In the time since the Seattle meetings, the WTO has gained in legitimacy and practical functioning. With the accession of China in November 2001, only Russia among the world's largest economies remained outside the WTO—and its joining was widely seen as in the works. Moreover, as observed in the preceding chapter, the developing countries have been aggressively using the WTO to focus and push their demands, and they have begun to see some significant success. At the Doha summit, most notably, the coalition of developing countries led by India and Brazil secured major concessions on pharmaceutical patents that would allow them to accelerate the spread of cheap generic drugs to combat AIDS and other ravaging diseases. Such achievements bolstered the legitimacy of the organization as a forum for substantive resolution of issues—and contributed to expanding its brief to a wider range of subjects than merely a narrow definition of trade.

International finance also requires new regimes, as recent events have devastatingly demonstrated. The currency crisis and financial contagion that swept through Asia and other parts of the world in 1997 and 1998 underscored how integrated national financial systems are becoming—and the vulnerabilities created by the rapid growth in lending and other capital movements. The lesson of the crisis was clear: the rules governing the international financial system were inadequate and inconsistent. They needed to be revised and reformed at both the national and international levels. The new rules, in their entirety, are meant to construct what was first heralded as the "new financial architecture." What has transpired so far is less a grand architecture and more like a remodeling. Even as such, it is a complex process, with many different bodies and groupings involved. A new group was created in early 1999 to help coordinate the process: the Financial Stability Forum. Its chairman, Andrew Crockett, has described what he called a major "paradigm shift" in the organization of the international economy—the move away from the postwar "government-centered system" of Bretton Woods and fixed exchange rates to today's "market-centered system." The focus now is on international cooperation on "codes and standards" and "best practices" for such matters as transparency about the debt levels of governments and financial institutions, banking and securities regulation and surveillance, data dissemination, and corporate governance.

Among the most important elements of the new financial initiatives is the creation, for the first time, of truly international accounting standards. "If you look at the history of the American capital market," said Lawrence Summers, the secretary of the treasury during Bill Clinton's second administration, "there's probably no innovation more important than the idea of generally accepted accountancy principles. Transparency is good because it avoids surprises and shocks that cause crises. Transparency is good because, as someone once said, conscience is the knowledge that someone's watching. And it discourages bad behavior." The objective in creating international accounting standards is "a convergence" of existing national systems. One of the weaknesses revealed by the Asian crisis was inconsistent, poor, and misleading corporate financial accounting; improvement is necessary for greater flows of capital. Among other things, it would provide investors with a common framework for evaluation.

The same pressures of globalization are driving "antitrust" (the American term) and "competition policy" (the European term) from purely national systems toward a coordinated international system. Historically, antitrust policy has received much greater emphasis in the United States than in Europe and other parts of the world. In most of Europe, the thrust was quite different from that of antitrust—toward promoting nationalization and consolidation to create national champions. But privatization, the development of the European Union, and the lowering barriers to trade and investment—these all are giving greater weight to antitrust in Europe as well. And it is happening not just in Europe. "A century ago, only the United States had comprehensive antitrust laws in place," observed the recent International Competition Policy Advisory Committee to the U.S. Department of Justice. "Today, more than 80 countries have antitrust laws, approximately 60 percent of which were introduced in the 1990s."

A result is that merger review has become a hugely complex process involving premerger ratifications and submissions in as many as sixty countries—three times as many as four years ago—many of them with enormous filing requirements. All of this not only imposes great burdens on both companies and regulators but also introduces great costs, delay, and other inefficiencies into the review process. This has sparked efforts to develop some kind of international regime for coordinating antitrust considerations—perhaps even, in one proposal, a single international organization to set global standards. However it is done, some kind of thorough coordination will be required if antitrust is to work effectively—and rationally—in the era of the global marketplace. Antitrust takes on a new prominence in a more market-oriented era in order to protect the public. It is also required if the market system is to have lasting legitimacy and the confidence of the public.

In every case, regime building is a complex, often contentious process. It requires a grasp of the issues that need to be addressed, an assessment of the proper mechanisms, and a balancing of competing interests not only among but also within nations. The participants include governments, themselves often subject to divergent interests; the private sector, with many different interests; and increasingly NGOs of one kind or another. By one count, the number of international NGOs rose in the 1990s from 6,000 to 26,000. The very diversity of participants makes agreement difficult. As the problem has been put, "How do you get everyone into the act and still get action?"

But no matter the obstacles, the pace of globalization leaves no choice. It ensures that modernizing existing regimes and creating new ones will be a central and unavoidable challenge—one by which the impact and success of globalization will be evaluated.[1]

A New Consensus?

The market focus that seemed radical and beyond the pale when Margaret Thatcher initiated her revolution has become the new consensus in less than two decades. Governments continue to be entrusted with a fundamental responsibility for welfare, but in the industrial world, the debate is now about how to define that responsibility, how broad or limited it should be, and how to deliver services—in short, how to reform the system.

Yet, whatever the transformations in the world economy, an underlying mistrust of the market persists. Why? George Shultz pointed to one reason when he said, "Markets are relentless." As competition becomes more intense, there is no respite from its pressures. People turn to government to provide shelter from the constant demands of the market. The move to the market may bring a higher standard of living, better services, and more choice. But it also brings new insecurities—about unemployment, about the durability of jobs and the stress of the workplace, about the loss of protection from the vicissitudes of life, about the environment, about the unraveling of the safety net, about health care and what happens in old age. Workers—both white- and blue-collar—fear, and sometimes find, that employers, in order to please financial analysts, will break the social contract and cut the salaries, benefits, and jobs of employees who have given fifteen or twenty irretrievable years of their life to the company. Further, the global nature of the marketplace disrupts traditional values and familiar forms of organization, amplifying the sense of a loss of control and generating a nostalgia for the past and its settled order. Globalization can radically change one's sense of the dimensions of the world and one's place in it. While there are gains in this movement, there are also losses. There are an ambivalence and an uneasy balance. It is heard when a Democrat in Washington talks about the battle between "the free marketeer in me and the liberal in me." It is encountered in the conviction in some countries that the process of privatization has meant the movement of government assets into the hands of those who are friends of the government, massively enriching them in the process. Even with an expertly executed privatization program, the results mean a redistribution of wealth, power, and status within a society, all of which can be highly unsettling. "This is, in some ways, the age of anxiety," observed Robert Rubin, former treasury secretary. "It's an age in which a lot is happening very quickly, and the forces of globalization create not only economic dislocations but cultural dislocations and a great sense of insecurity and unease. And I think at the same time that we get the economic benefits of globalization, we on a parallel track need to find ways to deal with these other effects."

Yet despite the doubts and the discontents, the move to the market has been driven by a shift in the balance of confidence—a declining faith in the competence of government, offset by a renewed appreciation of the working of the market. One's parents and grandparents, so deeply traumatized by the Great Depression, may have lived with the permanent expectation of another slump. In the United States, suspicion and criticism of the market historically focused on the tendency toward collusion—the Progressives' critique—and the risk of market failure—the New Deal's preoccupation. Yet over the half century since World War II, market systems have demonstrated extraordinary vitality, enormously enhancing their credibility. One has to pause to grasp the extent of the shift in outlook. In 1975, the economist Arthur Okun—a chairman of the President's Council of Economic Advisers and, of course, a child of the Great Depression—would say, "The market needs a place, and the market needs to be kept in its place. . . . Given the chance, it would sweep away all other values, and establish a vending-machine society. I could not give it more than two cheers." In the two decades since, real GDP in the United States has almost doubled; and that tone, and the mistrust that underlies it, sounds archaic. In 1997, the annual report of the Council of Economic Advisers made its main theme the "advantage of markets." The council's focus on what it called the "insufficiently appreciated property of markets"—"their ability to collect and distribute information"—was vintage Hayek. And the report criticized the New Deal for having "crystallized" the belief in "the omniscience and the omnipotence" of the government "into a new kind of liberalism." All this is a very different view of the world.[2]

The Woven World

Today, there is a resumption—a relinking—of a global economy after the disruptions of world wars, revolutions, and depression. As the steam engine and the telegraph shrank the dimensions of the nineteenth-century world, so technology today is once again eroding distance and borders. But this time the effects are much more comprehensive, for they leave virtually no country or community untouched. The pattern is evident in a host of measures. The number of international air passengers rose from 75 million in 1970 to 142 million in 2000. Between 1976 and 2000, the cost of a three-minute phone call from the United States to England dropped in real terms from about $8 to as low as 36 cents—and the number of transborder calls increased from 200 million in 1980 to 5.2 billion in 1999. Today the world shares the same images from film and entertainment; the same news and information bounces down from satellites, instantaneously creating a common vocabulary for events. The war in Afghanistan happened in real time.

Amid all this, the decisive new force is information technology—computers, software, the Internet, smart devices. Information technology is creating a woven world of distant encounters and instant connections. Knowledge and information do not have to wait. Within, outside, and across organizations and national boundaries, people are tied together, sharing information and points of view, working in virtual teams, bartering goods and services, swapping bonds and currencies, exchanging chatter and banalities, and passing the time. Information of every kind is available. With the establishment of the U.S. government data Web site in 1997, a ten-year-old could gain access to more and better data than a senior official could have done just five years earlier. Libraries are open for business on the Internet. Researchers share their results in real time. Activists band together to promote their causes. Terrorists surf for weapon designs and information on biological agents. All this is increasingly heedless of the nation-state and outside the traditional structure of organizations. If the Internet is the new commanding heights, it is also at least partly beyond the reach of the state. While governments can promote the Internet, they cannot decisively control it.

The hallmark of this new globality is the mobile economy. Capital sweeps across countries at electron speed; manufacturing and the generation of services move flexibly among countries and are networked across borders; markets are supplied from a continually shifting set of sources. Ideas, insights, and techniques all disperse among countries with increasing ease. Access to technology across national boundaries continues to grow. Borders—fundamental to the exercise of national power—are eroded as markets are integrated. Along with the surge in trade, one indicator of the rapidity of change is the transformation of more and more firms into multinationals that provide the world market with goods and services that are conceived, produced, and assembled in several countries. The criterion of "national origin" has given way to "local content," which in turn is becoming harder and harder to pin down. The spread of fast, reliable information and communications technology pushes companies to draw on people and resources the world over.[3]

The Company in the Mobile Economy

The emergence of market focus around the world has changed the position of companies as well. The prospect is both attractive and threatening: wider opportunities and tougher competition. Boundaries of many sorts are coming down. Political, economic, and ideological borders among nations continue to erode, promoting the flow of investment and trade. Regulatory systems and national monopolies that provided protection against competition are being altered. Restrictions on the movement of information and knowledge are disappearing in the face of advances in communications technology and computers (and declining costs thereof) and in the freer flow of ideas. The very walls of the company are being made more permeable by computers, alliances, and outsourcing. Indeed, it is becoming more difficult to ascertain where one company ends and another begins. Financial walls are coming down, too, as operations become more transparent and subject to much more aggressive scrutiny and demands by outside investors. All this adds up to a much wider and more diverse range of opportunity. It also means more bracing competition and more risk, along with the relentless pressure generated by capital markets and by customers who have a broader range of choice. Indeed, one clear consequence of the emergence of the global marketplace is intensified competition and constant pressure on costs.

Thus, companies are being forced to think differently. They have to prepare themselves for a world in which the pressures are only going to become more intense. That means fostering a culture that encourages alertness, responsiveness, and flexibility and speeding up the cycle time of processes and decisions. In the aftermath of "reengineering" and restructuring, competitive forces now demand a rediscovery of employees and the knowledge they command. Emphasizing the importance of knowledge, harnessing it, and speedily integrating it across the organization—these have become the ways to strengthen a firm in the marketplace. Information technology is driving the process; and as a result, the way that companies are organized is undergoing a massive change. The high-rise pyramids of hierarchical corporate structures are being transformed into the low-rise of the flatter organization—less bureaucracy, more teamwork, and greater dispersion of responsibility, information, and decision making.

How much more will companies change? BP is one of the more advanced "traditional" large companies in reshaping its organization to fit the computer age. Yet its CEO, John Browne, argues that the impact of information technology on business is still in its early stages: "Technological advance is not reversible. Political trends can come and go, but we do not throw away new technology. It is a ratchet of progress. This is a wave of new technology of major proportions, probably more deeply rooted and wide-ranging than the development of electricity or the internal combustion engine, and, as a result, there is a real possibility that the process of change is still only gathering momentum."

A distinct aspect of cultural change concerns the concept of the "entrepreneur." In the past, the word often carried a negative connotation; it sounded unsavory and made someone seem unreliable. To be identified as an entrepreneurial personality within an organization was to be branded as a threat to the established hierarchy. Today, in a fast-moving and more open economy, companies are finding that they need to encourage and nurture entrepreneurial values and attitudes that emphasize initiative and rapid response. Contributing to this change of attitude was the tremendous success of what came to be known as the Silicon Valley ethos. Companies—and the entire countries—around the world are attempting to emulate the self-perpetuating, highly fluid model that transformed what used to be known as the "Valley of the Hearts' Delight" into the world's foremost center of technological innovation and America's most powerful engine of economic growth throughout the 1990s. At the heart of the model is the expectation of an entrepreneurial approach, whatever the task at hand. "An entrepreneur has to feel that there is something wrong with the world today and that he can change it," said Tim Draper, a militant venture capitalist in Silicon Valley. "He makes it his mission, and a spark goes on in his eyes, and he is determined to do everything in his power to make that a reality." Without empowering their employees and encouraging them to become more entrepreneurial, companies today can no longer keep up. They hardly want swashbuckling egomaniacs. But they need creators and builders.

At a time when governments are slimming their responsibilities, companies as much as individuals will find that their responsibilities to the community are expanded. Whether that community is defined as a city, a region, or something larger, the corporation is part of it and benefits from it. Whatever the demands for obeisance at the altar of quarterly or half-yearly performance, companies will find that they have to engage with the community's interests, environmental concerns, and social issues. Otherwise, they will eventually be penalized by the political process.[4]

Judging on Results: Critical Tests

A common question underlies the shift away from the state and toward the market: Is this move permanent, or will there be a shift back—a recalibration and readjustment in the boundary between state and marketplace—that will expand the role and responsibilities of government once more? Are we looking at a long historical trend—or a pendulum? This is, of course, the appropriate question with which to conclude this journey through ideas and history. It takes on even more significance in the more integrated world of globalization, both because of the higher growth rates and wider opportunities it brings, and because of the crises and the rise of the antiglobalization opposition. For it is a question not only about the boundaries between government and market within nations but also about the character of the borders between countries and the rest of the world. Of course, there can be no definitive answer. But what people believe and how they interpret the world—the ideas they accept and those they reject—will do much to shape the answer in the years ahead. And thus it is possible to provide a framework that will help bring the answer into focus as it evolves.

For some, the embrace of the market is a matter of conviction. For many more, it is a matter of practicality, finding something that works better than the historic alternatives. Lee Kuan Yew, the progenitor of modern Singapore, summed up the reality. Asked why the turn to the market, he replied pithily, "Communism collapsed, and the mixed economy failed. What else is there?" Results count. The global economy—and the market consensus that underpins it—will be evaluated by the consequences.

Five tests, in particular, are likely to be decisive in shaping people's thinking and judgment about the market. The outcome of these tests will over time provide the signposts to the future frontier between state and market—and to the character of the battle over globalization.

1. Delivering the Goods?

What made both socialism and the traditional mixed economy and then discredited both will make or break the commitment to markets. Will market economies deliver on what they promise in terms of measurable economic goods: growth, higher standards of living, better-quality services, and jobs? After all, it was the failure of markets and the loss of confidence in their capacity that led to governments' assuming a much more assertive role in economic management.

If, in the industrialized countries, privatization, deregulation, and the opening up of economies to competition are seen as job-destroying rather than job-creating, market policies will surely be subject to continuing attack and constant revision. In developing countries, too, employment—along with the overall rate of economic growth—will be critical. Many of these nations are confronting an explosive social issue: a rapid growth in the number of young people of working age but no jobs for them. Failure to incorporate them into productive work will mean that the economic system, along with the political system, will be under stress and at risk. But for developing countries, the most telling measure of success will be a clear-cut one: the degree to which the move to the market delivers such basics as electricity, clean water, and reliable transportation.

The counterpoint to globalization has become the reduction of poverty in the developing world. The record to date shows that those countries that have integrated into the global economy have experienced much higher growth and much higher standards of living—with large numbers of people moving from poverty into the middle class in a single generation. "The global trading system and trade is the greatest force for reducing inequality in the world," said Stanley Fischer. "The fact that huge parts of Asia that used to be dirt poor are now at middle-income levels—and some of them growing very fast, like the Chinese—is because of the global trading system." But the distribution of these benefits is uneven, and billions continue to live in abject poverty in many countries. "Within a country, in the short run, there is no question that some of the people are going to get hurt when you open up to trade," Fischer said. "That is a real problem that . . . must be dealt with." Indeed, mitigating poverty is now a standard against which the new global economy will be judged. And the challenge will only grow larger. Of the eighty-three million people added to the world's population each year, eighty-two million will be in developing countries.

The experience of the past ten years teaches that, in order to reap the benefits of globalization, countries need to make the necessary investments in education, health, and social safety nets. But this is probably not enough, because ample experience has shown that public investment, no matter how well intentioned, does not necessarily reach its targeted beneficiaries: it can disappear into the tangle of inefficiencies, corruption, and poorly adapted rules. This means getting the appropriate institutional arrangements into place, including those involving law, contracts, and regulations that encourage the investment and small business that spur job creation. This process happens not overnight, but over time.

The Peruvian economist and political philosopher Hernando de Soto has pushed this line of thinking further. He identified what he described as a critical endemic weakness in developing countries: the pervasive exclusion of the poor from the system of laws and property rights. The result is to deprive them of the ability to utilize their capital. This, as he puts it, helps explain the economic problems in many countries and the emergence of discontents that turn into a backlash. The problem, he argues, is twofold: the wide-ranging persistence of regulations that keep the "poor" from making progress; and, even more important, the inaccessibility of property rights to the majority of people, which prevents them from putting their capital to work: "Globalization is occurring because developing and former communist nations are opening up their once-protected economies, stabilizing their currencies, and drafting regulatory frameworks," he writes. "What is not good is that these reforms assume that these countries' populations are already integrated into the legal system and have the same ability to use their resources in the open market. They do not. . . . Most people cannot participate in an expanded market because they do not have access to a legal property rights system."[5]

2. Ensuring Fairness?

The economic tests are eminently measurable; they can be counted in national income tables. The second set of tests cannot be expressed in figures, but it is no less powerful. It goes to the basic values by which people judge the world, the system in which they live, and their own place in it. For many, the market system will be evaluated not only by its economic success but also by the way in which that success is distributed. How widely shared is the success? Is the system just and fair? Or does it disproportionately benefit the rich and the avaricious at the expense of hardworking people of more moderate circumstances? Does it treat people decently, and does it include the disenfranchised and the disadvantaged? Are there equity, fair play, and opportunity? This question takes on a special significance in developing countries: Do the poor have access to property rights and participation in the economy that will enable them to leave poverty behind?

Market systems, by their very nature, confront the question of fairness. Because of their character, and indeed the very nature of the incentives on which they depend for motivation, they generate a much greater range of inequality of income than more controlled societies in which the egalitarian values are so strong. This is what Deng Xiaoping meant when he said that he had two choices: to distribute wealth, or to distribute poverty. Before Deng came to power (indeed, in those years he was under arrest), Mao's China was a very equal place—because everyone was desperately poor. The only way out of poverty, as Deng saw it, was to turn toward the dynamic of markets and incentives, which results in both generally higher incomes and greater inequality. But notions of fairness and justice run very deep and are powerful motivators in their own right. In Britain, Tony Blair's great accomplishment was to fuse social-democratic values of fairness and inclusiveness with the market-oriented program initiated by Margaret Thatcher.

Excessive concentration of wealth will undercut the legitimacy that a market-oriented system requires. Of course, the operational word is the altogether subjective *excessive.* What a market advocate describes as "incentives" is translated into "greed" in the vocabulary of a market critic. Conspicuous consumption and the flaunting of wealth weigh the scales toward "greed" and thus accentuate the criticism of inequality. American society accepts a greater income inequality than many others do. For this, there are many explanations—from the lack of a social-democratic tradition of "solidarity," to the confidence that a rising sea really does lift all boats, to the obvious connection between entrepreneurship and job creation, to the celebration of pluck and initiative in the tradition of Horatio Alger. Yet surely there are limits to what is acceptable even in the United States. That is one of the chastening warnings of Peter Drucker, one of the most influential modern thinkers on capitalism. Drucker, credited with inventing the word *privatization,* has observed the "bitterness and contempt" that grow against the rich when the business cycle turns down.

For many, in whatever country, extreme inequality not only fans discontent but also suggests hidden cabals and secret strings—in short, the abuse of power by those with the wealth. Privatization is particularly sensitive in this regard: Who benefits as state-owned assets are transferred to private owners? How transparently was the job done? Do the enterprises work better now that they are privately owned? How are the gains measured against the rationalization and modernization of the enterprise, which result in job losses?

Yet privatization is bolstered by another powerful trend. Globally, it will become more accepted owing to a profound change in capital markets—toward diffusion of ownership. The shift to pension funds based upon savings—as opposed to pay-as-you-go government pension systems—means that the preponderant owners of private firms will be not a few very rich families or big-time, big-shot capitalists but rather the aggregated savings of present and future retirees, mobilized through stock markets, bonds, and direct investment. This provides an expanding legitimacy that would not have existed a quarter century ago.

Confidence in the fairness of the system depends upon the effectiveness of the legal system and the transparency of the rules by which the economy operates. Corruption is a deadly enemy of such confidence. It corrodes the moral bedrock of trust upon which markets depend. To be sure, the institutional setups in traditional state-controlled economies make them fertile spawning grounds for corruption. After all, it was government officials—and not only those at the top but also woefully underpaid civil servants—who called the critical shots. But there is also plenty of opportunity for corruption in economies that are releasing assets and creating new opportunities as they move from state control to market focus.

The question of global poverty has moved to the fore as one of the great tests of the global marketplace. Is it just? Is it fair? A more open trading system will be evaluated by its impact not only on industrial countries but also for what it does for developing countries and for the eradication of poverty.[6]

3. Securing the Environment?

After more than a quarter century of activism, the environment is firmly ensconced as both a national and an international priority. Economic systems will be judged by how they respond to the wide range of environmental concerns, and they will be compelled to find further improvements and new solutions. The increasing interconnection and transparency brought by globalization will turn local problems into international issues. But globalization also means that foreign investment will embody higher standards of environmental performance and that local activities will be benchmarked against world-class standards.

For the industrial world, the environmental imperative means continuing on a track along which it is already well advanced. Compared to where they started at the beginning of the 1970s, the 850 million people of the industrial world have experienced dramatic improvements in their national environments. This has been accomplished through legislation and regulation, innovation and technology, changes in practices and behavior and norms—and by spending a great deal of money. But how to go forward? Will it be through command and control and familiar forms of regulation or through innovative market-based systems?

The most pressing environmental issues are those that affect the 5 billion people in the rest of the world. A large number of these countries start from low levels of standards and practice—and management. Their environments are under stress because of poverty—for example, in many countries, the rural poor have cut down forests for firewood, creating a host of difficulties, including erosion, which damages water supply and cripples agriculture. Countries also suffer from the environmental problems that come from climbing onto the growth ladder: wretched urban air from unprotected factories and power plants, proliferating automobiles, and poor-quality fuels. These problems can be ameliorated, but the price tag is high, especially for a country that is struggling to raise its income and has many needs but limited resources. How will investment be mobilized? Who will pay the price? Such choices are not limited to developing countries. One of the lasting legacies of communism is the extensive environmental damage that afflicts the former Soviet Union and Eastern Europe. But neither the economic resources nor the means are readily available to remedy the ills in the former communist world.

Increasingly, however, environmental issues are becoming international. Some are regional matters. The burning of forests in Indonesia turns the air hundreds of miles away, in Malaysia, Singapore, and Thailand, into smoke with a pervasive burning smell that makes one think a nearby house is on fire. Some issues are global. Climate change is the best known. As the global-warming debate demonstrates, the first challenge is to come to some rough agreement on the dimensions of the problem. But that is only the beginning. For a multitude of nations then have to come to a meeting of minds on the solutions. Then they face the difficult job of apportioning responsibilities and costs.

The battle over the Kyoto climate-change protocol illustrates the potential for conflict among nations. One axis of conflict has run between developed and developing countries. Calls for concerted action by the industrial countries can appear to developing nations as an effort to constrain their growth opportunities—imposed by countries much richer than themselves. The industrial world, for instance, expresses concern at the absolute amount of carbon emitted by coal-fired electric generation in China. The Chinese reply by observing that, on a per capita basis, they use only 5 percent as much electricity as Americans. How, they ask, can they be denied the opportunity to strive toward a higher standard of living, which, even if achieved, will still be only a fraction of that in the developed world?

The first stage of the Kyoto protocol is aimed at the industrial world. And here the disagreements are highlighted by the split between the Europeans and the United States over acceding to the treaty. This discord was based upon sharply different views of the clarity of the risk, the distribution of burdens, the achievability of the targets, the methods of achieving them, and the impact on overall economic performance. A fundamental point of difference is over to what degree to rely on regulation and to what degree on market mechanisms. The contentious Kyoto process underlines how daunting it is to try to create a globally acceptable, nonintrusive regime for something that is so complex and that touches so many interests as international climate change.

In this whole range of environmental concerns, the private sector will find itself carrying an increasing environmental role. Not only will companies be regulated from a multitude of directions and by multiple authorities, they will also find themselves judged by the nature of their commitment and contribution to improving the environment. Focusing on the environment will become a growing responsibility of senior management.

4. Coping with Demographics?

Population trends will challenge the performance of market economies. The more familiar population issue is in the developing world. Those countries confront an enormous swelling in the younger age groups and the difficult tasks of generating jobs and increasing per capita income. The surge in population has created a combustible mixture of idleness, poverty, disillusionment, and a bitterness that can be a tremendous source of political and economic instability that spills over borders. Nowhere is this more evident than in the Middle East countries, which have some of the fastest-growing populations. The bulge in their populations of unemployed and underemployed young men has proved a fertile ground for extremism and terrorism and raises larger questions about the future of the region.

Over time, income growth in developing countries will lead to a tapering off of births. In the meantime, liberalized economies will struggle to generate opportunities for their populace. The effects will not be limited within borders. For population growth also drives migration both among these countries and into industrial countries, creating new political and social conflicts.

For the developed world, the key population trend is the growing proportion of the elderly, which will add to the critical need to reform the traditional welfare state. The key period will begin toward the end of the first decade of this century, when the baby-boom generation starts to retire, putting an enormous strain on the health and pension systems. The pressures will grow more severe as the years pass. "There can be little doubt," said economist David Hale, "that the great economic policy challenges of the twenty-first century will be how to finance everyone's retirement." He added, "The only good analogy to the magnitude of the fiscal challenge posed by the aging of . . . population is war."

On whose shoulders, on which age group, will the costs of retirement and health care fall? How much responsibility will belong to government, and thus to taxpayers, and how much will be the responsibility of individuals and the private sector? One can well imagine political conflict along generational lines over health care and pensions. The votes will be there to expand government's role and the share of the national income going to meet the needs of the elderly. In such circumstances, the working population will find an increasing proportion of its output being taxed away to support the older generation. The challenge for each society will be to sort out what it considers entitlements, to be paid out of public funds, and what it regards as marketable services, for which the individual is responsible. Over the twenty-first century, the population issues for the developing and developed countries will converge as the daunting challenge of the elderly becomes a problem for developing countries as well. By the year 2030, China will likely have 400 million people over the age of sixty-five, compared to 100 million today.[7]

5. Upholding Identity?

For many countries, participation in the new global economy is a very mixed blessing. It promotes economic growth and brings new technologies and new opportunities. But it also challenges the values and identities of national and regional cultures, including ethnic and religious identities. It can undermine a traditional and comforting sense of security—whether the high degree of job security in Europe, social rules in Asia, or religious values in the Middle East, or indeed values about family, cooperation, and to what young people should be exposed. People in a number of countries may not believe that their cultural life should be dominated by the satellite-borne media images from the West that globalize the values of Hollywood and New York nor that their national news budget should be driven over the Internet. Nor, they argue, should their companies be subjected to what has been called the "Anglo-Saxon culture of shareholder value," which would cut away what are seen in other societies as social obligations and responsibilities and foundations for stability. If these assaults are too strong or the reactions too bitter, countries that have reduced their tariffs and other import barriers may respond with renewed nationalism and new barriers in the form of regulations and restrictions. They will not have to renationalize in order to assert sovereignty and control.

The interconnection of financial markets, while promoting investment flows, also makes national economies vulnerable to major shocks and turbulence that call into question what participation in the global economy actually means. Leaders and publics are stunned to see how part of a country's economic wealth, built up over decades by the hard work and sacrifice of the nation, can be destroyed—at least temporarily—in a matter of weeks.

Yet this new focus on financial vulnerability also reveals a change—that the danger comes from fleet-of-foot capital markets, not from multinational corporations, which were seen as the great threat not so many years ago. Indeed, the perspective on multinationals has been much altered. Instead of being seen as predators, they are now courted as investors who make long-term commitments and who, in the process, bring capital, technology, skills, and access to global markets. They are also seen as less threatening for other reasons; it is not only because there now so many more of them—more than sixty thousand, according to one United Nations count—but also because they are not seen as primarily American but rather as firms whose home countries are very diverse.

This does not mean, however, that there will not be renewed hostility to foreign control and foreign ownership of domestic industries, particularly industries that are seen as too close and too central to national identity and security. Local participation and partnerships can help alleviate such conflicts, to everybody's benefit. But there will continue to be a clash of interests and inherent tensions between multinational corporations and national values. The conflict arises from their fundamental differences in perspective and constituencies. Government's job, after all, is to respond to national interests and concerns, while the multinational unit is driven by the imperatives of an international perspective.

In 2001, the return of terrorism to the global agenda, and on an unprecedented scale, brought home the destabilizing force of a nihilistic backlash against a more interconnected world. It appeared that a violent strain of radical Islam was defining itself, more and more, in opposition to existing governments and social order, and to the process of globalization itself. And it also became clear that international terrorism could thrive on the very networks and connections that enabled globalization—networks of finance, telecommunications, media, and individual travel—often in very sophisticated ways. Meanwhile, the sense of risk that terrorism induced in the targeted countries could only spark, in the public mind, a new suspicion of international economic, political, and cultural involvements. These were unexpected challenges, all of which suggested how precarious the balance between global integration and local identity can be—and how volatile the effects.

The Balance of Confidence

The increasingly integrated global marketplace, but one that is vulnerable to new forms of contagion, inequality, and insecurity, presents, in contrast to the unbridled optimism of the early 1990s, a sobered reality, recalling older truths. Clearly the participants in the new global economy—consumers, investors, and lenders alike—need to maintain a clear-eyed assessment of perils and to keep in mind, even as they think about global markets, the realities and limits of national and regional politics, culture, and history. In short, the market consensus is best bolstered not by enthusiasm and a lowering of the guard, but by a measured prudence.

The market also requires something else: legitimacy. But here it faces an ethical conundrum. It is based upon contracts, rules, and choice—in short, on self-restraint—which contrasts mightily with other ways of organizing economic activity. Yet a system that takes the pursuit of self-interest and profit as its guiding light does not necessarily satisfy the yearning in the human soul for belief and some higher meaning beyond materialism. In the Spanish Civil War in the late 1930s, Republican soldiers are said to have died with the word *Stalin* on their lips. Their idealized vision of Soviet communism, however misguided, provided justification for their ultimate sacrifice. Few people would die with the words *free markets* on their lips.

Even without that extreme contrast, the moral appeal of socialism and state intervention is clear and explicit: altruism; concern, sympathy, and solidarity with fellow humans; dignity and social betterment; justice and fairness; hope. The market system cannot offer such direct appeals. Its moral basis is more subtle—and indirect—in terms of the opportunities and results it affords.

Yet the essential morality of the market is twofold. The first is in the results that it delivers, in what it makes possible for people—which is based upon the premise that the pursuit (though hardly the unfettered pursuit) of individual interest cumulatively adds up to the overall betterment of society. That was, after all, at the heart of Adam Smith's argument for self-interest. The second lies in the conviction that a system based upon rules, property, contracts, and initiative is more fair and provides against the arbitrary and unchecked power of the state and other entities. Those two premises are the bedrock of the market, and it is against them, over time, that the workings of the market will be evaluated. Neither of these premises implies that all values are market values, that human endeavor is to be judged only by what it fetches in the commercial arena. Large realms of activity are to be valued—and motivated—in terms that are distinct from dollars and cents. What is being said is that there are better and worse ways of organizing economies to achieve objectives. To choose the market focus is not automatically to embrace a money culture.

Yet if the market is seen to fail on these grounds—results, restraints, the quality of its rules—if its benefits are regarded as exclusive rather than as inclusive, if it is seen to nurture the abuse of private power and the specter of raw greed, if it does not contribute to higher standards of living, then surely there will be a backlash, a return to greater state intervention, management, and control. The state would again step forward to expand its role as protector of the citizenry against the power of private interests. This is not only a matter of what happens within nations. The backlash against globalization is premised exactly on the idea that there is something seriously wrong with the workings of the global marketplace, and that is where the focus of the debate is. On one side are those who say, though often with more emotion than data, that a globalized economy is fundamentally unfair and immoral and that markets and capitalism are the enemy. On the other are those who say that the priority is to develop the new and appropriate rules for the new world that will enhance and broaden the benefits while dealing with the downsides.

In the meanwhile, in a vast drama, the general movement away from traditional state control of the commanding heights continues, leaving it more and more to the realm of the market. At the same time, the process of defining the regulatory roles of the state for the twenty-first century is at the center of national politics in many countries. This overall movement represents a great reconnecting—a conjoining of the beginning of the twentieth and the beginning of the twenty-first centuries. The twentieth century opened with markets ascendant and an expanding global economy, buttressed by a spirit of optimism. That economy was fractured by war, depression, nationalism, and ideology. Crisis and disaster, human need and suffering, and a profound sense of justice and dignity—these propelled the expansion of the state's responsibilities. The decades after World War II were years of recovery and then of great growth. Today's possibilities are built on those achievements of yesterday. But now, because of experience and reassessment—and also because of technology—the role of the state is being redefined, and the realm of the market is now expanding. Hard questions result: What services should the state provide? What is its welfare role? And how much less "mixed" will its economy be?

These changes signify the establishment of the first truly global economy, integrated and interconnected, in which work and production are networked around the world and in which everything from knowledge to commerce is taking electronic form. With all its benefits and all the hopes it sparks, this reassertion of the market will nevertheless encounter a host of new challenges and bracing tests. The opportunities it can create for people are enormous; yet there is clearly unease with its demands, its impact, and the reordering that it can impose. Risk will be a very evident part of this new world, as it should be. For out of risk emerge the innovation and the incentives—and the imagination—that carry the world forward.

Many forces have driven the shift from state control to market consensus. Yet fundamentally it rests upon a recasting of beliefs and ideas—away from the traditional faith in the state and toward a new view of the state, and toward greater credibility for the market. Perhaps, then, what will really determine whether this change will persist, or whether there will be a swing back, is the quality and character of the confidence that underpins the marketplace. Confidence is more likely to endure if it is anchored—if it is tempered by a realistic appraisal of risk and uncertainty, and of the benefits and limits of the market and its values. Within countries, where will fall the future frontier between state and market? Will there be an increasingly integrated global economy, or will it be fractured again as new barriers go up. Those answers will be found in the cumulative judgments and experience that will orient beliefs and shape that balance of confidence—the very balance that, in turn, does so much to drive the wheels of ideas and history itself.